

## NEXIA SURVEY

### QUESTIONNAIRE

- Application of the “Authorized OECD-approach” (AOA) –  
(July 2014)

#### A. Background

On 22 July 2010 the OECD released the “Update 2010” to the OECD Model Tax Convention and its Commentary as well as the final version of its “Report on the Attribution of Profits to Permanent Establishments” . One of the major changes in this update was the implementation of the “Functionally Separate Entity Approach” for the profit allocation to permanent establishments in article 7, also called the “Authorized OECD-Approach” (AOA). The AOA replaces the “Relevant Business Activity Approach” , which was the standard for the allocation of profits to permanent establishments in the OECD Model Tax Convention and its Commentary before the update 2010 was implemented.

#### B. Characteristics of the AOA

1. “Functionally Separate Entity Approach” , i.e. permanent establishments (PEs) are treated like separate and independent enterprises (corporations) for tax purposes.
2. Determination of profit to be allocated to PE is done in two steps:

Step 1: Allocation of functions, risks, assets and free capital to PE

- Attribution of functions to PE based on “significant people functions” , i.e. analysis of all functions performed by the company as a whole and allocation of the ones performed by the people working for the PE to the PE.
- Attribution of risks to PE based on the functions performed ( “risks follow functions” ).
- Attribution of assets to PE, which are necessary to perform the functions identified ( “assets follow functions” ).

- Attribution of free capital to PE based on the risks borne and assets economically owned by the PE.

Step 2: Identification and pricing of dealings between head office and PE

- Identification of the nature of the dealings between PE and head office based on the functions, risks, assets and free capital allocation done in step one.
- Determination of appropriate pricing for the identified dealings based on the arm's length principle.

### C. Questions

1. Does your country apply the AOA as described by the OECD in its Commentary to article 7 of the OECD Model Tax Convention 2010 and the “2010 Report on the Attribution of Profits to Permanent Establishments” ?
  - If yes, how was it implemented (by reference in the local tax law to the OECD Model Tax Convention and the respective Commentaries only or by introducing a separate set of rules in the local tax law)?
  - If no, do you know whether such an implementation is planned in the near future?
  
2. The AOA implies that the allocation of assets, free capital and profits is determined by the “direct method” only, i.e. the allocation of assets and free capital has to be based on the functional and risk profile of the PE and the allocation of profit is the result of individual “dealings” with the head office for which arm’s length remunerations have to be determined under consideration of the functional and risk profiles. An allocation of assets, free capital and profits by applying the “indirect method” (i.e. allocation based on allocation keys) is not intended.
  - Do the tax laws of your country allow the use of the “indirect method” ?
  - If yes, are there any pre-conditions that have to be fulfilled in order to be allowed to apply it (please provide a short description)?
  
3. The “Functionally Separate Entity Approach” means that all dealings between head office and PE have to be remunerated arm’s length. Do the tax laws of your country
  - stipulate that “services” performed by or for the benefit of the PE for which no external sales are realized by the company as a whole (e.g. internal administrative services like bookkeeping or legal support) need to be remunerated? If yes, is it necessary that this remuneration includes a profit component or is an

- allocation of the respective costs (e.g. respective parts of the personnel costs) to the beneficiary of these “services” (PE or head office) sufficient?
- stipulate that the “temporary use of assets” (e.g. premises or intangibles such as brand, technology or customer base) by the PE or the head office need to be remunerated? If yes, how does this remuneration typically look like (e.g. arm’ s length rental fee for premises or arm’ s length license fee for intangibles or just an allocation of the costs related to these assets such as depreciation, maintenance costs or parts of the development costs)?
  - stipulate that the “transfer of assets” (e.g. tangible fixed assets such as premises, tangible current assets such as finished goods or intangible assets such as a customer base) need to be remunerated? If yes, does this remuneration have to reflect an arm’ s length price (current fair market value) or is it sufficient that the remuneration reflects the current book-value of the asset only? In case it has to reflect an arm’ s length price: are there any special rules to consider with regard to the moment of the profit / loss realization resulting from the transfer (example: head office transfers finished goods to PE with the intention that the PE resells them to third party customers. However, PE is not able to sell them before the end of the fiscal year. Does the head office have to tax the notional profit resulting from the transfer even though the PE did not sell the goods to third party customers in the same year?)?
4. According to section D-4 of the OECD “Report on the Attribution of Profits to Permanent Establishments” and also according to the new set of rules planned in Germany, documentation of all dealings between the enterprise and its permanent establishment is required. For this purpose the OECD refers to the respective Chapter V of the OECD Transfer Pricing Guidelines, which explains what kind of documentation should be requested by tax authorities in order to be able to evaluate whether transactions between related enterprises are remunerated arm’ s length. These requirements imply that there usually exist contracts, invoices or other paperwork that document the existence of the transactions and the applied conditions. However, due to the fact that a permanent establishment is only a part of the

