

PE Watch: Latest developments and trends, June 2020

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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)

In May 2020, a number of developments occurred with respect to the MLI. First, the **Czech Republic** and **South Korea** deposited their instruments of ratification with the OECD and confirmed their preliminary positions regarding the PE provision. Both the Czech Republic and South Korea reserved the right for all the PE provisions not to apply to their Covered Tax Agreements (CTAs). The MLI will enter into force for both jurisdictions on 1 September 2020.

See EY Global Tax Alert, [The Czech Republic deposits its instrument of ratification of the MLI](#), dated 27 May 2020.

See EY Global Tax Alert, [South Korea deposits its instrument of ratification of the MLI](#), dated 4 June 2020.

Also, **Russia** and **Switzerland** deposited with the OECD, a notification confirming they have completed their internal procedures for the entry into effect of the MLI provisions with respect to specific CTAs. This notification is required when a signatory has made the reservation in Article 35(7)(b) of the MLI. Hence, Switzerland notified the CTA with Luxembourg, and Russia notified 27 CTAs. With respect to the PE provisions of the MLI, Switzerland reserved the right to not apply any of the PE provisions, while Russia opted to apply all the PE provisions. The MLI will have effect with respect to notified CTAs after a certain time has elapsed from the date of the notification.

Switzerland and Russia will submit additional notifications once they have completed additional internal procedures for the entry into effect for other CTAs.

See EY Global Tax Alert, [Russia notifies OECD of entry into effect of the MLI for 27 of its tax treaties from 1 January 2021](#), dated 13 May 2020.

PE developments in response to COVID-19

In May 2020, a number of countries released guidance on PEs in response to the COVID-19 crisis, including Austria, Canada, Germany, Malaysia, Malta, and the United States (US). Specifically, **Malta** announced that it will adopt the OECD [guidance](#) on tax implications due to the COVID-19 crisis and their connection with tax treaty provisions. The Inland Revenue Board of **Malaysia** (IRB) published [guidance](#) on whether a foreign company may have a PE in Malaysia due to the temporary presence of employees in Malaysia due to COVID-19 related travel restrictions. According to the guidance, IRB will consider that the temporary presence of employees of a nonresident company does not result in the creation of a PE, provided it meets certain conditions, such as not having a PE before the travel restrictions and that the economic circumstances of the nonresident company have not changed.

The **German** Federal Centre Tax Office released [guidance](#) on various tax issues resulting from the COVID-19 crisis. With respect to a PE, the guidance only covers construction PEs. In this case, there should not be any tax consequences for nonresident companies, i.e., the interruption period should not be considered for the calculation threshold provided the company meets certain conditions, such as: the interruption period is at least two weeks, employees are not present on the construction site and the income derived from the construction project is taxed in the resident state of the nonresident company and the nonresident employees.

Likewise, the **Austrian** Ministry of Finance provided [guidance](#) on various international tax issues. Among others, the guidance covers a home office PE and a construction PE. For a home office PE, the guidance clarifies that employees of nonresident companies will not constitute a PE unless the home office becomes the new norm. For a construction PE, the guidance states that if a construction project is interrupted due to COVID-19, the interruption period should be taken into account for the calculation threshold. In addition, there is an ongoing consultation with Germany to address construction PE issues related to the ongoing crisis that may arise between Austria and Germany.

The **Canada** Revenue Agency (CRA) also published [guidance](#) on various international income tax issues. Among others, the guidance covers different situations regarding PEs such as: home office PE, agency PE and service PE. For a home office and agency PE, the CRA will not consider the existence of a PE provided that such activities would not have been performed in Canada but for the travel restrictions. For a service PE, the CRA will exclude from the 183-day threshold for any days of physical presence in Canada that are solely the result of travel restrictions. It is important to note that a PE analysis is a factual analysis and therefore, all facts under the specific case must be considered and the CRA reserves the right to review each scenario on a case-by-case basis.

