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The Commissionaire Distributor Model in a Post-BEPS Environment

University of Helsinki
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Master's thesis
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Tiivistelmä/Referat – Abstract

The commissionaire structure is an operating model well-known for its tax planning features. Commissionaire distributor arrangements have been widely used since the late 1980s by multinational enterprises (MNE) engaged in the business of selling and distributing tangible goods. A commissionaire distributor is best described as a hybrid between a traditional distributor and an agent. The commissionaire sells products in its own name, but on behalf of a foreign principal.

Tax planners have characterized the commissionaire arrangement as the "next best thing to not paying taxes at all", while policy-makers generally consider the structure abusive. In essence, the commissionaire arrangement enables distribution to the customers' jurisdiction without respective taxable presence. Because of the well-established formal interpretation of current provisions on permanent establishments (PE), a MNE will usually not constitute a PE in the state concerned if products are distributed via a commissionaire arrangement. The key relevance of a PE is that under most tax treaties, the business profits of a foreign enterprise are taxable in a state only to the extent that the company has a PE to which profits are attributable. Avoiding PE status enables shifting profits out of the state wherein the sales contract is concluded in actual fact.

The OECD and the G20 have recently carried out extensive work to fight base erosion and profit shifting (OECD BEPS). PE-avoiding commissionaire arrangements are targeted with Action 7 of the 15-point Action Plan. A multilateral instrument (MLI) for the implementation of BEPS-countering measures has also has been recently issued. Hence, swift implementation of treaty measures to update international tax rules is foreseeable and, therefore, MNEs are under pressure to re-evaluate their existing operating models. The study seeks to answer whether and how will tax treaty amendments set forth in Action 7 affect existing commissionaire distributor arrangements. Furthermore, it is analyzed whether the current national PE concept is compatible with forthcoming tax treaty amendments. To answer these questions, the legal dogmatic method is applied as a primary research method together with a comparative approach.

The forthcoming changes to tax treaty law, especially the lowered PE threshold, will change the established notion. Under the new PE provisions, all key conditions for PE constitution by virtue of an agent's activities are of substantive nature, rather than formal. The implementation of the MLI will have a PE-constituting effect on commissionaire distributor arrangements. Such effect will most importantly result in an increased administrative burden and cause uncertainty among taxpayers. However, as the MLI allows for countries to opt-out of the new PE provisions, the current notion will also remain relevant to some extent. This is likely to encourage treaty shopping. Other reactive options are also available for MNEs, such as conversion from a commissionaire to a limited-risk distributor structure.

The changes in tax treaty law also call for updates on a domestic level. A proposal for an updated definition of PE in Finnish domestic legislation, which would better limit uncertainties and minimize interpretational issues, is set forth in the study. In tandem with this update, certain existing uncertainties relating to the threshold of business profit taxation are also proposed to be cleared.

Realignment of taxation and relevant substance, the revival of source state taxation or inter-state equity will not be materially affected by the amendments to the definition of PE in tax treaties. The commissionaire distributor model is likely to survive the forthcoming changes in tax treaty law. However, other operating models may prove more beneficial in the future for the MNE concerned.

Avainsanat – Nyckelord – Keywords

commissionaire, commissionnaire, permanent establishment, komissionääri, kiinteä toimipaikka, TVL 13a §, BEPS, Action 7

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Tiivistelmä/Referat – Abstract

Komissionäärirakenne (commissionaire structure) on verosuunnitteluominaisuuksistaan yleisesti tunnettu toimintamalli. Tuotteiden valmistukseen ja jälleenmyyntiin keskittyneet monikansalliset yritykset ovat yleisesti hyödyntäneet komissionäärijärjestelyitä 1980-luvun lopusta alkaen. Myyntikomissionääri on parhaiten määriteltävissä perinteisen jälleenmyyjän ja agentin risteytykseksi. Komissionääri myy tuotteita omissa nimissään, mutta ulkomaisen päämiehen lukuun.

Verosuunnittelijat ovat kuvailleet komissionäärijärjestelyä “lähes yhtä hyväksi tilanteeksi kuin täysi verottomuus”, kun taas poliittiset päättäjät yleisesti pitävät rakennetta väärinkäyttönä. Pohjimmiltaan komissionäärijärjestely mahdollistaa jälleenmyynnin asiakkaiden sijaintivaltiossa ilman vastaavaa verotuksellista läsnäoloa. Vakiintuneen, kiinteän toimipaikan säännösten muodollisen tulkinnan vuoksi, yritykselle ei yleensä synny kiinteää toimipaikkaa kyseiseen valtioon, mikäli jälleenmyynti on järjestetty komissionäärirakennetta hyödyntäen. Kiinteän toimipaikan keskeinen merkitys on, että kansainvälisten verosopimusten mukaan ulkomaisen yhtiön elinkeinotulo on verotettavissa lähdevaltiossa vain siltä osin kuin kyseiseen valtioon syntyy kiinteä toimipaikka, johon voitot ovat allokoitavissa. Kiinteän toimipaikan välttäminen mahdollistaa voittojen siirtämisen ulos valtiosta, jossa myynti on todellisuudessa tapahtunut.

OECD ja G20 ovat toteuttaneet suurhankkeen veropohjan rapautumisen ja voitonsiirron estämiseksi (OECD BEPS). Kiinteän toimipaikan välttäviin komissionäärijärjestelyihin pyritään vastaamaan 15-kohtaisen toimenpidepaketin seitsemännellä toimenpiteellä (Action 7). Äskettäin on julkaistu myös multilateraali instrumentti (MLI) BEPS-toimenpiteiden implementoimiseksi. Verosopimuksiin vaikuttavien toimenpiteiden implementointi kansainvälisten verosäännösten päivittämiseksi on näin ollen oletettavaa ja sen seurauksena monikansallisten yritysten on uudelleenarvioitava olemassa olevat toimintamallit. Tutkimus pyrkii vastaamaan siihen, vaikuttavatko ja miten seitsemännessä toimenpiteessä esitellyt muutokset verosopimuksiin tulevat vaikuttamaan myyntikomissionäärijärjestelyihin. Tutkimuksessa tarkastellaan myös kansallisen kiinteän toimipaikan määritelmän yhteensopivuutta tulevien verosopimusmuutosten kanssa. Tutkimusmetodina on oikeusdogmaattinen metodi, jota oikeusvertaileva näkökulma täydentää.

Verosopimusoikeuteen tulevat muutokset, erityisesti alempi kiinteän toimipaikan syntymiskynnys, muuttanevat voimassaolevan käsityksen. Toisin kuin ennen, uusien kiinteän toimipaikan säännösten alla kaikki edellytykset kiinteän toimipaikan syntymiselle agentin toiminnan perusteella ovat laadultaan sisällöllisiä, eivät muodollisia. MLI:n implementoinnilla tulee olemaan kiinteän toimipaikan synnyttävä vaikutus olemassa oleville komissionäärijärjestelyille. Vaikutus johtaa ennen kaikkea hallinnollisen taakan kasvamiseen ja epävarmuuden syntymiseen veronmaksajille. MLI kuitenkin antaa valtioille mahdollisuuden jättäytyä pois uusien kiinteän toimipaikan säännösten soveltamisesta. Vallitseva käsitys pysyy osin muuttumattomana, mikä myös todennäköisesti kannustaa edullisimman verotuksellisen kotipaikan valitsemiseen (treaty shopping). Monikansallisille yrityksille on tarjolla myös muita reaktiivisia toimintavaihtoehtoja, kuten esimerkiksi toimintamallin muutos komissionäärirakenteesta rajoitetun riskin jälleenmyyjä -rakenteeksi (limited-risk distributor structure).

Muutokset verosopimusoikeudessa edellyttävät uudistuksia myös kansallisella tasolla. Tutkimuksessa esitetään ehdotus päivitetyksi kiinteän toimipaikan käsitteeksi, joka rajoittaisi paremmin epävarmuuksia ja minimoisi tulkinnalliset haasteet. Samanaikaisesti tiettyjä olemassa olevia epävarmuuksia ulkomaisten yhtiöiden elinkeinotulon verottamiskynnykseen liittyen ehdotetaan selkiytettäväksi.

Verosopimusten kiinteän toimipaikan käsitteeseen tehtävät muutokset eivät tule merkittävästi vaikuttamaan verotuksen ja toiminnan todellisen sisällön vastaavuuden tavoitteen saavuttamiseen, lähdevaltion verotusoikeuden elvyttämiseen tai valtioiden väliseen yhdenvertaisuuteen. Todennäköisesti myyntikomissionäärijärjestely selviää verosopimusoikeuteen tulevista muutoksista. Toiset toimintamallit voivat kuitenkin jatkossa osoittautua edullisemmiksi kyseessä olevalle yritykselle.

Avainsanat – Nyckelord – Keywords

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HE 1/1998 vp	Hallituksen esitys Eduskunnalle uudeksi Suomen Hallitusmuodoksi

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Roche	Tribunal Supremo (Supreme Court), 12 January 2012, Case 1626/2008, DSM Nutritional Products Europe Ltd. (formerly Roche Vitamins Europe Ltd.) v. Agencia Estatal de Administración Tributaria

Swedish Case Law

NJA 2012 s. 419	Högsta domstolen (Supreme Court), 18 June 2012, Case NJA 2012 s. 419, Bilgallerian Thomas Jönsson AB:s konkursbo (bankruptcy estate) v. Citroën Sverige AB

Diagrams

List of Abbreviations

1963 OECD Draft	OECD Draft Double Taxation Convention on Income and Capital, 1963.
Action 7	OECD BEPS Action 7: Preventing the Artificial Avoidance of Permanent Establishment Status
ATAD	Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market
BEPS	base erosion and profit shifting
CCCTB	common consolidated corporate tax base
Commentary/Commentaries	The OECD Commentary to the Model Tax Convention on Income and Capital, 2014 update
DTC	double tax convention
Explanatory Statement	Explanatory Statement to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, 24 November 2016
Final Report	See OECD 2015d
G20	Group of Twenty (Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, South Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, United Kingdom, United States and the European Union)
GAAR	general anti-avoidance rules
HE	Government proposal (Hallituksen esitys)
Interest and Royalties Directive	Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States
KHO	Supreme Administrative Court of Finland
KKO	Supreme Court of Finland
KVL	Central Tax Board (Keskusverolautakunta)
LRD	limited-risk distributor

LähdeVL	Act on the Tax Treatment of the Income of a Person Subject to Unlimited Tax Liability (Laki rajoitetusti verovelvollisen tulon verottamisesta 627/1978)
MLI	Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, 24 November 2016
MNE	multinational enterprise
MSC	marketing services company
OECD	Organisation for Economic Cooperation and Development
OECD BEPS	OECD/G20 Base Erosion and Profit Shifting Project
OECD Model	The OECD Model Tax Convention on Income and Capital, 2014 update
OECD TP Guidelines	The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, 2010
OEEC	Organisation for European Economic Co-operation
Parent–Subsidiary Directive	Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States
PE	permanent establishment
Public Discussion Draft	See OECD 2014b
Revised Discussion Draft	See OECD 2015b
RP	Government proposal (Regeringens proposition)
TP	transfer pricing
TVL	Income Tax Act (Tuloverolaki 1535/1992)
UN Model	United Nations Model Double Taxation Convention between Developed and Developing Countries, 2011 update
US Model	United States Model Income Tax Convention, 2016 update
VAT	value added tax
VAT Directive	Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax
VCLT	Vienna Convention on the Law of Treaties, 22 May 1969
VML	Act on Assessment Procedure (Laki verotusmenettelystä 1558/1995)

1 Introduction

1.1 Background

The commissionaire structure is an operating model well-known for its tax planning features. Commissionaire arrangements have been widely used by multinational enterprises (MNE) engaged in the business of selling and distributing tangible goods, since the late 1980s. A *commissionaire distributor* is best described as a hybrid between a traditional distributor and an agent. In the eyes of the customer, the commissionaire operates just like any distributor—in its own name. However, in relation to a foreign group company, the commissionaire operates on its behalf, like an agent, thus not taking title to the goods sold.

Tax planners have characterized the commissionaire arrangement as the "next best thing to not paying taxes at all".[1] Policy-makers, on the other hand, generally consider these arrangements put in place to erode the taxable base of the state where sales took place.[2] Fundamentally, the commissionaire arrangement is by no means abusive. Commissionaires operate as middlemen between vendors and buyers. However, this hybrid between a traditional distributor and an agent has certain characteristics in relation to tax law provisions, which have proven to be significant.

The key relevance of the commissionaire arrangement in taxation is that it enables distribution in the customers' jurisdiction without respective taxable presence. Under a duly established commissionaire arrangement, a MNE will not constitute a permanent establishment (PE) in the state concerned. In a broader context, the key relevance of a PE to an internationally operating enterprise is that under most tax treaties, the business profits of a foreign enterprise are taxable in a state only to the extent that the enterprise concerned has a PE to which profits are attributable.

The question of fair allocation of taxing rights between the source state and the residence state has challenged policy-makers for a long time. The PE concept, which is key in this discussion, has been an area of controversy for years. Traditionally PEs are constituted where an enterprise has a substantial physical presence in the state concerned. In addition, it is generally accepted that an enterprise should be treated as having a deemed PE by virtue

[1] See Swanick et al. 1997, p. 137.
[2] See OECD 2014b, p. 6.

of its activities, where another person acts for that enterprise. However, the characterization of an agency PE and setting the threshold on PE-constituting activities has turned out to be challenging.

The Group of Twenty (G20) and the Organisation for Economic Co-operation and Development (OECD) have recently carried out extensive work to fight base erosion and profit shifting (BEPS). Under the BEPS initiative, tax avoidance is fought on multiple fronts. PE-avoiding commissionaire arrangements are also targeted. A Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI) has been recently issued and has been open for signature as of 31 December 2016. Therefore, swift implementation of treaty measures to update international tax rules is foreseeable.

Under these circumstances, MNEs are under pressure to re-evaluate their existing operating models. The application of updated tax treaty provisions may have an effect on the taxation of business profits. The forthcoming changes may also render existing structures sub-optimal for other reasons. Effects far broader than those on income taxation are also possible. Therefore, an in-depth analysis on the current situation, forthcoming changes to provisions of tax treaty law, and possible next steps, is necessary.

1.2 Purpose and scope of the study

The primary research question to be answered in this study is whether and how will the new agency PE provisions set forth in OECD BEPS Action 7 affect existing commissionaire distributor arrangements.[3] The study seeks to systematize and analyze the current tax position of commissionaire distributors and the forthcoming amendments to double tax conventions (DTC). In addition, the definition of PE in Finnish national legislation is studied in light of the new tax treaty definition of PE. The study seeks to answer whether the current national PE concept is compatible with Action 7 provisions and to highlight relevant issues relating particularly to the commissionaire distributor model. Further, a solution with regard to the required changes to the definition of PE in Finnish national legislation is set forth.

The results of this study are to serve as a systematization of the current PE concept and the forthcoming changes to the PE concept with regard to commissionaires. Furthermore, the

[3] OECD BEPS Action 7: Preventing the Artificial Avoidance of Permanent Establishment Status. See OECD 2015d.

study seeks to highlight the practical implications of the forthcoming changes for MNEs operating via a commissionaire distributor arrangement in Finland.

This study will focus on related-party commissionaire distributor arrangements, put in place for the distribution and sale of finished tangible goods. A *commissionaire distributor* can be defined as an indirect agent engaged in the business of distributing the products of an enterprise by entering into sales contracts in its own name but on behalf of another enterprise. The concept is further defined in Chapter 2. The focus is on the income tax aspects of the commissionaire distributor model, primarily its ability to avoid PE status.

Profit shifting caused by artificial avoidance of PE status can be countered in multiple ways. In addition to lowering the PE threshold, other measures are also available for tax administrations and policy-makers. Profit shifting caused by the avoidance of PE status can be fought, inter alia, by applying transfer pricing (TP) provisions. A balanced allocation of tax revenues can be achieved by restructuring non-arm's length transactions under TP rules.[4] The possibility of tax administrations seeking to apply general anti-avoidance rules (GAAR) to find PEs cannot be completely ruled out either.[5] However, no published Finnish case law supports the application of a GAAR to commissionaire structures. Prominent European case law does not support such application of GAARs either. In fact, GAARs fit rather poorly for the purpose of countering the avoidance of PE status.[6] Above all, the BEPS initiative shows a clear preference for lowering the PE threshold to fight commissionaire arrangements. Therefore, this study is concerned with the reduction of the PE threshold.

Other group structures, which may be used in connection with the commissionaire distributor model, such as the migration of intellectual property to a holding company, toll manufacturing arrangements and maintaining a stock of distributable goods in the customers' jurisdiction, cannot be studied in this context. These arrangements encompass unique characteristics and issues which are loosely related to those discussed in this study. For the same reasons, auxiliary or preparatory activities are not studied either. Rather, the

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[4] See Section 31 of the Act on Assessment Procedure (1041/2006; VML), which includes a special profit adjustment provision.

[5] See Section 28 of the VML (1558/1995) for the Finnish GAAR, which allows re-characterization of transactions and levying a tax based on the real nature of the arrangement.

[6] Fundamentally, the PE concept is only a threshold which determines whether the source state or the residence state has a right to levy a tax on the taxpayer's income. In fact, source state taxation is an exception to the general rule of income taxation in the taxpayer's residence state. Avoiding PE constitution will not itself result in tax avoidance.

study is concerned with fully operative commissionaire distributor models. The attribution of income, TP between the commissionaire and its principal, the elimination of double taxation or the application of anti-avoidance provisions are also beyond the scope of this study. PEs for purposes of value added tax (VAT) and customs matters are not studied in this context either.

The study is primarily concerned with tax treaty situations where an OECD Model-based treaty is applicable. A tax treaty situation can be defined as a situation where a tax object simultaneously has a connection with more than one state and a bilateral or multilateral tax treaty is applicable. However, also non-tax treaty situations and treaties based on the UN and US Models are studied where relevant.[7]

1.3 Research methods

The approach of the study is that of a traditional legal study. Therefore, the legal dogmatic method is applied as a primary research method. Hence, the study is primarily concerned with the interpretation and systematization of existing legal norms—*de lege lata*.[8]

MNEs operate cross-border and in a vast number of jurisdictions with different legal systems and traditions. Therefore, an international perspective is essential. To be able to answer the primary research question, a comparative method is used in conjunction with the dogmatic method. Furthermore, foreign legal literature is made use of where the study is concerned with the interpretation of internationally uniform legal norms, such as the provisions of The OECD Model Tax Convention on Income and Capital (OECD Model).

The comparative approach of this study is solely problem-based and the results are to serve practical purposes rather than theoretical purposes. Comparative information is to serve as a constructive tool and is used to support interpretative solutions where domestic case law or other primary sources of law are not available. Comparison in this study is primarily functional, concerned with how the same or very similar legal problems have been resolved in other jurisdictions. Jurisdictions in comparison are chosen based on the functional equivalences available within the field of study.[9]

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[7] United Nations Model Double Taxation Convention between Developed and Developing Countries, 2011 update; United States Model Income Tax Convention, 2016 update.

[8] See Hirvonen 2011, pp. 21–26.

[9] See Husa 2013, pp. 36–148.

As a basic methodological solution, the comparative method is used on macro and micro levels. Legal traditions, namely the civil law and common law traditions, are compared on a macro level. On a micro level, a comparison is drawn to Sweden and other European jurisdictions where relevant case law is available and legal norms are equivalent to a relevant extent and similarly interpreted to those in Finland.[10]

Finally, commissionaire structures are generally tax-motivated. The underlying motivations and rationale of MNEs as taxpayers are also of interest. The commissionaire distributor model can only be understood in this context. Therefore, the current legal state and forthcoming changes thereto are also analyzed from a tax planning perspective.

1.4 Earlier studies and materials

The PE concept has been of interest to legislators, legal academics, and taxpayers for the better part of the 20th and 21st century. Discussion on the matter has also been active within the OECD, G20, EU, and UN. Therefore, a substantial amount of legislative material, articles in tax and legal journals, European case law, and other research material is available on the subject.

The current tax position of commissionaire distributor models is studied in light of the 2014 OECD Model and the respective Commentary as they read on 15 July 2014. The primary source of interpretation with regard to the proposed amendments to tax treaties is the OECD BEPS Action 7 Final Report (Final Report), published 5 October 2015. Proposals set forth in Action 7, which specifically target the commissionaire, have also been included in the text of the MLI.[11]

There is little domestic case law or domestic legal literature available on commissionaire structures.[12] Unlike many other European supreme courts, PE constitution on the basis of the activities of a commissionaire distributor or a dependent agent has not been subject to the Finnish Supreme Court's (KHO) considerations. Furthermore, domestic tax law provisions regarding the constitution of a PE have been previously revised over 20 years

[10] See Husa 2013, pp. 36–148.
[11] See OECD 2015.
[12] See Aalto 2002, Malmgrén 2008 and KVL 1996/68 (same as KHO 7.6.1996 T 1928).

ago. Hence, the position of a commissionaire distributor has not been comprehensively analyzed in a domestic legal study either.

1.5 Sources of law and theoretical basis of interpretation

The interpretation of the current PE threshold relies heavily on the interpretation of DTCs. Therefore, the discussion on the tax treatment of commissionaire arrangements has mostly focused on the interpretation of Article 5(5) of the OECD Model, i.e. the agency PE rule, and the respective OECD Commentary to the Model Tax Convention on Income and Capital (Commentary). These sources are without a doubt among the most important with respect to this study. However, to answer the research question, a broader analysis of the sources of law is necessary.

1.5.1 Domestic doctrine

A Nordic doctrine on the sources of law is well-established in the Finnish legal tradition. Sources of law are divided into strongly binding sources of law, weakly binding sources of law and allowed sources of law.[13] Section 81 of the Finnish Constitution (731/1999) requires that state tax is governed by an act, wherein provisions on the grounds for tax liability, the amount of tax, and provisions on the legal protection of the taxpayer are included. Further, these provisions should be accurate and precise, leaving little room for interpretation.[14] Therefore, the emphasized principle of legality, arising out of Section 81, requires that the wording of the provision is a primary and strongly binding source of law. Preparatory works and case law are considered weakly binding sources of law.[15] Legal doctrine, legal principles, and guidance issued by the Finnish Tax Administration are allowed sources of law.[16]

The Nordic doctrine on the sources of law should not be understood as a closed system.[17] The Europeanization of the Finnish legal system requires that EU law provisions, including

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[13] Määttä 2014, pp. 8–22.