whole enterprise but no separate entity, such documents (written contracts, invoices, etc.) are not available.

- a. Does your country provide detailed guidance on how the documentation of dealings between enterprises and their permanent establishments has to look like? If yes, please provide us with a summary.
  
- b. If no, please provide us with a description of the best practice regarding documentation of dealings between enterprises and their permanent establishments in your country and/or with recommendations based on your practical experience.

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	Application of the "Authorized OECD-approach" (AOA)					
	AUSTRIA	BRAZIL	CANADA	CZECH REPUBLIC	CYPRUS	DENMARK
Does the country apply the "Authorized OECD Approach"?	Yes, but not explicitly in national tax law but through reference to OECD-Commentaries in Austrian TP-Guidelines 2010 published by the the Austrian tax authorities	No; there is also no information whether an implementation is planned in the future, Brazil does not follow the definitions of the OECD; in PE cases Brazilian general transfer pricing rules apply	Yes, but not explicitly in national tax law but through reference in Circular 87-2R published by the Canadian tax authorities; treaties can provide for different methodologies	No; there is also no information whether an implementation in domestic law is planned in the future; application possible when particularly agreed in a specific double tax treaty	Yes, but not explicitly in national tax law or in circular / guidelines of the tax authorities but rather in practice / tax rulings	Yes, implemented in Section 2 (2) of the Danish Corporation Tax Act with effect from 1 July 2012
Does the country allow the "indirect method" for allocating assets, free capital and profits?	Yes, but not preferred method. Application only when the activities of the PE cannot be clearly separated from the activities of the company as a whole and the arm's length principle is met	No specific rules	Yes, but not preferred method. Sufficient justification of applied keys necessary when applied.	No; there is generally only the "direct method" allowed	Yes, when adequately justified that arm's length principle is met. There are no specific rules regarding application of the "direct" or "indirect method"	Yes, but according to new law not preferred method, i.e. application only when included in respective double tax treaty. Under old law the "indirect method" was preferred method
How do the following transactions between the company and its PE have to be remunerated? a) internal services b) temporary use of assets c) transfer of assets	a) at cost b) at cost (e.g. depreciation) c) at arm's length; when transfer to a PE within the EU and moment of transfer to PE and sale from PE to third party customer deviates, profit / loss realization can be postponed	a) no specific rules, general Brazilian TP rules are applicable b) no specific rules, general Brazilian TP rules are applicable c) no specific rules, general Brazilian TP rules are applicable	a) at cost b) at cost (e.g. depreciation) c) at arm's length but no specific rules on moment of profit / loss realization when moment of transfer to PE and sale from PE to third party customer deviates	a) at cost b) at cost c) at cost	a) no specific rules, only general statement that arm's length principle has to be considered b) no specific rules, only general statement that arm's length principle has to be considered c) no specific rules, only general statement that arm's length principle has to be considered	a) no specific rules, only general statement that arm's length principle has to be considered b) no specific rules, only general statement that arm's length principle has to be considered c) no specific rules, only general statement that arm's length principle has to be considered
Is a specific TP documentation for the documentation of dealings required?	No; general TP documentation rules are applicable	No; general TP documentation rules are applicable	No; general TP documentation rules are applicable	No; general TP documentation rules are applicable	No; general TP documentation rules are applicable	No; general TP documentation rules are applicable

