

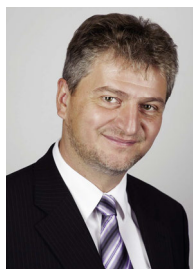
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Permanent Establishment Risk in Central and Eastern Europe



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Zoltán Lambert
Managing Partner

*WTS Global
partner firms from
10 different countries*

Dear Readers,

I am happy to introduce you to our first Tax Bridge this year. In order to place stronger emphasis on regional tax problems in Central and Eastern Europe, and to rise to the challenges of our era, we have renewed and refreshed not only the content but also the format of our publication.

From 2018 our Tax Bridge doubles up as our Central and Eastern European Newsletter. We still address a specific issue every quarter, just like before, but now the selected issue will also be examined from the viewpoint of different countries and WTS Global partner firms in the CEE region. We are proud to say that we were able to collect expertise from 10 different countries for our first regional Tax Bridge, focusing on the latest developments in permanent establishments in our region. This means you can read about the regulations in Austria, Belarus, the Czech Republic, Hungary, Poland, Russia, Serbia, Slovakia, Slovenia and in Ukraine.

BEPS (base erosion and profit shifting) Action 7 (Preventing the Artificial Avoidance of Establishment Status) on permanent establishments (PE) and the profit attributable to permanent establishments will sooner or later become a very hot topic in all CEE countries too, as it is now in Poland for example (where not only the corporate

income tax but also the VAT aspects can be challenging). Keeping the tax base in the countries where the actual work or service is performed will be more and more important. At this stage we see that CEE tax authorities do not follow a uniform approach with respect to permanent establishments. Some countries apply only the minimum standards in the Multilateral Instrument (MLI), while others focus more closely on the topic and have strict rules to conclude that a permanent establishment actually exists, and thus to tax the profit created in the given country.

If you are contemplating cross-border activities, it is good to know at least the basic tax rules in the country where the service or work will be performed. Nevertheless, we recommend contacting our colleagues directly before starting activities in these countries to avoid tax exposure and excess tax administration related to retrospective tax compliance for permanent establishments.

On behalf of all our regional staff, WTS hopes you will enjoy reading our Tax Bridge.

Zoltán Lambert
WTS Klient Hungary
Managing Partner
Regional Coordinator CEE

*CEE tax authorities
do not follow a
uniform approach*

*avoid tax exposure
and excess tax
administration*

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Passionate



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Excellent



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Reliable



Our actions are based on a reliable system of values. We keep our promises.



Mag. Martin Hummer
Senior Manager Tax

Increasing PE risk based on update of OECD-Commentary 2017

Author: **Mag. Martin Hummer**

Austria acted with great caution when it adopted the amendments proposed in BEPS Action 7. During the implementation of the MLI approximately 40 contracting states were named from an Austrian perspective (Covered Tax Agreements).

Several rules have not been adopted by Austria

The Austrian tax authorities have not undertaken a strict, formal interpretation of what is meant by an agency permanent establishment, but instead interpreted it from an economic standpoint. There was also no hesitation to accord commissioning agents the character of a dependent agent. As a result, Austria – as well as Germany and Switzerland – has not implemented Article 12 para 1 and 2 MLI (agency PE).

agency PE

auxiliary establishments

With regard to auxiliary establishments, Austria has decided to adopt Option A (Article 13 para 2 MLI), according to which all activities referred to in Article 5 (4) OECD-Model Tax Convention (MTC) 2017 shall not constitute a permanent establishment unless they are of a preparatory nature or ancillary to the overall activity of the company. The Austrian tax authorities have previously taken the view that the catalogue of exceptions only applies if the activities listed therein are not the core functions of the company. Therefore, in future the company will have to examine overall whether the activities mentioned contribute significantly or only slightly to its added value. Austria has not adopted the anti-fragmentation rule (Article 13 para 4 MLI).

