Comparative Survey

The French Supreme Administrative Court recently decided in the Zimmer case that a French subsidiary of a foreign parent company, which operated in France under French law as a commissioner, did not constitute a taxable French permanent establishment in France of the foreign company. The case has been explained in July/August issue of the International Transfer Pricing Journal by Mr. Pierre-Jean Douvier and Ms. Xenia Lordkipanidze (2010, Vol. 17, No. 4). The present issue features a comparative overview on this subject, covering several countries. More country reports about this matter will also be published in the next issue.

Netherlands

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and Jorn Tiele

Commissionaire/Agency Permanent Establishment Structures

Part of the Comparative Survey. The French Supreme Administrative Court recently decided in the Zimmer case that a French subsidiary of a foreign parent company, which operated in France under French law as a commissioner, did not constitute a taxable French permanent establishment in France of the foreign company. The case has been explained in “Zimmer Case: The Issue of the Deemed Existence of a Permanent Establishment Based on Status as a Commissioner” by Mr Pierre-Jean Douvier and Ms Xenia Lordkipanidze (17 International Transfer Pricing Journal 4, 2010). Country report about this issue on the Netherlands.

1. Introduction

Commissionaire structures, limited risk structures and other types of centralized business models have been on the radar of the Dutch tax authorities for many years. With the OECD revisions introduced on 22 July 2010, the OECD Transfer Pricing Guidelines (OECD Guidelines) have undergone a complete transformation. However, already prior to the OECD Discussion Draft on Transfer Pricing Aspects of Business Restructurings and the OECD Discussion Drafts regarding comparability and profit-based methods, the Dutch tax authorities have been at the forefront with regard to how to apply the arm’s length principle to these types of centralized business models. Rather than taking a very legalistic view, the Dutch tax authorities have focused much more on the economic reality and associated alignment between functions and risks. In fact, today’s international focus on the concept of “managing and controlling risks” reflects an approach that had already been introduced in the Dutch regulations back in 2004.1

Outside of transfer pricing, one of the key risks of a centralized business model relates to the fact that local “sales” activities may create a permanent establishment of the foreign principal in a host country to which potentially additional profits would be allocated. Recent international court cases do confirm that such risks should not be overlooked.

This article elaborates on the potential impact of the Zimmer case on the Dutch tax and transfer pricing practice and the relationship with the Dutch tax framework for (dependent agent) permanent establishments. Furthermore, this article provides insight into the relative emphasis on transfer pricing exposure versus permanent establishment exposure under the Dutch regulatory environment and enforcement of the Dutch rules in practice.

2. Dutch Tax Framework for Permanent Establishments

2.1. Generally

The Dutch tax framework for defining permanent establishments in general, and more specifically in the context of centralized business models such as commissioner models, basically follows similar considerations as in most other OECD countries. Nonetheless, to understand the specific Dutch framework for permanent establishments in relation to centralized business models with a non-Dutch principal, one must consider not only domestic tax law and jurisprudence, but also applicable Dutch income tax treaties.

In addition, the OECD Model Convention (OECD Model) and the Commentary thereto are quite important sources of information (see below).2 The use of the term “permanent establishment” below also includes the

2. There are several references in Dutch jurisprudence. See e.g. Supreme Court case VN 1992, at 3407 (considering withholding tax on dividends): VN 1995, at 2561 (considering an insurance agent BV). In both cases, the Court referred to guidance in the OECD Model Convention and the Commentary thereto.

* Ernst & Young Transfer Pricing & Tax Effective Supply Chain Management Group, Amsterdam. The opinions expressed in this article are those of the authors and not necessarily those of the firm. The authors would like thank Jeroen Kuppens, a Director in the Ernst & Young Transfer Pricing & Tax Effective Supply Chain Management Group for his valuable input to this article.
term "permanent representative", which is a form of permanent establishment for tax treaty and OECD purposes.

