

Commissionaire Agreements: Some Remarks in View of the Recent Italian Tax Authorities Challenges

By Carlo Maria Paoletta and Alessio Persiani



CCH

a Wolters Kluwer business

1. Introduction

In recent years, the Italian Tax Authorities have launched a wave of tax audits aiming at scrutinizing the tax position of multinational companies carrying on trading activity in Italy. In particular, the Tax Authorities focused their attention on supply chain reorganizations decided by a number of such multinational companies in the last few years in order to change functions and ways business operations are conducted in Italy. Generally, these restructurings led to changes in the risk profile of group entities involved and, as a consequence, in the profitability of operations in countries where activities take place: these latter changes frequently result in a shift in the jurisdiction where profits arise—and, as a consequence, are taxed—from the place where activities are carried on towards the place where risks are assumed and responsibilities are taken. In this context, Tax Authorities scrutinize supply chain reorganizations and, grounding either on factual or legal arguments, often challenge the existence of a permanent establishment in Italy, deriving the appropriate tax consequences both for income taxes and VAT purposes.

Among the techniques most frequently used for supply chain and trade reorganizations, commissionaire agreements play an important role for the twofold reason that this kind of arrangement is very common among U.S. multinationals¹ and it gives rise to a number of interesting legal and tax implications.

After a brief description of the commissionaire agreement having regard to Italian Civil Code (Par. 2), we will discuss its tax implications focusing on the principles deriving from the OECD Model



Carlo Maria Paoletta is a Partner in the law firm of McDermott Will & Emery Studio Legale Associato, based in its Rome office and is the head of the Italian Tax department.



Alessio Persiani is an Associate in the law firm of McDermott Will & Emery Studio Legale Associato, based in its Rome office and is a member of the Tax department.

and Commentary to Art. 5 concerning dependent agent P.E. (Par. 3). We shall then analyze how these principles should be applied in the contractual practice and in the day-by-day business activity in order to prevent challenges based on the P.E. arguments (Par. 4). In paragraph 5, we will draw some brief conclusions.

2. Commissionaire Agreement

According to Article 1731 of Italian Civil Code, the commissionaire agreement is a mandate aimed at buying or selling of goods in the name of the commissionaire and on behalf of the principal. In large distributor organizations, commissionaire arrangements are generally used for the sale of products manufactured by a related party (*i.e.*, the principal or parties related to the principal). It is worthwhile to highlight that the commissionaire agreement provided by the Italian Civil Code differs from the common law agency arrangement: while the latter normally entails that the agent has the authority to sign contracts in name of the principal, in the former case the commissionaire enters into sales (or purchase) contracts in his own name, becoming formally party to the contract. Generally, the commissionaire does not receive title to the goods, which directly transfers from the principal to the customer. According to Article 1734 of the Civil Code, the principal may withdraw his instructions until the deal is concluded by the commissionaire. The commissionaire may assume the risk for the performance of the contract (*s.c.* “*star del credere*” clause), provided that the commission fee is specifically increased in order to reflect this additional risk (Article 1736 of Italian Civil Code).

3. Permanent Establishment

Article 5, paragraphs 5 and 6 of the OECD Model Double Taxation Convention stipulate for the *s.c.* dependent agent P.E., providing that:

where a person – other than an agent of an independent status to whom paragraph 6 applies – is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise.

The following paragraph 6 deals specifically with agents, stating that “an enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.”

According to the anti-single entity clause provided by paragraph 7, these same rules apply also to subsidiaries, which cannot be considered as P.E. of the parent solely because of the parent’s ownership of the share capital.

As a consequence of such provisions, an agent constitutes a P.E. if two requirements—one positive and one negative—are met: (*i*) the agent has and habitually exercises the authority to conclude contracts binding on the foreign enterprise relating to the proper business of that foreign enterprise; and (*ii*) the agent does not have an independent status or does not act in the ordinary course of his business, as provided in Art. 5, par. 6 of the OECD Model.