[14] See HE 1/1998 vp, p. 134.

[15] Published case law of the Supreme Administrative Court of Finland (KHO) is considered primary to the advance rulings of the Central Tax Board of Finland (KVL).

[16] Määttä 2014, pp. 14–16; For clarification, Finnish Tax Administration's publications are not legally binding sources of law. Furthermore, with regard to PE rules, the guidance mostly repeats what is stated in the OECD Commentary; See Verohallinto 2014.

[17] See Määttä 2014, pp. 18–19.

non-discrimination provisions and basic freedoms, are taken into account. Furthermore, foreign case law can be accepted as an allowed source of law, especially in situations where the national provisions interpreted correspond to the provisions interpreted in the foreign case concerned.[18] For example, interpretation of the provisions of double tax conventions (DTC), which are based on the OECD Model, in accordance with European case law may be well-founded. However, foreign court cases are approached with some caution to avoid misinterpretations.[19]

1.5.2 International context

In practice, the interpretation of DTCs and EU law is the cornerstone of international tax law. However, domestic law provisions shall not be overlooked. Aside from EU tax law, international tax law is not supranational legislation. Rather, it is a part of the domestic legislation of each country. Unlike other provisions of private international law, DTCs are not concerned with choosing between the application of domestic and foreign law provisions. DTCs and domestic tax rules are concurrently relevant, as DTCs are only concerned with limiting the content of domestic tax law by excluding the application of domestic tax law provisions or by obliging the other state to eliminate double taxation.[20] DTCs cannot be the ground to levy a tax. Instead, a state tax must be governed by an act of Parliament.[21]

International taxation operates in a multi-level system, wherein EU law, DTCs, and provisions of domestic tax law apply side-by-side.[22] This traditional understanding is about to change slightly. The MLI will add an additional layer above bilateral DTCs. Therefore, more than ever before, the precedence in relation to one another must be resolved. EU law provisions take precedence over domestic law provisions as well as provisions of the MLI

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[18] See Määttä 2014, p. 271.

[19] The use of foreign case law has traditionally been approached with particular caution. See KKO 2012:35, where the Finnish Supreme Court's (KKO) decision was based on Swedish case law, however, without direct reference; See Husa 2013, p. 81.

[20] In Finland double taxation is eliminated either by granting credit for foreign-paid taxes or by exemption from domestic taxation; See Reimer – Rust 2015 pp. 23–29 on the relationship of DTCs and private international law.

[21] On the first point see Vapaavuori 2013 p.17; See Reimer – Rust 2015, p. 30 on similar provisions in Switzerland, the US, the UK, and Germany.

[22] In the Finnish legal system, DTCs are not self-executing. DTCs must be enacted into domestic law before treaty benefits can be given to treaty subjects.

and DTCs.[23] The relationship between DTCs and domestic tax law provisions is more complex.

As a general principle, DTC provisions take precedence over domestic tax law provisions in conflict situations. This applies where the application of the treaty provisions result in a more favorable result for the taxpayer concerned.[24] In any other case, taxation will conform to the applicable domestic law taxation, because DTCs cannot be the ground for levying a tax.

Not all DTCs are based on the OECD Model. As for the Finnish DTC network, most DTCs with developing countries are based on the UN Model. The more asymmetric the economic relations between the two states are, the more relevant the threshold for source state income taxation becomes. A high or otherwise easily avoidable PE threshold may deprive the developing countries' tax revenues. Therefore, evaluation of the agency PE concept also in light of the UN Model is well-founded. In essence, the OECD Model and the UN Model are based on the same fundamentals and their wordings are very similar. Therefore, deviations from the provisions of the OECD Model are mentioned in this study, where necessary.[25] In other respects, the models are considered to coincide.

1.5.3 Interpretation of treaty terms

Most of the treaty terms have not been explicitly defined in DTCs. Moreover, some DTC provisions include explicit references to the meaning of terms under domestic law. Where such reference is not explicitly provided, Article 3(2) of the OECD Model provides that any term not defined in the DTC shall be given the meaning that it would have according to the applicable domestic tax law provisions, unless the context requires otherwise. Article 3(2) requires ambulatory interpretation, i.e. refers to domestic provisions applicable when the treaty is applied.[26]

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[23] See Terra – Wattel 2012 pp. 115–120 on the primacy and direct effect of EU law.

[24] See Vapaavuori 2003, p. 17; Similarly Helminen 2016, Chapter "Fundamentals of International Tax Law", "Concept of International Tax Law", "Relationship among the Legal Systems of International Tax Law", "Tax Treaties and Domestic Tax Law".

[25] The commentary on the UN Model has not generally been used for interpretation of tax treaties by Finnish courts. Therefore, the commentaries on the UN Model are not comprehensively studied in this context.

[26] In the context of Article 3(2), a relevant question is whether the Article refers to the domestic law provisions in force at the time when the treaty was concluded (static interpretation) or to the domestic provisions applicable when the treaty is applied (ambulatory interpretation). The latter should be preferred, however, a different result may occur in individual cases where an amendment to the provisions of domestic law would have made the DTC partially inoperative or the context otherwise would require a static interpretation. See Paras. 11–12 of the Commentaries on Article 3; Traditionally, many commentators have been cautious about

The means of interpretation have not been comprehensively codified into DTCs. Rather, principles of international law provide further rules on interpretation. The most prominent customary norms of international law have been codified into the 1969 Vienna Convention on the Law of Treaties (VCLT), which entered into force in January 1980. The VCLT applies to international agreements, including DTCs.[27] Articles 31 and 32 of the VCLT provide general rules on the interpretation of international agreements, such as OECD Model-based DTCs.

Regarding the means of interpretation, the ordinary meaning of a treaty term and the wording in the context of the entire agreement is overriding.[28] The object and purpose of the agreement may be used as a subordinate source of interpretation. However, it should not be applied as an independent means of interpretation. It is essential to note that the intention of the contracting parties is only relevant to the extent that such intent has been expressed in the treaty text, i.e. the intent must be supported by the wording of the treaty in order to have an interpretative effect. Each language version is equally binding if not agreed otherwise. This means that the majority of DTCs must be interpreted in the light of two or more language versions.[29]

In conclusion, a primary order of reference for interpreting DTCs terms is adopted in this study. The order is the following: special definitions provided in the treaty, the domestic meaning of the term in the state concerned, meaning in accordance with the context, and general rules of interpretation.[30]

1.5.4 Relevance of the OECD Commentary

In practice, the Commentaries are the most important source for interpretation with regard to DTCs, after the wording of the treaty text. Tax administrations and courts worldwide

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interpretation in accordance with domestic law and have preferred common interpretation arising from the DTC's context. Such systematic preference for interpretation from the context should not be adopted. To the extent terms are not defined in the DTC, the clear wording of Article 3(2) requires that the domestic law meaning is given precedence "unless the context requires otherwise". See Reimer – Rust 2015, pp. 211–212.

[27] Among 113 other states, Finland has ratified the VCLT in 1969. The VCLT is commonly recognized and used as guidance for interpretation also in states which have not ratified the treaty.

[28] Pursuant to 31(2) of the VCLT, the context of the agreement includes the preamble, annexes and any other agreement or instrument (for example, notes and letters) made in connection with the agreement. However, "accompanying materials" created during negotiations only serve as supplementary means of interpretation.

[29] Reimer – Rust 2015, pp. 37–41.

[30] Ibid., p. 213.

routinely consult the Commentaries when interpreting tax treaties.[31] However, in light of the rules of interpretation of treaties set forth in the VCLT, the Commentaries do not qualify as "preparatory work", which could be used as supplementary means of interpretation in the meaning of Article 32. Regardless, because of their general conspicuousness and easy obtainability, it is commonly accepted that the Commentaries are consulted in the interpretation of DTCs.[32]

It is worth noting that the Commentaries do not represent legally binding interpretations of the terms of a DTC and that the wording of the Commentaries cannot overrule an unambiguous interpretation of the DTC's text. What can be concluded, however, is that the relative value of the Commentaries varies case to case. Their interpretative weight in each particular situation depends on whether the mutual intention of the contracting states was to copy the substance of the OECD Model in the relevant terms of their bilateral treaty or to adopt a divergent form.[33]

1.6 Terminology

The term *commissionaire* is a concept derived from the French language without clear counterpart in the English language. The concept does not fully correspond with the term *commission agent*, therefore, the French-inspired concept is used in this study.[34] The English language term *commissionaire* is used as a synonym for the original French term, *commissionnaire*. The former spelling, which is more commonly used in English and American legal literature, is preferred over the French spelling. The latter spelling more commonly appears in the publications of the OECD and the texts of French-speaking commentators.

The terms *commissionaire arrangement*, *commissionaire structure*, and *commissionaire distributor model* all refer to the same operating model structure, as defined in Chapter 2.1. The term *commissionaire distributor* refers to the entity acting as a commissionaire for the principal.

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[31] For example, see KHO 2013:169.

[32] See Reimer – Rust 2015, p. 46; See Nieminen 2013a and 2013b for a comprehensive review of the Commentaries' relevance.

[33] See Nieminen 2015a and 2015b.

[34] Finnish commentators have also regularly used a French-inspired term, *komissionääri*.

Because the commissionaire distributor model involves two or more jurisdictions, a clear distinction between the jurisdictions must be drawn for the purposes of this study. The jurisdiction wherein the commissionaire entity operates, i.e. distributes goods to local customers, is referred to as the *customer jurisdiction*. In some other contexts, the same jurisdiction may be referred to as the *source state* or the *PE state*.

1.7 Outline of the study

The study begins with an overview of the commissionaire distributor model. Chapter 2 discusses its legal and contractual structure. The commissionaire distributor model is analyzed in the context of underlying civil law and common law legal doctrines. Applicable contract law provisions are also identified in Chapter 2. Furthermore, the tax consequences and other implications of the operating model are discussed.

Chapter 3 deals with the interpretation of the current international and domestic tax law provisions of direct taxation which are applicable to commissionaire distributors. Relevant case law and the most prominent interpretations by commentators are also analyzed to provide a comprehensive systematization of the current and future tax position of a commissionaire distributor. Furthermore, with regard to domestic legislative solutions, a comparison is drawn to Swedish legislative counterparts.

Chapter 4 is concerned with the implementation of the new PE provisions affecting commissionaire distributor models. The MLI and its implications are analyzed in this context. The compatibility of current domestic law provisions with respective tax treaty provisions is viewed in light of the forthcoming changes to tax treaty law. An updated definition of PE and other related amendments to Finnish domestic legislation are also proposed.

Finally, in Chapter 5, conclusions are drawn on the implication of the forthcoming changes to DTCs. In addition, possible reactions to such changes are studied and operating model alternatives for MNEs are introduced. Finally, the prospects and the remaining concerns regarding the commissionaire distributor model are discussed.

2 Commissionaire Distributor Model

MNEs in the business of selling tangible goods have multiple ways of carrying on business abroad. They may choose to set up a full-fledged distributing entity in a customer jurisdiction, a limited-risk distributing entity (LRD), set up a commissionaire, sell goods via a local agent or resort to the services of a local marketing services company (MSC). In essence, the difference between these distribution models is down to the functions performed, risks assumed and assets used by the distributor in the customer jurisdiction.[35] The more functions performed, risks assumed and assets employed, the more profit is attributable to the distributing entity in the customer jurisdiction.

In the business of selling tangible goods, the overall profit can be divided into three components. Firstly, there is profit attributable to the product itself which is down to the markup, i.e. the difference between the cost of goods sold and the selling price. Secondly, there is profit attributable to marketing and sales activities. Thirdly, the value can typically also be attributed to intangibles, such as trade names or trademarks.[36] These profit components do not necessarily need to be taxed in the customer jurisdiction. Therefore, several tax planning strategies can be applied.

A traditional fully-fledged distributor performs all of the central value chain activities of a company.[37] It takes care of its own operations, product logistics, marketing and sales activities, after-sales support and servicing. Also, all key support functions are performed and risks are borne by the fully-fledged distributor itself. In addition to distribution, a full-fledged distributor may also be engaged in a wide variety of other business activities, such as buying products directly from unrelated manufacturers and reselling them in its jurisdiction.[38]

A LRD operates similarly to the fully-fledged alternative, in regard to taking title to the products.[39] This title may be a *flash title*, meaning that the distributor has ownership to the

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[35] See Storck – Petruzzi 2016, p. 88.

[36] Buss et al. 2006, p. 13.

[37] Porter's concept of value chain divides a company's activities into nine distinct business activities. See Porter 2008, Chapter "How Information Gives You Competitive Advantage", "Strategic Significance".

[38] Buss et al. 2006, p. 14.

[39] In this study, the terms *limited-risk distributor* and *low-risk distributor* are considered to coincide. The OECD has preferred the latter term in its publications, on the other hand, commentators generally prefer the former. Both terms refer to a distributor with less risk associated to the business than a fully-fledged distributor. Occasionally, the term *stripped buy–sell distributor* is used to refer to the same type of entity.

product for a very limited period of time. This arrangement might be accompanied with a *drop shipment contract*, where the products are directly shipped from another company within the same group to the customer of the LRD. Therefore, activities such as logistics and warehousing are stripped from the distributing entity. Also, the LRD may only be required to pay for its purchases after it has collected its own receivables from customers. With regard to pricing, the intra-group prices of goods may be flexibly set, guaranteeing a gross margin return to the LRD. These arrangements differentiate a LRD from fully-fledged distributors. Even though it takes title to the product, the risks it bears are significantly reduced.[40]

A commissionaire distributor is best described as a hybrid between a traditional distributor and an agent.[41] It is a legal structure well-known and recognized in civil law jurisdictions, with no clear counterpart in the common law legal system. A commissionaire distributor sells products in the customer jurisdiction and act in its own name, but for the account of a principal. The activities of a commissionaire are similar to those of a LRD. However, a commissionaire does not take title to the products. Therefore, the risks borne are even more limited. If structured correctly, the only profit component attributable to the commissionaire is profit for marketing and sales activities, which is typically the smallest profit of the components. The rather complex legal structure of a commissionaire is analyzed comprehensively in Chapter 2.1.

Distribution in the customer jurisdiction can be arranged via an agent, acting in the name and account of a principal. In such a structure, practically all of the risks are borne and most value creating activities are carried out by the principal. Unlike the abovementioned distribution alternatives, a traditional agency arrangement will generally constitute a PE for the principal.

Finally, as a fifth alternative, a marketing services company set up in the customer jurisdiction may provide a utilitarian solution in some industries. MSCs are not directly engaged in the distribution of tangible products. Instead, they provide local sales support and marketing services for the foreign principal. An MSC will only discuss contracts with customers and advise them to conclude contracts directly with the principal. Contracts are then concluded by the principal and the customer, typically via on-line form or other means

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[40] See Buss et al. 2006, p. 14. The LRD will typically not bear inventory risk or foreign exchange risk. The product liability risk is also very limited.

[41] Darby 2006, p. 2.

of electronic communication. An MSC's risk profile is very similar to that of the commissionaire. Furthermore, if structured correctly, no PE is constituted for the principal and the only profit component attributable to the MSC is profit for its marketing and sales activities.[42]

2.1 Legal and contractual structure of the commissionaire distributor model

A commissionaire engaged in the business of distributing tangible goods is typically structured flowingly (Diagram 1):

1) The principal company, also called the *SalesCo*, is typically a legal entity established in a low-tax jurisdiction, selling products to high-tax jurisdictions. The principal is in the business of manufacturing and distributing the products of the MNE.

   To be able to benefit from treaty protection, the country of choice should have a strong DTC network. Furthermore, in choosing the optimal state, the repatriation of the profits from the commissionaire to the SalesCo and from the SalesCo to a possible corporate parent must be considered, as well as favorable exit-tax regulations. Practicalities relating to employees should also be acknowledged. The most prominent court cases show that Ireland and Netherlands have been popular jurisdictions for establishing SalesCos.[43] However, traditional alternatives might not be optimal much longer. Local peculiarities and implementation of the MLI ought to have a significant effect on the choice of jurisdiction.
2) The commissionaire is either a direct subsidiary or a company belonging to the same multinational group as the SalesCo. The commissionaire is established as a separate legal entity, typically a limited company, in the customer jurisdiction.
3) The commissionaire acts as a sales agent in the customer jurisdiction and enters into sales contracts with customers. However, the commissionaire acts as if it would be a local company of the MNE and operates in its own name, not disclosing that economically it acts for the account of a principal. Therefore, invoicing is done by and in the name of the commissionaire.
4) After entering into a sales contract with a customer, the commissionaire then enters into a back-to-back contract with the SalesCo. The contract terms stipulate that the

[42] See Eisenbeiss 2016, p. 486.

[43] See *Dell* and *Boston Scientific*; See Buss et al. 2006 p. 16 on the choice of jurisdiction.

legal title to the product is passed directly from the principal to the commissionaire's customer. The product is then delivered directly to the customer via an international carrier service or delivered by the commissionaire.[44]

5) The commissionaire is remunerated on a commission basis for its sales activities. Because the functions performed, risks assumed and assets employed by the commissionaire are very limited, the arms-length remuneration is also rather low. If structured correctly, the only profit component attributable to the commissionaire is profit for sales activities. The commission may be calculated, for example, as a percentage of the total sales price or on a cost-plus basis.[45]

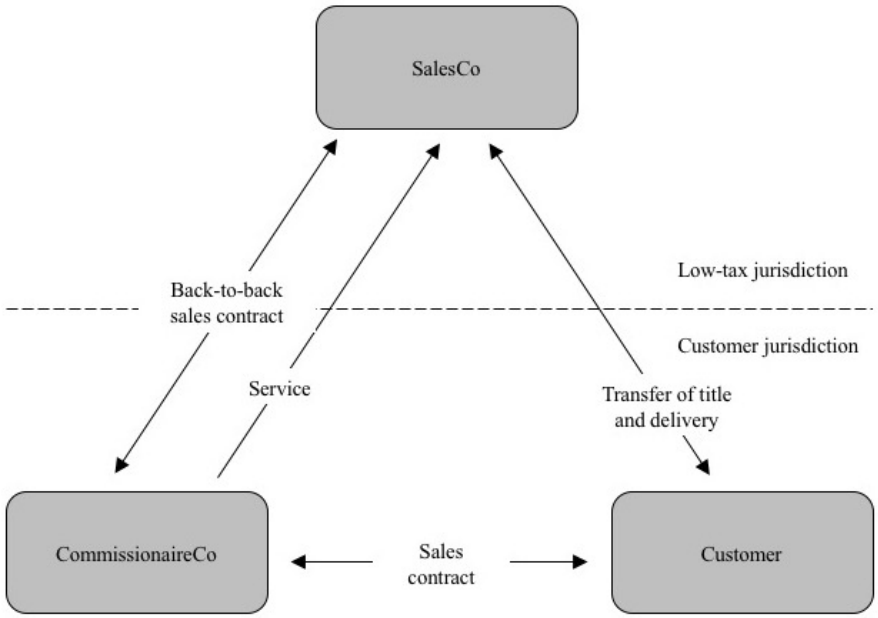

Diagram 1

The most significant feature of the commissionaire distributor model is that products are sold to the customer without any contractual relationship or legal enforceability between the company engaged in the sale of products, the SalesCo, and the customer. This notion relies

[44] Regardless of the transfer of title, the tangible product itself may in some cases be passed on by the commissionaire. In order to avoid constitution of a PE for the principal, the commissionaire should refrain from maintaining stock in its own premises. In case a stock of goods owned by the principal is maintained, the arrangement is likely to constitute a "fixed place of business", i.e. a general PE in the meaning of Article 5(1) of the OECD Model. In such case, the PE would result from the principal having "space at its disposal" at the commissionaire's premises. Even though not in the scope of this study, it is worth mentioning that in case a MNE is willing to maintain a stock of goods in the customer jurisdiction, it is common practice to establish separate premises, wherein the good are stored. Under the current OECD Model, such structure can benefit from the preparatory and auxiliary activities exception, i.e. the *negative list* of Article 5(3). See Para. 4 on the Commentary on Article 5.

[45] See Darby 2006 pp. 2–3 and Buss et al. 2006 p. 14.

on the concept of indirect representation found in civil law jurisdiction.[46] The Finnish system, which is fundamentally in line with other civil law jurisdictions, serves as a good example. It is therefore studied hereunder.

In order to attain the desired result with regard to taxation, the legal structure of the commissionaire arrangement is of high relevance. The principle of *falsa demonstratio non nocet* entails that headlining the agreement between the principal and the commissionaire as a *commissionaire agreement* is not in itself sufficient. In terms of content and characteristics, the terms of the agreement shall be equivalent to a true commissionaire relationship. In essence, the sales income must be received by the principal and the commissionaire shall be remunerated on a commission basis. The commissionaire must also have full right to return the principal's goods without limiting contractual terms and the principal must bear the risks related to distribution. Furthermore, the commissionaire shall not have right to dispose of the principal's property other than to enter into sales contracts with customers. Also, in a true commissionaire arrangement, the property sold must not be recorded as assets in the accounts of the commissionaire. In case a genuine commissionaire arrangement does not exist, there is a risk of the arrangement being considered an agreement for an infinite number of credit sales or sales as an agent.[47]

2.1.1 The concept of agency in Finnish contract law

Two types of representation—direct and indirect—are identified in Finnish contract law. In direct representation, a third party doing transactions with the agent is aware of the principal and aware that the agent's transactions bind the principal, which will be bound to the agreement. It is common that the agent openly informs third parties on the representation when acting on behalf of the principal, or representation is otherwise apparent.

Indirect representation refers to an arrangement where the agent acts in its own name on behalf of another person. In a strict legal sense, indirect representation is not considered representation at all in the Finnish legal tradition. The acts of the indirect representative do

[46] See Eisenbeiss 2016, pp. 484–485.