Under Art. 7.2(2)(a) of the Individual Income Tax Act 2001 (IITA), profits from "a domestic enterprise" (i.e. a permanent establishment) of a non-resident taxpayer are taxable in the Netherlands. However, the IITA does not contain a general definition of permanent establishment. For non-resident corporate taxpayers, Art. 17a of the Corporate Income Tax Act 1969 (CITA) covers taxation rights. Again, the CITA also does not contain a definition of permanent establishment. Although a definition of permanent establishment can be found in the Decree on Avoidance of Double Taxation 2001 (the Decree), in principle it is valid only for purposes of the Decree. Art. 2 of the Decree describes a permanent establishment as "a fixed place of an enterprise through which the activities of that enterprise are being wholly or partly carried on". In addition, the same article of the Decree describes what does not constitute a permanent establishment. Apart from this, there is not much guidance in domestic law or the legislative history regarding permanent establishments. In the legislative process, however, it has been stated that the Netherlands conforms to the definitions and explanations in the OECD Model.

The main source for determining what constitutes a permanent establishment or permanent representative can be found in Dutch tax jurisprudence. Due to the lack of guidance under domestic rules, the actual jurisprudence however, often cites the OECD Model and the Commentary thereto when dealing with permanent establishments. The OECD Model provides much more precise definitions of permanent establishments/permanent representatives, and also contains provisions that describe what particularly constitutes a permanent establishment (or not). In fact, the Commentary to the OECD Model contains quite elaborate guidance, including explanations and examples, regarding what does (and does not) constitute a permanent establishment. The majority of permanent establishment articles in Dutch income tax treaties are based on, and very similar to, the OECD Model definition of a permanent establishment in Art. 5. By almost mirroring the OECD Model articles concerning permanent establishments, the Dutch parliament appears to confirm in an implicit manner that the Commentary to the OECD Model is very relevant and serves as guidance for the definition of a permanent establishment for Dutch tax purposes.

Most Dutch treaties (in accordance with Art. 5(1) of the OECD Model) define a permanent establishment as "a fixed place of business through which the business of an enterprise is wholly or partly carried on."

Art. 5(5) of the OECD Model and its equivalent in most Dutch treaties state that a person, other than an independent agent, who acts on behalf of an enterprise situated outside a contracting state (e.g. the Netherlands) and regularly exercises the authority to conclude contracts in the name of such enterprise, is a permanent establishment of that enterprise (as under the OECD Model the term "permanent representative" as such is not used). This applies to any activities undertaken by that person on behalf of the enterprise, except activities excluded from the definition of permanent establishment under Art. 5(4) of the OECD Model.

Finally, most Dutch tax treaties and the OECD Model explicitly state (in Art. 5(6)) that a broker or any other independent representative is not a permanent representative if such person acts in the ordinary course of his or her own business.

2.2. Dependent sales agent

2.2.1. Generally

Specifically in relation to commissionaire and other limited-risk type of sales structures, the dependent sales agent permanent establishment reflects a key area of permanent establishment exposure.

Although the definition in the Decree is phrased negatively and is only valid for purposes of the Decree, it provides some guidance on how the term "dependent agent" should be defined. Under Art. 2 of the Decree a representative is not a dependent agent permanent establishment if:
- it is fully independent; or
- it is not authorized to conclude contracts.

However, according to the Commentary to this article, one can assume that the definition in the Decree does not deviate substantially from the definition contained in Dutch tax treaties, which are in general based on the OECD Model. Following the case law with regard to Dutch tax treaties, a dependent agent permanent establishment is deemed to exist if the following criteria are met:
- the representative has permanent authority to conclude contracts in the name of the foreign enterprise;
- the representative to a certain extent is dependent on the company he is representing;
- the authority to conclude contracts is exercised habitually; and
- the activities performed by the representative are in line with the activities of the foreign enterprise.

Although the representative should have the authority to bind the foreign enterprise to business activities in the Netherlands, a formal authorization does not seem to be required. It is also not required that the representative literally act in the name of the principal. In such a case a permanent establishment can be deemed to exist if the customers know to which entity they are bound based on other facts and circumstances.

It could be argued that the Dutch Supreme court supports a view that if the criteria of Para. 5 are met (i.e. a permanent establishment exists), it is still possible to

3. For example, Court of Amsterdam, 11 December 1995, 948/80, V.N. 1986, at 1982.
5. Supreme Court, 20 November 1940, at 7230.
avoid a permanent establishment classification by meeting the criteria of Para. 6.