	Application of the "Authorized OECD-approach" (AOA)					
	FRANCE	GERMANY	HUNGARY	INDIA	IRELAND	ITALY
Does the country apply the "Authorized OECD Approach"?	<b>No</b> ; but will be referred to in case law and for negotiation of future double tax treaties	<b>Yes</b> , implemented in the German Foreign Tax Act with effect for all fiscal years starting after 31 Dec 2012; however, in case a specific treaty does not include AOA, application of old Relevant Activity Approach possible; adoption in future treaties intended	<b>Yes</b> , reference is made in the Hungarian Corporation Tax Act to the OECD Guidelines; treaties can provide for different methodologies especially when the treaties were concluded before the implementation of the AOA	<b>No</b> ; there is also no information whether an implementation is planned in the future, India does not follow the definitions of the OECD when it comes to PEs	<b>No</b> ; there is also no information whether an implementation is planned in the future	<b>Open</b> , neither implemented in national tax law nor through other publications such as circulars; in general Italy applies the 2010 OECD Model Tax Convention
Does the country allow the "indirect method" for allocating assets, free capital and profits?	<b>Yes</b> , but not preferred method; applicable in case the operations of the PE are not totally different to operations of the headquarters and the PE does not have a separate accounting	<b>No</b> , generally is only the "direct method" allowed; however, handling by tax authorities not yet known since no official publication from the tax authorities regarding the AOA so far	<b>No</b> , only the "direct method" is allowed; allocation keys might be applied when it comes to an allocation of overhead costs	<b>No specific rule</b> ; in practice there is typically no asset or free capital allocation to a PE but rather only a direct profit allocation considering the functions of the PE; allocation keys might be applied when it comes to an allocation of overhead costs	<b>No specific rule</b> , i.e. neither the "direct method" nor the "indirect method" are preferred as long as the profit allocation is done on a just and reasonable basis	<b>No specific rules</b> , i.e. neither the "direct method" nor the "indirect method" are preferred as long as the profit allocation is done on an arm's length basis
How do the following transactions between the company and its PE have to be remunerated?  a) internal services b) temporary use of assets c) transfer of assets	a) <b>no specific rules</b> , typically at arm's length  b) <b>no remuneration</b>  c) <b>no specific rules</b> , typically at arm's length	a) <b>at arm's length</b> , typically based on costs including an arm's length profit mark-up when CUP not applicable  b) <b>at arm's length</b>  c) <b>at arm's length</b> , profit / loss realization when assets are transferred, moment of sale to third party customer is irrelevant (taxation of notional profits is possible; in case of a EU PE the notional profit can be allocated and taxed over a five years period when the transferred asset belongs to the noncurrent / fixed assets)	a) <b>at arm's length</b>  b) <b>at arm's length</b>  c) <b>at arm's length</b>	a) <b>no specific rules</b> ; however, remuneration for internal services is typically under close scrutiny of the Indian tax authorities  b) <b>no specific rules</b> ; such cases are not often seen in India  c) <b>no specific rules</b> ; such cases are not often seen in India on account of the limited nature of PEs constituted in India	a) <b>no specific rules</b> , allocation needs to be reasonable  b) <b>no specific rules</b> , allocation needs to be reasonable  c) <b>no specific rules</b> , allocation needs to be reasonable	a) <b>no specific rules</b> ; in general the arm's length principle has to be considered  b) <b>no specific rules</b> ; in general the arm's length principle has to be considered  c) <b>no specific rules</b> ; in general the arm's length principle has to be considered
Is a specific TP documentation for the documentation of dealings required?	<b>No</b> ; general documentation rules in tax matters are applicable	<b>No</b> ; general TP documentation rules are applicable besides the necessity to prepare a separate profit calculation scheme for the PE	<b>No</b> ; general TP documentation rules are applicable	<b>No</b> ; development of internal basic documentation for explanation purposes recommended	<b>No</b> ; general cooperation rules in tax matters are applicable	<b>No</b> ; general TP documentation rules are applicable