[47] See *NJA 2012 s. 419* regarding a commissionaire's bankruptcy. The Supreme Court of Sweden examined, inter alia, whether a real commission undertaking existed; See Tepora 1991 pp. 646–647 on the characteristics of commissionaire agreements.

not legally bind the principal. Commissionaires may be described as indirect representatives under Finnish contract law.[48]

Dispositive representation is arranged via authorization.[49] *Hemmo* and *Hoppu* (2006) define authorization as a power of representation founded by legal act, wherein the principal grants the agent the power to represent and act on behalf of the principal with direct legal effect.[50] Pursuant to the provisions of Chapter 2 of the Finnish Contracts Act (228/1929), the principal will become bound by way of the transactions entered into by the agent within the scope of his/her authority and in the name of the principal. Respectively, the agent is not bound to the transactions entered into by the way of direct representation.

In the case of indirect representation, where an agent acts in its own name on behalf of another person, two separate contracts are formed. One, entered into between the principal and the agent (1. Contract), for example a commissionaire, and another between the agent and the other party (2. Contract), for example a final customer (Diagram 2). No legally binding contract is formed between the end customer and the principal.[51]

Diagram 2

2.1.2 The concept of agency in common law jurisdictions

Like in the civil law system, agency is arranged via authorization also in common law jurisdictions, wherein the agent is authorized by a principal to act on its behalf. However, unlike in civil law jurisdictions, common law legal systems do not make distinction between direct and indirect representation or different types of agents. To this end, common law only distinguishes disclosed and undisclosed agents.[52]

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[48] Hemmo – Hoppu 2006, Chapter 5. ”Edustus”, ”Edustuksen lajeja”, ”Välitön ja välillinen edustus”.

[49] In some situations, representation is statuary or even inevitable. Corporate bodies shall be represented by natural persons. For example, limited companies are represented by their board members (Companies Act, 624/2006).

[50] Hemmo – Hoppu 2006, Chapter 5. “Edustus”, ”Tahdonvaltainen edustus”, Valtuutus.

[51] See Chapter 2.3 on the collateral security functions of a commissionaire arrangement.

[52] Parada 2013, pp. 59–61; Avery Jones – Ward 1993, p. 158.

When a third person enters into a contract with the agent and is aware that the agent acts in the name of the principal, that situation is a disclosed agency. If the third party does not have that knowledge and the agency, as well as the principal, remain undisclosed, that situation is an undisclosed agency. However, regardless of the fact that the principal remains undisclosed to the third party, the undisclosed agent doctrine provides that all contracts made by an agent are legally binding on the principal. Both disclosed and undisclosed principals are bound to the contracts entered into by the agent if the agent has acted within its authority.[53]

In the case of non-performance, the contracts entered into by an undisclosed or disclosed common law agent are enforceable against the principal. Some differences do exist among common law jurisdictions on whether the third party must decide to take action against the agent or the principal, or whether a third party can subsequently take action against the undisclosed principal if it holds a judgment against the agent.[54]

Clearly, the civil law commissionaire does not have a common law counterpart. Undisclosed agents and commissionaires shall, therefore, not be confused. These concepts are far from equal. In common law agency, only one contract can be identified, i.e. a contract made between the principal, acting via the agent, and the third party. Therefore, in civil law terminology, all agency contracts entered into by common law agents shall have a similar effect as direct representation.[55]

Regardless of the above mentioned, some workarounds are available for the purposes of avoiding PE status in common law jurisdictions as well. The agreements entered into between the commissionaire and the customer can be supplemented with a specific provision providing that the sales contract is entered into exclusively between the parties and does not bind any other party, such as the principal. Such arrangements are referred to as *synthetic commissionaires*. Therefore, with some caution, it can be concluded that the freedom of contract enables parties to exploit commissionaire distributor arrangements also in jurisdictions where indirect representation is not recognized.[56]

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[53] Parada 2013, pp. 59–61; Avery Jones – Ward 1993, p. 158.

[54] Ibid.

[55] See Avery Jones – Ward 1993, p. 158.

[56] See OECD 2012, p. 34; Eisenbeiss 2016, p. 486; Baker 2014, p. 28; See Avery Jones – Ward 1993, p.158 on cases under common law in which the principal is not bound; To the author's knowledge, a synthetic commissionaire structure has not yet been tested in a supreme court of a common law country.

2.1.3 Domestic law provisions on commissionaires

Unlike most Nordic countries, Finnish legislation does not include a specific act on commissionaires. The Finnish Act on Commercial Representatives and Salesmen (417/1992) does not apply to commissionaires, only to traditional agents. Certain general provisions on agents are included in Chapter 18 of the Finnish Commercial Code (3/1734), regarding inter alia, the agent's liabilities towards the principal. However, general principles of contract law, as described above, determine the legal and contractual relationship between the principal and the agent.

Some Nordic countries have commissionaire-specific acts and the civil codes of Central European countries include commissionaire provisions. These acts and provisions lay down the principals of commissionaire arrangements and set forth the general principle that contracts entered into by commissionaire are in the name of the commissionaire, not the principal. Therefore, the commissionaire's contracts do not generally bind the principal.[57] For example, Section 1 of the Swedish Commissionaire Act provides that the law applies to acting on behalf of another person but in the name of the commissionaire to sell or buy movable property.

In conclusion, regardless of different legislative measures, the contracts entered into by civil law commissionaires are in the name of the commissionaire, not in the name of the principal. As a premise, the commissionaire's agreements do not bind the principal in civil law jurisdictions.

2.2 Tax consequences

The success of the commissionaire distributor model relies on two key factors. Firstly, the most crucial factor is the ability the ability to avoid PE status in the customer jurisdiction. Secondly, favorable TP and profit attribution enables profit shifting to the principal's state. The focus of this study is on the commissionaire's ability to avoid PE status, however, a brief introduction to the relevant TP rules is necessary in this context.

[57] See Swedish Commissionaire Act (Kommissionslag 2009:865), Norwegian Commissionaire Act (Lov om kommisjon; 1916-06-30-1), French Civil Code (Code de commerce; 2013-504) Section L. 132-1, German (Handelsgesetzbuch or HGB) Section 383 and Spanish Código de Comercio (Commercial Code) Article 246.

In a related-party commissionaire distributor arrangement, the commissionaire provides services to its principal, i.e. a company belonging to the same group, engaged in the business of selling the products of the MNE. Because no PE is constituted for the principal, questions regarding profit allocation in terms of Article 7 of the OECD Model do not arise. However, Section 31 of the VML requires that the principal remunerates the commissionaire for its services on an arms-length basis.

Pursuant to the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD TP Guidelines), compensation paid between related-party enterprises must reflect the functions that each enterprise performs, taking into account assets used and risks assumed.[58] From a tax planning perspective, in case the principal is located in a low-tax jurisdiction which provides for more beneficial tax treatment than the customer jurisdiction, it is in the taxpayer's interest to limit the functions performed, assets used and risks assumed by the commissionaire to a bare minimum. The more limited, the less tax exposure the commissionaire will face in the customer jurisdiction.

The commissionaire's remuneration is commonly determined on a cost-plus basis or determined as a percentage of sales.[59] Appropriate arm's length remuneration to the commissionaire distributor may vary across different markets even for transactions involving the same services. Therefore, conducting a study which takes into consideration the different commission rates used between unrelated principals and distribution agents is advisable. A typical commission would amount to 5–15% of the sales income concerned.[60] However, in certain situations, commissions as low as 1% of the total turnover have not been scrutinized.[61] In conclusion, the commission can be set at a relatively low level. However, it cannot be non-existent and should always be set at an arms-length level to avoid income tax adjustment on the basis of Section 31 of the VML.

In typical commissionaire distributor arrangements, the commission will be the only profit attributable to the group entity in the customer jurisdiction. Sales profits will not incur in hands of the commissionaire because the title to the products passes directly from the

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[58] OECD 2010, Chapter 1; Tax authorities and courts regularly use the OECD TP Guidelines as a source of reference in matters that require interpretation.

[59] The remuneration is determined by taking into account the costs incurred by the commissionaire and adding a markup to this cost to make an appropriate profit in light of the functions performed. See OECD 2010 p. 26 on the definition of the cost-plus method.

[60] Darby 2006, p. 15–16.

[61] See Leegaard 2012 p. 318 on the *Dell* case.

principal to the customer. Where the commissionaire structure is accompanied with the migration of intellectual property to a holding company, the tax exposure will remain very limited.

Regardless of the nuances relating to remuneration, the success of the commissionaire arrangement boils down to the principal's ability to distribute goods in the customer jurisdiction without constituting a PE. Due to the current interpretation of agency PE provisions, the activities of the commissionaire will generally not exceed the current PE threshold set forth in OECD Model-based DTCs.[62]

Altogether, the commissionaire distributor model lets MNEs have local representation in customer jurisdictions without respective taxable presence. The commissionaire distributor model enables minimization of taxable profits in customer jurisdictions by shifting taxable income to the entity acting as the principal. In certain circumstances, such arrangement is beneficial and works together with other tax planning arrangements to reduce the overall effective tax rate of the MNE. However, the taxation of a MNE must be optimized on a group level. Therefore, a commissionaire distributor model is not always the optimal solution. PE constitution may be beneficial in some circumstances.[63]

In certain jurisdictions, commissionaire structures may bring other tax benefits as well. As an excursion, a brief introduction to the relationship between commissionaire distributor arrangements and anti-deferral regimes, such as CFC provisions, is appropriate in this context. One interesting feature of the commissionaire structure, which has been a significant factor in the structure's popularity, is that the commissionaire distributor model has enabled US-based MNEs to circumvent local CFC rules—the subpart F provisions. When the SalesCo, i.e. the group entity controlling the distribution of goods, purchases goods from an unrelated party and sells them to a local full-fledged distributor, subpart F rules are triggered. The sales income from a foreign base company is subject to income taxation in the US. However, where a commissionaire distributor model is implemented, the SalesCo will not engage in a related-party sale, because the transfer of title is directly transferred to the customer without a related party taking title. Therefore, without material change in actual

[62] On this conclusion, see Chapter 3.1.5.

[63] See Chapter 3.4.

distribution models or change in operations, MNEs have been able to achieve significant advantages. Therefore, many US-based MNEs have opted for commissionaire structures.[64]

2.3 Other implications

Even though the implementation of a commissionaire distribution model may primarily or solely tax-motivated, the structure will have implications to the MNE that are way broader than tax. Many aspects of business will be affected by the changes in contractual relationships between the principal and the local distributor.

Regardless of the avoidance of PE status, the entity acting as a commissionaire will have to meet the local compliance requirements in the customer jurisdiction, wherein the entity is established and operative. However, the avoidance of PE status limits the principal's administrative burden. Firstly, PE status would require filing a start-up notification and trigger the requirement to file a Finnish income tax return.[65] Secondly, depending on the specific circumstances, a MNE operating via a PE would be required, inter alia, to seek for entry in the Register of Employers, pay social security payments, file periodic tax returns and employer payroll reports. Thirdly, PE status triggers the requirement to make and maintain an accounting of the business transactions of the PE. In principle, these accounting materials should be kept in a place located in Finland.[66] With regard to VAT, the requirement to register is connected to somewhat similar requirements, PE constitution for the purposes of VAT.[67] These requirements cannot be further discussed in this context. However, what can be concluded in general, is that avoiding PE status will prevent the MNE from fulfilling similar burdensome compliance requirements twice in one jurisdiction.

In comparison to a full-fledged distributor, a commissionaire distributor arrangement has a risk-shifting effect on the MNE as well. When the commissionaire does not take title to the distributed products and due to other contractual arrangements, product liability risk, bad debt risk, foreign exchange risk and inventory risk are all centralized to the principal entity.

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[64] See Swanick et al. 1997, p. 137; See US Internal Revenue Code, §§ 951–965; A commissionaire distributor model may allow circumvention of CFC rules in jurisdictions where related-party sales trigger application.

[65] In case the principal would be located in a country outside the European Economic Area, also a permit from the Finnish Patent and Registration Office for the establishment of the branch would be required.

[66] See Finnish Accounting Act (1336/1997). See also Finnish Auditing Act (1142/2015) on situations where a statutory audit of a Finnish PE must be arranged.

[67] Provisions on PE for purposes of VAT differ from those applied in income taxation. See Section 11 of the Finnish VAT Act (1501/1993).

Furthermore, the principal's risk position is affected by the circumstance that sales contracts are entered into in the name of the commissionaire, not the principal. Where the contracts do not bind the principal, most contractual responsibilities are not enforceable against the principal either. In the case of bankruptcy of the commissionaire, the principal is not obliged to execute the contracts, i.e. deliver products to the customer. In fact, the principal would have the right of separation to the products it holds title to.[68] Therefore, the commissionaire arrangement also works as an effective and simple collateral security arrangement.[69]

In respect to management of the distribution business, centralization may provide certain advantages. As an operating model alternative, the commissionaire distributor model renders possible the centralization of the MNE's buy–sell operations. This may help optimize stock management and enhance control over the entire value chain. Even better, centralization can be carried out without changing the appearance of the local business structure. Customers will continue to believe that they are entering into transactions with a local distributor.

Consolidation of profits to the SalesCo can also provide advantages where operations in customer jurisdictions are unprofitable. Entering into new weaker markets is likely to result in start-up losses, which may not be offset anywhere else. In a commissionaire structure, the losses in the customer jurisdiction are minimized, because operations are very limited. Consolidation will enable subsidizing the weak markets with the revenue flows from profitable markets.

Controlling the administrative burden, collateral security characteristics and centralization of business functions together with the agile structure of a commissionaire distributor allows for cost reduction in the customer jurisdiction. In consequence, a MNE may opt to distribute its products also to smaller jurisdictions, without extensive revenue potential, via a commissionaire distributor arrangement.

The cost reduction advantages and efficiencies accomplished by the distribution model may, however, be offset by the additional costs incurred because of local tax authorities challenging the somewhat artificial or abusive arrangement. A particularly high risk of scrutiny from the local authorities is present in the process of establishing the

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[68] See Tepora 1991, p. 631; Such right would become relevant in case the distributable goods would already be under the commissionaire's control and the commissionaire would face insolvency. Pursuant to Chapter 5 Section 6 of the Finnish Bankruptcy Act (120/2004), the assets have to be detached from the debtor's assets, in order to exercise the right of separation.

[69] Ibid., p. 655.

commissionaire distributor model. Issues may arise in connection with business restructurings or conversions, where traditional full-fledged distributors are converted into commissionaires. Restructurings typically include the sale of fixed assets, stock and customer base to the principal.[70] For example, restructurings may constitute taxable the sale of goodwill or other intangibles. Moreover, when new entities are established to replace full-fledged distributors, compensation payment for breach of existing contracts may be required and limitations to the transfer of existing losses may apply.[71]

Distribution models have implications broader than tax, some of what have been discussed here. In addition to tax treatment, many practical issues have to be considered. For instance, customs procedures and other aspects in connection with importation must be taken into account.

[70] OECD 2014b, p. 11.

[71] See Buss et al. 2006, pp. 14–16; Swanick et al. 1997, pp. 138–143.

3 The Concept of Agency Permanent Establishment

3.1 OECD Model

In its current form, Article 5 of the OECD Model consists of seven paragraphs, which define the concept of PE. Paragraph 1 gives a general definition of the concept, brings forward its characteristics. It is referred to as the *general PE rule*. Paragraph 2—the *positive list*—further clarifies the concept and gives examples, which *prima facie* constitute a PE.

Paragraph 3 provides a 12-month threshold for building sites, construction and installation projects. Therefore, Article 5(3) is referred to as the *construction PE*.[72] The Paragraph clarifies some of the uncertainties relating to such projects and limits the scope of application of the PE concept.

A number of business activities are listed in Article 5(4), which are treated as exceptions to the general definition of PE laid down in Article 5(1). The exceptions listed in the non-exhaustive *negative list* are considered, as such, preparatory or auxiliary activities. Therefore, the listed activities will not amount to a taxable presence in the said state. Furthermore, Article 5(4)(e) serves as a general restriction to the scope of the general PE rule. It excludes any activity of a preparatory or auxiliary character from the scope, even activities which have not been explicitly mentioned in the negative list. Pursuant to Article 5(4)(f), combinations of activities are also exempt, provided that the overall activity is of a preparatory or auxiliary character.[73]

It is commonly accepted that in addition to substantial physical presence in the state concerned, a PE should also be constituted where business by a non-resident is carried on via a dependent agent. In this manner, the Paragraph 5 of the OECD Model sets forth an alternative test to whether a company has a PE in a state. Even though the foreign company

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[72] In this respect, the UN Model differs from the OECD Model. Firstly, instead of a 12-month test, the UN Model includes a six-month test for a construction PE. Secondly, Article 5(3)(a) of the UN Model is broader than article 5(3) of the OECD Model, also including assembly projects and supervisory activities carried out in connection with a building site, a construction, assembly or installation project.

[73] See Paras. 24 and 27 of the Commentaries on Article 5 on the preparatory or auxiliary character of activities and interpretation thereof; Article 5(4) of the UN Model differs from that of the OECD Model. The word "delivery" has been deleted from Articles 5(4)(a) and (b) of the UN Model, therefore, it does not apply to the delivery of goods or merchandise belonging to the enterprise. With regard to commissionaire distributor arrangements, mostly subparagraphs a) and b) of the OECD Model are relevant to the extent that the principal company maintains inventory, separate of the commissionaire, for the purposes of acquiring, storing or delivering its own goods or merchandise. The negative list, therefore, enables the parent to maintain inventory in the state of the customer without taxable presence.

may not have a fixed place of business in that state within the meaning of Article 5(1) and 5(2), the enterprise should be treated as having a PE in a state if there is a dependent agent acting for it. Article 5(5) is also referred to as the *agency PE*. The threshold for the constitution of an agency PE is further defined in Paragraph 6, which has been inserted in the Article for the sake of clarity and emphasis.[74]

With regard to the concept of PE, Paragraph 7 sets forth the underlying principle that, for the purpose of taxation, a subsidiary company constitutes an independent legal entity. Paragraph 7 also further clarifies the concept of PE. However, it is to be noted that a parent company may be found having a PE in a state where a subsidiary has a place of business, under the general PE rule or under the agency PE rule.[75]

The OECD Model sets the foundation for the interpretation of agency PE provisions. Because the current definitions set forth in EU law and Finnish domestic legislation are fundamentally based on the OECD Model, the wording of the OECD Model is studied first.

With regard to commissionaire distributors, Articles 5(5) and 5(6) represent the most material part of Article 5. However, the agency PE is only an alternative PE test included in the OECD Model. In certain situations, a commissionaire may also fall within the scope of the general PE rule as well.[76] Furthermore, to a certain extent, the provisions in EU law and Finnish national legislation adhere to the wording of Article 5(1) and 5(2). Therefore, also the provisions of the general PE are studied to a relevant extent.

Article 5 in the OECD Model and in the UN Model are rather similar. Most differences with respect to PEs boil down to the allocation of profits under Articles 7 and additional types of PEs—the services PE[77] and the insurance PE[78]. Deviations from the OECD Model are highlighted where relevant.

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[74] Para. 36 of the Commentaries on Article 5.

[75] The counterpart of Article 5(7) in the UN Model includes a second sentence addressing situations where an agent acts wholly or almost wholly on behalf of an associated enterprise. Such discrepancy does not have relevance to the PE status of commissionaires which do not rely on the independent agent exception. As *Vann* 2011 p. 8 notes, the ”relationship issue only enters once the agency test is satisfied”.

[76] For example, see *Dell Spain*.

[77] See Article 5(3)(b) of the UN Model; A similar services PE provision, which countries may include in their bilateral DTCs, is provided in Para. 42.23 of the OECD Commentary on Article 5.

[78] See Article 5(6) of the UN Model.

3.1.1 Historical developments

The emergence of the PE concept dates back to 19th century German Empire, where the PE concept was first included in tax statutes in 1885. The concept was first established in international tax provisions in the 1899 Austria-Hungary–Prussia tax convention, wherein the term "business establishment" was used for the first time. The same convention is considered the first general international tax treaty. This treaty already included the substantial elements of a PE, such as the "fixed place of business" requirement, also found in the current OECD Model. From early on, taxing jurisdiction could also be justified on the basis of permanent agency, even though the distinction between dependent and independent agents was not yet established.[79]

The 1927 League of Nations Draft DTC also contained a PE provision, including the "fixed place of business" requirement and the agency element, which now specifically excluded independent agents.[80] The Mexico Model of 1943, developed by the League of Nations Fiscal Committee, added to the PE concept adopted in the 1927 League of Nations convention by introducing the construction PE rule for building sites, the exclusion of commercial travelers and subsidiaries, and several rules for agents, which are present in the current OECD Model.[81] Contrary to current Models, the 1943 Mexico Model did require that the fixed place of business have a productive character.[82]

The League of Nation's work in the development of DTCs was continued by the Organisation for European Economic Co-operation (OEEC) and its successor, the OECD. Their work lead to the 1963 OECD Draft, which contained a definition of PE.[83] The underlying principles of PE developed by the League of Nations were not changed, but a completely new draft text was set forth. This text included the current formulation of the

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[79] Skaar 1991, pp. 72–77.

[80] League of Nations Draft Bilateral Convention for the Prevention of Double Taxation, 1927.

[81] Mexico Draft Model Bilateral Convention for the Prevention of the Double Taxation of Income and Property, 1943.

[82] Arnold 2016, Chapter 1.2.1.3 "The Mexico Draft (1943)"; Skaar 1991, p. 88 notes that the international taxing jurisdiction of business profits was radically changed by the Mexico Model. The Mexico Model introduced a system of source state taxation, wherein the PE was just an example, not a decisive criterion for the taxation of business profits. However, the source state system was then abandoned in the 1946 London Draft Model Bilateral Convention for the Prevention of the Double Taxation of Income and Property.

[83] OECD Draft Double Taxation Convention on Income and Capital, 1963.

general PE rule, the list of positive examples, wherein the construction PE provision was included, and a simplified agency clause.