Finally, in the Cargadoors case, the Dutch Supreme Court stated that a commissioner can be considered a species of an independent agent in the OECD Model. This arguably also provides room for asserting that a commissioner does not qualify as a dependent agent permanent establishment.

2.2.2. Commentary to the OECD Model

The Commentary to Art. 2 of the Decree states that the definition of a dependent agent permanent establishment does not deviate substantially from the definition provided in Dutch tax treaties. These tax treaties are in general based on the OECD Model, including Art. 5(5). Therefore, the Commentary to the OECD Model is of great importance when analysing whether a dependent agent permanent establishment exists in the Netherlands.

The Commentary to Art. 5(5) of the OECD Model explains in detail what can be considered a dependent agent and what cannot. It seems that the OECD Model is in favour of a more factual approach instead of a legalistic approach when analysing whether a permanent establishment exists. Para. 32.1 of the Commentary, for example, states that agents can create a permanent establishment even if the contracts are not actually concluded in the name of the principal. Furthermore, Para. 33 states that a person may have the authority to conclude contracts even if a person has not been formally given a power of representation.

Although the Dutch tax authorities will use the legal agreement as the starting point for their analysis, they are increasingly more focused on the actual conduct of parties. For example if a representative is contractually not allowed to bind the foreign principal to its customers, but in fact does so (which by itself is an area of interpretation), it is possible that the Dutch tax authorities would claim that a Dutch dependent agent permanent establishment exists. However, it is not likely that this will happen often in practice because the Dutch tax authorities have so far favoured transfer pricing approaches above permanent establishment assertions in these types of cases.

3. Interpretation Aspects of Dependent Agent Permanent Establishments

The previous section described the theoretical framework which should be considered when analysing whether a Dutch dependent agent permanent establishment exists or not. The section below elaborates on the four criteria (i.e. in the name of, habitually, independence, ordinary course of business) which should be met before activities in the Netherlands constitute a dependent agent permanent establishment and discusses the underlying interpretation aspects of these criteria.

Although the Commentary to the OECD Model provides guidance on how to interpret the four criteria, there is certainly a grey area that is further discussed below from a Dutch perspective.

3.1. Acting in the name of

In discussions about dependent agent permanent establishments, reference is made to the terms “in the name of”, an authority to conclude contracts and “binding on”. The relationship between these various terms is not entirely clear, and opinions with regard to the each of these terms tend to differ.

Several authors argue that “in the name of” actually means “binding on”, while others argue that “in the name of” must be read literally. According to the Dutch Commentary to tax treaties, it is not required that the representative literally act in the name of the principal. It is sufficient that customers know to which entity they are bound based on other facts and circumstances.

There is also no consensus with respect to the meaning of “authority to conclude contracts”. Some authors argue that this should be read in a strict legal sense, whilst others argue that the actual facts and circumstances are more decisive (i.e. substance over form).

Based on the Dutch Commentary to tax treaties, it appears that the actual facts and circumstances should be considered as decisive, as a formal authorization as such does not seem to be required to establish that there is an authority to conclude contracts. A similar conclusion can be derived from a decision of the Dutch court of appeal, which ruled that a Dutch resident could be considered to trigger a permanent establishment although it had the formal authority to conclude contracts. In other words, substance-over-form considerations play an important role.

There is also no consensus on the meaning of “binding on”. On the one hand, it can be argued that a principal is never bound by a commissioner because a commissioner acts in its own name and does create a relationship between itself and the customers, and not between the principal and the customer. Under this view, the commissioner, by definition cannot create a permanent establishment. On the other hand, Art. 7:421 of the Dutch Civil Code states that under specific circumstances (e.g. bankruptcy of a commissioner), the principal is ultimately bound to the commissioner’s customers. Furthermore, a commissioner binds the principal to economic risks, as it acts for the account and risk of the principal. As a result, a Dutch commissioner can have binding power to the principal under specific circumstances.

Although it is not unreasonable to assume that a substance-over-form approach will prevail in the Netherlands, Dutch courts have so far provided only limited guidance on the specific interpretation of the various terms described in this section.

