

Impact of OECD BEPS Action 7 proposals on modification of Articles 5(4), 5(5) and 5(6) of OECD Model Convention

An evaluation of Action 7 on the future of intra-group transactions and business models of MNEs in their cross-border investments

Abstract

The notion of permanent establishment (PE) is one of the most important issues in treaty-based international fiscal law; it is perhaps the single most important and dynamic one, too.

With openness in economies, globalisation and rapid development of e-commerce business models, there is a complete change in the way business is carried out throughout the world by multinational companies (MNE). Traditional ways of doing business have given way to modern and rather flexible ways of operating globally. Naturally, taxing rules need to keep up the pace at which businesses are evolving. It is extremely crucial that taxes are paid at the place where substantial activity and operations of multinationals effectively take place. To achieve this, the Organisation of Economic Co-Operation and Development (OECD) Base Erosion and Profit Shifting (BEPS) Project identifies Action 7 to prevent the issues of artificial avoidance of PE status. This Action seeks to revamp the definition and scope of PE as is currently existing in Article 5 of the OECD Model Convention on Income and on Capital.

Whilst examining the recommendations of BEPS Action 7, the authors will analyse how the existing rules of Article 5(4) (dealing with preparatory and auxiliary activities), Article 5(5) (dealing with Agency PE rule) and Article 5(6) (dealing with exclusion for Independent Agents) are likely to be modified. The authors will also evaluate how these changes are likely to have an impact on Singapore's existing treaties (if these changes are re-negotiated in existing treaties, whether bilaterally or through the BEPS Multilateral Instrument (MLI)). The paper will also shed light on how these changes could impact business models and supply chains in a post-BEPS world.

It must be noted that BEPS Action 7 recommendations are proposed to give effect to the PE Article in existing treaties by way of the MLI, under development by the OECD as per BEPS Action 15 (Developing a Multilateral Instrument to Modify Bilateral Tax Treaties).