The legal foundations for the current commissionaire model, as we know it, can also be dated back to the OEEC drafting of the 1963 OECD Draft. Stock holding agents were then removed from the scope of the agency PE provision. Prior to removal, a commissionaire holding a stock for the enterprise would have constituted a PE. In consequence, the article was left with the definition of "authority to negotiate contracts or to enter into contracts on behalf of the enterprise".[84] However, the revised version of the Fiscal Committee's draft Report to the Council, dated 19 April 1958, contained changes which would, later on, have far-reaching implications. It contained the definition present in the current Article 5(5), i.e. "authority to conclude contracts in the name of the enterprise".[85]

Different interpretations have been presented on why the expression "in the name of" was adopted. No document explains the change from "on behalf of" to "in the name of".[86] *Avery Jones* and *Ward* (1993) assume that this change in content was down to the unfortunate adoption of the civil law concept of "in the name of" due to a faulty literal translation from the French language version. They further claim that this expression should have been translated differently.[87] On the contrary, *Pijl* (2013b) justifies consistently that this change in content was not considered relevant, because the drafters did not perceive any difference between the terms "on behalf of" and "in the name of ", both meaning *binding*.[88]

The treaty text adopted in the 1963 OECD Draft did not attempt to describe the characteristics of a dependent agent. Pursuant to *Skaar* (1991), this was because the previous attempts to describe and exemplify the concept had not been very successful. The OECD rather chose to deal with the issue with a comprehensive Commentary. The OECD did, however, attempt to reach a general dependent agent definition, emphasizing on the authority to conclude contracts and habitual execution thereof.[89]

To reflect the change in opinions of OECD member countries and changes in international business and national tax laws, the OECD Model of 1977 and respective Commentaries

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[84] Fiscal Committee's original report, dated 17 September 1956.
[85] See Pijl 2013a, p. 12; Pijl 2013b, pp. 70–71.
[86] Pijl 2013b, p. 72.
[87] Avery Jones – Ward 1993, pp. 156–166.
[88] Pijl 2013b, p. 73.
[89] Skaar 1991, pp. 96–97.

where introduced. The construction PE rule was moved into a separate provision, Article 5(3). Furthermore, the general exception for preparatory or auxiliary activities, current Article 5(4)(e), was moved into a separate provision. Finally, the specific exemption for agents engaged exclusively in purchasing goods for an enterprise was removed.[90]

Since the 1977 OECD Model, the wording of Article 5 has not changed. However, the concept of PE has evolved considerably through changes to the Commentary. In recent years, the OECD has strived to clarify issues arising from the definition of PE by publishing two discussion drafts dealing with questions relating to PEs.[91] These discussion drafts, published in 2011 and 2012, touched upon many highly relevant questions subject to debate.[92] However, the 2014 update to the OECD Model did not include any of the proposed changes to the Commentary, since it was expected by the OECD that Action 7 would result in changes to Article 5. It was decided that the proposed changes to the Commentary would not be finalized until the work on Action 7 was completed.[93] The reasons for not adopting the changes proposed in 2011 and 2012 are likely to include the lack of common understanding among the OECD member states on the matters at hand and the realization that amendments to the Commentary would not be sufficient. Rather, the wording of the OECD Model would have to be changed to achieve policy goals.[94]

Clearly, OECD and G20 policy-makers have been of the opinion that the Commentary driven change has not been considerable enough, thus lagging behind the vast developments in international business. After 36 years of stagnant development of the PE concept, the OECD and G20 countries have adopted a 15-point Action Plan to address BEPS in September 2013. Action 7 will result in significant changes to the wording of Article 5.

As *Skaar* (1993) concludes, the development of tax treaties since the late 19th century shows a clear change in paradigm, a tremendous shift from source state taxation to residence state taxation. Most amendments to DTCs since the 1927 League of Nations Draft DTC have, in fact, resulted in the loss of tax revenues to the source state. In line with this shift, the PE

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[90] Arnold 2016, Chapter 1.2.2. "The OEEC/OECD to 1977".

[91] See OECD 2012 and OECD 2011.

[92] See OECD 2012, especially issues 19. (Meaning of "to conclude contracts in the name of the enterprise"), 20. (Is paragraph 5 restricted to situations where sales are concluded?), 21. (Does paragraph 6 apply only to agents who do not conclude contracts in the name of?), and 22. (Assumption of entrepreneurial risk as a factor indicating independence).

[93] OECD 2014.

[94] Storck – Petruzzi 2016, p. 94.

concept has been significantly narrowed down since the late 19th century. This tendency is apparent especially regarding the concept of agency PE.[95] As was concluded over 25 years ago by *Skaar*, many consider that this shift across the board has accumulated and see a need to revive source state taxation.[96] No doubt, the proposals in Action 7 are a response to these concerns.

3.1.2 General rule

The general PE rule in Article 5(1) provides that term PE means a "fixed place of business through which the business of an enterprise is wholly or partly carried on". Three distinct cumulative conditions for PE constitution can be identified:

1) existence of a "place of business"
2) the place of business must be "fixed"
3) business of the enterprise shall be "carried on" through this fixed place of business

At first sight, the general definition of PE appears rather broad. However, the general PE rule is subject to the exceptions in Articles 5(3), regarding construction activities, and Article 5(4), regarding preparatory and auxiliary activities. A general restriction on the scope of the definition is provided in Article 5(4)(e), which excludes activities of preparatory and auxiliary character from the scope.[97]

Place of business

The first requirement, the existence of a "place of business", refers to any premises, facilities or installations which also fulfill the other two requirements. The Commentary further clarifies that a place of business may also exist where the enterprise simply has "space at its disposal". This interpretation broadens the first requirement to cover also business activities which are carried on without premises available or to activities which, in fact, do not require premises for carrying on the business. Therefore, space at the enterprise's disposal in the business facilities of another enterprise may also constitute a "place of business" in the meaning of Article 5. This is regardless of whether the enterprise has formal legal right to

[95] Pijl 2013a, p.12.
[96] Skaar 1991, p. 101.
[97] Para. 21. of the Commentaries on Article 5.

use the space, such as a lease contract.[98] However, the Commentary clarifies that mere presence at a location is not sufficient to constitute a ”space at its disposal”.[99]

Fixed

The second requirement sets forth the rule that the place of business has to be “fixed”. This means that there has to be a link between the “place of business” and a specific geographical point. This requirement of a link does not entail that the place of business has to be fixed into soil. Remaining on a particular site is sufficient.[100]

Being “fixed” also requires a certain degree of permanency. Depending on the specific DTC, the required permanency may be subject to different interpretations. However, as of January 2003, the Commentary has mentioned as a rule of thumb that a six-month threshold has been generally accepted in tax praxis. Temporary interruptions of activities do not cause a PE to cease to exist.[101]

Through which the business of an enterprise is wholly or partly carried on

The third requirement for the application of the general PE rule is that the business of the enterprise must be “carried on” through this “fixed place of business”. Pursuant to the Commentary, business is carried on through a fixed place of business in any situation where business activities are carried on at a particular location that is “at the disposal of” the enterprise for that purpose. Therefore, the words “through which” must be given a wide meaning.[102]

According to the Commentary, the “business of an enterprise is carried on” either by the entrepreneur, the employees of the enterprise or a dependent agent. In certain situations, the business of an enterprise can be “carried on” also via automatic equipment.[103] The word

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[98] See Paras. 4. and 4.1 of the Commentaries for examples of an enterprise having ”space at its disposal”. Examples include a pitch in a marketplace, a permanently used area in a customs depot, another enterprise’s premises at the disposal of a foreign enterprise and an illegally occupied location.

[99] The difference between mere presence and having space at one’s disposal is illustrated in Paras. 4.2 (a salesman who regularly visits a major customer), 4.3 (an employee at the premises of a newly acquired subsidiary), 4.4 (a road transportation enterprise using a delivery dock), and 4.5 (a painter at the office of the main client).

[100] See Paras. 5.1. to 5.5 of the Commentaries for examples of “fixed” places of business, such as a mine, office hotel, fair, painter in a large office building or a consultant engaged in training employees.

[101] Paras. 6 and 6.1 of the Commentaries on Article 5.

[102] Para. 4.6 of the Commentaries on Article 5.

[103] See Arnold 2016, Chapter 5.5 “Digital economy PEs”.

"business" should also be interpreted in a broad manner. A productive character of the fixed place of business is not required.[104]

As soon as the activities of the enterprise fulfill the three distinct requirements, i.e. carries on its business through a fixed place of business, a PE begins to exist. The PE ceases to exist if either the fixed place of business is disposed or any activity through it is discontinued.

Positive list

Pursuant to Article 5(2), the term PE includes especially:

a) *a place of management;*
b) *a branch;*
c) *an office;*
d) *a factory;*
e) *a workshop, and*
f) *a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.*

This list of activities further clarifies the general PE concept and gives examples which, according to the Commentary, *prima facie* constitute a PE. It is noteworthy, that also the examples listed are subject to the conditions set forth in Article 5(1). Therefore, the general PE rule has primacy.[105] The list is by no means exhaustive and has been subject to many reservations and additions in actual DTCs.

3.1.3 Agency PE

In today's world, MNEs may be engaged in significant business activities which do not necessarily require fixed places of business in the traditional sense. MNEs may choose to operate via an agent in the source jurisdiction. For reasons of neutrality and to limit the possibility of artificially avoiding PE status, tax treaties include rules which lead to the constitution of fictional PEs in certain situations.[106]

The agency PE rule is set forth in Article 5(5) of the OECD Model and reads as follows:

> *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*

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[104] Unproductive PEs will seldom have attributable profits. However, compliance requirements must be met regardless of profitability.

[105] Skaar 1991, p. 114.

[106] Skaar 1991 p. 463 claims that:"[t]axation would infringe neutrality if the tax position of an enterprise's foreign business operations depended upon whether the enterprise conducted the business itself or through an agent who was integrated to a large extent in the principal's business".

> *acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the 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.*

Three distinct, cumulative conditions for the constitution of an agency PE can be identified. For the sake of clarity, the third requirement is broken down into three components:

1) existence of a dependent person (agent)
2) that person is acting on behalf of an enterprise (principal)
3) that person has, and
    a. habitually exercises, an
    b. authority to conclude contracts
    c. in the name of the enterprise

Two restrictions to the application of Article 5(5) are also laid down in Article 5:

1) activities of a dependent agent which are limited to those mentioned in the negative list (Article 5(4)), do not constitute an agency PE, and
2) the rule does not apply to an agent of an independent status to whom Article 5(6) applies.

Person

Pursuant to the first condition, only a "person" may constitute a dependent agent in the meaning of Article 5(5). Article 3(1) of the OECD Model defines the term "person", which includes an individual, a company and any other body of persons. The Commentary further clarifies that such persons may either be individuals or companies, regardless of the person's state of residence or employment, as long as the person acts for the enterprise in accordance with Article 5(5).[107] Persons whose activities may create a PE for the principal are referred to as *dependent agents*.

Acting on behalf

The second requirement is not clarified to a great extent in the Commentary, which only states the general principle, according to which PE constitution is accepted by virtue of activities "if there is under certain conditions a person acting for" the enterprise.[108]

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[107] See Para. 32 of the Commentaries on Article 5.

[108] Para. 31 of the Commentaries on Article 5.

Certainly, "acting" on behalf of another requires that some activity takes place and that the principal's and agent's activities are somehow interrelated.[109] Mere passive representation shall not constitute sufficient "acting".[110] As the Commentary puts it, the authority to conclude contracts must cover contracts relating to operations which constitute the "business proper" of the enterprise, i.e. business belonging to the enterprise.[111] French case law also confirms this interpretation. In *Interhome,* the French Supreme Administrative Court held relevant that the Swiss parent company's and French subsidiary's business activities were legally different. The French subsidiary was not involved in the negotiation or conclusion of holiday accommodation contracts with customers. Its activities were limited to signing rental contracts and taking care of the proper execution of the rental contracts. The fact that the subsidiary's activities were different from those of the parent can be considered one relevant factor, which lead to the conclusion that no agency PE was constituted for the Swiss parent company in France.[112]

The term "on behalf of" is clearly not defined in the OECD Model. There is no explicit definition included in the Commentary either. Therefore, to obtain the meaning of the term, one must consult the national laws of the state concerned.[113]

As *Storck* and *Schmidje* (2014) point out, the words "acting on behalf of" are generally translated in the German language as "eine Person, welche für ein Unternehmen tätig ist", which corresponds to the English version. However, the wording of the official French version of the OECD Model is "une personne agit pour le compte d'une entreprise", which can either be translated as "on behalf of" or "for the account of".[114] Respectively, in modern Finnish tax treaties the words "acting on behalf of an enterprise" have been translated as "harjoittaa yrityksen lukuun".[115] In the author's view, the Finnish translations adopted in DTCs, rather hold the meaning of "for the account of an enterprise" than "on behalf of an enterprise".

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[109] Storck – Schmidje 2014, p. 52.

[110] Ibid., p. 51.

[111] Para. 33 of the Commentaries on Article 5.

[112] International Tax Law Reports 2003; However, it is to be borne in mind that in *Interhome*, another key factor was that the subsidiary did not have legal authority to bind its Swiss parent company. These factors together lead to conclude that the subsidiary was of independent nature. See Storck – Schmidje 2014, p. 53.

[113] See OECD Model Article 3(2).

[114] Storck – Schmidje 2014, p. 54

[115] Such translation has been adopted in all DTCs entered into by Finland during the past 10 years. For further information on Finnish DTCs in force, see Verohallinto 2016.

Further, to define the concept of "acting on behalf of" another, it must be resolved whether acting on behalf of another in a formal manner is required, for example acting as an authorized agent, or does the concept refer to acting in a more substantive, factual or economic character.

The meaning of the official French version of the OECD Model indicates that a person acting "for the account*"* of an enterprise is, in fact, acting for another in an economic sense.[116] Similarly, the Finnish translation also refers to acting in a factual or economic sense. For example, the Finnish term "lukuun" ("on behalf") has been used in the last sentence of Section 10(d) of the Act on the Tax Treatment of the Income of a Person Subject to Unlimited Tax Liability (627/1978; LähdeVL) to refer to, whether shares are possessed "for the account of" oneself or "for the account of" another. In this context the word "lukuun" clearly refers to an activity of an economic nature rather than purely legal activity. Furthermore, Article 28 of the VAT Directive (2006/112/EC) uses the phrase "on behalf of" in the following context: "[P]erson acting in his own name but on behalf of another person takes part in a supply of services".[117] The author's interpretation is that in that context "on behalf of" is used to refer to an activity of a factual nature. Therefore, at least in the jurisdictions and languages discussed above, the concept "acting on behalf of an enterprise" does not confine the application strictly to legal activities, i.e. does not require that one acts legally on behalf of another.[118]

Habitually exercises

The Commentary clarifies that whether the agent habitually exercises his right or not, should be determined on the basis of the commercial realities of the situation. The agent's presence should at least be more than merely transitory. Secondly, it is stated that the right is sufficiently exercised "in a Contracting State", even if the contract is signed elsewhere or the signatory does not have a formal power of representation.[119]

Authority to conclude contracts

Whether the "authority" of the person is restricted in one way or the other, such restriction is not material with regard to the application of the agency PE rule. It is highly unlikely that

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[116] Storck – Schmidje 2014, p. 52.

[117] Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax.

[118] Ibid., p. 54

[119] Paras. 33 and 33.1 of the Commentaries on Article 5.

an agent would be granted unlimited powers to bind the principal. Rather, it is common that the agent's authority is limited to specific activities, such as certain lines of business.[120]

As stated earlier, the "authority to conclude contracts" must cover contracts relating to operations which constitute the "business proper" of the enterprise. However, this requirement does not confine the existence of a permanent establishment only to the extent that such a person exercises the authority to conclude contracts. Instead, the PE exists to the extent that the person acts for the principal.[121]

In the name of the enterprise

Pursuant to the first sentence of Paragraph 32.1 of the Commentary:

> *Also, 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.*

Paragraph 32.1 of the Commentary reflects the interpretation that the expression "in the name of" should be interpreted as "binding". Therefore, at least according to the Commentary, acting literally in the name of the enterprise is not required.[122]

The aforementioned clarification in Paragraph 32.1, which in fact seems to be in contradiction with the clear wording of Article 5(5), was inserted in the Commentary in 1994. However, Article 5(5) of the OECD Model was not amended. Rather, the phrase has remained unchanged up to this date since 1963, when the first version of the OECD Model was published. There has been debate and different interpretations on whether the interpretation suggested in the Commentary holds true. The issue is further discussed in Chapter 3.1.5. However, there is no doubt that simply an additional paragraph in the Commentary by itself cannot justify interpretation in contradiction with the wording of the OECD Model.[123] Such effect would be contrary to the rules of interpretation established in international tax law.[124]

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[120] The History on Commentaries on Article 5 goes on to explain that the term "general authority" was commonly used in DTCs prior to the 1963 OECD Draft. However, such wording has been abandoned and replaced simply by the term "authority"; See Daxkobler 2014, pp. 127–129.

[121] Paras. 33 and 34 of the Commentaries on Article 5.

[122] Para. 32.1 of the Commentaries on Article 5.

[123] See Pijl 2013a, p. 13.

[124] See Chapter 1.5 for the interpretation of international tax law provisions.

Limitations to the scope

The agency PE rule is subject to two separate rules, which limit the scope of application. Activities in the scope of the negative list set forth in Article 5(4) do not constitute a general PE or an agency PE. In other words, the level of activities of an agent shall exceed those mentioned in the negative list. Secondly, independent agents, to whom Article 5(6) applies, will not constitute an agency PE. The interpretation of Article 5(6) is studied in the following Chapter.

UN Model stock agent provision

Unlike the OECD Model, Article 5(5)(b) of the UN Model includes a *stock agent* provision, which provides that a PE is deemed to exist also where a person:

> *habitually maintains in the first mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise.*

This provision effectively broadens the scope of the agency PE rule, as compared to the OECD Model. Therefore, an agency PE will also be deemed to exist under the UN Model, where an agent does not have the "authority to conclude contracts in the name of the enterprise", but acts as a stock agent for the principal.[125] If however, the sales-related activities of the stock agent only take place outside the agent's state, a PE should not be constituted.[126] Some DTCs with developing countries also include similar additions, inter alia, applying to agents engaged in habitually securing orders for the principal.[127]

3.1.4 Independent agent

As clarified in Article 5(5), the agency PE rule does not apply to an independent agent. Article 5(6) of the OECD Model reads as follows:

> *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.*[128]

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[125] For example, see Article 5(5)(b) of the Finland–Turkey DTC (49/2012), dated 6 October 2009.

[126] See Para. 26 of the UN Model Article 5 Commentary.

[127] For example, see Article 5(5)(c) of the Finland–India DTC (58/2010), dated 15 January 2010.

[128] Article 5(6) of the UN Model includes a special provision on situations where insurance businesses constitute PEs. Article 5(6) of the OECD Model corresponds to Article 5(7) of the UN Model.

Therefore, an agency PE is not constituted where two cumulative conditions are met:

1) the agent is of an independent status, and
2) such agent is acting in the ordinary course of its own business

In addition to the two cumulative conditions, one cannot help but wonder why general commission agents and brokers are specifically mentioned in Article 5(6). A civil law lawyer might ask, what is the rationale for mentioning these two if commission agents and brokers generally fall outside the scope of Article 5(5). There has been some debate on whether these examples have been misplaced and are without meaning in civil law jurisdictions, or whether such tension exists at all.[129] In spite of this minor obscurity, commission agents and brokers must fulfill both cumulative requirements in order to be independent agents in the meaning of Article 5(6).

Agent of an independent status

In order to be considered an independent agent in the light of Article 5(6), the activities of the agent must pass two separate tests, the tests of legal and economic dependence. With regard to legal dependence, the Commentary notes that a corporate parent's control over its subsidiary in its capacity as a shareholder is not relevant in this consideration.[130] This interpretation conforms with Article 5(7) as well. The Article sets forth the general principle that for the purpose of taxation, a subsidiary company constitutes an independent legal entity. This, of course, does not entail that a subsidiary could not constitute a PE for the parent.

To the end of economic independence, the extent of the obligations which the agent has vis-à-vis the enterprise is decisive. If the agent's commercial activities are subject to detailed instructions or it is otherwise under comprehensive control by the principal, such person cannot be regarded as independent of the enterprise. The agent cannot be considered economically independent either, if the entrepreneurial risk of the agent's activities is borne by the principal.[131]

Acting in the ordinary course of their business

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[129] On the first point, see Avery Jones – Ward 1993 p. 178; On the second point, see Pijl 2013a pp. 9–10; See Chapter 3.1.5 for further discussion on the relationship of Articles 5(5) and 5(6).

[130] Para. 38.1 of the Commentaries on Article 5.

[131] Para. 38 of the Commentaries on Article 5. See Paras. 38.3 to 38.6 for further considerations for determining independence.

A negative definition for the second requirement is that a person is not acting in the ordinary course of their own business if the activities performed belong to the sphere of the principal's business.[132] A comparison between the agent's activities and the customary activities carried out within the agent's trade as a broker, commission agent or another independent agent, may serve as an indication of dependence.[133]

Altogether, the interpretation of the independent agent exception makes it clear that the commissionaire distributor will seldom fall within Article 5(6). However, falling within the exception may be possible under certain circumstances. In a rather dated Finnish advance ruling by the Central Tax Board (KVL) 68/1996, a Finnish subsidiary of a Dutch company operated via a typical commissionaire arrangement. The subsidiary was engaged in sales activities in its own name but on behalf of its principal. Firstly, based on the circumstances that the commissionaire was not subject to detailed instructions and no acceptance was needed from the principal for the conclusion of contracts, KVL found that the Finnish commissionaire entity was independent. Moreover, the commissionaire did not have an exclusive right to a specific market area, and the commissionaire bore the associated business risks since the commissionaire's performance directly affected its profitability. Secondly, the commissionaire acted in the ordinary course of its own business. KVL reasoned that the commissionaire only carried out activities within its own industry. No PE was constituted for the Dutch company acting as the principal.

Far-reaching conclusions should not be made from KVL 68/1996.[134] Recent European case law shows that commissionaires have seldom been considered of an independent character.[135] Therefore, the commissionaire distributor model must primarily rely on its ability to fall outside the scope of Article 5(5).

3.1.5 Interpretation of Article 5(5)—especially the "in the name of" requirement

The interpretation of Article 5(5), especially the expression "in the name of the enterprise", is the cornerstone for the success of the commissionaire distributor. A typical commissionaire will not benefit from the independent agent exception in Article 5(6).

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[132] Para. 38.7 of the Commentaries on Article 5.
[133] Para. 38.8 of the Commentaries on Article 5.
[134] Same case as KHO 7.6.1996 T 1928.
[135] See Chapter 3.1.5 for recent European case law.