For what regards requirement sub (*i*), different views exist concerning the interaction between the aforementioned paragraphs 5 and 6 of the OECD Model are very well known: while the majority of scholars—especially those coming from a “civil law” background—consider the binding effect on the principal as a key element for the definition of dependent agent,² other scholars, in a perspective more coherent with “common law” principles on authority to conclude contracts, affirm that even though paragraph 5 is literally restricted to agents concluding contracts in the name of the foreign enterprise, it does not exclude all other agents from such a notion. The OECD Commentary takes a somewhat intermediate position and, privileging the “substance over form” principle, it affirms that “the binding effect on the principal” requirement has to be interpreted giving relevance not just to the formal aspect of the contract concluded in the name of the enterprise, being the paragraph equally applicable “to an agent who concludes contracts which are binding on the enterprise even if those contracts are not actually in the name of the enterprise.” As a consequence, “an agent may be considered to possess actual authority to conclude contracts where he solicits and receives (but does not formally finalise) orders which are sent directly to a warehouse from which goods are

delivered and where the foreign enterprise routinely approves the transactions.”³

In light of different interpretations regarding requirement sub (i), requirement sub (ii) frequently plays a key role in the qualification of the agent for the purpose of the P.E. notion. In this respect, the OECD Commentary to Article 5, paragraph 6 lays down the s.c. “independency test,” clarifying that an agent operating on behalf of a foreign enterprise can be deemed as an independent agent for the scope of paragraph 6 if (1) he is independent of the enterprise both legally and economically, and (2) he acts in the ordinary course of his business when acting on behalf of the enterprise. As the independence degree has to be analysed from both an economic and legal point of view, the OECD Commentary indicates for a number of elements that should be appropriately taken into account. One of these considerations regards instructions and guidelines from the principal: where these instructions are so detailed to result in a significant control of the manner in which agent’s work is carried out and influence the very conduct of the work, it is unlikely to deem the agent as an independent one for the scope of dependent agent P.E. provisions. In this regard, the OECD Commentary points out that reliance of the principal on the special skill and knowledge of the agent constitutes an indication of independence. Another criterion, impinging on the economic independence of the agent, regards the risks assumed by the agent: on this point, the Commentary asks to ascertain whether the entrepreneurial risk is to be borne by the agent or the enterprise the agent acts on behalf of.

The same Commentary also points out other criteria, which, even if important, are not decisive for the scope of the independence test. First of all, limitations on the scale of business do not affect agent’s degree of independency, which has to be determined considering the extent to which the agent exercises freedom in the conduct of his own business. On the same ground, the number of principals represented by the agent is not in itself determinative for its independence, even if the performance of the activities wholly or almost wholly on behalf of only one principal constitutes an element that has to be considered.

As far as the “ordinary course of business” requirement is concerned, the Commentary clarifies that relevance should be attributed to agent’s actual conduct. Agent’s conduct can be encompassed in the

ordinary course of his business if he performs activities falling within the sphere of his authority—and for which he assumes the risks and is correspondingly rewarded—having regard to the business activities customarily carried out within the agent’s trade.

4. Commissionaire Agreement: Independence Degree for the Scope of Permanent Establishment Provisions

Focusing our analysis on the commissionaire structure, we have to first highlight that commissionaire agreements regulated by Italian law normally state that the agent does not have the authority to conclude contracts in the name of the principal. Such a feature directly derives from the exposed Italian civil law discipline of the commissionaire agreements, where it does not entail the conclusion of the sale contract in the name of the principal, but only on behalf of him. In other words, according to Italian commercial law, the principal is not a party to the contract with the end customer, neither formally nor substantially. According to a certain interpretation of Article 5, paragraphs 5 and 6 OECD Model such a lack of representative power could as such be sufficient to determine the exclusion of the commissionaire from the area of the dependent agent and, as a consequence, from the notion of dependent agent P.E. However, as said above, the OECD Commentary takes a different position, disregarding the formal aspects related to the conclusion of the contract in name of the enterprise, and attributing relevance to the actual conduct of the agent carrying on his activity. In this respect, it has to be considered that in the Italian practice, commissionaire agreements often provide for guidelines for the actual supply of the goods to the customer, regulating the different activities including the conclusion of the sale contract, the delivery of the goods in the most efficient way for the customer’s necessity, the discounts and the payment terms. However, the sole existence of such guidelines should not imply the qualification of the commissionaire as a P.E. of the principal. On the other hand, the contents of such guidelines should be carefully analysed and taken into account. For instance, where the commissionaire agreement states that all the contracts signed by the commissionaire with his customers are automatically approved and enforced by the principal, independently from the consideration amount due for the

goods and from the merit of credit of the customer, it could be reasonable to deem the contracts signed by such an agent binding on the principal. However, different conclusions should be drawn where the same guidelines provide brackets of possible discounts or that the automatic approval from the principal is limited to cases where goods are sold to the customer in line with the standard pre-agreed terms and conditions of sale set forth in such guidelines, while specific approval by the principal is required in non-standard cases: this would respond to the customary need for large corporations to streamline and expedite their operations when the number of transactions would make individual approvals simply unfeasible and not compatible with the standard commercial uses.⁴ Such a