7. Supreme Court, 15 June 1988, BNB 1988/258, Para. 4.3.
8. Supreme Court, 20 November 1940.
3.2. Habitually exercising

When analysing whether the commissioneer habitually exercises its authority, it seems to be required to apply a permanence test (e.g. for how long in time) and a frequency test (e.g. the number of times). The Ministry of Finance described that the authority to conclude contracts for several years can be considered to have a sufficiently permanent nature to attract permanent representative status. Furthermore, whether contracts are concluded frequently depends on the characteristics of the contracts. As a result it may be the case that a commissioneer which concludes only few large contracts in a year will trigger a permanent establishment.

3.3. Independence

In the Cargadoors case, it was ruled that a person with an independent status should be independent from both a legal and economic perspective. Whether this is the case, should be analysed on a case-by-case basis. An important factor that should be taken into account when analysing whether a party is legally independent, is whether receiving and following detailed instructions can be considered as common practice within the respective industry.

Whether there is economic dependency should also be analysed on a case-by-case basis. There are no defined thresholds for meeting the economic independence criterion.

With regard to economic dependency, whether a Dutch entity has only one principal during the whole or part of its existence is an important factor, but not determinative by itself. In 1988 case, the Supreme Court ruled that for purposes of determining whether a representative is a permanent representative, the number of principals concerned is one relevant factor. However, in centralized business models, often there is only one principal. As the discussion regarding the number of principals is only one element for the economic dependency issue, other requirements for (avoidance of) economic independence should be carefully managed.

In the same 1988 case, the Supreme Court ruled that in order not to be economically dependent, the local enterprise must decide regarding its own entrepreneurial activities instead of being subject to detailed instructions from its principals. In other words, economic dependency can be avoided by a local Dutch entity if that entity is responsible for its own entrepreneurial activities and also bears the associated (but limited) risks in this regard. This entails a careful balance of dividing roles and responsibilities between the principal and the local operating company, and the underlying transfer pricing/remuneration model. Thus, whether the number of principals is a decisive factor remains to be seen. Although it is widely argued that having only one principal is a strong indication of having a certain degree of economic dependence, within different industries one may see many non-exclusive agent or distributor relations that frequently change. In other words, if third-party examples provide indications of alternative options available, this arguably also impacts the level of economic dependence. Therefore, other important factors may include the following:

- whether the agent also performs activities for its own account;
- whether the agent bears (certain) entrepreneurial risks; and
- the agent’s remuneration model.

3.4. Ordinary course of business

When analysing whether a dependent agent permanent establishment exists, it is important to assess whether the agent acts in the ordinary course of its business. However, it is not entirely clear whether this should be assessed from a subjective (i.e. how does the respective agent itself operate) or an objective (i.e. how do agents in general operate) perspective.

Based on various Dutch court cases, it seems to be the case that the analysis should be performed from an objective perspective. This also seems to be in line with comment 38.8 to Art. 5(6) of the OECD Model. To avoid a permanent establishment classification discussion, the agent should act in accordance with general industry principles.

4. Authority to Negotiate Contracts

4.1. Dutch tax law

As discussed above, Dutch law regarding permanent establishments in general follows the guidance provided by the OECD and the Commentary thereto. This entails that the Dutch tax authorities in general apply a substance-over-form approach, consistent with the OECD approach.

Similar to what is described in the Commentary to the OECD Model, a Dutch agent may be considered to have the authority to conclude contracts if it solicits and receives orders without formally finalizing them, and those contracts are routinely approved by the principal (i.e. so-called rubber stamping). In such a case, the agent creates a dependent agent permanent establishment for the foreign principal, assuming that the other criteria are met as well.

Unlike to a Dutch agent, a commissioneer is allowed to negotiate and conclude contracts with its customers. This will not create a Dutch dependent agent permanent establishment as long as the commissioneer is binding itself to its customers, and not the principal. As soon as a commissioneer is in fact binding the customers to the principal, this will constitute a dependent agent permanent establishment.