	Application of the "Authorized OECD-approach" (AOA)					
	LITHUANIA	LUXEMBOURG	MALTA	MEXICO	NETHERLANDS	POLAND
Does the country apply the "Authorized OECD Approach"?	Yes, reference is made in the Lithuanian tax law to the OECD Guidelines	Yes, implemented in national tax law	No; neither implemented in national tax law nor through other publications such as circulars; most Maltese treaties contain the old version of article 7 (2) of the OECD Model Tax Convention	Yes, the rules in Mexican tax law are comparable with the AOA; for interpretation purposes the Mexican tax law refers to the OECD Commentary	Yes, reference is made in the Dutch tax law to the OECD Model Tax Convention; furthermore, a decree of the Ministry of Finance explicitly declares that the Netherlands prefer the AOA	Yes; implemented in national tax law in July 2013
Does the country allow the "indirect method" for allocating assets, free capital and profits?	No, only the "direct method" is allowed	Yes, but typically the "direct method" is applied; however, there is no need to allocate free capital under Luxembourg law	No specific rules, i.e. neither the "direct method" nor the "indirect method" are preferred	No specific rules, i.e. neither the "direct method" nor the "indirect method" are preferred; rules concluded in specific treaty to be considered	Yes, but only in specific cases (e.g. insurance companies) or when the application of the "direct method" is not possible or unfair	Yes, but not preferred method; applicable only in case the operations of the PE are not totally different to operations of the headquarters and the arm's length nature of the allocation key can be
How do the following transactions between the company and its PE have to be remunerated? a) internal services b) temporary use of assets c) transfer of assets	a) at arm's length b) at arm's length c) at arm's length	a) no specific rules b) no specific rules c) no specific rules	a) no specific rules, but typically at arm's length b) no specific rules, but typically at arm's length c) no specific rules, but typically at arm's length	a) at cost b) at arm's length c) at arm's length	a) at cost b) at arm's length c) at arm's length, but profit realization only when assets are actually sold to a third party customer (no taxation of notional profits)	a) at arm's length b) at arm's length c) no specific rules, but in general the arm's length principle has to be considered
Is a specific TP documentation for the documentation of dealings required?	No; general TP documentation rules are applicable	No; only for financial transactions towards subsidiaries exist documentation rules	No; in practice, several documents such as invoices, contracts or other paperwork are sufficient	No; general TP documentation rules are applicable; contracts and invoices are advised	No; general TP documentation rules are applicable	No; general TP documentation rules are applicable

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	PORTUGAL	ROMANIA	RUSSIA	SINGAPORE	SOUTH AFRICA	SPAIN
Does the country apply the "Authorized OECD Approach"?	<b>No</b> ; there is also no information whether an implementation is planned in the future	<b>No</b> ; there is also no information whether an implementation is planned in the future	<b>No</b> ; there is also no information whether an implementation is planned in the future	<b>No</b> ; neither implemented in national tax law nor through other publications such as circulars, but in general, the arm's length principle applies also for PEs	<b>No</b> ; South Africa's understanding of profit allocation to PEs is based on the old version of article 7 of the OECD Model Tax Convention and its Commentary	<b>Yes</b> ; not implemented in national tax law or through other publications such as circulars, but according to Spanish Supreme Court direct application of OECD Commentaries without law change possible
Does the country allow the "indirect method" for allocating assets, free capital and profits?	<b>No</b> , only the "direct method" is allowed; allocation keys might be applied when it comes to an allocation of overhead costs.	<b>No specific rules</b> , i.e. neither the "direct method" nor the "indirect method" are preferred as long as the profit allocation is done on an arm's length basis	<b>No</b> , only the "direct method" is allowed; allocation keys might be applied when it comes to an allocation of overhead costs; Russian treaties with other countries can provide for different rules	<b>No specific rules</b> , i.e. neither the "direct method" nor the "indirect method" are preferred as long as the profit allocation is done on an arm's length basis. Reasonable allocation keys might be applied to overhead costs allocations.	<b>No specific rules</b> , i.e. neither the "direct method" nor the "indirect method" are preferred as long as the profit allocation is done on an arm's length basis	<b>No</b> , only the "direct method" is allowed; allocation keys might be applied when it comes to an allocation of overhead costs
How do the following transactions between the company and its PE have to be remunerated? a) internal services b) temporary use of assets c) transfer of assets	a) <b>at cost</b> b) <b>no specific rules</b> c) <b>at arm's length</b> ; profit / loss realization when assets are transferred, moment of sale to third party customer is irrelevant (taxation of notional profits is possible)	a) <b>no specific rules</b> , but in general the arm's length principle has to be considered b) <b>no specific rules</b> , but in general the arm's length principle has to be considered c) <b>no specific rules</b> , but in general the arm's length principle has to be considered	a) <b>no remuneration</b> b) <b>no remuneration</b> c) <b>no remuneration</b>	a) <b>at arm's length</b> , typically cost + 5% for internal routine services except for routine support services provided on a cost pooling basis. b) <b>no specific rules</b> ; general arm's length principle to be applied c) <b>no specific rules</b> ; general arm's length principle to be applied	a) <b>at cost</b> ; no taxation of notional profits b) <b>at cost</b> ; no taxation of notional profits c) <b>at arm's length</b> , but profit realization only when assets are actually sold to a third party customer (no taxation of notional profits)	a) <b>no specific rules</b> except for deductibility of interest and royalties; in general the arm's length principle has to be considered b) <b>no specific rules</b> ; in general the arm's length principle has to be considered c) <b>no specific rules</b> ; in general the arm's length principle has to be considered
Is a specific TP documentation for the documentation of dealings required?	<b>No</b> ; general TP documentation rules are applicable	<b>No</b> ; general TP documentation rules are applicable	<b>No</b> ; development of internal basic documentation for explanation purposes recommended	<b>No</b> ; adequate TP documentation (general guidance is provided via circulars) should be maintained to demonstrate compliance with the arm's length principle.	<b>No</b> ; general TP documentation rules are applicable	<b>No</b> ; general TP documentation rules are applicable