Therefore, the ability to avoid the constitution of a PE for the principal boils down to the application of Article 5(5), most importantly the "in the name of" condition.

The matter at hand is whether the agency PE rule should only apply to an agent who enters into contracts literally "in the name of the enterprise" or can the expression "in the name of" be given the meaning of *binding*, as the Commentary suggests.[136] Furthermore, it is of great relevance to the commissionaire distributor model, whether *binding* is interpreted as requiring legal bindingness, or should *binding* be interpreted in a broader sense, thus referring to something of an economic or factual nature.

As *Pijl* (2013a) argues, Article 31(4) of the VCLT requires that a meaning, other than what grammatical interpretation would imply, is given to a treaty term when it has been established that the parties intended this.[137] Furthermore, based on thorough analysis of historical OECD, League of Nations and UN records and considering the genesis of Article 5(5), *Pijl* concludes that the expressions "in the name of", "on behalf of" and "binding" have all been intended to hold the same meaning.[138] *Avery Jones* and *Ward* (1993) conclude that the expression "in the name of" means also *binding*, at least in the civil law context.[139] In conclusion, both *Pijl* and *Avery Jones* and *Ward* agree that in a civil law context the expression "in the name of" should be given the meaning of *binding*.[140] This interpretation has been generally accepted by scholars.[141] Interestingly, the US Model uses the expression "are binding on", instead of "in the name of".[142]

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[136] Para. 32.1 of the Commentaries on Article 5.

[137] It is noteworthy, that pursuant to Article 2(1)(a) of the Vienna Convention, it does not actually apply to model tax treaties. However, international agreements concluded between States are within the scope. Therefore, actual DTCs should be interpreted in accordance.

[138] Pijl 2013a, pp. 13–14.

[139] Avery Jones – Ward 1993, p. 156.

[140] The discrepancies in interpretations of Pijl and Avery Jones and Ward relate to different understandings on the relationship between Articles 5(5) and 5(6). Pijl has developed a conceptual system, the "integration system", wherein first independent agents that meet the conditions of Article 5(6) are excluded and only after then Article 5(5) should be consulted to determine whether the dependent agent constitutes a PE. Avery Jones and Ward see the conceptual system differently. According to them, Article 5(5) is the main rule and Article 5(6) is the exception. Pijl (2013) has referred to this understanding as the "main rule/exception system or model". With regard to commissionaires, both Pijl's "integration system" and Avery Jones and Ward's "main rule/exception system" lead to the same result. As Pijl notes, the choice of a system does not matter in practice. As a general rule, a civil law commissionaire should not constitute a PE. See Pijl 2013a, pp. 7–10; See Avery Jones – Ward 1993, p. 178. See also Roberts 1993 on a different interpretation, wherein Article 5(5) and (6) are considered independent PE-constituting rules. Robert's system is no longer in accordance with the Commentary and has been heavily criticized. See Pijl 2013a on Robert's critique.

[141] See Arnold 2016, Chapter " 3.2. The authority to conclude contracts in the name of the enterprise".

[142] See Article 5(5) of the US Model.

The second question is whether *binding* is interpreted as requiring *de jure* bindingness, or should it be interpreted in a broader, economic or factual sense. The former interpretation is referred to as the *legalistic approach*, where the principal is required to be legally bound by the agent's contracts. The latter approach also suggests application to those contracts which are not actually, strictly legally, binding on the enterprise and puts emphasis on the *de facto* situation—the *economic approach*.[143]

Arnold (2016) finds that the abovementioned is still unresolved.[144] On the contrary, *Pijl* (2013a) is rather convinced that "to conclude contracts in the name of" is to be interpreted as legally binding.[145]

In light of the most prominent case law, wherein Article 5(5) has been interpreted, *de jure* bindingness has been required. Three European supreme court cases are outlined hereunder. The courts' focus has been on the phrase "authority to conclude contracts in the name of the enterprise" of the OECD Model, which can be found as such in the DTCs subject to interpretation.

One of the most prominent cases on the matter is The French Supreme Administrative Court's *Zimmer* case from the year 2010. In *Zimmer*, a UK company Zimmer Ltd, had concluded a typical commissionaire agreement with Zimmer France, a company belonging to the same group as the UK company, in 1995.[146] Prior to the conclusion of this contract, the French company had gone through a business restructuring, in which it was converted from a traditional distributor into a commissionaire. The UK entity was the only client of the French company, it was economically fully dependent on the UK entity, and the risks were borne by the UK entity. The commissionaire also received detailed instructions from the UK entity and was remunerated on a commission basis. All the agreements with the final customers were concluded in the name of the French company.[147]

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[143] See Daxkobler 2014 for a comprehensive review of the discussion regarding this issue.

[144] Arnold 2016, Chapter "3.2.1.4. The need to legally or economically bind the enterprise".

[145] Pijl's argument is based on his grammatical, historical and contextual interpretation. See Pijl 2013a, pp. 14–15.

[146] The DTC subject to interpretation was the France–United Kingdom DTC, concluded on 22 May 1968. The countries have entered into a new DTC on 19 June 2008, however, the relevant provisions have not been amended.

[147] International Tax Law Reports 2010; For a detailed review and analysis of the *Zimmer* case, See Gouthière 2010 pp. 350–358.

The French tax authorities challenged the arrangement and claimed that Zimmer France constituted a PE of Zimmer UK. To this end, with regard to taxation of business profits, the authority's assessments were upheld in lower instances. However, The Supreme Administrative Court held that the words "acting in the name of" must be interpreted as binding. Further, the court concluded that under civil law, the conditions under which an agent has the authority to bind the principal have to be examined purely from a legal standpoint, thus adopting the legalistic approach. Under French commercial law, similarly to other civil law jurisdictions, a commissionaire cannot legally bind the principal. Therefore, the court set the principle that a commissionaire may not be regarded as a PE and that only a legal power to bind the principal is relevant in determining whether an agent constitutes a PE.[148]

A similar structure was put in place in the renowned *Dell* case, wherein, in line with *Zimmer*, the Supreme Court of Norway held that a commissionaire arrangement did not constitute an agency PE.[149] An Irish company, Dell Products, had entered into a commissionaire agreement with a Norwegian subsidiary of the same group, Dell AS. The Norwegian subsidiary sold in its own name, the products of Dell Products under a commissionaire agreement. The Norwegian subsidiary was remunerated on a commission basis. The commission was set low due to the fact that sales were done at the economic risk and account of Dell Products.[150]

In line with most civil law jurisdictions, Norwegian law provides that a commissionaire cannot legally bind the principal.[151] Furthermore, the Court refused to bypass the clear

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[148] Gouthière 2010 pp. 350–358; Gouthière notes that there is no mention of the Commentaries in *Zimmer* and that Paragraph 32.1. of the Commentary was introduced after the conclusion of the DTC subject to interpretation in this case. Regardless, Gouthière is of the opinion that the same conclusion should be drawn regarding tax treaties concluded after the adoption of the current Commentaries; Daxkobler 2014, p. 116.

[149] The Supreme Court considered the *Zimmer* decision relevant also in this case.

[150] International Tax Law Reports 2011; Leegaard 2012; It is also noteworthy that, at the time, the group had put in place a similar structure in 15 other countries, without agency PE issues being raised, except for Spain where a similar structure was considered to constitute an agency PE in the *Dell Spain* case. As Jiménez 2016 argues, in *Dell Spain* the Spanish High Court disregarded the wording of Article 5(5) of the OECD Model, the Commentary and Spanish domestic legislation to adopt the economic approach. In June 2016, the Spanish Supreme Court upheld the High Court's decision by ruling against the appellant's position and found that the taxpayer had a "fixed place of business", in the meaning of Article 5(1). With regard to commissionaires, far-reaching conclusions cannot be drawn from the ruling because the PE status was grounded on the general PE rule. The Supreme Court did also find an agency PE. However, such conclusion can be regarded as *obiter dicta*. See Osborne Clarke 2016; In the author's view, the reasoning in *Dell Spain* does not represent the correct interpretation of tax treaty law. Rather, the interpretation is a reaction to secure the tax base in favor of the state's interests.

[151] See Norwegian Commissionaire Act (Lov om kommisjon; 1916-06-30-1).

wording of Article 5(5) of the Norway–Ireland DTC, which is identical to the provision in the OECD Model.[152] Therefore, similarly to Conseil d'État in *Zimmer*, the Supreme Court held that in order for an agency PE to be constituted, the principal must be legally bound by the agent's contracts. What is interesting, is that the Norwegian Supreme Court also discussed the impact of Paragraph 32.1 in the Commentary. The court stated that the Paragraph was partly intended to clarify specific issues arising from commissionaire arrangements under common law, which were not relevant in Norway. For the other part, it was considered with proof of whether or not binding contracts exist, which was not in question here. Therefore, no part of the Paragraph was relevant to the case at hand.[153]

In *Boston Scientific International,* the Boston Scientific group had put in place a commissionaire arrangement in Italy, where an Italian subsidiary sold the products of its Dutch parent company, Boston Scientific BV. In line with *Zimmer* and *Dell*, the Supreme Court held that the Italian subsidiary did not constitute a PE of the Dutch principal in the situation where the Italian subsidiary acted in its own name. Legal bindingness would have been required for the constitution of an agency PE.[154]

In line with the most prominent supreme court cases mentioned above, wherein courts have defined "in the name of" as equivalent to *legally binding*, *Pijl* (2013a) and *Avery Jones* and *Ward* (1993), with different reasoning, come to the same conclusion that "acting in the name of" shall be interpreted as demanding the agent to act in such way that the contracts are binding on the principal.[155] Other theories which do not conform to the prevailing interpretation, have also been presented. However, after decades of debate, the prevailing interpretation of Article 5(5) is clear.[156]

Given the above mentioned interpretations of the agency PE concept by the French, Norwegian and Italian supreme courts, the phrase "authority to conclude contracts in the name of the enterprise" should be interpreted as authority to conclude legally binding

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[152] Article 5(5) of the Convention between Ireland and the Kingdom of Norway for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital, 22 Nov 2000.

[153] Arnold 2012 p. 254 has heavily criticized the Norwegian Supreme Court's reasoning in *Dell*, stating however that he considered the decision "probably correct".

[154] International Tax Law Reports 2012b; See Persiani 2012; See Daxkobler 2014, p. 120.

[155] Pijl 2013b, p. 97; Avery Jones – Ward 1993, p. 178; See Daxkobler 2014 for a comprehensive review.

[156] See Piltz 2004, p. 199, who takes the view that the "in the name of" condition is only fulfilled if an agent explicitly declares or expresses that he is not acting for himself. See Daxkobler 2014, for a rather different approach adopted by Roberts, accepting that indirect representatives constitute agency PEs.

contracts. In other words, the legalistic approach should be adopted. Even though in some cases courts have reached opposite conclusions with highly questionable reasoning, it is clear that the legalistic approach is the prevailing interpretation in civil law jurisdictions and a typical commissionaire arrangement should not constitute a PE.[157] It is also worth mentioning that the OECD and G20 agree that the current Article 5(5) relies on the formal conclusion of contracts in the name of the foreign enterprise.[158]

As MNEs' tax planning activities have shown, the implications of this interpretation have been substantial. Commissionaire arrangements enable effective circumvention of the application of Article 5. In fact, a typical commissionaire will not fall within the scope of the general PE rule in Article 5(1) of the OECD Model. Even though a commissionaire can seldom be considered to fall within the independent agent exception, an agency PE is not constituted because the arrangement also falls outside the application of Article 5(5) in civil law jurisdictions. As long as laws of the country of residence of the commissionaire provide that a commissionaire cannot legally bind the principal, commissionaires slip through the fingers of the source state's tax authorities.

3.2 OECD BEPS Action 7

The OECD and G20 have adopted a 15-point Action Plan to address BEPS in September 2013. The 15 actions have now been completed and the outputs have been consolidated into a comprehensive package. Action 7 on preventing the artificial avoidance of PE status sets forth a re-evaluation of the existing definition of PE. The amendments to the agency PE definition specifically target commissionaire arrangements.

OECD released its Final Report on Action 7 in October 2015.[159] The wording of Action 7 has been materialized in the MLI, which is a multilateral instrument adopted for the purpose of swiftly amending existing tax treaties. The instrument contains the four articles arising from the work on Action 7 and was published in November 2016. Specifics with regard to the MLI are further discussed in Chapter 4.1.2.

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[157] See Jiménez 2016 and Daxkobler 2014 pp. 117–119 on the mistaken interpretation of the agency PE concept in *Roche*; See International Tax Law Reports 2012a; See Aalto 2002, p. 439; See Arnold 2016, Chapter 3.6.2.1. "The relevance of article 5(5) of the OECD Model".

[158] OECD 2015d, p. 10.

[159] OECD 2015d.

The UN has also proposed amendments to the UN Model to help address BEPS. In November 2016, the Committee of Experts on International Cooperation in Tax Matters published a paper with proposals addressing possible changes relating to PEs. Pursuant to the paper, the Committee set forth two alternative options to broaden the scope of the agent PE rule. The first option is based on OECD's Action 7. The second option also mainly adheres to Action 7. However, the option removes certain wording which, in the Committee's view, might be confusing or adversely limiting the scope of application of the PE provision. Deviations from Action 7 are highlighted to a relevant extent in the following Chapter.[160]

3.2.1 Drafting of Action 7

The OECD's work has been a multi-step process, which has led to the formulation of PE provisions now included in the MLI. The work on Action 7 was initially carried out by the OECD Focus Group on Artificial Avoidance of PE Status, which discussed BEPS concerns in connection with the definition of PE. Different schemes for avoidance of PE status were also identified, most importantly the commissionaire. The Focus Group's work lead to the First Discussion Draft, released in October 2014.[161]

The First Discussion Draft laid down four alternatives, A, B, C and D, to amend the definition of agency PE, which would better reflect the policy objectives of the OECD member states.[162] Interested parties were invited to comment the alternatives.[163]

A subsidiary body of the OECD Committee on Fiscal Affairs, Working Party 1 on Tax Conventions and Related Questions continued the drafting process. Seven months later, in May 2015, a Revised Discussion Draft was published.[164] Option B, which was preferred by a vast majority of stakeholder commentators, was adopted as the basic structure of the new agency PE provision.[165]

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[160] United Nations 2016.

[161] OECD 2014b.

[162] See OECD 2014b p. 6 on policy objectives.

[163] See OECD 2015a and OECD 2015b.

[164] OECD 2015b.

[165] At this point, it was agreed that the term "associated enterprises" used in a draft of Article 5(6) should be replaced with a narrower concept. Furthermore, the Working Party 1 agreed that the Article should not automatically exclude unrelated agents acting exclusively for one enterprise either.

Four months later, in October 2015, the Final Report was published. Compared to the Revised Discussion Draft, the Final Report includes some changes reflecting the interested parties' concerns along with some further clarifications.

3.2.2 Final Report

As stated, Action 7 sets forth multiple amendments to the existing definition of PE with relevance to commissionaire arrangements. In consequence, new wordings of Article 5(5) and 5(6) were introduced. However, current provisions will remain partly unchanged. To the extent not discussed hereunder, current treaty provisions and Commentaries thereto are considered to remain unchanged.

Action 7 proposes amendments to Articles 5(4), 5(5) and 5(6) of the OECD Model. Therefore, the wording of the general PE definition set forth in Art 5(1), the positive list in Article 5(2) and Article 5(7) remain unchanged. The proposed new wording of the amended paragraphs and respective amendments to the Commentary are studied in the following.

The changes to Articles 5(5) and 5(6) and the Commentary specifically target commissionaire structures and similar strategies. According to the view of the OECD and G20, they were put in place primarily in order to erode the taxable base of the source state where sales took place. The report gives examples of similar strategies, which are also targeted by amending the said paragraphs. Such strategies include arrangements where contracts, which are substantially negotiated in one state, are finalized or authorized abroad and not within scope of the current Article 5(5). Further, the OECD and G20 seek to apply the new Article 5(5) to situations previously within the Article 5(6) exception. These include situations where a closely related person habitually exercises an authority to conclude contracts. It is clarified in the report that similar strategies do not include LRD arrangements.[166]

3.2.3 The new agency PE rule

The new wording of Article 5(5) reads as follows:

> *Notwithstanding the provisions of paragraphs 1 and 2 but subject to the provisions of paragraph 6, where a person is acting in a Contracting State on behalf of an enterprise and, in doing so, habitually concludes contracts, or*

[166] OECD 2015, p. 15.

habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts are

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,

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.

Three conditions must be met, in order for the new agency PE rule set for the in Article 5(5) to be applicable. These three conditions are cumulative. However, alternatives are provided within the latter two conditions. The second condition has two alternatives and the third condition has four, one of which must be fulfilled.

Under the new wording of Article 5(5), an agency PE would be constituted where the person's activities fulfill the following conditions:

1) Acts on behalf of an enterprise, and
2) In doing so
    a. habitually concludes contracts, or
    b. plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and
3) these contracts are
    a. in the name of the enterprise, or
    b. for the transfer of the ownership of, or
    c. for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or
    d. for the provision of services by that enterprise

Acting on behalf of an enterprise

Firstly, a person in a contracting state shall act on behalf of an enterprise. This condition is a reproduction of the current OECD Model. One is acting "on behalf of an enterprise" when such person involves that enterprise in business activities to a particular extent in the state concerned. The enterprise shall be at least indirectly affected by the person's actions, in order to satisfy the first condition. The enterprise is affected in the meaning of the provision for

example where an agent acts for a principal, a partner acts for a partnership, a director acts for a company or where an employee acts for an employer.[167]

Also, the proposed Commentary would further clarify that a buy–sell distributor in a particular market would not be considered to be acting "on behalf of an enterprise" when it buys products from an enterprise and sells them to customers. The decisive requirement is that the transfer of the title to the property sold is passed from the enterprise to the distributor and from the distributor to the customer. Therefore, the distributor would receive a profit from the sale. Even LRDs, which would only hold the title to the property for a very limited period and buy the product from an associated enterprise, would be regarded as not acting "on behalf of an enterprise".[168]

Habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts

Secondly, that person shall habitually conclude contracts, or habitually play the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise. Hence, it is clear that the actions of the person have to go beyond mere promotion, advertising or marketing, i.e. activities which in itself do not directly lead to the conclusion of contracts. It is also noteworthy that such contract-concluding activity shall take place repeatedly and not merely in isolated cases. The requirement of "habitually" concluding contracts implies that the enterprise's presence in a contracting state should be more than merely transitory. However, no specific frequency test is laid down. Rather, the Commentary settles for a more general requirement, according to which the threshold for habitual activity will "depend on the nature of the contracts and the business of the principal".[169]

Pursuant to the Commentary, the term "concludes contracts" refers to situations where, "under the relevant law governing contracts, a contract is considered to have been concluded by a person".[170] If the relevant law provides, the contract may be considered to have been "concluded" in that state even though it was entered into without any active negotiation of

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[167] Para. 32.3 of the proposed Commentary. OECD 2015, p. 18.

[168] Para. 32.12 of the proposed Commentary. OECD 2015, p. 21.

[169] Paras. 32, 32.5 and 33.1 of the proposed Commentary. OECD 2015, pp. 17–19 and 22.

[170] According to Finnish legal doctrine, concluding contracts is not limited to the ways described in the Contracts Act. However, the Commentary only refers to concluding "under the relevant law governing contracts". Therefore, other ways of entering into contracts are not relevant here.

the terms of contract or it was signed outside that state.[171] An example of "concluding contracts" pursuant to Finnish contract law is set forth hereunder.

Pursuant to the Finnish Contracts Act (228/1929), contracts are concluded by an offer to conclude a contract and the acceptance of such an offer. The recipient's expression of intention is either an acceptance or a rejection. An acceptance may also be expressed by fulfilling the offer without giving specific acceptance. Also, an implied expression of intent is considered effective in Finnish contract law. An expression of intent is implied when the willingness to be bound to the contract is not specifically expressed. In such case, the party in actual fact acts in accordance with the contract. For example, if a distributor delivers a product requested by the buyer, without specifically expressing acceptance to the buyer's offer, the dispatching of the product may be considered an implied expression of intent.[172] Therefore, when the rules of interpretation of the relevant DTC lead interpretation of treaty terms in accordance with Finnish law, a contract may be concluded without any active negotiation of the terms of that contract.[173]

Under Finnish law, an agreement is concluded when the recipient of the offer expresses acceptance. This is however subject to two conditions set forth in the Finnish Contracts Act. Section 4(1) provides that such an acceptance shall not reach the offeror too late, otherwise the acceptance is deemed to constitute a new offer made by the original acceptor. In such case, the contract is concluded only when the original offeror accepts the new offer. Secondly, pursuant to Section 6(1), a reply that purports to be an acceptance but which, due to an addition, restriction or condition, does not correspond to the offer, shall be deemed a rejection constituting a new offer. Again, in such case, the contract is concluded only when the original offeror accepts the new offer.

Therefore, the signing of the contract is not a decisive factor "under the relevant law governing contracts". If the contract has been entered into in accordance with the Finnish Contracts Act, it does not matter that the contract is later signed abroad. However, it is to be noted that the freedom of contract allows the parties to agree on the terms of conclusion of

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[171] Para. 32.4 of the proposed Commentary. OECD 2015, pp. 18–19.

[172] See Saarnilehto 2009 pp.16 and 48; Hoppu – Hoppu 2011, p. 47.

[173] For example, see Chapter 6 of the Finnish Consumer Protection Act (1211/2013); Contracts of standard form or contracts which require performance in order to become effective, are not always concluded in the manner presented here. Specific provisions apply, inter alia, to door-to-door selling and distance selling to customers.

contracts. Furthermore, in many situations, it might be difficult to determine whether the acceptor has accepted the offer by an implied expression of intent. In such case, the signing of the contract may be considered a circumstance which best illustrates the conclusion of the contract.