10. Decree of 16 November 2004, IFZ2004/828M.
12. For example, Supreme Court, 15 June 1988, BNB 1988/258.
13. Para. 31.1 Commentary to Art. 5(5) of the OECD Model.
4.2. Dutch Civil Law

Under Dutch law, commissioner agreements are based on Art. 7:414 of the Dutch Civil Code, which covers the concept of "lasteving" (effectively a form of mandate). This article describes that an intermediary can engage in legal transactions for a principal. Based on the agreement between the intermediary and the principal, the intermediary should do this in its own name or in the name of the principal. In the first case the intermediary will operate as commissionaire, while in the second case it will operate as agent.

Because a commissionaire will typically conclude contracts with its customers in its own name, and not in the name of the principal, the permanent establishment exposure in a commissionaire model is in theory relatively remote. However, as discussed above, the tax authorities may assess cases more from a factual perspective. Commissioner in practice may bind the principal to the local customers, and therefore may create a dependent agent permanent establishment.

5. Approach of the Dutch Tax Authorities

5.1. Consequences of the Zimmer case

In the Zimmer case, the French Conseil d’Etat ruled that Zimmer SAS did not create a permanent establishment of Zimmer Ltd, unless the latter is bound by the contracts concluded by Zimmer SAS. However, this was not the case because the commissionaire agreement did not evidence that the Zimmer Ltd was bound by the contracts concluded by Zimmer SAS.

In the authors opinion, this ruling, in which a legalistic approach was applied, will not have a significant impact on Dutch tax and transfer pricing practice as such. The Dutch tax authorities in general take a more factual (rather than legalistic) approach. Although contracts may and will be used as the basis for their analysis, they will also analyse the actual facts and circumstances (i.e. substance over form). If the Dutch tax authorities are of the opinion that more profits should be allocated to the Dutch activities, they have so far favoured challenging the transfer prices applied between the commissionaire and its principal. This is arguably partially driven by the fact that the tax authorities may have more difficulties in proving that a permanent establishment exists in the first place.

5.2. Tools to challenge commissionaire structures

The design of a company’s operational structure is intertwined with the discussion about potential tax and transfer pricing risks. Especially centralized business models using sales entities with limited functional, risk and asset profiles (e.g. commissioners, agents) are often challenged by the tax authorities.

The tax authorities can test whether the actual conduct of the parties (e.g. commissionaire versus principal) is in line with the commissionaire agreement. If the substance (i.e. activities performed in the Netherlands) overrides the legal form and limitations of the commissionaire contract, and the commissionaire factually binds the principal, the Dutch tax authorities may be able to claim that the Dutch commissionaire creates a permanent establishment for the foreign principal. In such a case, the tax authorities have taxing rights over two legal entities, namely the commissionaire and the foreign principal (which has a dependent agent permanent establishment in the Netherlands). As a result, the tax authorities in principle have two possibilities for challenging the profits allocated to the Dutch activities.

On the one hand, the Dutch tax authorities may claim that the division of profits between the principal and the commissionaire is not in line with the division of functions, risks and assets. The commissionaire should in principle receive a basic remuneration for the routine and limited-risk activities performed. However, if the commissionaire also performs some significant people functions that manage a part of the principal’s enterprise in the commissionaire’s country and a permanent establishment is present, the permanent establishment should be allocated additional profits for these additional functions performed, as well for the additional risk managed locally and assets used. The profit that should be allocated to the dependent agent permanent establishment will be the difference between the arms length profit for the combined Dutch activities (e.g. permanent establishment and commissionaire) less the basic return that was already allocated to the Dutch commissionaire itself. This alternative is illustrated by the following example.

A company has a centralized business model with its head office in country A and 10 commissioners in various countries, of which one is located in country B. It is assumed that the commissionaire creates a permanent establishment for the head office. However, the activities performed in country B are not considered to reflect significant people functions. As a result, no additional profits should be allocated to the Dutch activities, as the commission paid to the commissionaire was already arm’s length.