anti-fragmentation rule

dividing contracts

Article 14 para 1 of the MLI seeks to enable states to prevent the avoidance of permanent establishments through dividing contracts into various elements of the contract (for the purpose of falling below the establishment threshold) (Article 14 para 2 MLI). Up to now, the Austrian tax authorities have dealt with the artificial division of contracts between two affiliated legal entities by applying national anti-abuse defences (Section 21 et seq Austrian Federal Fiscal Code). In addition, Austria had to incorporate the Principal Purpose Test (PPT) in its Covered Tax Agreements as stipulated in Article 7 MLI. This makes it possible to deny double taxation agreement (DTA) benefits if it can be assumed that one of the main reasons for an agreement or transaction was to gain an advantage. However, this regulation does not depend on whether the separation

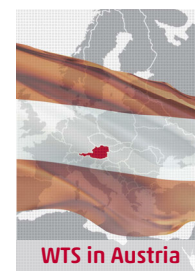
Principal Purpose Test (PPT)

of the contract is motivated by taxation or if non-tax-related reasons were decisive. Not least because of this, Austria has not incorporated this provision into its MLI-compliant DTA.

Consolidated version of double taxation agreement

The MLI requires national implementation in the form of a law (expected in 2019). In order to make it easier for the taxpayer to apply a DTA, taking into account the changes and adjustments made by the MLI, the Austrian Federal Ministry of Finance announced that it would publish a "consolidated" version of the respective DTA. In this, the regulations of existing DTAs are to be merged with the regulations adopted from the MLI.

The adjustments to the term definition proposed in BEPS Action 7 and Articles 12 to 15 MLI have been included in the 2017 update of the OECD-MTC and OECD Commentary and can therefore be used during DTA renegotiations and revisions regarding the Austrian treaty law. Moreover, practice shows that some states, including many developing and emerging economies, believe that the changes to the wording of Article 5 OECD-MTC and the OECD Commentary 2017 proposed by BEPS Action 7 do not represent new codifications, but rather just clarifications. These states could therefore be tempted to interpret existing, unchanged DTAs in light of the 2017 update. It is incomprehensible why "micro-businesses" should be assumed in future if no profit is attributable to them anyway due to a lack of definitive personnel functions. The OECD report Additional Guidance on the Attribution of Profits to Permanent Establishments of 22.3.2018 was thus keenly awaited.



regulations of existing DTAs are to be merged with the regulations adopted from the MLI

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"micro-businesses" should be assumed

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Local specifics of PE concept still cannot be ignored

Author: **Alexey Fidek**

Belarusian rules on the taxation of permanent establishments have peculiar local features in comparison to the OECD approach. This article briefly outlines some key specifics of the permanent establishment concept in Belarus, which foreign companies should take into account when entering the Belarusian market.

Sale of goods through a fixed place of business

A fixed place of business (e.g. a warehouse or an office) in the territory of Belarus through which a foreign company regularly sells goods can constitute a permanent establishment of the foreign company. However, in practice such foreign company will not be able to register its permanent establishment with the Belarusian tax authorities and fulfil its tax obligations. This is because the law does not establish a tax registration procedure in this case.

Under effective laws, foreign companies cannot open Belarusian branches and are not allowed to run business activities through their representative offices in Belarus. Therefore, in order to sell goods through a fixed place of business in Belarus a foreign company should either consider opening a Belarusian company or approaching a Belarusian intermediary.

Services permanent establishment

Under the Tax Code of Belarus, if a foreign company performs work or renders services in the territory of Belarus for 90 days (continually or on aggregate) in any 12-month period, the place for performing the work or rendering the services normally constitutes a permanent establishment of the foreign company.

The majority of Belarusian double tax treaties do not contain specific rules on a services permanent establishment. In practice, however, rules on a services permanent establishment from the Tax Code still apply. There are also certain double taxation treaties that prolong the term for recognising a services permanent establishment to 6 months in any 12-month period.

Dependent agent negotiating transactions

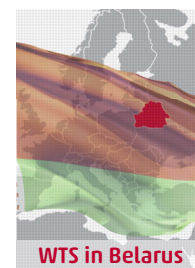
The vast majority of Belarusian double taxation treaties recognise a permanent establishment only if a dependent agent has and habitually exercises powers to conclude contracts in the name of a foreign company in the territory of Belarus. However, the Tax Code can be interpreted broadly in that a dependent agent of a foreign company involved merely in negotiating the essential conditions of transactions on behalf of the foreign company can constitute a permanent establishment. This should be taken into account especially if the foreign company resides in a country which has no double taxation treaty with Belarus.

