

12th IBA London 2023 Finance & Capital Markets Conference

16-17 January 2023



Permanent Establishment

Monday 16 January 2023
(8:30 am - 9:30 am)

CHAIR AND SPEAKERS



Chair:

Guglielmo Maisto, Maisto e Associati, Milan, Italy

Speakers:

Jessica Kemp, Travers Smith, London, United Kingdom

Guadalupe Díaz-Súnico Aboitiz, Gómez-Acebo & Pombo, Barcelona, Spain

Stefan Mayer, Gleiss Lutz, Frankfurt, Germany

Rachel Fox, William Fry, Dublin, Ireland

Yuval Navot, Herzog Fox & Neeman, Tel Aviv, Israel

Luca Romanelli, AndPartners Tax and Law Firm, Milan, Italy

AGENDA



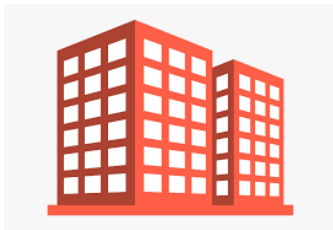
- I. Agenda**
- II. Employees working from home: PE or not PE?**
- III. Recent case law and administrative practice on PEs and evolving trends**
- IV. Conclusion**

II. Employees working from home: PE or not PE?

EMPLOYEES WORKING FROM HOME: PE OR NOT PE?

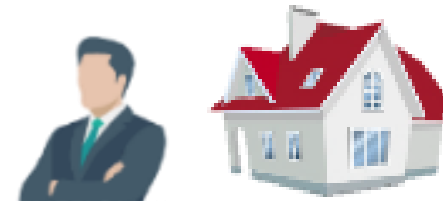


State R



Company R
HQ

State S



Home Office
Employee

UNITED KINGDOM: PE OR NOT PE?



I. Fixed place of business PE

Requirement	Relevance to international home working
Must be a « Place of business »	Requirement to use + Continuous basis = «may» be PE
Place of business must be « fixed »	Established at a distinct geographic place + certain degree of permanance
Business must be carried on « through » the fixed place of business	Personnel working at the place of business

“[...] the term “permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on” (Article 5(1) OECD Model Convention)

UNITED KINGDOM: PE OR NOT PE?



II. Dependent agent PE

Requirement	Relevance to international home working
Agent acts on behalf of non-UK resident	Authority to act
Agent has authority to conclude contracts/do business on behalf of the company	Contracts – executing/negotiating contracts relating to the business proper UK law – authority to do business
Agent habitually exercises that authority	Not defined – could one contract be enough?
Agent not independent	Independent agents and the investment management exemption

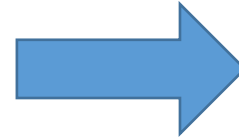
“Paragraph 5 shall not apply where the person acting in a Contracting State on behalf of an enterprise of the other Contracting State carries on business in the first-mentioned State as an independent agent and acts for the enterprise in the ordinary course of that business [...]”
(Article 5(6) OECD Model Convention)

UNITED KINGDOM: PRACTICAL POINTS, AND AN OTS CALL FOR A NEW APPROACH



Practical challenges

- New working models
- Competition for talent
- Administrative burden
- Lack of certainty
- Cross border collaborations and attribution of profits
- Interaction with diverted profits tax



Potential solutions

- **Domestic approach:**
 - Clearer guidance
 - Bright line tests
 - Safe harbours
 - Clarity on transfer pricing
- **International approach:**
 - Cooperation and leadership

The Office of Tax Simplification (OTS) is the independent adviser to the UK government on simplifying the tax system

SPAIN: HOME OFFICE



The Spanish General Directorate of Taxes guidance on **home office and PE: permanence + availability**

✓
1

Personal will /
wish of the
employee

✓
2

Bearing of costs
by the employer /
additional
compensation
provided

✗
3

Sales-related work
and connection to
customers in home-
office country
(Agency PE)

✗
4

Creating
independent
value for the
company or
internal matters?

✓
5

Decision or
interest (explicit or
implicit) of the
company?