Illustration 1

<table>
<thead>
<tr>
<th>Whole enterprise (in 10 countries, head office in A)</th>
<th>Commissioner/ legal entity (country B)</th>
<th>Permanent establishment (in country B)</th>
</tr>
</thead>
<tbody>
<tr>
<td>turnover 10,000</td>
<td>turnover 1,000</td>
<td></td>
</tr>
<tr>
<td>COGS 7,000</td>
<td>COGS 750</td>
<td></td>
</tr>
<tr>
<td>gross profit 3,000</td>
<td>commission 250</td>
<td>gross profit 250</td>
</tr>
<tr>
<td>OPEX/SGA 2,000</td>
<td>OPEX/SGA 200</td>
<td>OPEX/SGA 250</td>
</tr>
<tr>
<td>operating profit 1,000</td>
<td>operating profit 50</td>
<td>operating profit</td>
</tr>
</tbody>
</table>

1. Commission is less as a percentage than the gross profit of the "whole enterprise", because the commissionaire assumes less risk and therefore should receive less "reward".
2. OPEX/SGA as a percentage is more or less the same as the OPEX/SGA of the "whole enterprise".
3. COGS is higher as a percentage of turnover because less risk is managed in country B and borne in country A instead.
4. OPEX FE is equal to the commissionaire’s commission.
The authors believe that additional profits can be allocated to the permanent establishment only if the original transfer price between the principal and the commissioneer was not arms length. Thus, this could happen only if the commissioneer were not properly remunerated for its functions performed, assets used or risks assumed. This is, for example, the case if the commissioneer also employed significant people functions which manage specific risks of the principal for which the commissioneer has not been remunerated. Under such circumstances, the Dutch tax authorities may allocate this functionality, the related risks and assets, and an appropriate remuneration to the permanent establishment, in addition to the basic remuneration for routine activities that was already allocated to the commissioneer.

Illustration 2

<table>
<thead>
<tr>
<th>Whole enterprise (in 10 countries, head office in A)</th>
<th>Commissioneer/ legal entity (country B)</th>
<th>Permanent establishment (in country B)</th>
</tr>
</thead>
<tbody>
<tr>
<td>turnover 10,000</td>
<td>turnover 1,000</td>
<td></td>
</tr>
<tr>
<td>COGS 7,000</td>
<td>COGS 720</td>
<td></td>
</tr>
<tr>
<td>gross profit 3,000</td>
<td>commission 280</td>
<td></td>
</tr>
<tr>
<td>OPEX/SGA 2,000</td>
<td>OPEX/SGA 200</td>
<td></td>
</tr>
<tr>
<td>operating profit 1,000</td>
<td>operating profit 80</td>
<td></td>
</tr>
</tbody>
</table>

As the commissioneer/permanent establishment is managing more risks than in the first situation, the head office can only “sell” its products to the commissioneer/permanent establishment at a lower price. The commissioneer’s profitability will not change, as its commissioneer (as a percentage of sales) and its operating expenses (OPEX) remain the same. However, because of the additional functionality of the permanent establishment vis-à-vis the head office, the COGS of the permanent establishment should be lower. As a result, the permanent establishment is allocated additional profits amounting to 30.

On the other hand, the Dutch tax authorities may challenge the “transfer prices” applied between the principal and the commissioneer, as the division of profits is not in line with the division of functions, risks and assets. The tax authorities may adjust the “transfer price” (i.e. commission), which will have an impact on the commissioneer’s profitability, but not on the permanent establishment’s.

Illustration 3 (please compare to Illustrations 1 and 2)

The financial impact of both alternatives (i.e. transfer pricing versus permanent establishment) is similar for both the tax authorities and the company as a whole. However, contrary to tax authorities in certain other countries, the Dutch tax authorities are in favour of using the first alternative (i.e. transfer pricing) to ensure that sufficient profits are allocated to Dutch activities. This is partially due to the notion that it is easier to examine and challenge transfer prices than seek to claim the existence of a permanent establishment and determine the amount of profits that should be allocated to it.

Therefore, the authors believe that from a Dutch perspective the permanent establishment discussion in the context of commissionaires principally is an academic discussion because it has few practical implications, especially if the transfer prices are correct. Nonetheless, the authors note that if a commissioneer creates a permanent establishment for its foreign principal, this in theory does create an obligation for the principal to file a Dutch tax return on an annual basis.