Virtual permanent establishment

Effective Belarusian legislation and tax authority practices do not recognise the concept of a virtual permanent establishment. At the same time, the provisions of the Tax Code can be interpreted broadly in that a server in the territory of Belarus effectively controlled by a foreign company can constitute a permanent establishment if business is run through this server.

Permanent establishment and VAT

Belarusian law does not recognise the concept of a fixed establishment for value added tax (VAT) purposes. Normally, a foreign company incurs VAT obligations when it registers its permanent establishment with the Belarusian tax authorities.



a dependent agent of a foreign company involved merely in negotiating the essential conditions of transactions

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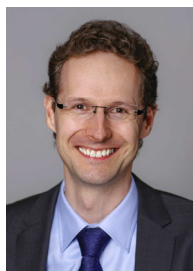
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National specifics of a service permanent establishment

Author: **Roman Pechacek**

According to Czech law, any active profits from business and self-employment are subject to taxation either as income of a resident taxpayer or income gained by a non-resident taxpayer from sources in the territory of the Czech Republic.

Basic principles

According to one of the key principles in double taxation treaties (DTTs), the taxation of active incomes gained by non-resident taxpayers is limited to cases where such incomes meet the parameters giving rise to a permanent establishment.

Incomes gained by residents of contracting states before the existence of a permanent establishment are not taxed in the source country, while the same incomes gained from sources in the Czech Republic by tax residents of countries with no double taxation treaty are subject to withholding tax of 15% or even 35%.

Thus in practice, the active incomes of a taxpayer resident in a contracting state are generally not subject to tax withheld at source by the payer of the income, with the exception of selected individuals' incomes (such as artists and sportspeople).

If the activity of taxpayers resident in contracting states gives rise to a permanent establishment, their income from sources in the Czech Republic shall be taxed based on a tax return.

Existence of a permanent establishment

Permanent establishment parameters are defined both by the national rules contained in the Czech Income Tax Act (ITA) and by the respective DTT.

According to the ITA, a permanent establishment means a place of business in the Czech Republic, such as a workshop, office, a place of extraction of natural resources, place of purchase (outlet) or construction site. A site or place of construction and assembly works and activities and services carried out by a taxpayer, its employees or persons working on behalf of the taxpayer are considered a permanent establishment if their duration exceeds six months within any period of 12 consecutive calendar months.

The above definition of a permanent establishment is very broad and is considerably modified or reduced by DTTs (DTTs define the institution of a dependent agent more broadly for example than Czech law). In particular, DTTs emphasise the permanent nature of the place of business.

Thus, most disputes arise with regard to a service permanent establishment, which is not defined in the OECD Model Tax Convention either.

Specifics of a service permanent establishment

Service permanent establishments are governed by the 6-month rule applicable to any consecutive 12-month period without the need for a permanent place of business.

According to the ITA, this applies to incomes from services, with the exception of construction and assembly projects, incomes from business, technical or other consultancy services, management and brokerage activities as well as similar activities carried out in the territory of the Czech Republic.

The application of this provision does not raise any doubts with service permanent establishments of taxpayers resident in countries that have not concluded a DTT with the Czech Republic.

Likewise, there are no problems with entities from countries that have agreed with the Czech Republic in their respective DTT that a service permanent establishment is defined by the duration of such activities. Most often a six-month period is specified, like in the ITA.

Currently, more than half of the treaties stipulate the period giving rise to a service permanent establishment. However, a large number of treaties do not include a definition of a service permanent establishment, such as with Germany, Italy, Japan, the Netherlands, Sweden, United Kingdom or Switzerland.

continued on the next page



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construction site*

*6-month rule
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12-month period*

*defined by the
duration of such
activities*

*a large number of
treaties do not include
a definition*

Disputed opinion of the Czech tax administration

The Czech Republic infers the existence of a service permanent establishment even in the case of entities resident in countries with which there is no special regulation in the DTT.