The second condition also includes an additional test focusing on substantive activities, i.e. when a person plays "the principal role leading to the conclusion of the contract". The test is applied where, under the relevant rules of contract law, the contract is not concluded by that person in that State, but rather, the rules provide that the conclusion of the contract takes place outside that State. The test aims to cover situations where in reality, the conclusion of a contract directly results from the actions that the person performs on behalf of the enterprise. Such actions could for example be convincing a third party to enter into a contract with the enterprise, receiving orders or requesting offers from third parties but not formally finalizing these contracts.[174]

The proposed Commentary sets forth two examples of situations, regarding the "principal role leading to the conclusion of the contract" condition.[175] The first example considers the pharmaceutical industry, where representatives of a pharmaceutical enterprise actively promote drugs produced by that enterprise. There representatives engage in marketing activities, such as contacting doctors. Even though the marketing activities would lead in doctors subsequently prescribing these drugs, in the light of the proposed Commentary, that marketing activity does not directly result in the conclusion of contracts between the doctors and the enterprise. In conclusion, the first example entails that marketing with indirect effects, such as effect on future purchasing decisions, will not exceed the new agency PE threshold.

The second example (Diagram 3) encompasses a company (RCO) distributing products and providing services worldwide through its websites. The company has a fully-owned subsidiary (SCO) in the customer jurisdiction (State S). The subsidiary's employees engage in marketing activities (emails, telephone calls and visits) in order to convince customers to buy the parent company's products and services. SCO can be described as a traditional MSC entity. The employees of the subsidiary are considered responsible for large accounts in the source jurisdiction and their remuneration is partially based on the revenues derived from

[174] Para. 32.5 of the proposed Commentary. OECD 2015, p. 19.
[175] Paras. 32.5 and 32.6 of the proposed Commentary. OECD 2015, pp. 19–20.

these accounts. The employees also use their relationship building skills to try to anticipate the needs of these customers. When a customer is convinced to buy products and services, the employee indicates the price and explains the parent company's standard terms of contract, which the employees are not authorized to modify. The employee also instructs that a contract must be concluded on-line with the parent company. The customer subsequently concludes that contract on-line. In the light of the proposed Commentary, the employees play "the principal role" leading to the conclusion of the contract and such contracts are routinely concluded without material modification by the enterprise. Even though the subsidiary's employees cannot vary the terms of contract, the conclusion of contracts is considered a direct result of the activities that they perform on behalf of the enterprise.

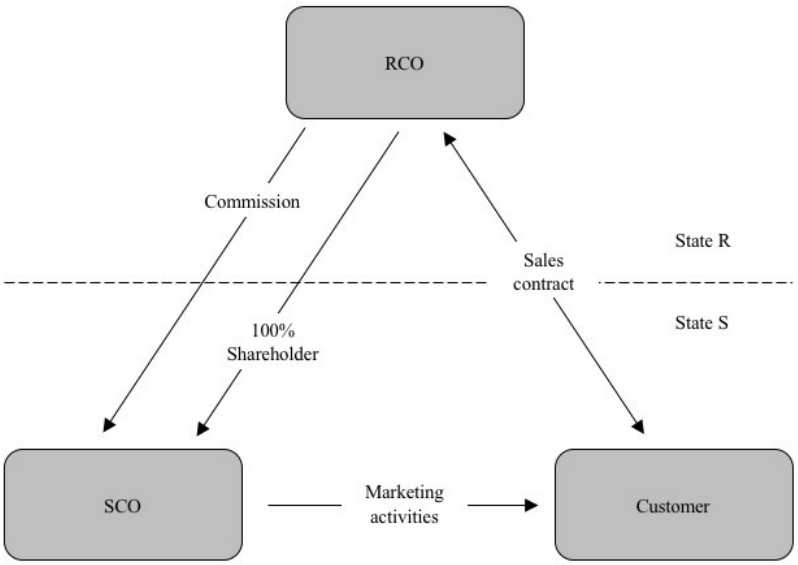

Diagram 3

Alternative 2)b) also includes the phrase "contracts that are routinely concluded without material modification by the enterprise". Interestingly, the UN Committee of Experts on International Cooperation in Tax Matters has observed, that this addition might be confusing or adversely limiting the scope of application of the agency PE provision and has proposed an option to remove the said phrase.[176]

Clearly, the UN is looking to adopt a broader agency PE concept. Initially, this ought to have been the OECD's intention as well. In the Revised Discussion Draft, alternative 2)b) was

[176] United Nations 2016, p. 23.

phrased ”negotiates the material elements of contracts”.[177] However, stakeholder commentators considered this formulation way too broad.[178]

Whether not the UN opt for the broader phrase or the alternative set forth in Action 7, the choice should not have relevance on the PE status of commissionaires. There is no doubt that commissionaires “conclude contracts” in the meaning of Article 5(5). Rather, the choice is material for MSC structures and may have an effect on the whether a MSC’s activities constitute a PE or not.

Contracts in the name of the enterprise

The third condition consists of three alternative points, of which one has to be fulfilled in order to constitute an agency PE. For Article 5(5) to apply, contracts shall be “in the name of the enterprise or 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 for the provision of services by that enterprise”.

Similar to the current wording of Article 5(5), the proposed wording will cover situations where the contracts create legally enforceable rights and obligations between the principal and clients, therefore being “in the name of the enterprise”. Such contracts are typically concluded by an agent, a partner or an employee of an enterprise.[179]

The proposed Commentary seeks to clarify that the application of Article 5(5) shall no longer be limited only to contracts legally binding between the enterprise to third parties. At least points b) and c) of the threefold third condition will cover such situations. Also, the proposed Commentary directly points out that the phrase “in the name of” will no longer restrict the application only to concluding contracts literally “in the name of” the enterprise or contracts legally binding on the enterprise. Whether contracts are “in the name of” is no longer material because the alternative provisions cover a broad range of other relevant arrangements.[180]

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[177] OECD 2012, p. 13

[178] See OECD 2015a.

[179] See Para. 32.8 of the proposed Commentary. OECD 2015, p. 20.

[180] Para. 32.9 of the proposed Commentary. OECD 2015, p. 20.

Contracts 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 for the provision of services

The term "property" covers any type of tangible or intangible property and it does not matter whether or not the property concerned existed or was owned by the enterprise at the time of the conclusion of the contract.[181]

The proposed Commentary sets forth a decisive requirement for the application of conditions 3)b), 3)c) and 3)d). The person acting on behalf of the enterprise and satisfying the first and second condition must not perform the parts of the contracts relating to the transfer of property or provision of services oneself. Instead, these activities must be performed by the enterprise, i.e. the principal.[182] Therefore, to fulfill the conditions, a person acting on behalf of the enterprise must sell the enterprise's products, not products owned by the person itself. In consequence, where the person acting on behalf of the enterprise takes title to the products, this requirement is not fulfilled.

The proposed Article 5(5) will broaden the scope to target commissionaire arrangements, which have so far relied on the formal interpretation of the agency PE rule, namely the "in the name of requirement". To make the OECD's and G20's view even more clear, the proposed Commentary articulates that at least point 3)b) or 3)c) will apply to commissionaires' contracts, regardless the fact that they are not literally "in the name of the enterprise".[183]

3.2.4 The new independent agent exception

As described earlier, also the independent agent exception set forth in Article 5(6) is relevant when evaluating the constitution of an agency PE. In consequence of the new agency PE rule, the threshold for the application of Article 5(5) will be significantly lowered and more structures will fall within scope. Therefore, the relevance of Article 5(6) as an exception to the agency PE rule is likely to increase.

Article 5(6) has been fully redone in Action 7. Subparagraph a) of the new Article 5(6) reads as follows:

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[181] Para. 32.11 of the proposed Commentary. OECD 2015, p. 21.

[182] Para. 32.10 of the proposed Commentary. OECD 2015, pp. 20–21.

[183] Para. 32.8 of the proposed Commentary. OECD 2015, p. 20.

> *a) 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 enterprises to which it is closely related, that person shall not be considered to be an independent agent within the meaning of this paragraph with respect to any such enterprise.*

The first sentence of Article 5(6)(a) sets forth two cumulative and positive conditions which define the general scope of the independent agent exception. An agency PE is not constituted, even though Article 5(5) would apply, where the agent:

1) is an independent agent and;
2) acts for the enterprise in the ordinary course of that business.

In substance, these conditions are very similar to the current Article 5(6). What has changed, however, is that the provision no longer refers to an "agent of independent status". Rather, the term has been changed to "independent agent". Furthermore, the updated Commentary would not include a general mention that the agent must be "economically" independent.

With regard to the independence of the agent, the last sentence of the recommended Article 5(6)(a) sets forth a negative requirement, i.e. one can be considered an independent agent only where the last sentence does not apply. A person acting "exclusively or almost exclusively on behalf of one or more closely related enterprises" is not considered independent. The aforementioned renders that employees and partners, acting on behalf their employer or partnership, are categorically excluded from the scope of the exception.[184] Moreover, the words "exclusively or almost exclusively" mean that acting on behalf of non-related parties should represent a significant part of an independent agent's business. Pursuant to the proposed Commentary, less than 10 per cent of sales for unrelated parties, i.e. all other sales for closely related parties, would not represent such a significant part.[185] The concept of "closely related enterprises" for the purposes of the entire Article 5 is defined in Article 5(6)(b).

In addition to being an independent agent, one has to act in the ordinary course of that business—"that business" referring to the agent's own business. Therefore, acting in the

[184] Para. 37 of the proposed Commentary. OECD 2015, p. 23.
[185] Para. 38.8 of the proposed Commentary. OECD 2015, p. 26.

ordinary course of one's own business means performing activities that are related and expedient to the agent. This condition corresponds to the current Article 5(6).

Article 5(6)(b) defines the concept of closely related enterprises[186]:

> *b) For the purposes of this Article, a person is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises. In any case, a person shall be considered to be closely related to an enterprise if one possesses directly or indirectly more than 50 per cent of the beneficial interest in the other (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) or if another person possesses directly or indirectly more than 50 per cent of the beneficial interest (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) in the person and the enterprise.*

Firstly, the general rule on close relation is set forth in the first sentence.[187] A person is closely related to an enterprise if the principal has control over the agent, or vice versa, or both are under mutual control. In this evaluation, all the relevant facts and circumstances are considered.

The second sentence of Article 5(6)(b) provides alternative situations where a person is automatically considered a "person closely related to an enterprise". This is the case if:

a) the principal possesses, directly or indirectly more than 50 per cent of the
    i. beneficial interest in the agent, or vice versa; or
    ii. aggregate vote and value of the company's shares or of the beneficial equity interest in the agent's company, or vice versa, or if
b) another person possesses directly or indirectly more than 50 per cent of the
    i. beneficial interest in the agent and the principal; or
    ii. beneficial equity interest in the agent's and the principal's companies.

Under the abovementioned circumstances, the closely related person falling within Article 5(5) will be unable to benefit from the independent agent exception. However, an agency PE is not constituted only by virtue of being closely related. The agent must also fall within the scope of Article 5(5).[188]

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[186] Earlier discussion drafts used the terms "associated enterprises" and "person connected to an enterprise". However, the OECD did not adopt such broad and criticized concepts.

[187] The proposed Commentary would distinguish the concepts of closely related persons and associated enterprises used for the purposes of Article 9 of the OECD Model. It is somewhat ambiguously stated, however, that these concepts overlap to a certain extent. See Para. 38.9 of the proposed Commentary. OECD 2015, p. 26.

[188] Para. 38.12 of the proposed Commentary. OECD 2015, p. 26–27.

3.2.5 Commissionaires under the new PE provisions

The updated agency PE provision and exceptions thereto will not change the fundamentals of the agency PE. An agency PE will continue to be deemed PE, constituted by virtue of the activities performed by the agent. Article 5(5) will also continue to be subject to the exceptions and limitations set forth in Paragraphs 4 and 6 of Article 5. The threshold for being an independent agent is higher than before. Therefore, it can be concluded that commissionaire distributors are seldom—if ever—independent in the meaning of Article 5. Like before, to avoid PE constitution, the commissionaire must fall outside the scope of the new Article 5(5) as well.

With regard to commissionaire distributors, the new lowered agency PE threshold will change the playing field. Even though commissionaire distributors will continue to conclude contracts in the name of the commissionaire, not "in the name of the enterprise", the new substantive conditions for PE constitution will cover commissionaires. To this end, it is clear that commissionaire distributors conclude contracts "for the transfer of the ownership of" property owned by the principal.

However, what the new agency PE rule does not clarify, is the meaning of the phrase "on behalf of". Like its predecessor, the wording of the new Article 5(5) requires that the commissionaire must act on behalf of its principal to constitute a PE for the latter. Like with the current wording, a certain interrelation between the agent's and principal's activities can also be required. Even though the phrase has not been given an explicit definition in the respective Commentary, the phrase "on behalf of" is used in national tax law provisions to refer to an activity of an economic or factual nature. It can thus be concluded that a formal interpretation is not required, as proven in Chapter 3.1.3. Therefore, the concept "acting on behalf of an enterprise" shall be given the meaning of "acting on behalf of an enterprise" in an economic or factual manner.

It appears that, at least to certain extent, the OECD and G20 have achieved their goal to reform the agency PE provision. All key conditions for PE constitution are now substantive, rather than formal. As described earlier, up until now the commissionaire distributor model has relied on the formal interpretation of Article 5(5). Under the new substance-over-form rules, the commissionaire distributor model is unlikely to be able to benefit from the interpretive limitations in international tax law. The lowered PE threshold is likely to have a PE-constituting effect on commissionaire distributors.

3.3 Finnish national legislation

The threshold for source state taxation in Finnish national legislation is defined in the Income Tax Act (1535/1992; TVL), in particular Sections 9, 10 and 13(a) (1549/1995). This threshold is most relevant in cases where a DTC does not apply. However, also in situations where a DTC is applicable, the grounds for levying a tax must be found within national acts of Parliament, such as the TVL.

Pursuant to Section 9 of the TVL, Finnish residents, including local entities operating as commissionaire distributors, have an unlimited tax liability in Finland.[189] Non-resident entities have limited tax liability. This means that they are liable for tax only for Finnish-sourced income.[190]

Before studying the national PE concept, it must be resolved whether PE constitution is actually a precondition for levying a tax on the business income of a non-resident entity. Clearly, this is the case where an OECD Model-based DTC applies. The wording of the TVL does not clearly answer this question. According to Section 9(1), a non-resident entity is liable for tax for Finnish-sourced income. Further, pursuant to Section 9(3), if a foreign corporate entity has a PE in Finland, it must pay tax on all the income that can be attributed to that PE. The concept of Finnish-sourced income is further defined in Section 10(1). Point 2 stipulates that income from a business, profession, agriculture or forestry is Finnish-sourced income.[191] The wording of these two provisions and the Finnish PE concept renders unclear the relationship between the provisions.

As *Malmgrén* (2008) has shown, commentators have presented diverging views on whether and in which situations PE constitution is a precondition for levying a tax on the business income of a non-resident entity. In the author's view, interpretation in accordance with the wording of Section 9 entails, that PE status is not an imperative precondition for source state taxation, as long as income is Finnish-sourced.[192] Furthermore, The Finnish Tax

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[189] Only "domestic corporate bodies", i.e. corporate bodies established under the laws of Finland, are subject to unlimited tax liability. All other corporate bodies are subject to limited tax liability. See Section 9(1) of the TVL.

[190] All entities that are established under the laws other than Finnish law have limited tax liability in Finland. See KVL 2015/2.

[191] The list provided in Section 10 is non-exhaustive, thus not restricting the application of Section 9. However, defining the list as non-exhaustive cannot broaden the scope of application either.

[192] Pursuant to Section 83 of the VML a tax may be levied on the income of a non-resident entity, which is engaged in business activities, even where a Finnish PE does not exist. It is problematic that the said provision

Administration has taken the view that unless a DTC limits the right to a levy tax, there is a taxing right also where no PE exists in Finland.[193] Most commentators have settled to agree that levying taxes on Finnish-sourced business profits is possible where no Section 13(a) PE exists if a DTC does not prevent taxation.[194]

The aforementioned conclusion has been heavily criticized. As *Malmgrén* notes, source state taxation is difficult to justify in situations where no PE exists. Furthermore, in practice, the PE concept has been considered a *de facto* threshold for business income taxation.[195] Such view can be supported with the circumstance that, at least to the author's knowledge, there is no published Finnish case law where a foreign entity would have been taxed for business income without a PE in accordance with national law.[196] Therefore, it can be argued that a PE as precondition has become established practice. Regardless of the non-satisfactory provisions of the TVL, PE constitution should at least be considered a practical precondition for levying a tax on the business income of a non-resident entity.

If an enterprise, without a PE in the meaning of Section 13(a), would be taxed for business income in Finland, *Malmgrén* claims that the taxpayer could rely on the principle of protection of legitimate expectations, at least where tax is levied retroactively.[197] However, in the author's view, such protection could be relied upon only in very limited situations. Such protection would require, inter alia, that the taxpayer acted in accordance with the authority's praxis or in accordance with issued guidance. Clearly, the guidance issued by the Finnish Tax Administration would not support the taxpayer's argument. Therefore, the taxpayer must have acted in accordance with the authority's praxis. This requirement was further clarified in KHO 2010:50, where KHO stated that the authority's praxis "means an explicit commitment" to a matter just like the matter at hand. Therefore, the lack of published

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has been placed in the VML. According to Section 1, only assessment procedure and appeals against assessed tax are within the scope of the Act. The grounds for tax liability for business income are set forth in the TVL. Therefore, Section 83 of the VML cannot be given much relevance in this consideration. Rather, the threshold for source state taxation must be resolved by interpretation of the provisions of the TVL. However, Section 83 of the VML may be considered an indication of the legislator's intention.

[193] Verohallinto 2014, Chapter 6 "Income tax treatment if no permanent establishment is in existence".

[194] See Andersson et al. 2016, p. 97 and Helminen 2016, Chapter 6, "Forms of Doing Business and Business Profits", "Permanent Establishment", "Agent".

[195] See Malmgrén 2008, pp. 303–311.

[196] Some case law does exist where PE constitution was considered a precondition for levying a tax on the business income. However, in KHO 1977 B 510, the decision was based on the provisions of the DTC.

[197] See Section 26(2) of the VML (477/1998) on the protection of legitimate expectations; Firstly, the matter must be open to various interpretations and unclear. Secondly, the taxpayer must have acted in good faith and in accordance with the authority's praxis or in accordance with guidance.

Finnish case law where a foreign entity would have been taxed for business income without a Section 13(a) PE would not fulfill this requirement. It should also be taken into consideration that non-resident enterprises operating in Finland without constituting a PE would seldom be subject to any tax authority's decision. Only where the taxpayer concerned would have received an advance ruling from the KVL or could refer to a specific case similar enough, such protection could be given to the taxpayer.

3.3.1 Definition of PE in the TVL

The definition of PE in Finnish national legislation is included in Section 13(a) of the TVL. It reads as follows:

> *The term permanent establishment means a place where, for the permanent carrying on of business, a specific place of business is located or where special measures have been taken, such as a place, where the place of management, branch, office, factory, production plant, workshop or shop or any other permanent purchase facility or place of sales is located. The term permanent establishment also includes an operational mine or another discovery, quarry, peat bog, gravel pit or another comparable place, or parceled lots or real estate to be parceled into lots in the commercial sale of real estate, these real estates, and in building contract work, a place where such contract work has been carried out to a significant extent, as well as in the business of line service also the maintenance facility of the business or another specific place of business servicing transportation.*[198]

Firstly, there has to be either a "specific place of business" or a "place where special measures have been taken".[199] Like the general PE rule in Article 5(1) of the OECD Model, a place and a certain degree of permanence is required. A list of positive examples is also laid down within the same Section.[200]

To this end, the national PE concept is slightly broader than that of the OECD Model. Section 13(a) does not specifically require that the business of the enterprise is carried on through this specific place of business, like the OECD Model.[201] Furthermore, the list of examples in 13(a) is much more extensive than that of the OECD Model Article 5(2). It is also noteworthy that in Section 13(a), the examples are alternatives to the place of business

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[198] Author's translation.

[199] In Finnish, "erityinen liikepaikka" or "paikka … jossa on ryhdytty erityisiin järjestelyihin".

[200] The government proposal on the current Section 13(a) suggests that the provision should be interpreted similarly to the provisions in DTCs. See HE 76/1995 vp, p. 19.

[201] Such difference is not significant, because in any case, the PE must be set up for the "permanent carrying on of business".

requirement. Therefore, the wording does not require that the activities listed would fulfill the "specific place of business" requirement. Conversely, the examples in Article 5(2) of the OECD Model are always subject to the requirements set forth in Article 5(1).

Secondly, Section 13(a) requires that there is a place for the "carrying on of business".[202] In many jurisdictions such wording would not have material relevance. However, in Finland source state taxation is only possible to the extent that the enterprise has income belonging to the business source of income.[203] With relevance to this study, this requirement will certainly be fulfilled where the commissionaire distributor is engaged in the distribution of tangible products.[204]

What is most significant in comparison of the OECD Model PE concept to Section 13(a), is that the latter does not include a provision on agency PEs. A list of negative examples or a provision on parent–subsidiary relationship is not included either. With relevance to this study, the missing agency PE rule is of highest interest.

With respect to agents, the OECD Model PE concept seems much broader. However, in other respects Section 13(a) is broader, and the OECD Model narrower, because preparatory and auxiliary activities are not categorically out of the scope of the PE provision.

Regardless of the missing agency PE provision in Finnish national legislation, pursuant to established tax praxis, a dependent agent may also constitute a PE under Section 13(a).[205] One might question, how such interpretation is possible without breaching the fundamental principles of tax law. As mentioned, DTCs cannot broaden the scope of national tax provisions.

Such interpretation can be justified in two circumstances. Firstly, according to Section 13(a), a PE exists where special measures have been taken, such as a place, where a permanent purchase facility or place of sales is located.[206] Therefore, in some situations an agent's

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[202] Section 13(a) uses the Finnish term "liiketoiminta", which like the word "elinkeinotoiminta", translates into "business". The latter concept is considered broader. However, such difference is without relevance in this context.

[203] See TVL Section 29; In the Finnish system, income is divided into three different sources of income: business income, income from agriculture and other income (personal income). Such system is a Finnish peculiarity. For example, in Sweden an entity's income is always considered business income; On the relevance of different sources of income, for example, see KHO 2013:42.

[204] See Malmgrén 2008, p. 310.

[205] See KVL 1996/68 (same as KHO 7.6.1996 T 1928); Malmgrén 2008, p. 313.