5.3. Impact of the Report on the Attribution of Profits to Permanent Establishments

On 17 July 2008, the OECD published the final Report on the Attribution of Profits to Permanent Establishments (the Report). This report acknowledges the use of the authorized OECD approach for allocating profits to permanent establishments, including dependent agent permanent establishments. Based on this approach, the permanent establishment should be allocated the profits it would have earned at arms length if it would have been a legally and/or functionally distinct and separate enterprise. The same applies to dependent agent permanent establishments. However, there will be two separate taxpayers in the Netherlands if a dependent agent permanent establishment exists: on the one hand the local agent/commissioneer, while on the other hand the foreign principal through its permanent establishment. Therefore, local functions should be segregated in functions undertaken by the agent/commissioneer on its own account and those performed on behalf of the foreign principal. The same applies for risks, assets and free capital. The Dutch tax authorities also apply the distinct

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and separate entity approach when allocating profits to permanent establishments.

As the OECD and Dutch approach for the allocation of profits to a permanent establishment are in theory the same, the impact of the Report will not be significant. However, with regard to certain allocation issues (e.g. alternatives for the attribution of free capital), the Report leaves some freedom to the local tax authorities. Therefore, two countries (e.g. head office versus permanent establishment country) may in the end have a different view on the amount of profits that should be allocated to the permanent establishment.

Finally, it is expected that the Dutch tax authorities will issue a Decree that specifically comments on both the Report and the new Art. 7 of the OECD Model. It is expected that this Decree will specifically state that the Dutch policy is geared towards ensuring that agents are remunerated in a manner consistent with the arm’s length principle. If the agent’s return is arm’s length, in cases where a dependent sales agent as such triggers a permanent establishment, no additional profits will be allocated to the permanent establishment.

5.4. Importance of economic parameters

The Dutch tax authorities, similar to most other tax authorities, typically analyse a company’s overall profitability during tax and transfer pricing audits. In addition, they will analyse whether the division of functions, risks, assets and profits can be considered arm’s length. Therefore, tax authorities in general will make a comparison of the profits realized by a commissionaire and those realized by the entity as a whole (i.e. head office including permanent establishments). In addition, tax authorities may analyse the profits realized in the complete value chain. It is likely that the tax authorities will focus more on the appropriateness of the transfer prices and the existence of a dependent agent permanent establishment if it seems that the foreign head office’s profit or the profits in the entire value chain are much higher than the commissionaire’s profit. The recently released new OECD Guidelines include many considerations for opting for two-sided approaches, and also have elevated the status of profit split approaches. This will most likely increase the focus on total value chain profits.

The authors expect that the Dutch tax authorities will also focus more on structures where the gap between the principals and the commissionaire’s profits is considerable. However, the tax authorities will analyse whether this division is in line with the functional, risk and asset profiles of the various entities. If this is not the case, it is more likely that they will challenge the transfer prices applied by the principal and commissionaire instead of claiming that a dependent agent permanent establishment exists in the Netherlands.

5.5. Transfer pricing methods applied

When the Dutch tax authorities successfully claim that the activities of a Dutch commissionaire create a dependent agent permanent establishment of the foreign principal, in theory an arm’s length profit should be allocated to this permanent establishment (instead of adjusting the transfer price applied between the principal and commissionaire).

The question is how to split the remuneration of the commissionaire function and the dependent agent permanent establishment function. Under Art. 7(2) of the OECD Model, a permanent establishment should be allocated the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment. The authors therefore believe that a dependent agent permanent establishment should realize the same profits as comparable third parties.15 In other words, the remuneration method commonly used within the industry (e.g. percentage of turnover, fixed fee per closed contract) and the amount of profits realized should be similar.

Again, based on experience it seems that the tax authorities are more inclined to adjust the transfer price applied between the principal and commissionaire as compared to pursuing the permanent establishment alternatives.

5.6. Dutch treatment of conversion

Transfer pricing aspects of business restructurings have been high on the agenda of the Dutch tax authorities for many years. In principle, the Dutch treatment of conversions is similar for both inbound and outbound restructurings. The Dutch tax authorities may understand the business reasons for a specific restructuring. However, they will try to understand which parties perform the key significant people functions and whether assets and risks are allocated appropriately. The tax authorities will mainly focus their analysis on potential conversion issues and the transfer pricing model applied pre- and post-restructuring, in a manner that is consistent with the newly released OECD Guidelines.