- ✓ No general guidelines, only binding rulings for individual cases. Ruling V66-2022 “clean cut”
- ✓ Generally follows OECD 2020-2021 guidelines
- ✓ No rulings on home-office and Agency PE (yet). (IN)famous ‘*Spanish approach*’
- ✓ No rulings on home-office and POEM

The Spanish General Directorate of Taxes guidance on **home office and taxing rights**

- Most tax treaties following OECD model (ART. 15): the first day in home office already results in a **pro-rata apportionment of income** between source state and state of residence
- Directors: employment or corporate relationship?
- Spain to avoid double taxation (with limits). Domestic annual **exemption** up to 60,100 EUR for wages on work carried out abroad
- Special regime for **inbound workers** (*Beckham*): recent amendment including **home office**

IRELAND: MANAGING PE RISKS

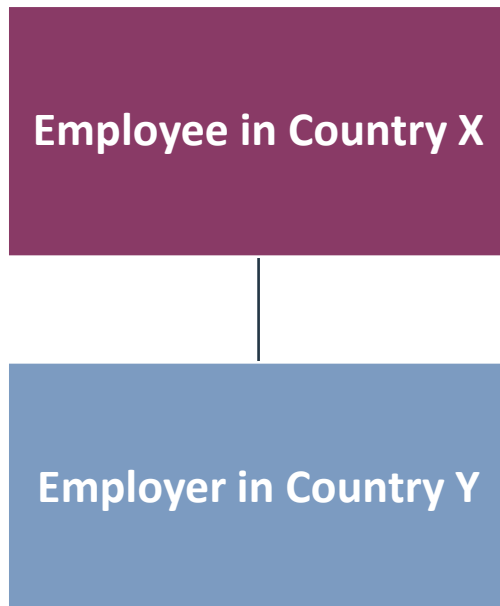


- Maintain office space that is available to all employees
- Employees should not be required to work from a home office or other fixed remote location and costs of home office should not be borne by the company
- Management and client-facing roles should be performed in the company's home country
- Limit remote work arrangements to internal support and back office roles to the extent possible
- Employees should not be authorized to conclude contracts on behalf of the company or hold themselves out as having such authority
- Contract negotiations should primarily take place in the company's home country
- Consider establishing a subsidiary, using a Global Employment Company or Employer of Record

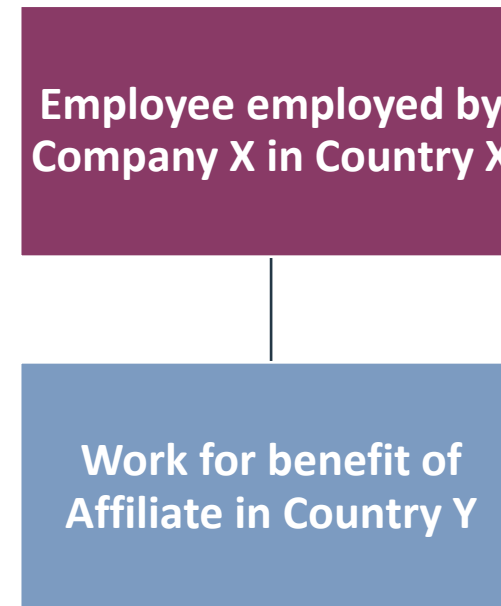
IRELAND: MANAGING PE RISKS



Model A



Model B





HOME OFFICE PE: TAXABLE INCOME



No guidance in the OECD Transfer Pricing Guidelines

➤ Cost-plus for low value functions

<p>State R</p>  <p>Company R HQ</p>	<ul style="list-style-type: none">• How to determine cost• Some APAs pending• Social security in State S	<p>State S</p>  <p>Home Office Data protection team officer</p>
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➤ Support function should not be a PE:



*“An activity that has an auxiliary character [...] generally corresponds to an activity that is carried on to **support**, without being part of, the essential and significant part of the activity of the enterprise as a whole” (Para. 60 of the OECD Commentary to Article 5(4) of the OECD Model)*

HOME OFFICE PE: TAXABLE INCOME



No guidance in the OECD Transfer Pricing Guidelines





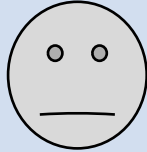
➤ Profit Split (for senior management?)

