



JOINT SEMINAR ON BASE EROSION AND PROFIT SHIFTING (BEPS)

*Ascertaining Agency Permanent
Establishment: an operational activity
conducted by Guardia di Finanza*

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Hamburg, 14th March, 2014



BEPS – ACTION 7



ACTION 7

Prevent the artificial avoidance of PE status

Develop changes to the definition of PE to prevent the artificial avoidance of PE status in relation to BEPS, including through the use of commissionaire arrangements and the specific activity exemptions. Work on these issues will also address related profit attribution issues.



**Action Plan
on Base Erosion
and Profit Shifting**



BEPS – ACTION 7

Underlines the need to WIDEN the notion of *AGENCY PERMANENT ESTABLISHMENTS*

Review of the relevant regulation of the OECD Model Convention (by September 2015)

MAIN PURPOSE

Countering - from a normative viewpoint - possible interpretations of the *DEPENDENT AGENCY CLAUSE* that may allow to conclude in certain States contracts for the sale of goods belonging to a foreign enterprise to be negotiated:

- through a local subsidiary of that foreign enterprise, often replacing arrangements under which the subsidiary traditionally acted as a distributor by «commissionaire arrangements»
- without the profits from these sales being taxable to the same extent as they would be if the sales were made by a distributor (instead of commissionaire)
- without it constituting a permanent establishment of the foreign enterprise in the concerned State

From the viewpoint of the Italian tax administration



Ministero
dell'Economia
e delle Finanze

Permanent establishment and tax evasion



when a foreign company operates in Italy through a permanent establishment which has not been formally set up, and therefore is unknown to the Revenue

when an enterprise that is a tax resident of Italy has undeclared permanent establishments abroad

“HIDDEN PERMANENT ESTABLISHMENT”

“HIDDEN PERMANENT ESTABLISHMENT”



when the juridical autonomy of the resident company is only formal, while in reality the controlled company is subservient and auxiliary to the mother company

controlled companies actually permanent organizations belonging to the respective controlling companies



absence of any financial independence by the controlled company

How to prove the existence of undeclared PE

it is the burden of the tax administration to prove the existence of an undeclared “*tax charge centre*” by gathering useful elements of proof

To this end, it is indispensable:



- to carry out a targeted and accurate records search
- to identify all indications of the existence of a permanent establishment of a foreign enterprise, by focusing on the possible existence of the circumstantial evidence which, according to the consolidated jurisprudence, allow to support the existence of a “hidden” permanent establishment



GdF Operational activity

«BRAVO Case»

Preliminary investigative activities



1. Selection of the company stemmed from autonomous information search activity

2. Audit for Income Tax and VAT purposes into BRAVO ITALIA S.p.A., placed under the German group BRAVO

Visit in BRAVO ITALY's premises

Record searching activity

Statements gathering

elements of proof and circumstantial goods to support the existence of a "hidden" permanent establishment



GdF Operational activity

«BRAVO Case»

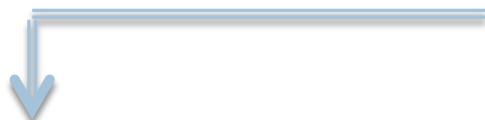
Results of the inspection activities



Established the presence, from the 1990s to 2011, on the national territory and on the premises of BRAVO ITALY Ltd., of a specific structure - **Alpha Division**



under an “agent representative agreement”
remunerated with fees



carried out activities in the exclusive interest of BRAVO GmbH that went **beyond** a mere “activity having a preparatory or auxiliary nature” and that involved the **“core business”** of the mother company