With regard to business restructurings, there are only a few cases that provide insight into relevant precedents. There is a Lower Tax Court ruling covering the conversion from a distributor to a commissionaire.16 In this particular case, the profit realized by a Dutch BV (amounting to NLG 10 million) acting as a distributor under a distribution agreement with its US parent, was reduced to only NLG 1 million under a new commissionaire relationship. The tax inspector argued that such a change in contractual conditions provided a justification for an indemnification.

The tax inspector used two arguments, namely that there had been (1) a transfer of profit-generating capacity (goodwill) out of the Dutch tax jurisdiction and (2) non-

15. See e.g. Van Bunschot in its note to the Cargadores case (BNB 1988/258*).
arm’s length dealings with regard to the amount of the goodwill. The first argument was not specifically addressed by the Court due to the particular fact pattern, and the second argument was rejected by the Court because the inspector was not able to substantiate that the taxpayer had been able to claim damages upon termination of the distribution agreement in this particular case. However, this part of the ruling has not been appealed (to the Supreme Court), and therefore has not been ruled upon by the Supreme Court. Nevertheless, the Court’s ruling seems to imply that the concept of damages upon termination of an agreement is one element of testing the arm’s length nature of dealings in conversion cases.

Typically, the (deemed) transfer of a marketing intangible is the main point of scrutiny, as well as the contractual arrangements (e.g. indemnification/compensation rights, termination clauses). The Dutch tax authorities tend to focus less on potential permanent establishment issues (with the exception for intellectual property structures), especially if the transfer prices applied are in accordance with the arm’s length principle.

In order to avoid potential conversion risks, it may be helpful to discuss business restructurings with the Dutch tax authorities upfront in an advance pricing agreement (APA) process. By doing this, a company may be able to avoid the non-Recognition of the restructuring and potential conversion issues. Furthermore, a company may be able to agree with the tax authorities on the future transfer pricing model to be applied. Obtaining an APA has proven to be an effective and efficient instrument to avoid controversy.

6. Conclusion

Recent cases adjudicated by courts in various countries (e.g. France, Norway) may lead to an increased awareness of the potential permanent establishment exposure of existing commissioner structures. Tax authorities may pay more attention to challenging these structures, while companies may feel pressured to focus more on managing the permanent establishment risks.

The authors expect that the recent developments will not have a significant impact on the approach of the Dutch tax authorities in tax and transfer pricing audits. If necessary, they will prefer to adjust transfer prices rather than engage in controversy about whether a permanent establishment exists or not, and if so, what is the arm’s length remuneration that should be allocated to it. Outside of commissioner structures, especially in cases whereby intellectual property has been migrated outside the Netherlands, there is a greater appetite for permanent establishment claims. As mentioned in this article, the Dutch tax authorities are expected to issue a Decree that provides more guidance (and interpretation) about the Report and the new Art. 7 of the OECD Model.

Most practitioners would embrace the approach that the dependent agent permanent establishment’s profit attribution is zero once it has been established that the dependent agent enterprise has been compensated in an arm’s length manner. In other words, the arm’s length remuneration of the dependent agent enterprise does not leave room for an additional profit attribution to the dependent agent permanent establishment. The rationale for this approach hinges on the premise that an appropriate remuneration of the dependent agent enterprise for the functions it performed, risks it assumed and assets it owned would leave no room for additional profit attribution if there were no other functions performed, assets owned or risks assumed in the host country.

The OECD Report emphasizes that this “single taxpayer approach” for dependent agent permanent establishments would not be consistent with the authorized OECD approach for other types of permanent establishments, and is therefore not acceptable from a consistency perspective. Although the Netherlands may favour the pragmatic approach, outside of the Netherlands, Dutch taxpayers are very much aware of the increased pressure from tax audits abroad, with tax authorities claiming that the company has a foreign dependent agent permanent establishment. Nonetheless, if transfer prices are aligned with the arm’s length principle, the entire permanent establishment discussion should become a rather academic discussion instead of a true exposure area.17