However, a number of experts do not agree with this opinion. Those opposed to this interpretation supported by the Ministry of Finance of the Czech Republic rely on case law, including that of the Supreme Administrative Court, since the views of the courts fundamentally contradict the opinion of the Czech Republic.

Also, foreign tax authorities often disagree with the opinion of the Ministry of Finance of the Czech Republic. For example, Germany's Ministry of Finance has long opposed the concept of service permanent establishments.

Consequently, if the duration of services in the territory of the Czech Republic exceeds the set period, there is a risk of a service permanent establishment that is not dependent on a fixed place of business. Taxpayers should always consider whether they should respect the opinion of the Czech tax administration or oppose it, thereby risking a legal dispute.

there is a risk of a service PE that is not dependent on a fixed place of business

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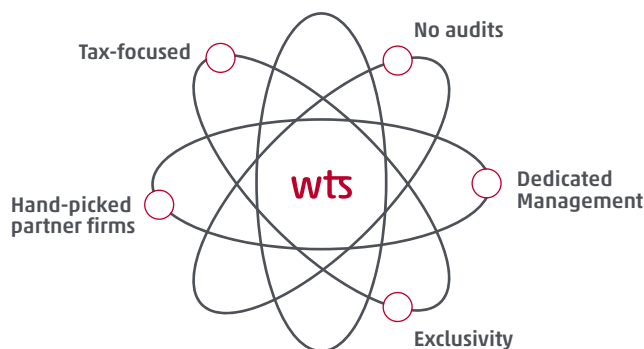
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Tamás Gyányi
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Stricter PE rules can be implemented in future

Author: **Tamás Gyányi**

At this stage there are no special Hungarian PE rules tailored to the BEPS initiatives. In June 2017 Hungary also signed the MLI, including only the minimum standards (preamble, principal purpose test (instead of limitation on benefits) and mutual reconciliation processes). It seems that Hungarian lawmakers do not treat action 7 as a high priority but may reconsider the application of stricter rules in future, i.e. after thorough consideration the provisions related to permanent establishments can be implemented.

Unchanged dependent agency PE rules

The domestic permanent establishment definition has been practically unchanged for many years now. However, the Hungarian Act on Corporate Income Tax clearly provides rules on the application of transfer pricing measures, i.e. transactions have to be set taking the arms' length rule into account, and TP documentation has to be prepared for transactions between the non-Hungarian head office and the Hungarian PE provided that the market value of the transaction is more than HUF 50 million (EUR 160,000) in a tax year.

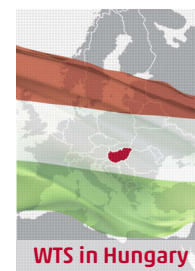
As far as special schemes are concerned, until now the Hungarian tax authority has not reviewed any agent / commissionaire schemes or warehousing taking the new approach of the OECD BEPS Action Plan into account, and the 2017/2018 tax law changes do not include any special dependent agent permanent establishment (DAPE) rule. In our practice, an agent scheme was never re-classified as a PE of a foreign (non-Hungarian) entity. There are no publicly available reports or information on the plans of the Hungarian Ministry of Economy to implement stricter provisions relating to the new dependent agent definition based on the final report of the OECD.

domestic PE definition has been practically unchanged for many years

2017/2018 tax law changes do not include any special DAPE rule

PE or a branch office is needed?

In Hungary, construction projects are often carried out with the participation of foreign companies. Companies registered within the EU are allowed to provide cross-border services without establishing a formal presence in the country in certain cases (Hungarian-registered company or branch). However, it is sometimes challenging to answer the legal question as to whether a branch / company is needed or simple PE registration is sufficient. This stems from the fact that there is a special Hungarian act on foreign investments, which does not really contain straightforward rules. The period for creating a construction or supervisory PE is set at 3 months by Hungarian law. In cases where the foreign company is resident in a country with which Hungary has concluded an agreement for the avoidance of double taxation, the provisions of the treaty prevail over the domestic regulations. So in most cases, the period provided in the respective treaties applies (generally 12 months as in the case of the treaty between Germany and Hungary), but the period can also be 24 months, like in the case of the Indian and Austrian double tax treaties.