clause should not result in a “*routine approval*” of the contract from the principal in the sense of the OECD Commentary⁵: the automatic approval would be limited to the merit of credit of the customer or the standard terms and conditions of sale and, above this threshold, the principal would maintain the discretionary power

to approve and enforce the contract signed between the commissionaire and the customer. It should be considered that according to commercial law (article 1734 of the Civil Code), the principal cannot refuse execution of a bona fide contract which was entered into by the commissionaire with the customer in compliance with the instructions provided by the principal: this is not meant to be an automatic approval, but merely the performance by the principal of his contractual obligation towards the commissionaire. It is not abnormal that the principal tends to provide guidelines with regard to discounts or payment terms, as these are economic elements of the transaction which mainly fall within the sphere of the principal (the main feature of the commissionaire arrangement is indeed that the transaction is entered into on behalf of the principal). In this respect, the commissionaire should not be regarded as a mere interposition of his principal, but as an entrepreneur who can give credit to selected end customers in order to promote and boost his own business. Different conclusions would be drawn if guidelines and/or

principal’s instructions interfere with the day-by-day organization of the commissionaire’s business: the principal must rely on the professional skills of the commissionaire and must simply hold him accountable for his results. The successful promotion and sale of products on behalf of the principal is the objective of the proper business of the commissionaire and only with respect to this portion should he bear the entrepreneurial risk.

As said, according to a certain interpretation of Art. 5, par. 6 of the OECD Model, an agent, even if formally lacking the authority to conclude contracts, can be qualified as a P.E. of his principal where he is a not an independent agent or he acts outside of the ordinary course of his own business.

The independent character should be ascertained with regard not only to the contract clauses, but also to the factual conduct of the agent. Apart for the case of guidelines that are so detailed and control so comprehensive to influence the day-by-day activity carried on by the agent,⁶ the key criterion for the independency test should be identified in the

correspondence between risks assumed and reward received by the commissionaire. In order to meet the independency test, the commissionaire should at least bear the market demand risk and to some extent the bad-debt risk.

As far as the demand market risk is concerned, it should be considered that the commissionaire is an entrepreneur himself, whose activity consists of identifying the potential market of the product, identifying the potential clients and promoting the sales of such a product. In this sense, the market demand risk represents a fundamental element of his activity: if lacking or strongly diminished, it could be reasonable to deem the commissionaire as a P.E. of the principal. On the other hand, limits to the scope of the activity of the commissionaire and/or monitoring service level and quality should be considered coherent with the independent status of the commissionaire: not only because the economic results of the transaction mainly fall within the sphere of the principal, but also because the commissionaire sells products manufactured and

Arrangements that provide for the commission fee to be inclusive of a consideration element for the transfer of customer lists to the principal are not advisable under Italian law, as they would appear in contrast with the nature and the aim of the commissionaire set-up.

branded by his principal (for which the latter is ultimately liable) and, in this sense, there is a legitimate interest of the principal that the value of the brand, the quality of the product and his overall reputation are accurately preserved.

As far as bad-debt risk is concerned, the independency test requires that the commissioner is responsible for prompt and good collection from his clients and that an automatic shift of debt risk to the principal does not take place. Suitable arrangements in this respect are those that by way of example provide that (1) no commission fee is paid in case of bad debt, (2) in addition a part of the cost of bad debt is borne (by way of a penalty—*star del credere*) by the commissioner, (3) the remittance of the sale proceeds from the commissioner to the principal occur on the basis of pre-agreed average collection terms, irrespectively of the actual collection date by the commissioner (this method, rather than the alternative “remit as you are paid” mechanism, would work as an incentive for the commissioner to speed up the collection and let him benefit from his ability to perform better than average).

The actual assumption of entrepreneurial risk by the commissioner should also be built in the mechanics to determine its commission fee. Typically, a fair commission would not be a fixed predetermined consideration, as a salary generally is; rather it would be linked to the results of the business, in the form of a percentage of sales or profit. Sometimes it can be accepted that a limited component of the commission is fixed.

While it is fair that the commissioner bears some entrepreneurial risk linked to the result of the business, on the other hand, as he incurs limited risks and performs limited functions in the whole supply chain, he should be entitled to a minority share of the overall available profit.

