

# Spanish Tax Alert

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## The Dell Case - Spanish subsidiary considered a permanent establishment

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### 1. Introduction

On 8 June 2015, the Spanish National Appellate Court (the "**Court**")<sup>1</sup> gave its judgment on the Spanish Dell case confirming the conclusion reached in the prior Decision delivered by the Spanish Central Tax Tribunal ("**TEAC**")<sup>2</sup>, that the activities of the Spanish subsidiary of Dell (Dell Spain) constituted a permanent establishment ("**PE**") of an Irish sales group company (Dell Ireland).

### 2. The Facts and TEAC decision

The main facts of this case are as follows:

- Dell's commercial structure for EMEA and in particular for Spain was operated through several companies forming a complex, blurred and fragmented model for carrying out the business activities of the multinational company in Spain.
- The production facilities were located in Ireland: Dell Products ("**Dell Ireland**") purchased products from Dell Europe (another Irish company), and sold them in the

market through local Dell subsidiaries, under commissionaire agreements.

- Dell Ireland had no personnel of its own. All human resources were subcontracted from affiliated companies (mainly, another Irish Company).
- Dell's computers were sold in Spain by Dell Spain (the commissionaire) under a commission agreement with Dell Ireland (the principal). Dell Spain sold and marketed the computers in the Spanish market in its own name but on account of Dell Ireland.
- Dell Ireland' function was the sale of computers and the management/control of their distribution in the different markets through local distributors, functionally characterized (and remunerated) as commissionaires, but which actually performed substantive activities, from a business perspective, beyond the mere commissionaire function.
- In particular, the Spanish commissionaire (Dell Spain) was directly and actively involved in the logistics, marketing, aftersales services and

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<sup>1</sup> Judgment of 8 June 2015 in Case 182/2012.

<sup>2</sup> Decision of 15 March 2012.

administration of Dell Ireland' Spanish online store.

- Dell Ireland had no employees or facilities in Spain (owned or rented). Goods belonging to Dell Ireland were stored in the premises of the Spanish commissionaire within the framework of the logistic service rendered by the latter to the former.
- Dell Ireland operated through a direct sales model so that purchase orders were placed in a web or call centre. The existing scheme was the result of prior restructuring that transformed the former Spanish full-fledged selling entity into a commissionaire.

The TEAC ruled that the Irish company (Dell Ireland) had a PE in Spain based on a technical reason which was to some extent in line with the one followed by the Spanish tax administration in the Roche case and other PE cases<sup>3</sup>, namely:

- i. The Irish company had a "fixed place of business" in Spain because, even if it had no premises of its own (i.e. as owner, lessee or otherwise) the ones belonging to the Spanish subsidiary were at its complete disposal. Equally, all human and material resources were entirely devoted to support the Irish principal's business. In the court's view, given that the Irish company did not have any staff and that the employees of the Spanish subsidiary were engaged in undertaking core functions of the principal company's business (e.g. marketing, promotion, logistics, aftersales, collection management, etc.) under its supervision and control, the Spanish entity should be considered a mere extension of the Irish entity in Spain.
- ii. Although the above would itself suffice to uphold the existence of a PE, the TEAC also concluded that the Spanish subsidiary was a dependent agent of the Irish principal. The reason behind this conclusion was the court's understanding that the Spanish company

did actually engage the Irish principal in its ordinary business operations and that the Spanish company was economically dependent on the principal company.

### 3. The Court's ruling

The Court affirmed the decision of the TEAC, concluding that Dell Spain was a Spanish PE of Dell Ireland, under article 5.4 (dependent agent) and 5.1 (fixed place of business) of the Spanish-Irish Double Taxation Treaty, by using the OECD CMC as an interpretative guideline. Therefore, the Court determined that all the sales made by Dell Ireland in Spain (minus commissions paid to Dell Spain and other related allocable expenses) should be attributed to Dell Ireland's Spanish PE, on the basis of the following reasoning:

- **Dependent agent:** The Court concluded that the construct of the commercial commission under Spanish legislation is not incompatible with a close connection between the principal and the third party (the commissionaire's customer), since the principal is required by law, even if the contracts were not actually in its name, to accept all the consequences derived from the commercial commission, implying that Dell Spain had authority to conclude contracts that were binding on Dell Ireland. Moreover, and in view of the concrete facts of the case, the Court determined that Dell Spain acted under comprehensive supervision and control of Dell Ireland, and its activities were not limited to those of an auxiliary nature.
- **Fixed place of business:** The Court basically held that Dell Ireland had a fixed place of business in Spain, giving rise to a PE, through the operational set-up provided by Dell Spain's facilities and activities, despite the absence of any formal ownership or rental of such facilities. The OECD CMCs to Article 5 expressly provides that a parent company can have a PE in the State where a subsidiary has

<sup>3</sup> Over the last years, the Spanish courts have adopted the functional and substantialist approach developed by the tax administration on the interpretation of tax treaties, departing from more legalistic positions invoked by the taxpayers that try to ground their positions on the OECD Model Convention commentaries ("OECD CMC"). In this regard, the main administrative and judicial precedents have been the following: Directorate-General for Taxation's binding responses of December 2012 (V2457/2012 and V2454/2012), the TEAC's decision of 20 December 2012 (*Honda* case), the National Appellate Court judgements of 20 May 2010 (*M-Real* Case) and the Supreme Court judgments of 12 January 2012 (*Roche vitamins* case) and 18 June 2014 (*Borax* case).

a place of business (e.g. space or premises belonging to the subsidiary that is at the disposal of the parent company).

On the other hand, although the Court did not examine whether the Dell website could be characterized or not as a fixed place of business, the Court mentions that, according to OECD CMC criteria, an online website does not in itself have a location that can constitute a PE, although such can be the place where the server of that website is located.

#### 4. The authors' comments

This Court judgment confirms the wide interpretation of the PE clause of the Spain-Ireland double taxation treaty, which largely supports the Spanish Supreme Court's decision in Roche Vitamins<sup>4</sup> and in the *Borax* Case, among others.

Although this approach raises a number of doubts from a technical OECD CMC perspective<sup>5</sup>, it is in line with the new Base Erosion and Profit Shifting ("BEPS") framework. In this sense, action 7 of the OECD Action Plan on BEPS specifically states the need to update the treaty definition of PE in order to prevent abuses of that threshold in particular, through the use of commissionaire arrangements as in the case heard by the Court.

Hence, not only the Court but also the OECD validate the approach of the Spanish tax

administration considering that rather than a legalistic point of view, a functional and substantialist interpretation of the PE clause (article 5) is more consistent with the spirit and finality of this treaty clause: a more balanced division of the tax power between the contracting States in accordance with the activities carried out in each country.

A correct functional characterization of the entities involved would have led to a more balanced profit allocation. Thus, an accurate determination of the arm's length remuneration for such intragroup functions or services should have allowed neutralizing or mitigating the risk of a PE approach as the one adopted by the TEAC, which ends up by attributing all the profit (all the sales) to the target market/country.

This judgment, together with the Roche Vitamins and Borax cases, constitutes another "warning" of the Spanish Tax Authorities on low-consistent international structures in terms of substance, that imply an inaccurately balanced attribution of profits obtained in Spain, in relation to the real economic functions performed in the country.

Another questionable aspect would result from the lack of debate on the interrelationship between transfer pricing rules and the PE clause within the tax treaty context. Basically, the Spanish tax administration approach goes through a prevalent application of the PE clause, avoiding the material and procedural application of the Spanish domestic transfer pricing rules.

<sup>4</sup> See Martínez-Matosas/Calderón Carrero, "Subsidiary Constituted PE, Supreme Court Rules", *Tax Notes International*, vol.65, nº10, 2012, pp.743 *et seq.*

<sup>5</sup> In this regard, it should be noted that Norway's Supreme Court came to an opposite conclusion in relation to the same business structure in Norway -Dell Products/Dell AS-, and in similar terms the French *Conseil d'Etat* in *Zimmer*.