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Global Tax Alert

PE Watch: Latest developments and trends, September 2020

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PE developments in response to COVID-19

Canada

On 31 August 2020, the Canadian Revenue Agency again extended the application period of its guidance on various international tax issues arising due to COVID-19 until 30 September 2020 (but noted that it "does not anticipate further extensions of the guidance"). For details on the guidance, see *PE Watch: Latest trends and developments, June 2020*.

Philippines

On 17 August 2020, the Philippine Bureau of Internal Revenue published a circular on some of the international tax issues arising due to COVID-19. Among other topics, the circular clarifies that temporary interruptions of construction activities due to COVID-19 should be included in determining whether such activities constitute a PE. The circular also explains that working from home would not create a PE for a foreign enterprise in the Philippines unless the home office is used on a continuous basis for carrying on business activities of the foreign enterprise in the Philippines even after the COVID-19 crisis. The circular further provides that where an employee, partner or agent of a foreign enterprise is present in the Philippines as a result of travel restrictions, the Bureau of Internal Revenue will disregard such presence in determining the existence of a PE as long as certain requirements are met.

However, if the employee, partner or agent were habitually concluding contracts in the Philippines on behalf of the foreign enterprise before the COVID-19 crisis, the Bureau of Internal Revenue would take a different approach. The circular includes an example to illustrate the guidance on agency PEs.

Finally, the circular includes a non-exhaustive list of relevant documents that taxpayers should maintain and submit to the Bureau of Internal Revenue in order to prove that the extended presence in the Philippines was due to COVID-19 travel restrictions.

Tax Rulings

Ukraine

On 13 August 2020, the State Tax Service (STS) of Ukraine issued a non-binding tax ruling (№3349/ІПК/99-00-05-05-02-06) whereby it analyzes whether a person concluding contracts in Ukraine on behalf of a nonresident company creates a PE. In this ruling, a nonresident company entered into an agreement to buy agricultural products from a Ukrainian company. The nonresident company authorized its director, a foreign citizen who lives in Ukraine and has a temporary residency permit in Ukraine, to negotiate and conclude contracts on behalf of the company. Further, the nonresident company opened a bank account in Ukraine for making settlement payments under the agreement. The Ukrainian company wanted to know if the activities performed by the director would result in the creation of a PE for the nonresident company.

The STS replied to this ruling by referring to the general PE definition, which includes, among others, persons authorized by an agreement, other transaction, or by *de facto*, to negotiate terms and conditions (without any further material modification) of a transaction or to conclude contracts on behalf of, on the account of and/or for the benefit of a single nonresident company or its related nonresident parties. The STS noted that, the existence of a *de facto* authority to conclude contracts may be established if any of the following criteria is met:

i) When a person receives and complies with mandatory instructions from the nonresident company.

ii) The person uses the corporate e-mail of the nonresident company for communication with the nonresident company or any other third party with whom the nonresident company has already concluded or will enter into a transaction or agreement.

iii) The person disposes, wholly or partly, the nonresident company's goods or other assets in Ukraine on the basis of the nonresident company's instructions.

iv) The person has premises at their disposal for storage of goods acquired at the expense or belonging to the nonresident company.

Further, the STS indicated that a nonresident is not considered to have a PE in Ukraine if it carries out business activities through a resident intermediary, and such intermediary activities are in the ordinary course of the resident intermediary's business. However, if the resident intermediary acts exclusively or almost exclusively on the account, in the interest and/or for the benefit of one or more nonresident companies, which are related persons, the intermediary could qualify as an agent PE of such a nonresident or each of its related nonresidents. Lastly, the STS stressed that, once a PE has been determined, a PE should be treated as a separate taxpayer operating independently and calculate its profits in accordance to the general procedure in the Ukrainian Tax Code following the arm's-length principle.

On 10 August 2020, the STS issued another non-binding tax ruling (№3292/ІПК/99-00-05-06-02-06) whereby it analyzes whether a resident in Ukraine providing property management services to a nonresident taxpayer constitutes a dependent agent PE. In this ruling, a resident taxpayer in Ukraine receives payments from a nonresident taxpayer in return for services involving the conclusion and implementation of lease agreements on behalf of such nonresidents, rent collection, and the performance of the lessor's obligations and undertakings under the lease agreements. The taxpayer in Ukraine inquired whether its activities under the agency agreement could result in the creation of a PE in Ukraine for the nonresident taxpayer. The STS ruled that an agency agreement does not automatically create a PE for the nonresident taxpayer unless such activities carried out by the resident agent are primarily in favor of one particular nonresident or its related parties, in which case the nonresident taxpayer may create a PE.