[206] In Finnish "pysyvä osto tai myyntipaikka"; Malmgrén 2008, p. 313.

actions could fall within the scope, however, only where a "permanent place" is located. This option would not cover nearly as many situations as would be covered by the OECD Model.

Secondly, if it is accepted that PE status is not an imperative precondition for source state taxation, the activities of an agent should be assessed in light of Section 10(1) of the TVL. The second point of the Subsection stipulates that income from a business carried out here or income from a profession is Finnish-sourced income.[207]

The second option would create an PE where the agent is in an employment relationship to its principal, thus resolving some agency PE uncertainties. Apart from this, the second option is clearly problematic. Constitution of an agency PE under 13(a) may be considered in contradiction with Section 81 of the Constitution, which sets forth the emphasized principle of legality. The significant difference between the two PE concepts is that under the OECD Model, an agency PE is deemed by virtue of the agent's activities. Quite differently, the Finnish PE concept would require a "place" for PE constitution, without clear reference to the agent's activities.

The government proposal on the current Section 13(a) suggests that the provision should be interpreted similarly to the provisions in DTCs, i.e. the OECD Model.[208] However, the agent's non-resident principal could only be taxed where the national PE concept is abandoned. Or, regarding the first option, Section 13(a) could only apply to agents where it is accepted that they fall within the general definition of PE, for example where permanent places of sale exist. To this end, the OECD Model has a completely different approach.

3.3.2 Excursion: Legislative solutions in Sweden

It is common practice that legislators and commentators refer to Swedish legislative solutions in drafting and interpreting provisions. The Swedish legislative solutions are of particular interest because, to a relevant extent, the legal systems in Sweden and Finland are alike. Such finding holds true also with regard to tax laws and international taxation.

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[207] See Helminen 2016, Chapter 6, "Forms of Doing Business and Business Profits", "Permanent Establishment", "Agent"; In Finnish, "täällä harjoitetusta liikkeestä, ammatista, maataloudesta tai metsätaloudesta saatu tulo".

[208] See HE 76/1995 vp, p. 19.

Both countries' DTC networks are primarily based on treaties which adhere to the OECD Model. However, the wording of the PE provision in Chapter 2 Section 29 of the Swedish Income Tax Act, is very different from the Finnish alternative.[209] Unlike the Finnish national PE concept, the definition of PE under the Swedish Income Tax Act is almost identical to the definition in Article 5 of the OECD Model.[210] It is intended to correspond to the OECD Model and is based on the same principles.[211]

However, some differences do exist. The Swedish definition of PE does not include a minimum construction PE threshold. Furthermore, a PE is constituted where a real estate is classified as inventory. Like the Finnish definition, a negative list or provisions on parent–subsidiary relationship are not included in the domestic law definition. Altogether, these discrepancies with the OECD Model are minor and mainly of a formal character.[212]

To other respects, the Swedish Income Tax Act is more unambiguous than its Finnish counterpart. Pursuant to Chapter 6 Section 11, entities with limited tax liability are liable to pay tax on "income from a permanent establishment or real estate in Sweden".[213] In consequence, the threshold for source state taxation is clearly linked to the constitution of a PE in Sweden.

Most importantly, Chapter 2 Section 29 of the Swedish Income Tax Act includes an agency PE provision and an independent agent exception similar to Articles 5(5) and 5(6) of the OECD Model. Interpretation of the provisions also adheres the OECD's approach. Also, in Swedish domestic legislation, the provisions are considered an alternative to the general PE rule. This means that under certain circumstances a PE can be created without a fixed place of business.[214] Therefore, an agency PE is created by virtue of the agent's activities.

3.4 EU law

The concept of PE is also used for other purposes than determining the source state threshold for taxation of business profits. What comes to PE-avoiding functions of the commissionaire

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[209] In Swedish, Inkomstskattelag (1999:1229).

[210] In Swedish, "fast driftställe".

[211] See RP 1986/87:30; Glansberg 2009, p. 610.

[212] For discrepancies see Glansberg 2009, pp. 610–630.

[213] Chapter 6 Section 7 of the Swedish Income Tax Act stipulates that foreign legal persons have a limited tax liability.

[214] Glansberg 2009, p. 626.

distributor model, current EU law definitions of PE are not material. In practice, the source state threshold for taxation of business profits is determined in accordance with DTCs. However, the legislative solutions chosen by EU policy-makers are of interest in this context.

3.4.1 CCCTB

In October 2016, the European Commission published a proposal for a Directive on a common corporate tax base.[215] In essence, the common consolidated corporate tax base (CCCTB), which also includes a proposal for a directive on tax base consolidation, is a set of rules to calculate MNEs' taxable base in the EU.[216] If implemented, MNEs in scope would have to file only one tax return within the EU and the base for income taxation would be determined on a EU level.[217] The taxable profits would be then shared in accordance with an apportionment formula between the Member States, in which the MNE is active. The share of profits determined under the apportionment formula would be taxed at a national rate. The CCCTB also includes a PE concept. However, the definition covers only PEs situated within the EU and belonging to a taxpayer who is resident for tax purposes within the EU.

In essence, Articles 5(4) and 5(5) of the CCCTB reproduce the substance of Action 7. Some minor technical differences do exist. Specifically, differences in the order of provisions and technical differences in terms can be identified. Furthermore, the definition of "closely related" enterprises in Article 5(5)(b) of the Directive on a common corporate tax base does not include the substantive definition of closely related person stating that a closely related person exists where "based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises". Therefore, the scope of the CCCTBs independent agent exception is slightly narrower. However, this discrepancy should not have material effect in practice.

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[215] COM(2016) 685 final.

[216] COM(2016) 683 final.

[217] Pursuant to Article 2(1)(c), the Directive would only apply to groups with a total consolidated group revenue exceeding EUR 750 000 000.

3.4.2 Interest and Royalties Directive and Parent–Subsidiary Directive

The Interest and Royalties Directive also includes a definition of PE, which has been implemented into LähdeVL (627/1978) in Finland.[218] The Interest and Royalties Directive is designed to eliminate withholding tax obstacles on intra-group cross-border interest and royalty payments. The directive abolishes withholding taxes on interest and royalty payments. A similar definition is also included in the Parent–Subsidiary Directive.[219]

Article 3(c) of the Interest and Royalties Directive and Article 2(b) of the Parent–Subsidiary Directive, defining the term PE, read as follows:

> *'[P]ermanent establishment' means a fixed place of business situated in a Member State through which the business of a company of another Member State is wholly or partly carried on…*

The wording is identical to that of Article 5(1) of the OECD Model with two differences. The definition requires that the "fixed place of business" is situated in a EU Member State and replaces the word "enterprise" with the definition "company of another Member State". These differences shall be considered mainly of a formal character relating to the scope of application of the Directives. The Parent–Subsidiary Directive includes an additional subject-to-tax condition, which relates to the anti-avoidance objectives of the Directive. The definition implemented in Section 3(e)(1) of LähdeVL, reproduces the exact wording of the Article 3(c) of the Interest and Royalties Directive.[220]

It is noteworthy, that the Directives or LähdeVL does not include a negative list or reference to agents. Firstly, no agency PE can be constituted for the purposes of the Interest and Royalties Directive or Parent–Subsidiary Directive. The agent's activities would have to fulfill the requirements of the general PE rule in order to get protection from the Directive. Secondly, where the requirements of the general PE rule are fulfilled, the scope of application is broad because preparatory or auxiliary activities are not excluded.

In conclusion, the PE concept in the Directives and LähdeVL operates rather differently as compared to Article 5 of the OECD Model or Section 13(a) of the TVL. Therefore, the

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[218] Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.

[219] Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

[220] The Finnish translation of the Interest and Royalties Directive uses the words "jonka kautta", meaning "through which". However, the definition in LähdeVL uses the Finnish term "josta". Such difference does not change the meaning of the provision.

legislative solutions chosen do not, in the author's view, serve as a good guide for domestic law provisions regarding the PE threshold. In most cases, the taxpayer's interests are opposite in these two situations. The taxpayer would prefer avoiding the constitution of PE for the purposes of business income taxation, however, falling within scope of the Directives would be usually preferred.

4 Implementation of the New Agency PE Threshold

4.1 International level

4.1.1 EU measures to counter BEPS

In tandem with the BEPS actions of the OECD and G20, EU Member States have put forward efforts to fight aggressive tax planning. The EU Commission has preferred common solutions among the Member States to fight tax planning. Therefore, an Anti-Tax Avoidance Package has been issued, which most importantly includes the proposal for an Anti-Tax Avoidance Directive (ATAD).[221] However, issues relating to PE-avoiding schemes have not been considered suitable for the ATAD. In the Commission's view, they relate more to tax treaties.[222] Regardless, the Commission has set forth a Recommendation on the implementation of measures relating to permanent establishments. [223]

The Commission's recommendation settles for encouraging Member States to implement the proposed amendments to PE provisions in their DTCs. Conversely, Member States are not obliged to implement the new agency PE provisions. Hence, it is possible that despite the significant efforts of OECD and G20, the PE threshold will remain as is in some EU Member States.

4.1.2 MLI

The proposals in Action 7 have recently taken a major leap forward, after OECD released the text of the MLI, which has been developed under OECD BEPS Action 15. As of 24 November 2016, more than 100 jurisdictions have concluded negotiations on the instrument and are likely to implement the instrument to some extent.

The MLI will operate in a significantly different manner as compared to traditional amending protocols to single DTCs. The MLI will not directly amend current DTC texts. Instead, it will add an additional layer on top of existing DTCs and work alongside them.

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[221] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.

[222] European Commission 2016a, p. 6.

[223] European Commission 2016b.

Therefore, where implemented, the provisions of the MLI will supersede current DTC provisions only to the extent that those provisions are covered by the provisions of the MLI.

The adoption of the MLI does not necessarily mean that the PE provisions in actual DTCs will be amended. Firstly, even though the MLI covers Action 7 proposals, these proposals are not included in the instrument's minimum standard. A state signing the MLI will be able to satisfy the minimum requirements without affecting current PE provisions of the state concerned. Secondly, the provisions included in the MLI will only apply to a specific DTC after all parties to that treaty have deposited an instrument of ratification and certain transition periods have passed. To this end, states also have the option to opt-out of certain provisions.

The MLI will be open for signature as of the beginning of 2017. A signing ceremony will be held in Paris on 5 June 2017. Projections are that first signatures will be received at the ceremony. The MLI will enter into force at the beginning of the fourth month after five countries have ratified it.[224] With regard to each signatory, the MLI will enter into force at the beginning of the fourth month after the instrument of ratification is deposited. Certain notifications are also due at the time of signature or when depositing the instrument of ratification. Entry into force will not mean immediate effectiveness. Rather, provisions on taxes other than withholding taxes, will come into effect on the beginning of a taxable period after a period of six calendar months has expired after entry into force by all parties to a specific DTC. Therefore, if no signatures are received before the signing ceremony in June, the new provisions on PEs would become effective at the earliest for the taxable period beginning on 1 January 2019.[225]

The relevant provisions with regard to the agency PE threshold are those included in Articles 12 and 15 of the MLI. Article 12(1) of the MLI reproduces the substance of Article 5(5) proposed in Action 7, with certain technical modifications.[226] Similarly, Article 12(2) of the MLI corresponds to Article 5(6)(a) proposed in Action 7. Action 7 Article 5(6)(b) is reproduced in Article 15(1) of the MLI.

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[224] See OECD 2016.

[225] If the entry into effect has happened by 30 June 2018, the first taxable period where the new agency PE provisions will apply is the period beginning 1 January 2019. Therefore, the deposition of the instrument of ratification by all parties must have happened at the latest on 30 February 2018.

[226] See Para. 159 of the Explanatory Statement to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, 24 November 2016 (Explanatory Statement).

Article 12(3) indicates the provisions which the new agency PE rule and independent agent exception shall replace. Article 12(3)(a) of the MLI reads as follows:

> *Paragraph 1 shall apply in place of provisions of a Covered Tax Agreement that describe the conditions under which an enterprise shall be deemed to have a permanent establishment in a Contracting Jurisdiction (or a person shall be deemed to be a permanent establishment in a Contracting Jurisdiction) in respect of an activity which a person other than an agent of an independent status undertakes for the enterprise, but only to the extent that such provisions address the situation in which such person has, and habitually exercises, in that Contracting Jurisdiction an authority to conclude contracts in the name of the enterprise.*

Without doubt, Article 12(1) will replace DTC articles in line with the current OECD Model Article 5(5). Article 12(3)(b) reads as follows:

> *Paragraph 2 shall apply in place of provisions of a Covered Tax Agreement that provide that an enterprise shall not be deemed to have a permanent establishment in a Contracting Jurisdiction in respect of an activity which an agent of an independent status undertakes for the enterprise.*

Therefore, Article 12(2) will replace DTC articles in line with the current OECD Model Article 5(6). In addition, where countries have chosen to implement Article 12(2), Article 15(1) of the MLI will apply.[227]

Unlike some articles of the MLI, Article 12 does not provide alternative options. A country may either implement both the new agency PE rule and the independent agent exception or choose to opt-out of both. Partial implementation is not possible. For the sake of clarity, the adopted approach is coherent.

In conclusion, the circumstance that countries may opt-out of the new agency PE provision and the independent agent exception is significant. New PE provisions will only apply to DTCs if the parties to a specific DTC reach mutual understanding and both agree to implement the MLI without reservations about the new agency PE provisions. Therefore, it is highly unlikely that such unanimity will be achieved with all tax treaty states. Rather, it is presumable that the current OECD Model and established practice thereto will remain relevant to a significant extent. The following diagram provides a simplification of the situations where new Action 7 agency PE provisions apply after the treaty has become effective (Diagram 4).

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[227] See first sentence of Article 15(1) of the MLI.

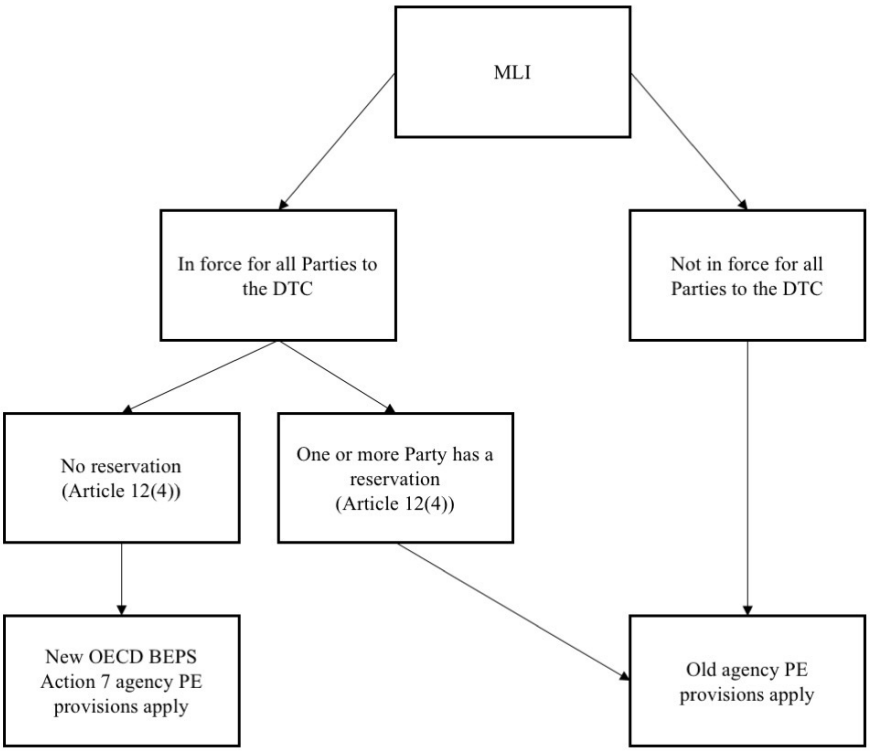

Diagram 4

4.1.3 Arguments for and against implementation

Countries participating in the MLI, Finland included, must now carry out an urgent review of their DTC network and notify their final position by the time the instruments of ratification are deposited.[228] Until further information is provided on the countries' positions, taxpayers will have to stand by and see which DTCs will be affected.

Pro et contra arguments can be easily presented on which position should be taken with regard to amending the PE threshold. Some key arguments in the view of the author are presented and evaluated in the following.

In accordance with the underlying principle expressed by the OECD, companies should pay taxes in the country where profits are generated. Policy-makers generally consider commissionaire arrangements as artificial avoidance schemes that were put in place to erode the taxable base of the state where sales took place. If such view is accepted, lowering the agency PE threshold to cover commissionaire arrangements seems a rational and justifiable BEPS-countering measure.

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[228] See Article 29 of the MLI.

The principle of neutrality in taxation requires that enterprises carrying out the same activities via dependent agents in a customer jurisdiction should be subjected to the same tax treatment, regardless if they conclude contracts on behalf of a principal "in the name of the enterprise" or in their own name.[229] Obviously, as established European case law shows, the current OECD Model definition does not conform to this principle.

Even though the argument on the principle of neutrality can be accepted and even considered rather convincing, there are some shortcomings to the argument. A commissionaire is a hybrid between an agent and a title-taking distributor. Therefore, it is not self-explanatory whether the commissionaire distributor should be compared to a dependent agent or a LRD. If compared to a LRD, the neutrality argument will not be sufficient justification. A LRD will not constitute a PE either. Actually, the taxable profit of a LRD is very similar to that of the commissionaire. Both entities are acting as local distributors in their own name. This conclusion would justify comparison to LRDs in neutrality considerations.

On the *contra* side, typical taxpayer arguments include the uncertainty of tax treatment, additional compliance costs for internationally operating companies, additional administrative burden, more disputes with tax authorities and risk of double taxation.[230] These arguments are somewhat convincing and true at least in jurisdictions where supreme courts have established a consistent praxis or tax authorities have not scrutinized standard commissionaire arrangements, such as in Finland. In these jurisdictions, uncertainty will definitely increase if new agency PE provisions with substantive conditions are adopted.

However, in other jurisdictions, even prior to implementation of Action 7, tax authorities have successfully challenged commissionaire arrangements and achieved substance-over-form interpretations on existing OECD Model agency PE provisions.[231] Even where such interpretations may be highly questionable, choosing not to implement new PE provisions will not take away uncertainty and PE risk. It is highly likely that uncertainty will, in fact, increase as a substance-over-form approach begins to prevail in other areas of international taxation.

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[229] See Skaar 1991, p. 488.

[230] See OECD 2015a and OECD 2015c on the stakeholder comments on Action 7.

[231] See Jiménez 2016 on the expansive interpretation of Article 5 of the OECD Model, in recent Spanish case law.

From a tax revenue perspective, changes to the PE threshold might cause a shift of tax revenues between states. Depending on whether commissionaire arrangements are more widely exploited by companies resident in Finland, operating in other tax treaty countries, or by non-residents operating via commissionaire arrangement in Finland, the lower PE threshold will either have a positive or negative impact on tax revenues. This of course assuming that additional PEs will result in more taxable profits, which is far from self-evident.[232]

Finland is a country with an export-dependent economy, where MNEs which are engaged in the sale of goods reside. Consequently, it is well-known that Finnish companies have put in place commissionaire arrangements to distribute goods abroad, which makes source state taxation rather limited for the MNE concerned.[233] There is very little double taxation to be eliminated in the residence state and profits are largely taxable by the Finnish state. In case the PE threshold is lowered, the companies' sales activities via commissionaires might constitute PEs. In consequence, a shift of tax revenues from Finland to other source jurisdictions is possible.

The argument on tax revenues falls short on the lack of comprehensive data to back the argument. Furthermore, with regard to any argument presented above, it must be taken into account that taxpayers will almost certainly reassess and change their corporate and contractual structures as consequence of amendments to the PE threshold. For example, the commissionaire distributor can be changed to a LRD structure in very little time. Such conversion could be simply done by amending intra-group contracts. Therefore, the taxpayers' reactions to new rules will determine whether policy objectives are reached and whether tax revenues are shifted to other jurisdictions.

4.2 Compatibility of the new agency PE provisions

4.2.1 Compatibility with domestic law provisions

Compatibility of the national PE concept with concepts included in DTCs has not been drawn much attention to in Finland. Traditionally, such question has not been considered

[232] Comprehensive data on the extent that commissionaire arrangements are used by Finnish-based MNEs is not available. The matter would have to be further studied in order to make further conclusions.

[233] It must be borne in mind that MNEs may operate with highly complex structures. Avoidance of PE status is only one component in the entire structure.

highly relevant, due to the fact that the PE concepts in DTCs and the TVL have been found similar enough. Furthermore, where the PE constitution is not considered a precondition for levying a tax on a non-resident entity, compatibility is not a key question either.

Considering that the implementation of the MLI will lower the PE threshold for agency PEs and in consequence agency PEs will be constituted on basis of an ever more artificial nexus, compatibility issues may raise. The new agency PE provisions set forth in Action 7 provide that where the commissionaire plays the "principal role leading to the conclusion of contracts" or concludes contracts for the "transfer of the ownership" of the principal's products, a PE may be constituted. In essence, the rule deems that sufficient coordination exists in these situations and in consequence, a PE is constituted. Now that a certain extent of deemed coordination between the commissionaire and the principal will be a sufficient nexus, a MNE might run into a situation where its activities constitute a PE under the new agency PE rule set forth in Action 7 and implemented through the MLI. However, in case the national PE concept is not amended, the same activities may not meet the national PE threshold. Section 13(a) of the TVL does not recognize such an artificial nexus. In fact, it does not include any specific agency PE provisions.

Section 13(a) is built on the fundamental principle that the "term permanent establishment means a place"—no alternative nexus is mentioned. With regard to commissionaire distributors, the PE threshold in Section 13(a) may not be met where the commissionaire does not have a specific place "where special measures have been taken", such as a permanent place of sales. In fact, in most circumstances, it is highly unlikely that such "place" would exist. Many commissionaires operate without a physical presence in a single location.

