

PE Watch: Latest developments and trends, July 2020

EY Tax News Update: Global Edition

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Overview

This is a monthly report with brief summaries of the latest global activities with respect to permanent establishments (PEs). The report will include multilateral developments at the OECD and regionally as well as the latest country specific legislative and administrative activity related to the global focus on PEs. Links to more detailed information are included.

BEPS Multilateral Instrument (MLI)

Kazakhstan

On 24 June 2020, Kazakhstan deposited its [instrument of ratification](#) of the MLI with the OECD and confirmed its MLI positions. With respect to the PE provisions, Kazakhstan confirmed its preliminary positions (including reservations) and did not make any additional reservations. Therefore, the PE provisions will be applicable to Kazakhstan's Covered Tax Agreements (CTAs) to the extent that there is a matching position between Kazakhstan and the other contracting state. The MLI will enter into force for Kazakhstan on the first day of the month following the expiration of a period of three calendar months beginning on the date of the deposit of its instrument of ratification, i.e., on 1 October 2020.

Oman

On 7 July 2020, Oman deposited its [instrument of ratification](#) of the MLI with the OECD and confirmed its preliminary positions regarding the PE provisions. Oman reserved the right so that none of the PE provisions apply to its CTAs. The MLI will enter into force for Oman on 1 November 2020.

Case law and tax rulings

Colombia

The Colombian Tax Authority's Tax Opinion No. 370, dated 30 March 2020, was recently published. As per this tax opinion, profits distributed from a Colombian branch to its head office in Spain should not be considered "dividends" under the tax treaty between Colombia and Spain since the dividend treaty definition requires the existence of a "corporate right," which does not exist between a branch and its head office. Instead, profits distributed from a Colombian branch to its head office should be considered "business profits" covered by Article 7 of the tax treaty.

See EY Global Tax Alert, [Colombian Tax Authority clarifies profits distributed by Colombian branch to its home office in Spain are not dividends](#), dated 10 June 2020.

Denmark

On 30 June 2020, the Danish Tax Board (DTB) published two binding tax rulings (*bindende svar*) analyzing whether a representative office in Denmark constitutes a PE and whether procurement and logistics activities in Denmark constitute a PE, respectively. The [first tax ruling](#) addresses a Japanese company intending to set up a representative office in Denmark where one employee of the Japanese company would be performing activities there. The activities mainly relate to the representation of the Japanese company with other group companies, and the identification of potential business opportunities in Europe, specifically the Nordic countries. According to the tax ruling, an office is not in itself sufficient to determine a PE but rather it needs to be a place of business. In this particular case, the employee of the Japanese company does not carry on any business in Denmark and no customer-related activities, therefore, the representative office can be considered as a preparatory or auxiliary activity and consequently a PE would not exist. There has been similar rulings in Denmark in the past where the DTB found that a representative office performing similar duties did not constitute a PE.

With regard to the [second tax ruling](#), an employee of a Danish entity of a group assists an Irish company with procurement and logistic activities in connection with the distribution of products in Scandinavia and participates in the entire initial procurement process, including meetings with suppliers. The Danish employee is not authorized to negotiate contracts on his own or to conclude contracts for the Irish company since the Irish managing director is responsible for negotiating prices, contract terms, and contracting with suppliers. According to the tax ruling, the Irish entity does not have a PE in Denmark since the Danish employee does not have sufficient authority to conclude contracts on behalf of the Irish company.

Spain

On 3 March 2020, the Spanish Supreme Court issued a decision regarding the limits of a dynamic interpretation of tax treaties. The case concerns a Spanish company operating in Switzerland by means of a branch located therein. In the case at hand, the Spanish Tax Authorities assessed this case by interpreting the 1966 Spain-Switzerland tax treaty invoking the Commentaries to the 2005 Model Tax Convention (OECD MTC). The Spanish Supreme Court ruled in favor of the taxpayer for a number of reasons including that the OECD MTC Commentaries may not be directly invoked without the basis of a tax rule with normative value, since doing so, ignores the definition of PE agreed by both jurisdictions and substitutes it with a different and extended definition of PE.

See EY Global Tax Alert, [Spanish Supreme Court rules on limits to dynamic interpretation of tax treaties](#), dated 17 June 2020.

PE developments in response to COVID-19

Canada

On 26 June 2020, Canada extended the application period of its [guidance](#) on COVID-19 on international income tax issues raised by the COVID-19 crisis, including PE issues. The guidance initially was going to be applicable from 16 March until 29 June 2020. However, as the COVID-19 situation and travel restrictions remain in place, the guidance will now be applicable until 31 August 2020. Additionally, as it is currently uncertain how long it will be necessary for the travel restrictions to remain in place, the Canadian Revenue Agency may further extend the guidance or rescind it if no longer required.