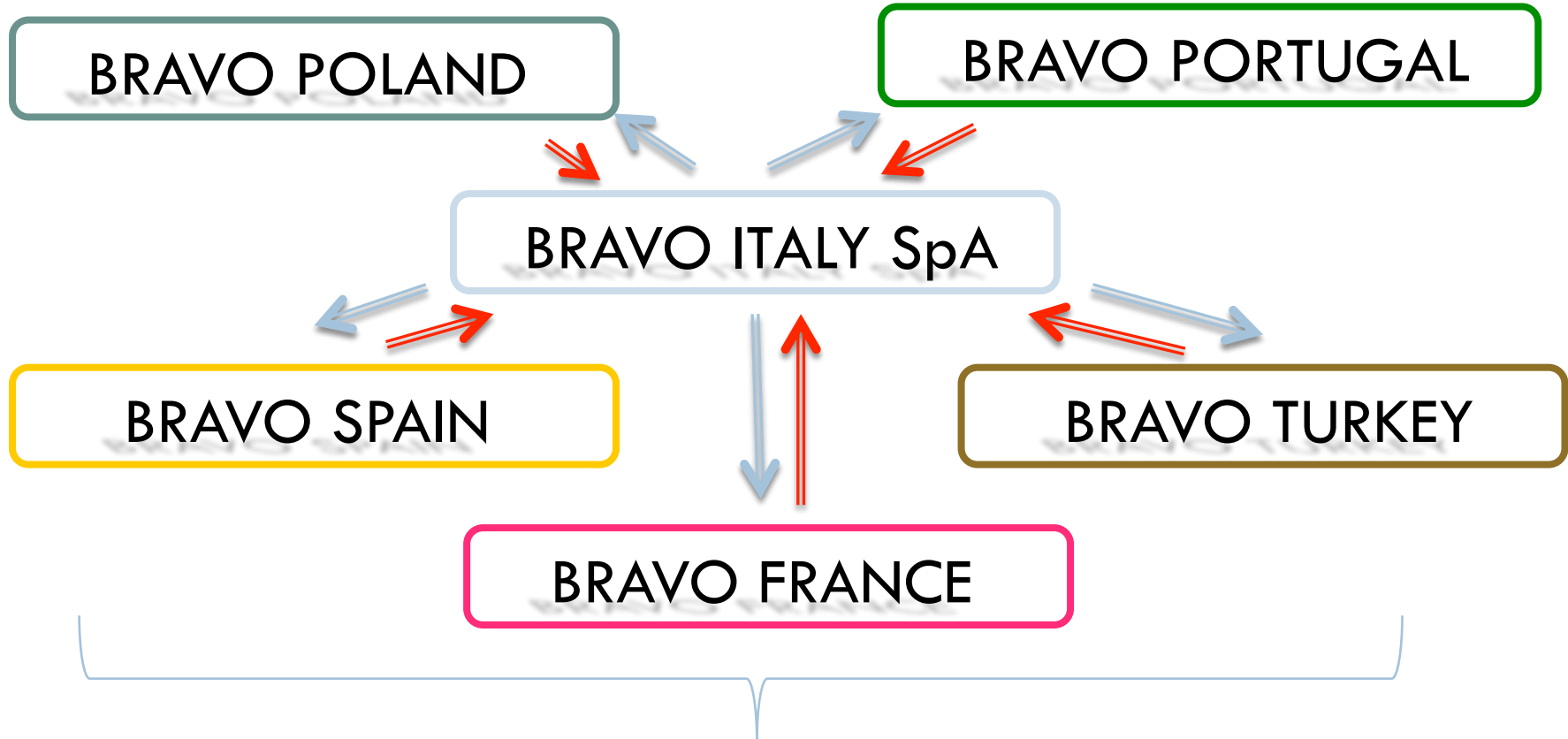
with the **significant** and **decisive participation** in the negotiation of the essential elements and signing of the sales contracts for BRAVO products to Italian clients



GdF Operational activity

«BRAVO Case»

Results of the inspection activities



“cooperation agreement” contracts



GdF Operational activity

«BRAVO Case»

Review of accounting and non-accounting records obtained



- the **employees of BRAVO ITALY Ltd.**, employed at the premises of the Italian clients (resident sales agents, engineers, technicians), reported directly to the top management of the Italian company but were placed **under the functional responsibility of the German group leader**;
- the employees of **BRAVO ITALY Ltd.** employed at the premises of the main Italian client – ECO Ltd. – **signed the global contracts in Italy for the mother company** as well as the confirmations of the purchase orders in the name and on behalf of the same;
- they habitually also exercised the **power to approve the negotiation of prices** and the **economic offers** by coordinating the **strategic business policies** with the client;
- although the **agreements** with the clients had been **formally prepared and then approved in Germany** by BRAVO GmbH, the **negotiation** of the same was **actually conducted only by personnel of BRAVO ITALY Ltd.**;
- the **presence** in the organizational structure since January 2005 – also confirmed by a note found in the office of the Managing Director – of a number of **positions with tasks performed in the name and on behalf of the German company.**





GdF Operational activity

«BRAVO Case»



Results

Hidden P.E.

BRAVO ITALY Ltd. was a GERMAN BRAVO's dependent agent, since it regularly exercised the power to conclude contracts in the name and on behalf of the latter

- a "multiple permanent establishment" of the foreign mother company, "hidden" or however not formally set up in Italy, in income tax matters
- a "permanent activity centre" in Value Added Tax matters

audit for income tax and VAT purposes



GdF Operational activity

«BRAVO Case»

Audit into the hidden P.E.



Need to quantify the income of the *Alpha Division*

- ✓ art. 7 of the OCSE Model: “*only the profits ascribable to the permanent establishment*” are taxable in one State where a permanent establishment of a foreign enterprise is placed
- ✓ income concealed from taxation quantified by determining the normal value of the profit margin earned by third party independent entities operating in similar situations and therefore by establishing a “*percentage*” of costs deemed to be adequate under the “*transfer pricing*” provisions
- ✓ quantification of the income ascribable to the permanent establishment, in accordance with the Italy-Germany Convention, OECD and national provisions



GdF Operational activity

«BRAVO Case»



Audit into the hidden P.E.



The undeclared income of the “hidden” permanent establishment quantified in over one billion euros

In reconstructing the income margins of the multiple permanent establishment in Italy of BRAVO GmbH, the portion of income declared in Italy by BRAVO ITALY Ltd. regarding *Alpha Division* was taken into account

Automatic information exchange model

As the world becomes increasingly globalized and cross-border activities become the norm, tax administrations need to work together to ensure that taxpayers pay the right amount of tax to the right jurisdiction. An open international architecture where taxpayers operate cross-border but tax administrations remain confined to their national borders, can only be sustained where tax administrations co-operate. One key aspect of international tax co-operation is exchange of information.

Thank You



Major Stefano Di Maria