This book, written by Raphael Holzinger, addresses the subject of profit attribution between both associated enterprises in light of Article 9 OECD MC and between a head office and its permanent establishments (PE) considering Article 7 OECD MC. The relevance of the topic arises from the increasing number of intra-group transactions and internal ‘dealings’ carried out by multinational enterprises (MNE) and the necessary pricing of these transactions/dealings which provides for challenges for MNEs and tax administrations. Examining the taxation of MNEs’ entrepreneurial activities from a (tax) structural perspective, the essential distinction can be made that cross-border activities can be performed, on the one hand, by using a PE (Article 7 OECD MC) and, on the other hand, by using an associated enterprise (Article 9 OECD MC). Based on this initial finding, this book scrutinizes whether the choice of the legal form makes or should make a difference for the purpose of profit attribution and the potential tax base of the host state of a PE or an associated enterprise. Further, the author analyses the changes introduced by the Base Erosion and Profit Shifting (BEPS) Project (in particular Action Plans 7 to 10) concerning the contents of Articles 7 and 9 of the OECD MC 2017. He questions whether they have led to (complete) equal treatment of PEs and associated enterprises with regard to the arm’s length principle (ALP) and the respective profit attribution.

As the issue of transfer pricing is gaining in complexity and is increasingly a factor in (tax) disputes, there is a range of literature in the field. Nevertheless, prior to this study, there was no comparable comprehensive academic research regarding the topic of profit attribution according to Articles 7 and 9 OECD MC 2010 and the changes that the relevant BEPS Action Plans brought in relation to these articles. In a detailed, clear, and structured manner, the author elaborates on the differences and the similarities between Articles 7 and 9 OECD MC pre- and post-BEPS. The book, based on the author’s dissertation that has won the Mitchell B. Carroll Prize 2020, deals with numerous aspects to the discussion and provides suggestions for further tax policy considerations in order to express a uniform understanding of the ALP and profit attribution.

In the first part of the book (Chapter 2), the theoretical foundations of the general and special principles of interpretation of double tax treaties (DTTs) are elaborated. The author describes why an autonomous interpretation of DTTs is necessary and why a static interpretation (instead of a dynamic one) should be preferred. These explanations are then placed in the context of the topic: It is examined whether DTTs and, in particular, the equivalents to Articles 7 and 9 OECD MC therein (defining the framework for the application of the ALP under national tax law) are to be interpreted in light of pre- or post-BEPS guidance. In order to answer this question, a division is made into three groups of DTTs: (1) DTTs that already existed before the update of the OECD MC; (2) DTTs that were concluded after the 2017 update and are based on the respective versions of the OECD materials; and (3) DTTs that were concluded after the 2017 update but negotiated on the basis of an earlier version of the OECD MC. While, for the first group of DTTs, the structural changes made by the BEPS Project have no impact on the interpretation (unless additional measures are undertaken by the treaty partners), the DTTs of the second group must be interpreted considering the OECD MC 2017, the related OECD materials, and the TPG 2017 that contain the results of BEPS Action Points 8 to 10. For the third group of DTTs, the interpretation should be made in accordance with the OECD materials on which they are based (e.g., OECD MC

In the next part of the book (Chapter 3), a comparison of Articles 7 and 9 OECD MC 2010 is made. Within the framework of this analysis, the author distinguishes between the levels of applicability and application. On the first level (applicability), it must be examined whether a PE within the meaning of Article 5 OECD MC 2010 or an associated enterprise according to Article 9 OECD MC 2010 exists. The level of application is subsequently focused on how Articles 7 and 9 OECD MC 2010 are technically applied. The chapter demonstrates that both provisions contain rules on the applicability (first level) and the application (second level) but that there are no conceptual differences that should have a material impact on profit attribution. The fact that Article 7 OECD MC 2010 aims at avoiding legal double taxation whereas Article 9 OECD MC 2010 aims to avoid economic double taxation does not change this conclusion.

Following on from Chapter 3, Chapter 4 provides an assessment of the substantive content of the Articles 7 and 9 OECD MC 2010 and deals with the question of whether the ALP has the same meaning in both provisions. The chapter begins by discussing the historic developments of the ALP, which is an essential principle of international tax law, and the understanding of this principle pre-BEPS. Afterwards, Articles 7 and 9 OECD MC 2010 are interpreted separately whereby a distinction is made between the levels of applicability and application in respect to the principle of profit attribution. With regard to the level of applicability, it is noted that any transaction that is conducted through an associated enterprise effectuates a taxing right of the host state whereas, in the case of a PE, a specific (stronger) territorial connection must exist. Nevertheless, this (marginal) difference does not per se argue against a neutrality of legal forms. However, this principle of neutrality is generally not upheld with regard to the provision of Article 5, paragraph 4 OECD MC 2010 providing for exemptions of a PE. According to the author, from the perspective of profit attribution, there are no legitimate reasons why, for example, activities covered by Article 5 paragraph 4 OECD MC 2010 are treated differently in the case of a PE versus an associated enterprise. Likewise, there appears to be no justification as to why construction/installation projects in the form of a PE are subject to the principles of profit attribution solely after fulfilment of a certain period of time (Article 5 paragraph 3 OECD MC 2010). When these activities are carried out by associated enterprises, they are subject to the profit attribution from the very beginning. The study of historical OECD materials, however, shows that this structuring option with respect to the ‘exemption rules’ and the construction/installation projects in the case of a PE corresponds to the will of the drafters of the OECD MC primarily from the (historic) understanding of nexus.

