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Global Tax Alert

PE Watch: Latest developments and trends, October 2020

EY Tax News Update: Global Edition

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BEPS Multilateral Instrument (MLI)

In September 2020, Albania, Bosnia and Herzegovina, Costa Rica, and Jordan deposited their instruments of ratification of the MLI with the OECD and confirmed their preliminary positions regarding the PE provisions. At the same time, Albania and Costa Rica removed certain tax treaties from their list of Covered Tax Agreements (CTAs). With respect to the PE positions, all these jurisdictions have adopted Article 12 (Agency PE) and Article 15 (Definition of closely related enterprises). Further, only Costa Rica and Jordan have adopted Article 13 (Specific activity exemptions), and only Jordan has adopted Article 14 (Contract splitting rule). The MLI will enter into force for all these jurisdictions on 1 January 2021.

On 22 September 2020, France added 29 tax treaties to its list of CTAs, to which all the PE positions previously confirmed by France would apply to the extent of a matching position.

PE developments in response to COVID-19

China

On 14 August 2020, the Chinese State Taxation Administration (STA) published a set of [Questions and Answers \(Q&A\)](#) on some of the international tax issues arising due to COVID-19. The Q&A makes a cross-reference to Circular 75 (2010) that reflects China's current interpretation on double tax treaties. Among other topics, the Q&A provides that a home office does not create a PE if the activity is intermittent or occasional during the pandemic. Likewise, the Q&A explains that occasional conclusion of contracts may not create an Agency PE. However, the Q&A clarifies that if an agent was already concluding contracts in China before the pandemic for a considerable period of time, an Agency PE may arise. Further, the Q&A provides that the STA will disregard the COVID-19 related interruptions of construction projects when calculating the time threshold of construction PEs.

Lastly, the Q&A also provides that if other tax authorities take different approaches to those set forth in the Q&A, and such approaches lead to double taxation or other tax-related disputes, taxpayers can submit the case for a Mutual Agreement Procedure.

Tax Rulings

Chile

On 31 August 2020, the Chilean Internal Revenue Service (IRS) published tax ruling 1876 whereby it analyzes the tax treatment of the notification of termination (*término de giro*) of a PE in Chile, according to the existing rules prior to 2020. In this ruling, a nonresident company carries out activities in Chile through a PE. The nonresident decided to incorporate a company in Chile via its PE. After which, the PE would cease to exist. The nonresident company asked the Chilean IRS about the tax consequences of the notification of termination of the PE in Chile.

The Chilean IRS indicated that after the notification of termination of a PE, the nonresident company should consider the following: (i) any accumulated profits of the PE will be subject to corporate income tax at a 35% rate; (ii) notwithstanding that the tax authority understands that there is no transfer upon the assignment of shares, since the head office and the PE configure the same legal entity,

the assessment faculty by the Chilean IRS if the assignment is substantially lower than fair market value would still apply; and (iii) upon termination of the PE, a withholding tax will apply on the distribution of profits made by the new incorporated company to the nonresident company.

Denmark

On 25 September 2020, the Danish Tax Board (DTB) published a binding tax ruling (*bindende svar*) analyzing whether a data center in Denmark, owned and operated under a hosting agreement by a Danish company, constitutes a PE of a nonresident company for Danish corporate tax or a Fixed Establishment (FE) for Value-Added Tax (VAT) purposes. In this tax ruling, the Danish company owns, leases and operates servers and other equipment. The servers and other equipment will be used by the nonresident company for hosting the website and related activity. Moreover, the Danish company's employees are responsible for installation, operation, maintenance under the instructions of the Danish company and do not conclude contracts on behalf of the nonresident company.

The DTB indicated that the nonresident company would not create a PE in Denmark under the fixed place of business or Agency PE provision of the relevant tax treaty (corresponding to article 5(1) and 5(5) of the OECD Model Tax Convention). The DTB also made a reference to earlier rulings published in 2015 and 2016. Additionally, the DTB determined that the Danish company did not give rise to an FE for VAT purposes since as a main rule a subsidiary does not create an FE and the nonresident company does not have the required human and technical resources in Denmark.

See EY Global Tax Alert, [Danish Tax Board rules Danish data center does not create a permanent establishment for nonresident company](#), dated 2 October 2020.

Ukraine

On 15 September 2020, the State Tax Service of Ukraine (STS) issued a non-binding tax ruling (3861/IPK/99-00-05-05-02-06) whereby it analyzes the tax consequences of a PE in Ukraine selling immovable property owned by the head office and located in Ukraine. Specifically, the taxpayer asked the STS about the tax treatment of the sale of an apartment owned by a nonresident and located in Ukraine, noting that the nonresident did not have a PE at the time of purchase of the apartment but had a PE at the time of sale.

The STS indicated that income from the sale of immovable property located in Ukraine is taxable therein as per the Tax Code. Further, the STS noted that any payment from income sourced in Ukraine to a nonresident is generally subject to a withholding tax at a rate of 15% unless an applicable tax treaty provides otherwise. However, the STS confirmed that this withholding tax is not applicable if the PE in Ukraine receives this income and then transfers it to the nonresident. In such case the PE should instead include this income in its taxable income subject to corporate income tax at the 18% rate. The tax base should be calculated under standard rules applicable to PEs.

On 10 September 2020, the STS issued another non-binding tax ruling (3797/IPK/99-00-05-05-02-06) whereby it addresses a situation where a nonresident entity contributes property of its Ukrainian representative office (which before that did not constitute a PE) into the capital of a Ukrainian company. The nonresident wanted to know if such capital contribution consisting of vehicles, owned by the nonresident and used by its representative office, would create a PE.

The STS noted that the Tax Code considers investments (including the purchase of shares) as business transactions, therefore such transactions may be a part of the nonresident's business activity in Ukraine. Further, the STS observed that the definition of a PE includes situations where a person has authority to negotiate the material terms of a transaction on behalf of a nonresident, or to execute such transactions. Hence, if the representative office of the nonresident negotiates the materials terms of the capital contribution/executes this transaction and meets the other conditions set out in the definition of a PE in the Tax Code, such representative office may create a PE.

Domestic law PE developments

Mexico

On 8 September 2020, Mexico's President submitted an economic proposal for 2021 to the Congress. Among other items, the proposal would extend the current joint liability rules to transactions between a company resident in Mexico or a PE in Mexico with nonresident related parties, to the extent the transactions effectively controlled by the nonresident relates parties lead to the creation of a PE.

The proposal is currently under discussion with the Chamber of Deputies and it may be subject to amendments. Once approved by the Chamber of Deputies, the proposal will be sent to the Senate for approval by 31 October 2020. Following approval by the Senate, the proposal will be sent to the President for his signature and will become law on the date of publication and it would be effective on 1 January 2021.

See EY Global Tax Alert, [Mexico's President submits 2021 economic proposal to Congress](#), dated 18 September 2020.

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