Denmark

On 5 June 2020, Denmark launched a [public consultation](#) on guidance around some of the international tax issues arising as a consequence of COVID-19, including: (i) tax residency of both individuals and persons other than individuals; (ii) taxation of employment income; and (iii) permanent establishments. The Danish Tax Authorities (SKAT) agree with the OECD guidance on the tax treaty implications of the COVID-19 crisis and hence the draft guidance follows the OECD Secretariat's analysis on the same. Following the public consultation period, on 3 July 2020, the SKAT published the [final guidance](#) which confirms, without modifications, the draft guidance.

Other PE developments

Nigeria

On 29 May 2020, Nigeria published the Companies Income Tax Order (the Order) with retroactive effect as from 3 February 2020, to provide guidance on the definition of Significant Economic Presence (SEP) as included in the *Finance Act 2019*. To clarify the scope of the SEP, the Order makes a distinction between digital services and technical, management, consultancy or professional services, provided that both type of services are rendered by nonresident companies (NRCs) to entities in Nigeria. Regarding digital services that may create a SEP, the Order includes three categories, namely: (i) downloading digital content, transmission of data, provision of goods or services and intermediation services through digital platforms, as long as these digital activities exceed certain turnover thresholds; (ii) use of a Nigerian domain name of a website; and (iii) a website has a strong and consistent interaction with users in Nigeria. Regarding technical, management, consultancy or professional (TMCP) services, the Order provides that NRCs providing TMCP in Nigeria shall have a SEP where they earn any income or receive any payment from a person resident in Nigeria, or from a fixed base or agent of NRCs in Nigeria. Furthermore, the Order clarifies that in the future, if there is a multilateral agreement/consensus arrangement addressing the tax challenges arising from the digitalization of the economy to which Nigeria is a party, such agreement should prevail over the SEP provisions for digital services.

The Federal Inland Revenue Service might issue additional guidance on the application of the SEP provisions, as well as on other tax considerations related to it, such as profit attribution to a SEP in Nigeria, in the future.

See EY Global Tax Alert, [Nigeria issues order on definition of significant economic presence in Nigeria](#), dated 2 June 2020.

United Nations (UN)

From 22-26 June 2020, the UN held virtually its [20th Session of the Committee of Experts on International Cooperation on Tax Matters](#).

With respect to a PE, the UN Tax Committee discussed some [proposed changes](#) to the Commentary on Article 5 (PE) of the UN Model Tax Convention (UN MTC). The proposed changes deal with some of the modifications made to the OECD Model Tax Convention (OECD MTC) Commentaries on Article 5 in 2017 but due to limitations of time, the UN Tax Committee did not have the opportunity to include these changes in the 2017 UN MTC update. The suggested changes also comprise editorial corrections, including the update from references made to paragraphs from the OECD MTC Commentaries. Furthermore, one committee member identified a few [drafting/quoting errors](#) related to Article 5(5) of the UN MTC and as a result the UN Tax Committee offered to hold a first discussion of the proposed changes on the errors.

Additionally, the UN Tax Committee discussed and approved [draft changes](#) to the UN MTC Commentaries regarding the application of the limited force of attraction rule in Art. 7(1) UN MTC. The limited force of attraction rule is designed to catch the sales or other business activities carried on in the other contracting state of the same or similar kind as those carried on by the PE. However, in some cases that rule is applied to activities not carried on in that other state. A typical example of this situation are engineering, procurement and construction (EPC) contracts where the home office of an enterprise of a contracting state undertakes the provision of goods or merchandise and a PE of the enterprise situated in the other contracting state undertakes the assembly or installation activities in connection with such goods or merchandise but it has no involvement in the provision of the goods or merchandise. Some countries would even take this approach without having the force of attraction provision in the tax treaty. In light of this, the proposed changes clarify that where goods or merchandise are supplied by other parts of the enterprise, the profits arising from that supply do not result from the activities carried on through the PE and are not attributable to it.

Furthermore, the UN Tax Committee discussed a [note](#) which identifies possible topics to address in the next update of the UN MTC and topics that membership may wish to consider. With reference to possible topics to address in the next update of the UN MTC, the note recommends adding paragraph 5 of the Commentaries on Article 5 OECD MTC 2017 to the UN MTC to clarify that registration for Value-Added Tax/Goods and Services Tax purposes is not relevant for determining a PE under Article 5 of a tax treaty. Also, the note recommends deleting the note at the end of Article 7 UN MTC regarding the unresolved issue of attribution of profits to a PE for the mere purchase of goods and merchandise by the PE. Further, on the issues that membership may wish to consider, the note includes

the following: (i) further discussion on possible changes to Article 5(6) of the UN MTC to remove the carve-out for reinsurance, i.e. delete the phrase “except in regard to reinsurance”; (ii) self-initiated adjustments in situations where a taxpayer amends a filed tax return to adjust previously-reported profits; (iii) and providing an alternative provision like the one added to the OECD MTC to establish a time limit on profit adjustments made in accordance with Article 7(2) and 9(1) of the UN MTC.

Based on the discussions during the twentieth session, the aforementioned proposed changes will be revised and presented for final discussion and approval at the twenty-first session (potentially virtual) of the UN Tax Committee on 20-24 October 2020 open to non-governmental officials.

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