Concerning the level of application, a distinction is made between the level of application on the merits and level of application to the extent. In the first step (application on the merits), it is examined whether the business transaction is to be qualified as a ‘dealing’ according to Article 7 OECD MC 2010 (in the case of a head office and its PE) or as a ‘transaction’ in accordance with Article 9 OECD MC 2010 (in the case of associated enterprises). In this context, the author highlights a significant difference between the articles. Under Article 7 OECD MC 2010, the profit attribution is essentially triggered by the significant people functions performed by each party of the enterprise. In contrast, Article 9 OECD MC 2010 focuses on the significant functions. The difference can be shown by an example of a ‘server PE’: The host state may have an abstract taxing right, but cannot attribute profits to the PE due to the lack of significant people functions being performed. If the same (automated and person-less) activity was carried out by an associated company having the same function and risk profile, there would be a need for an adequate remuneration for these activities. Hence, PEs and associated enterprises are not treated equally on the level of application on the merits pre-BEPS.

In a second step (application to the extent), the transactions/dealings have to be priced. According to the author, no material differences on this level pre-BEPS can be identified. This is due to the fact that the 2010 update of the OECD MC with regard to Article 7 Authorized OECD Approach (AOA) has resulted in a consistent function- and fact-based understanding of the ALP. According to both provisions (Articles 7 and 9 OECD MC 2010), profit attribution has to be determined by the ‘actual conduct of the parties’.
The third part of the book (Chapter 5) contains a detailed analysis of the BEPS Action Plans 7 to 10 followed by a discussion of their impact on the principle of profit attribution according to Articles 7 and 9 OECD MC 2017 on both the level of applicability and application. At the outset, it is emphasized that the structural changes resulting from the BEPS Project can only fully affect DTTs concluded on the basis of the OECD MC 2017 (see Chapter 2 of the book). The proposals of BEPS Action Plan 7, which were implemented by the OECD update 2017 in Article 5 OECD MC, led to a change of the requirements for the establishment of a PE (level of applicability). The revised provision of Article 5 OECD MC are intended to prevent the artificial circumvention of the PE status through the specific activity exemptions and the agency PE definition. Such circumvention will be avoided by the clarification of exempted activities including what is referred to as an ‘anti-fragmentation rule’. Furthermore, the author addresses several questions in connection with an agency PE. Based on the relevant OECD materials, it is shown that the OECD continues to adhere to the ‘dual-taxpayer’ approach even in the fact pattern of the ‘zero-sum-theorem’ (for which no profit can be allocated to the agency PE). This means that, although a dependent agency PE within the meaning of Article 7 OECD MC 2017 exists, profits cannot be attributed to this PE if the dependent agent enterprise (typically a subsidiary) is properly remunerated at arm’s length under Article 9 OECD MC 2017. The ‘dual-taxpayer’ approach in the form of the ‘zero-sum-theorem’ is criticized by the author as it leads to an increased administrative burden for tax authorities and taxpayers while not providing for an additional profit attribution to the host country. In summary, although the PE threshold has been substantially reduced by the BEPS Action Plans, the author concludes that the neutrality of legal forms between PEs and associated enterprises on the level of applicability is still not provided post-BEPS.

At the level of application on the merits of Articles 7 and 9 OECD MC 2017, the BEPS Project did not result in any changes to Article 7 AOA OECD MC, which is why no equal treatment is later accorded. For example, certain ‘dealings’ between the head office and its PE are still not recognized while all (business) transactions between associated companies must be priced at arm’s length. As before BEPS, there remains a neutrality of legal forms on the level of application to the extent (see Chapter 4 of the book). This is clarified by the amendments made in light of the BEPS Project. Due to BEPS Action Plans 8 to 10, the ALP in Article 9 OECD MC 2017 – as well as in Article 7 OECD MC 2017 – are to be interpreted according to the ‘actual conduct of the parties’. Thus, both provisions lead to the same result post-BEPS under similar fact patterns.

In the seventh and last chapter, tax policy considerations are made. In this context, the author discusses whether there is a need for two separate regulations governing profit attribution (Articles 7 and 9 OECD MC 2017) and whether they can be merged in order to emphasize the consistency of understanding the ALP and its application. Although there are some scoping differences between the two articles, a number of arguments regarding the functioning and purpose of both provisions advocate for a uniform profit attribution and a revision of the current provisions. At this point, the author proposes two solutions: On the one hand, Article 9 OECD MC 2017 could be completely removed and Article 7 OECD MC 2017 comprehensively reformed instead as a central ALP rule. Alternatively, the profit attribution rules of Article 7, paragraphs 2 and 3 OECD MC 2017 could be incorporated into Article 9 OECD MC by which Article 9 OECD MC 2017 would function as a general ALP rule and provision on profit attribution.

Overall, the book ‘Die Ergebnisabgrenzung bei verbundenen Unternehmen und Betriebsstätten post BEPS’ is strongly recommended for anyone working in the field of transfer pricing. With the support of several examples, the theoretical background is presented in a very systematic and comprehensible manner which is why the book is highly interesting and suitable for both academics and practitioners. The critical analysis of the provisions of Articles 7 and 9 OECD MC 2010/2017 from the perspective of neutrality of legal forms will, in any case, provide input for further discussions in addition to the current discourse on pillar one.

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Footnotes