On 1 July 2020, the STS also issued a non-binding tax ruling (No. 2644/6/99-00-05-05-02-06/ІПК), whereby it analyzes the tax consequences of payments made by a Ukrainian resident to nonresident companies for the provision of personnel in Ukraine. In this ruling, a resident in Ukraine entered into several agreements with nonresident companies to provide personnel to the resident in Ukraine.

The resident in Ukraine asked the STS whether the provision of personnel by nonresident companies would constitute a PE and therefore subject tax in Ukraine. Under the presented scenario, the STS concluded that if the activity of the nonresident companies consists exclusively in the provision of personnel at the disposal of third parties, then such activity should not constitute a PE.

Domestic law PE developments

Portugal

On 18 August 2020, Portugal published Law 43/2020 that establishes a temporary tax regime for income earned by non-tax residents with respect to the UEFA Champions League 2019/2020 finals held in Portugal. According to the law, nonresident entities organizing the UEFA Champions League, soccer teams, football players and technical team will be exempt from Corporate Income Tax and Personal Income Tax.

Latin America

In recent months, some Latin American countries have modified certain regulations to deem as a dividend distribution the remittance of profits by a PE to its head office, namely Ecuador and Colombia. Ecuador published Decree 1114 which, inter alia, deems the remittance of profits by a PE in Ecuador to its head office as a dividend distribution, and consequently such profits are subject to withholding tax at a 10% rate and 14% when the reporting of the ownership structure of the group is not fulfilled. The deemed dividend distributions from PEs to their head offices occur at the time the corporate income tax return of the PE is due (i.e., every year in April). This Decree follows the 2019 tax reform in Ecuador which introduced a dividend withholding tax from January 2020. Likewise, Colombia issued Decree 1054 that, among other items, clarifies that profits attributable to a PE and distributed to its head office are subject to dividend tax. Further, the Decree amends a number of regulations to adjust the taxation of PEs to not only cover Colombia source income attributable to the PE but also foreign source income.

See EY Global Tax Alert, *Colombia issues regulation on deferring income from private equity or collective investment funds, as well as rules on permanent establishments*, dated 5 August 2020.

Case Law

United Kingdom

On 28 August 2020, the United Kingdom (UK) Court of Appeal (Civil Division) dismissed the taxpayers' appeal in *Irish Bank Resolution Corporation Ltd. and Irish Nationwide Building Society v HMRC* [2020] EWCA Civ 1128 to allow deductions of interest paid by two British branches of Irish banks. This case is primarily concerned with two companies registered in Ireland performing financial services through branches in the UK which rendered them liable to UK corporate tax. In previous years, Her Majesty and Revenue Customs (HMRC) disallowed in the branches' calculation of taxable profits some of the interest shown in the accounts of the branches as an expense of the borrowings made by the branches in order to finance their lending business for the period between 2003 and 2007. Consequently, the taxpayers appealed such disallowance in 2019 and 2017 with the Upper Tribunal and the First-tier Tribunal, respectively. HMRC's basis for disallowing the interest deduction was the use of the Capital Attribution Tax Adjustment (CATA), which includes attributing notional additional free capital to a PE in cases where it is said that a PE operating as a distinct and separate enterprise would have had a higher amount of free capital and therefore a correspondingly lower amount of borrowed capital. The result of applying the CATA in this case was to disallow interest paid to third parties.

The taxpayers claimed that the business profits provision of the UK-Ireland tax treaty (Article 8) entitled them to the deductions. In particular, the taxpayers argued that the business profits provision in the tax treaty did not allow the application of CATA (notional capital to the PEs). The essence of the taxpayer's argument that the application of Article 8 requires an assumption not only that the PE is engaged in the same or similar type of business to the one it actually carried on, but also that it should be taken to have traded with the same ratio of free to borrowed capital as it actually employed during the relevant accounting period.

The Court of Appeal rejected the argument from the taxpayers by saying that in order to operate the assumption that a PE is a distinct and separate enterprise the tax treaty did not prescribe how this assumption is to be carried out. The judge noted that although there may be a number of different ways of giving effect to Article 8, the CATA is undoubtedly one of them and there is nothing in the language of Article 8 which prevents that being adopted by the UK.

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