	Application of the "Authorized OECD-approach" (AOA)			
	SWEDEN	SWITZERLAND	UK	USA
Does the country apply the "Authorized OECD Approach"?	Yes, functionally separate entity approach was already implemented in the Swedish tax law before 2010	Yes; not implemented in national tax law or through other publications such as circulars but Switzerland generally applies the OECD Model Tax Convention and its Commentary; however, discussions on which commentary is applicable to which treaty	Yes, indirectly adopted in the UK legislation as a result of the rules on the exemption for foreign branches and the CFC revised legislation	Yes, if adopted in the specific tax treaty, not implemented in US tax law; adoption in future treaties intended
Does the country allow the "indirect method" for allocating assets, free capital and profits?	Yes, but not preferred method	Yes, but not preferred method; applicable in case the operations of the PE are not totally different to operations of the headquarters	Yes, but only when the "indirect method" produces a more accurate result than the "direct method", i.e. "direct method" is the preferred method	No, only the "direct method" is allowed; however, also application of profit based TP methods (e.g. Comparable Profits Method) possible
How do the following transactions between the company and its PE have to be remunerated?  a) internal services b) temporary use of assets c) transfer of assets	a) <b>at arm's length</b> ; however, services as part of general management at cost  b) <b>at cost</b> (e.g. depreciation)  c) <b>at arm's length</b> ; when moment of transfer to PE and sale from PE to third party customer deviates, profit / loss realization can be postponed	a) <b>at arm's length</b> , if separate bookkeeping for PE, otherwise cost allocation accepted  b) <b>at arm's length</b> , if separate bookkeeping for PE, otherwise cost allocation accepted  c) <b>at arm's length</b> , but profit realization only when assets are actually sold to a third party customer (no taxation of notional profits)	a) <b>at arm's length</b>  b) <b>at arm's length</b>  c) <b>at arm's length</b>	a) <b>at cost</b> , if low-value service; profit mark-up possible when at arm's length  b) <b>no specific rules</b> ; general arm's length principle to be applied depending on individual facts and circumstances  c) <b>at arm's length</b>
Is a specific TP documentation for the documentation of dealings required?	No; development of internal basic documentation for explanation purposes recommended	No; development of internal basic documentation for explanation purposes recommended	No; general TP documentation rules are applicable	No; development of internal basic documentation for explanation purposes recommended