Arrangements that provide for the commission fee to be inclusive of a consideration element for the transfer of customer lists to the principal are not advisable under Italian law, as they would appear in contrast with the nature and the aim of the commissioner set-up. Clients are not known to the principal, and more importantly he remains undisclosed to them. A progressive transfer of customer lists would instead imply that the principal is in control of the customers and has direct relationship with them, insofar as the commissioner acts as a dependent agent. It is customary to stipulate that customer lists belong to the commissioner and if,

upon termination of the contract, the commissioner wants to transfer his customer lists to the principal, he should receive an appropriate consideration, as such lists represent a sort of goodwill of the activities carried on by the commissioner.

With regard to the “ordinary course of business” requirement, it is helpful to note that such an ascertainment should be based on the business activities customarily carried out within the agent’s trade. However, as a matter of fact, activities performed by the commissioner should not belong to the sphere of the principal and should remain within the boundaries of those typically pertaining to a commissioner. In this respect, the principal might well entrust the commissioner with the performance of all services and activities ancillary to the sale of the products, but not, for instance, with litigation concerning product liability or the warranty claim responsibility (he may well take care of the handling of such claims through a customer service, but not be ultimately responsible for them).

The ordinary course of business test, as with most of the facets concerning PE issues, has a factual nature: within global groups it is often observed that the actual role of the affiliate commissioner exceeds the obligations and duties set out in the contract, since the business is run as if, in substance, there was one sole global entrepreneur, without respect of the independence of each legal entity. This is where the risk of PE really hides: the commissioner formal set-up reflects the accurate approach defined by the legal counsel and the advisors of the company, but then it is superseded and contradicted by daily operations governed by a different commercial substance, which tends to consider the local affiliate as the *longa manus* of a global entrepreneur, and expects it to take care of any issues arising in the local market. This person clearly would not be a genuine commissioner, but rather an affiliate acting outside the ordinary course of business of a commissioner. This (indeed frequent) behaviour may have contributed to generate some confusion and the common belief that commissioner arrangements may per se give rise to PE issues, while issues actually stem from the improper labelling with the title of commissioner to agents whose activity goes well beyond the ordinary activity of a commissioner.

5. Conclusions

Commissioner agreements—similarly to other arrangements concerning distribution among related

parties—might well constitute a P.E. of the principal in the source State. However, such a scenario can be prevented if the commissionaire arrangement is appropriately devised and his performance is *in fact* compliant with the relevant clauses. In this respect, the key element for the ‘independency test’ has to be identified in the risks assumed by commissionaire and in the consistency between the commission fee and such risks.

Eventually, if the agent is deemed to be a P.E. of the principal in the source State, the whole sale proceeds remitted to the principal by the commissionaire should not be taxed in the source State: it should be considered that the commission fee is a taxable profit element of the commissionaire and it represents a cost for the principal to be taken into account when trying to allocate to him a fair share of taxable profit in the source country.

ENDNOTES

¹ Commissionaire structures typically address subpart F issues, this is the reason why they are more popular among US Multinationals: the Italian Tax Authorities do not have full understanding of this objective and are inclined to believe that by use of commissionaire structures, U.S. groups try to attain undue Italian tax savings.

² As a consequence, those scholars exclude all agents who do not conclude contracts in the

name of their principles from the notion of dependent agent for the scope of permanent establishment provisions.

³ OECD Commentary, par. 32.1.

⁴ It is indeed customary also in dealing with independent distributors (*i.e.*, in buy-sell arrangements), that suppliers automatically approve orders from dealers which fall within the plafond given to the client based on his merit of credit or are just standard,

having regard to the size of the order or the list prices: no doubt would arise in these cases that the customer does not constitute for this reason a PE of the supplier.

⁵ OECD Commentary, par. 32.1.

⁶ In this case, as mentioned, the commissionaire is likely to be regarded as an employee of the principal and, due to his lack of independence, as a P.E. of the latter.

This article is reprinted with the publisher’s permission from the INTERNATIONAL TAX JOURNAL, a bimonthly journal published by CCH, a Wolters Kluwer business. Copying or distribution without the publisher’s permission is prohibited. To subscribe to the Journal of INTERNATIONAL TAX JOURNAL or other CCH Journals please call 800-449-8114 or visit www.CCHGroup.com. All views expressed in the articles and columns are those of the author and not necessarily those of CCH.

a WOLTERS KLUWER BUSINESS