See EY Global Tax Alert, [Canada Revenue Agency issues guidance on internal income tax issues resulting from COVID-19 travel restrictions](#), dated 21 May 2020.

Lastly, the **US** Internal Revenue Service on 7 May released Rev. Proc. 2020-30. As a result of travel restrictions and disruptions resulting from the global outbreak of COVID-19, individuals may be temporarily conducting activities in a country other than the US or in a territory of the US (any such country or territory, a “foreign country”) that would not otherwise have been conducted there. Absent guidance, there may be uncertainty regarding whether these activities give rise to a foreign branch separate unit for purposes of the dual consolidated loss rules under section 1503(d) or an obligation to file Form 8858 (Information Return of U.S. Persons With Respect to Foreign Disregarded Entities and Foreign Branches). Rev. Proc. 2020-30 provides that certain “temporary activities” conducted during a single consecutive period of up to 60 calendar days, as described in the revenue procedure, will not be taken into account for purposes of determining whether a domestic corporation has a foreign branch separate unit, or whether a US person is required to file a Form 8858 (i.e., certain temporary activities will not

give rise to a foreign branch (that is, either a foreign branch as defined in Treas. Reg. § 1.367(a)-6T(g)(1) or a qualified business unit as defined in Treas. Reg. § 1.989(a)-1(b)(2)(ii)). Thus, according to the revenue procedure, certain temporary activities conducted within a specified time frame do not give rise to an obligation of a US person to file a Form 8858, including an obligation to file a Form 8858 by attaching the Form 8858 to a Form 5471 with respect to a controlled foreign corporation or to a Form 8865 with respect to a controlled foreign partnership.

See EY Global Tax Alert, [Report on recent US international tax developments](#), dated 8 May 2020.

Other country PE developments

Denmark

On 20 May 2020, the Danish Tax Board (DTB) published a [binding tax ruling](#) (*bindende svar*) whereby it is analyzed whether an employee of a German company working from home in Denmark would constitute a PE. The German company and the employee signed a six-month contract, according to which the employee would perform his activities (i.e., strategic development of the business in the Danish market) at home and the German company would provide him with the necessary equipment to operate. According to the tax ruling, the employee's home in Denmark constitutes a place of business of the German company since the employment contract stipulates the employee's home as place of work. In addition, the tax ruling established that the employee's activities constitute a significant part of the business of the German company and cannot be said to be of preparatory or auxiliary character.

Italy

On 12 May 2020, Italy published, in the *Official Gazette*, a [law](#) introducing tax measures for the 2026 Milano Cortina Winter Olympic and Paralympic games. Among others, the law provides that PE rules will not apply with respect to activities carried on in Italy for purposes of organizing such event by certain organizations, for example the International Olympic Committee and the International Paralympic Committee.

Malaysia

On 21 May 2020, the IRD published [Guidelines](#) on the application of subsection 12(3) and 12(4) of the *Income Tax Act* (ITA) of Malaysia in determining the "place of business" of a person in Malaysia. The term "place of business" in Malaysia is to some extent equivalent to the term "permanent establishment" in a tax treaty context. Sections 12(3) and 12(4) were introduced into the ITA via the *Finance Act 2018*. The Guidelines provide guidance and examples on the determination of a place of business in the following categories: (a) a physical place of business; (b) preparatory or auxiliary activities; (c) a building site, construction, installation, assembly and supervisory activities; and, (d) an agent as place of business.

It is important to note that the Guidelines suggest that for the purpose of its domestic law, IRD applies the anti-fragmentation rule. The Guidelines stipulate that if the overall activity by the person or its associated person resulting from the combination of preparatory or auxiliary activities constitute complementary functions that are part of a cohesive business operation, such activity would not be regarded as preparatory or auxiliary. This is illustrated in Example 9 of the Guidelines whereby the overall activities of a nonresident company in Malaysia - including warehousing, toll manufacturing and marketing activities of a sales representative office - constitute complementary functions that are part of a cohesive business operation, and consequently, the nonresident company would have a place of business in Malaysia.

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