Such non-compatibility is unlikely to directly result in the conclusion that the business income of the enterprise is not taxable in Finland. As mentioned, tax liability for business income of a foreign enterprise covers any Finnish-sourced income. However, compatibility issues are likely to occur on a more systemic level. Firstly, determining Finnish-sourced income is far from unambiguous. Therefore, the domestic PE concept serves as a practical guideline for determining where income is, in fact, derived from Finland.[234] Furthermore, domestic PE rules have been traditionally interpreted in accordance with the PE provisions

[234] In practice, such use of the PE concept is likely customary. The circumstance that the domestic PE concept is a *de facto* precondition for the taxation of foreign enterprises' income supports this assumption.

in current DTCs.[235] Now that the measures to counter BEPS are implemented through the MLI, the interpretation of the PE threshold in some tax treaties may be affected. Interpreting the domestic PE provisions in accordance with the new BEPS compatible rules would be a total disregard of the principle of legality and should not be accepted in any circumstances. It cannot be accepted that amendments in tax treaties, which cannot be read from the domestic act, would amend the meaning of a domestic law provision. However, tax praxis has shown that authorities have a tendency to adhere the OECD's rules in interpretation—authorities even tend to anticipate forthcoming amendments. As *Jiménez* (2016) has shown, this is not a futile or far-fetched concern.[236] Such tendency can already be seen in European jurisdictions, even prior to the MLI entering into force. Therefore, a risk of tax authorities' interpretations in contradiction with the principle of legality is a relevant concern.

Secondly, it could be reasonably argued that the unclear provisions and relationship of Section 10(1) Point 2 and Section 13(a) are not in line with the emphasized principle of legality. Section 81 of the Finnish Constitution requires that state tax is governed by accurate and precise provisions.[237] The current threshold for source state taxation can hardly fulfill these requirements.

This level of incoherence between the domestic concept and tax treaty PE concept is by no means appropriate. Non-uniformity may lead to unforeseen situations and create uncertainty among taxpayers. Therefore, an updated PE concept and clarifications to the TVL are needed.

4.2.2 *De lege ferenda*: Adoption of a stripped PE rule and other amendments to the TVL

In order to maximize tax revenues, a low threshold for purposes of foreign enterprises' income taxation is in the states' interest. To achieve such threshold, countries have chosen to adopt broad PE concepts in domestic legislations. Section 13(a) of the TVL is no different.

Where a broad national PE concept stipulating a low income tax threshold is adopted, the domestic law provisions seldom have much relevance. Countries have comprehensive DTC networks. In consequence, the number of non-treaty situations is very limited. In general,

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[235] The government proposal HE 76/1995 suggests that PE rules should be interpreted in accordance with provisions of DTCs.

[236] See Jiménez 2016, pp. 472–473.

[237] See Chapter 1.5.1.

non-treaty situations where PE considerations are relevant relate to companies established in tax havens. Other regimes, such as CFC rules, are in place to tackle such arrangements.

Therefore, in most cases, the application of DTCs is the most significant factor in determining the extent of source state taxation. Regardless of the aforementioned, also domestic rules must allow taxation, as stressed earlier. Therefore, DTC provisions and domestic rules have to conform to a relevant extent. Even though current TVL provisions are unsatisfactory, such endeavor can also be read from the Finnish preparatory works. The government proposal HE 76/1995 suggests that PE rules should be interpreted in accordance with DTC provisions.[238]

To ensure compatibility, Sweden has chosen to implement the exact wording of the OECD Model to the Swedish Income Tax Act. Due to the recent developments in tax treaty law, the Swedish provisions are no longer optimal and may require certain amendments. However, in the author's view, such general approach best fulfills the principles of legality and best promotes legal certainty.

De lege ferenda, the new PE provisions set forth in Action 7 should be implemented in their broadest possible form into the Finnish TVL. The paragraphs do not need to be copied in entirety. However, the key building blocks should be included. An outline of a satisfactory PE provision is laid down hereunder.

Firstly, it is only rational to include the general PE rule set forth in Article 5(1). Furthermore, a list of positive examples similar to Article 5(2), should be included. For reasons of clarity, the positive list could be supplemented with additional examples. However, in a similar manner to the OECD Model, examples should always be subject to the conditions set forth in the general PE rule. Secondly, for the sake of clarity, the construction PE should be included as well. However, the domestic construction PE rule could be implemented without a specific 6 or 12-month threshold, thus adopting the construction PE rule in a broader form. To further broaden the application of the construction PE, a wording similar to the UN Model, including assembly projects and supervisory activities carried out in connection with construction projects, could be implemented without compatibility issues. Thirdly, the exceptions laid down in Article 5(4) of the OECD Model would not necessarily need to be implemented. Such option would ensure the broadest possible application of the domestic

[238] See HE 76/1995 vp, p. 19.

law PE concept and would not limit the application of the general PE and agency PE rule. In any case, interpretation in accordance with the Commentary requires a certain level of permanency or habitual activity for PE constitution.

Similarly, the new agency PE rule set forth in Article 5(5) of Action 7 should be included in the domestic law definition. Again, to ensure the broadest possible interpretation, the phrase "contracts that are routinely concluded without material modification by the enterprise" would not need to be included. As mentioned, a UN committee has observed, that such phrase might be adversely limiting the scope of application of the agency PE. Finally, the contents of Article 5(7) of the OECD Model do not necessarily need to be copied to a domestic law definition. Established Finnish doctrine provides that as a starting point, separate entities are to be taxed independently.

In conclusion, the new stripped Article 5 would include the essential parts of the PE concept set forth in Action 7, without adversely limiting the scope of application. Because the new PE provisions set forth in Action 7 can be considered way broader than those of the current OECD Model, compatibility issues should not occur even in situations where the MLI would not apply and the current DTC provisions would remain relevant. Unlike with the current Section 13(a), under the proposed wording, the legislator's ambition to interpret domestic law provisions similarly to provisions of DTCs would actually be possible.

As mentioned above, the current wording of Section 13(a) is not the only sub-satisfactory part of the current TVL. For the reasons of clarity and certainty, other amendments are also necessary. At least with regard to limited liability companies, the Finnish peculiarity of dividing income to different sources appears outdated. To this end, the Finish Ministry of Finance has already initiated an action and appointed a group of experts to support drafting new provisions, which would end the division of limited liability companies' income into different income sources.[239] However, division into different sources of income is a minor issue. More importantly, for reasons of clarity, it would be advisable to set the constitution of a PE as a precondition for levying a tax on the business income of a non-resident entity.[240]

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[239] Ministry of Finance 2016.

[240] Nissinen 2010 p. 197 has proposed that Section 83 of the VML would be transferred to the TVL, for the sake of clarity. Pursuant to the Section, a tax may be levied on the income of a non-resident entity, which is engaged in business activities, even where a Finnish PE does not exist. In this study, the Swedish alternative is preferred over Nissinen's proposal, because it provides more certainty for taxpayers. Interpretation of PE provisions is more predictable and better fulfills the principle of legality than attempting to separately define the threshold where a company "engages in business activities".

Such approach has been adopted in Sweden. It would clear out the current uncertainty without having much—if any—effect on tax revenues. However, such clarification would provide much more certainty for non-resident taxpayers.

5 Concluding Remarks

5.1 Implications of the new PE rules on commissionaire distributor models

The new lowered agency PE threshold will change the operating environment of the commissionaire distributor model. Even though commissionaire distributors will continue to conclude contracts in the name of the commissionaire and contracts will remain binding only on the commissionaire itself, the new agency PE provisions almost certainly exclude the possibility to rely on any formal interpretation thereof and to consequently avoid PE constitution.

Even under the new agency PE rule, Article 5(5) and 5(6) of the OECD Model will not represent dichotomy. The two paragraphs are not mutually exclusive, meaning that not all agents are either dependent or independent. Therefore, dependency does not certainly constitute a PE for the principal. Regardless, it appears that the OECD and G20 have achieved their goal to reform the agency PE provisions. Under the new provisions, all key conditions for agency PE constitution are of substantive character, rather than formal. Under the new substance-over-form rules, the commissionaire distributor model is likely to have a PE-constituting effect on the principal.

As one might expect, PE constitution for the principal entity is very likely a sub-optimal circumstance for a MNE. Commissionaire structures have been put in place to serve the opposite purpose. Firstly, the MNEs tax exposure in the customer jurisdiction may increase as the attribution of profits under Article 7 of the OECD Model is required where a PE exists. Secondly, additional compliance and administrative costs will result in many areas. As mentioned, PE constitution will trigger various compliance requirements all the way from filing a start-up notification and income tax returns to completing and maintaining accounting records for the PE's transactions. The paradox is that the commissionaire must already fulfill all local compliance requirements. Therefore, PE status in tandem with a local entity will result in burdensome compliance requirements that must be fulfilled twice in one jurisdiction.

As the new PE provisions are substantive, rather than formal, uncertainty may also increase. At least where operating models vary from traditional alternatives, such as the commissionaire distributor model, the substantive agency PE conditions which allow leeway in interpretation, may not be interpreted consistently in both the residence state and the

source state or any other state where the MNE operates. This is because many terms are not explicitly defined in the MLI or the Commentary, thus left to be interpreted in accordance with the domestic laws of the state concerned. In consequence, disputes with tax authorities are likely to become more frequent and the risk of double taxation is higher. However, the double taxation will not result from PE status itself. To this end, profit allocation and elimination of double taxation are key.

Even though profit allocation to PEs is not in the scope of this study, certain preliminary conclusions can be drawn. For an existing commissionaire distributor model, PE constitution will certainly become an additional administrative burden. However, added tax exposure for the MNE in the customer jurisdiction is not inevitable. Even where a PE will be constituted for the principal, the activities performed will not have changed. Where the commissionaire is already remunerated on an arm's length basis, there may not be any additional profit attributable to the MNEs activities in the customer jurisdiction. However, as many commentators have claimed, the attribution of profits analysis under Article 7 of the OECD Model is less certain than TP analysis. This may cause some variation in profit allocation.[241] However, in general, profit allocated to the customer jurisdiction should not drastically change in consequence of PE constitution.

Despite the risks related to the new agency PE provisions, MNEs will not be crippled. Firstly, it is to be kept in mind that the new agency PE provisions introduced under Action 7 will certainly not cover all existing tax treaties. Countries may opt-out of the new agency PE provision and the independent agent exception, even where the MLI is signed. New PE provisions will only apply to DTCs if the parties to a specific DTC reach mutual understanding and both agree to implement the MLI without reservations concerning the new agency PE provisions. It is highly unlikely that such unanimity will be achieved with all tax treaty states. Rather, it is presumable that the current OECD Model and established practice thereto will remain relevant to some extent.

5.2 Treaty shopping

Where the new agency PE provisions are implemented, MNEs will be urged to take action. In order to keep the operating model agile, to minimize uncertainty, and to retain beneficial

[241] For example, see EY's comments on the Public Discussion Draft at OECD 2015a, p.237.

treatment, certain options are available. Firstly, the new agency PE provisions introduced under Action 7 will only cover tax treaties which states have specified together, in consensus, and where either country has not opted out from the new PE provisions. Therefore, it is likely that DTCs with some states will remain as is.

These circumstances enable tax planning to a certain extent and may encourage treaty shopping. With regard to existing commissionaire distributor models, which are not intended to be changed, the objective is to fall under the application of a DTC with *old agency PE provisions*, i.e. rules in force currently. Application of old agency PE rule can be achieved by establishing the SalesCo, i.e. the entity acting as the principal, in a country with a beneficial DTC with the customer jurisdiction. Treaty shopping may not even require establishing new entities. Practically any operative entity within the group may be appointed as the new principal, for example, an existing full-fledged distributing company. Where the commissionaire is acting on behalf of the SalesCo in a country which is not implementing the MLI, PE constitution should not occur.

In conclusion, the new Action 7, which has been designed to counter schemes relating to the artificial avoidance of PE status, is likely to encourage rather than discourage treaty shopping. Where treaty shopping is possible for the MNE concerned, the new PE provisions will only add an additional factor to be considered in finding the most beneficial jurisdiction for the entity acting as the SalesCo.

Treaty shopping may not be the optimal long-term solution for MNEs. Rather, it is likely that tax authorities will continue to aggressively scrutinize commissionaire arrangements. Therefore, also other reactions ought to be contemplated.

5.3 Operating model alternatives

The commissionaire distributor model is a light and rather agile structure which can be restructured with relative ease. In case operations in the customer jurisdictions remain consistent, avoiding PE status continues to be in the MNE's interest, and treaty shopping is not feasible or practical, conversion to a LRD is possible.

Conversion from a commissionaire distributor to a LRD would simply require an amendment to intra-group contracts. In essence, the contract terms should be amended so that the title to the products is transferred to the entity in the customer jurisdiction before the transfer to the local customer. After conversion, the products sold would be entered as assets

to the entity's books. In fact, little change in the actual operations would occur, where the contract terms would give the entity a flash title. Hence, in the eyes of the customer, the operations of the entity in the customer jurisdiction would not change. The products could continue to be directly shipped from another company in the group to the customer of the LRD, by virtue of a drop shipment arrangement. Therefore, taking title would not require activities such as logistics and warehousing to be carried on by the entity itself. Extensive re-financing of the entity would not be required either, where the LRD would only be required to pay for its purchases after it collected its own receivables from customers, and where the intra-group prices of goods are flexibly set, thus guaranteeing a gross margin return to the LRD. However, some additional administrative costs, such as tax and legal consultants' fees, would certainly incur in connection with a conversion.

With regard to the PE status of the LRD, Action 7 not only targets avoidance of PE status through the use of commissionaire structures but also "similar strategies" are in focus. The Final Report defines "similar strategies" as strategies in which contracts are substantially negotiated in a state and concluded abroad or strategies which exploit the independent agent exception set forth in Article 5(6) of the OECD Model.[242]

The PE status of an LRD was discussed to some extent during the drafting process of Action 7. Many stakeholder comments brought up the LRDs' PE status as well. This uncertainty was considered in the Revised Discussion Draft, which stated that "similar strategies" do not include LRD arrangements.[243] The same conclusion was reproduced in the Final Report.[244]

The Commentary to the new agency PE rule clarifies that a buy–sell distributor in a particular market is not considered to be acting "on behalf of an enterprise" when it sells products bought from an enterprise. Furthermore, the proposed Commentary goes on to clarify that LRDs, which would hold the title to the property and buy the product from an associated enterprise, would also be regarded as not acting "on behalf of an enterprise".[245] In addition, LRDs would not fulfill the decisive requirement set forth in Article 5(5)(b) and clarified in Paragraph 32.10 of the proposed Commentary. In order to constitute a PE, it is required that products owned by the principal are sold by the person acting on behalf of the enterprise.[246]

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[242] OECD 2015d, p. 15.
[243] Ibid., p. 5.
[244] Ibid., p. 15.
[245] Para. 32.12 of the proposed Commentary. OECD 2015, p. 21.
[246] Para. 32.10 of the proposed Commentary. OECD 2015, pp. 20–21.

Clearly, an LRD is selling products owned by itself. Considering these clarifications together with the underlying principle set forth in Article 5(7) of the OECD Model, which stipulates that different legal entities are taxed separately regardless of parent–subsidiary relationship, it can be concluded that LRDs should not constitute PEs.

As the "on behalf of" condition is a prerequisite for agency PE constitution also under the new agency PE provisions, the correct interpretation is that where the title to the products sold is passed to the distributor in the customer jurisdiction, an agency PE is not constituted for the distribution activities concerned. However, the Commentary's clarification does not entail that tax authorities would not scrutinize LRD structures as well. Even though the correct interpretation of the new agency PE provisions suggest that a PE should not be constituted, it is likely that the TP between the LRD and related companies within the same group is subject to scrutiny. In fact, Action 9 of the BEPS Action Plan specifically targets the contractual transfer of risks between associated enterprises. Far-reaching conclusions on whether LRD structures are beneficial for a specific MNE cannot be made in this context. Instead, further research on the matter would be required to draw conclusions.

Other restructuring alternatives are also available. In case avoiding PE status is in the MNEs interest, conversion to an MSC might be feasible as well. However, to be able to avoid PE status in such structure, the operations in the customer jurisdiction would have to be scaled down. This could not be done without the operations changes becoming evident to customers. To avoid playing the "principal role leading to the conclusion of the contracts" in accordance with the new Article 5(5), the MSC could only engage in marketing activities which would not directly result in the conclusion of contracts between the foreign principal and the customer. The MSC would have to operate in the somewhat gray area of carrying out marketing activities without directly leading to the conclusion of contracts. Therefore, it is unlikely that restructurings other than a conversion to a LRD would be possible without changes in the actual operations in the customer jurisdiction.

5.4 Conclusion

Regardless of whether commissionaire distributor arrangements are considered artificial by their very nature or regarded fully acceptable, a PE should not be constituted under the current provisions of the OECD and UN Models where the commissionaire agreement and the commissionaire's activities correspond to the true nature and characteristics of a commissionaire–principal relationship. Such conclusion can be drawn from the

interpretation of the current agency PE provision in Article 5(5) and the respective well-established European case law, wherein a literal, form-over-substance interpretation has been preferred. In consequence, a MNE is able to exploit a commissionaire structure in its distribution so that sales profits are not subject to income taxation in the customer jurisdiction. Consequently, profits are effectively shifted to the country where the principal entity resides.

The forthcoming changes to tax treaty law will change the established notion. The implementation of the MLI will likely have a PE-constituting effect on commissionaire distributor arrangements. Such effect will most importantly result in an increase in the MNE's administrative burden. As the MLI allows for countries to opt-out of the new agency PE provisions set forth in Action 7, the current notion will remain relevant to some extent. Countries' positions, which have yet to be made public, will determine the extent to which the commissionaire distributor model will be able to avoid PE constitution in the future.[247] The schedule of implementation also remains unknown. It is likely that the new PE provisions will come into effect at the beginning of the year 2019, at the earliest.

Even where the MLI will not apply on top of an existing DTC, the new agency PE provisions in accordance with Action 7 may become relevant in the mid-to long-term. Firstly, the new post-BEPS OECD Model is likely to become an established basis for the negotiation of future DTCs, after the OECD and UN Models are updated and adhere to Action 7. Secondly, where EU level harmonization of direct taxation increases, the new agency PE concept may be included in EU law. First indications of such developments can be read from the proposal for a CCCTB, which already includes an agency PE concept adhering to the definition included in the MLI.

Where the new agency PE provisions do apply, reactive options are available for MNEs. Firstly, the configuration of the MLI will encourage treaty shopping. Secondly, the most common response to the forthcoming amendments is likely to be a conversion from a commissionaire distributor to a LRD. The implications of Action 9 of the OECD BEPS should be further studied to determine whether LRD structures under the MLI will allow for similar profit shifting as the current treaty provisions. That being said, realignment of

[247] According to most recent news from the UK, it appears that the UK will not be adopting the new agency PE provisions in their DTCs. However, the British government has not publicly confirmed this position. See Bloomberg 2016.

taxation and relevant substance or revival of source state taxation will not be achieved with the new definition of PE. In a metaphorical sense, tax treaties will continue to function like a bathtub—"a single leaky one is a drain on a country's [tax] revenues".[248] Because PE constitution itself will not lead to new taxable income where risks and activities do not change, the amendments to profit allocation under Article 7 and the updated TP rules by virtue of OECD BEPS Action 9, if any, are more likely to revive source state taxation.

Regardless of the limited contribution of the new definition of PE to the underlying objective of the BEPS initiative, the forthcoming amendments are likely to cause uncertainty for taxpayers. The legal status of a commissionaire under relevant contract law will drift ever further apart from its status under tax law. The civil law commissionaire will continue to enter into agreements which do not legally bind the principal. However, new agency PE provisions will assume coordination between the commissionaire and the principal, thus disregarding the underlying concept of the independence of legal entities set forth in Article 5(7) of the OECD Model. In this artificial legal environment, which might not correspond with reality, profits are allocated in accordance with Article 7. On this note, the growing concern for uncertainty and lack of predictability relating to the attribution of profits does not seem far-fetched.

Increased uncertainty is also evident on the domestic law level. In the author's view, the need for uniformity of the tax system requires that provisions in national law closely correspond to the tax treaty provisions regarding the new nexus triggering source state taxation of business income. Therefore, the implementation of a stripped PE rule into Finnish domestic legislation is proposed. In principle, the definition set forth in Action 7 would be transposed to the TVL in its broadest possible form, thus stripping the new agency PE article from provisions which limit its application. In tandem, certain existing uncertainties relating to the threshold of business profit taxation of foreign enterprises should be resolved.

Without doubt, the forthcoming amendments to tax treaty law will cause uncertainty. What is certain, however, is that commissionaire arrangements and other PE-avoiding and profit shifting distribution models will not be killed off. The commissionaire distributor model will stay in the toolbox of tax planners and remain relevant also for the years to come. Depending

[248] The World Bank 2016. An insight into tax treaty law by Stephen Shay, a senior lecturer at Harvard Law School.

on the countries' positions, the popularity of the said model may decrease and the preference for LRD arrangements or similar distribution models may respectively increase.

Neither the realignment of taxation and relevant substance, a revival of source state taxation nor inter-state equity will be materially affected by the amendments to the definition of PE in tax treaties. Therefore, in today's business environment, the notion of PE can hardly be described as the single most important issue in treaty-based fiscal law any longer.[249] Instead, profit allocation and TP will be key areas in achieving these fundamental goals.

Even though the commissionaire distributor model will likely survive the forthcoming changes in tax treaty law, MNEs must stay alert. The OECD's lowered PE threshold is only one tool to counter avoidance of PE status. Policy-makers' do have other options up their sleeve. MNEs should also pay close attention to legislative developments in the jurisdictions they operate in. Most recently, OECD BEPS has inspired European national diverted profits tax bills—the so-called "Google tax". These unilateral measures, inter alia, target MNE's commissionaire distributor models. Diverted profits tax provisions have been recently included in the United Kingdom Finance Act 2015. A tax is levied on an amount equal to notional PE profits even though no PE would be created under the relevant DTC.[250] Similarly, a diverted profits tax has been presented on the French Draft Finance Bill for 2017.[251] Such initiatives are problematic with respect to EU law and DTCs and have yet to be discussed in Finland. What can be concluded, however, is that if multilateral measures to counter BEPS caused by commissionaire arrangements will not succeed, countries may be willing to set forth strict unilateral measures to achieve policy objectives.

[249] Skaar 1991, p. 1.
[250] See Sections 86 and 87 of the United Kingdom Finance Act 2015, which came into effect 1 April 2015.
[251] See EY 2016.