<p>State R</p>  <p>Company R HQ</p>	<ul style="list-style-type: none">• No “unique and valuable contributions”• No highly integrated business• No sharing or risks• Used in PEs for income allocation based on payroll	<p>State S</p>  <p>Home Office Senior manager</p>
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➤ “Services of corporate senior management” are not low value services (Para. 7.45 of the OECD Transfer Pricing Guidelines)

HOME OFFICE PE: CASE LAW AND PRACTICE AT GLANCE



Country	Case / Decision	PE		Criteria
Canada	Tax Court of Canada 16/05/2008 <i>Knights of Columbus v. Her Majesty the Queen</i>	No		<ul style="list-style-type: none"> • No enterprise's control over the dwellings • Not «visible» by third parties
Denmark	Danish Tax Council 26/04/2022 SKM2022.250.SR	Yes		<ul style="list-style-type: none"> • Connection with the geographical area • Amount of time spent in Denmark
Denmark	Danish Tax Council 26/10/2021 SKM2021.584.SR	No		<ul style="list-style-type: none"> • No connection with the geographical area • Personal reasons behind the choice
Denmark	Danish Tax Council 25/05/2021 SKM2021.412.SR	No		<ul style="list-style-type: none"> • Personal reasons behind the choice • Nature of the activity carried out by the employees
Sweden	Swedish Revenue Agency 13/05/2022 Guidance on home office	Yes / No		<ul style="list-style-type: none"> • Focus on the advantage for the enterprise • Office equipment made available not relevant

III. Recent case law and administrative practice on PEs and evolving trends

GERMANY: DIRECTORS AS PERMANENT REPRESENTATIVES



- **“Permanent representative” (PR) in Germany may trigger corporate income tax liability**
- **Until recently board members were not regarded PRs (they “are” the company and cannot represent themselves)**
- **German Federal Fiscal Court (23 October 2018, I R 54/16) now holds a board member may be a PR if: (i) acting regularly over a certain period of time in Germany (most treaties also require conclusion of contracts on behalf of the enterprise); (ii) income is actually attributable to the PR**
- **Alert for board members of foreign corporations acting out of Germany (15.8% corporate income tax but no trade tax if no “fixed place of business” in Germany available to board member)**
- **Practical recommendations:**
 - Avoid “fixed place of business” in Germany as working base for a foreign director
 - Ensure foreign director is only occasionally acting out of Germany (“no significant footprint”)
 - No board meeting to take place in Germany
 - No signing of documents to take place in Germany

ISRAEL: ADMINISTRATIVE PRACTICE ON PEs OF INTERNET COMPANIES



- **Circular 4/2016 imposed broad PE standards, including:**
 - **Fixed Place of Business PE** – imputation to MNEs of the activities of Israeli subsidiaries' employees such as sales support and marketing
 - **“Principal Role” standard** – employees of Israeli subsidiaries perform the substantive activities that lead to the contract being signed
- **Retroactive effect** - the circular interprets existing law / PE definitions, thus applies retroactively even prior to the entry into force of the MLI and even with respect to treaty counterparties that have not signed the MLI
- Non-treaty countries MNEs are subject to the **“Significant Digital Presence”** standard

ISRAEL: ADMINISTRATIVE PRACTICE ON PEs OF INTERNET COMPANIES

RECENT DEVELOPMENTS



- **Tax audits**
 - Most MNEs are under audit
 - The ITA also argues for failure to withholding tax from deemed royalty payments made by the PE
 - Some audits are settled via transfer pricing-based adjustments
- **Withholding tax** – all cross-border payments are subject to withholding tax unless the payee obtains an ITA exemption certificate. Banks serve as gate keepers. The ITA generally agrees to issue exemption certificates.

ITALY: INVESTMENT MANAGEMENT PE EXEMPTION



- **2023 Budget Law: agency and material PE exemptions for foreign SPV** acting through agents who:
 - act in the name or on behalf of SPV (or its subsidiaries) AND
 - conclude (or contribute to the conclusion of) contracts for the acquisition or sale or negotiation of financial instruments, including derivatives, shares and receivables AND
 - meet the following conditions:



ITALY: INVESTMENT MANAGEMENT PE EXEMPTION



- (a) SPV resides in a White List country
 - (b) The agent neither is a board member nor controls SPV or its subsidiaries and does not hold more than 25% of the profit participation rights in the same vehicle
 - (c) The remuneration of the manager must be supported by TP documentation
 - (d) Implementation requirements for independency to be set by Revenue Agency Regulations
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- Fixed place of business at disposal of a resident company is not considered as a Material PE of the non resident vehicle just on the basis of the circumstance that said activity produce a benefit to the foreign vehicle

IV. Conclusion

PE RISKS: POINTERS FOR 2023



- Review home office corporate guidelines (restrictions for senior management)
- Replace home office with service agreements or secondment of employees
- Apply for APAs
- Take advantage of domestic PE exclusions
- Avoid physical presence at premises of foreign subsidiaries
- Review and restrict (where appropriate) powers of directors of foreign corporations