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More focus on the issue of fixed establishments for VAT purposes

Author: **Lidia Adamek-Baczyńska**

Permanent engagement by a foreign company conducting business in Poland may imply a risk of having to create a permanent establishment for corporate income tax (CIT) purposes and a fixed establishment for VAT purposes in Poland.

Generally, the issue of fixed establishments affects the taxation of services provided by Polish entities to foreign businesses. If a foreign company has a fixed establishment in Poland, the services supplied to the company for the purposes of such establishment are subject to Polish VAT. Moreover, the company shall register for Polish VAT purposes and charge Polish VAT on its domestic supplies of services, unless the fixed establishment is not involved in the transaction.

No legal definition for fixed establishments in the VAT Act

Even though identifying whether the foreign entity has a fixed establishment in Poland is necessary for a proper VAT settlement, there is still no legal definition for fixed establishments in the Polish VAT Act.

Such a definition is provided in EU regulations (Article 11 of Council Implementing Regulation (EU) No 282/2011 of 15 March 2011 laying down implementing measures for Directive 2006/112/EC on the common system of VAT). As implementing regulations apply as a legal act in each EU country without the need to transfer into national law, the definition implemented by the EU is also applicable in Poland.

According to the definition for a fixed establishment, a company must have a sufficient degree of permanence as well as human and technical resources to allow it to receive and use the services supplied to it for its own needs.

Taxpayer-unfriendly approach

So, one crucial issue is what scale of human and technical resources are required for the fixed establishment to exist? As a difference in opinion across EU countries about what

constitutes a fixed establishment could result in double or non-taxation, or at least time-consuming clarifications, it is important to know how the different Member States define a fixed establishment.

Polish tax authorities and courts recently tend to prefer a taxpayer-unfriendly approach to the issue of fixed establishments for VAT purposes by broadening the scope according to which a company may be viewed as having a fixed establishment in Poland. They are also becoming more and more focused on this issue.

Foreign business presence in Poland has been increasingly considered to meet the conditions of a fixed establishment for VAT purposes, even though not all the related requirements are met to reach such a conclusion. According to some recent tax rulings and court decisions, a foreign entity has a fixed establishment in Poland under VAT regulations even if it has no human or technical resources there. It suffices if it transacts in Poland on a permanent basis, using its Polish subcontractors' infrastructure and personnel for this purpose.

Bearing the above in mind, the existence or non-existence of a fixed establishment and permanent establishment is critically important and should be taken into consideration when doing business in Poland.



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Vladislav Donchenko
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Development of permanent establishment concept

Author: **Vladislav Donchenko**

According to the general rule, a permanent establishment of a foreign company in the Russian Federation means a branch, representation, division, bureau, office, agency or any other economically autonomous subdivision or other place of business where that company regularly carries out some kind of business activity in the territory of the Russian Federation (Article 306 of the Russian Tax Code).

List of activities and types of PE in Russia

The activities of a preparatory or auxiliary nature as per Russian tax law that do not lead to the formation of a PE is similar to the list established by the OECD Model Convention, for example:

- Use of facilities solely for the purpose of storage, display and (or) delivery of goods belonging to said foreign company, before the beginning of such delivery;
- Maintenance of a permanent place of business solely for the purpose of purchasing goods;
- Collection, processing and (or) dissemination of information, accounting, marketing, advertising or market research of goods (works, services) sold by a foreign company if such activity is not the main (ordinary) activity of this company;
- Simply signing contracts on behalf of the foreign company, if the signing of contracts takes place in accordance with detailed written instructions from the foreign company.

three types of PE

Russian tax law covers three types of PE:

- Basic PE
- Agency PE
- Construction PE

from the moment business activity is regularly carried out

A permanent establishment of a foreign company is deemed formed from the moment business activity is regularly carried out through a subdivision of that company. Please note that establishing a subdivision without carrying out business activity does not result in a permanent establishment.

A foreign company acting through a PE in Russia has to submit a registration application to the Russian tax authorities within 30 days of beginning its business activity.

Description of PE types

Basic PE

A basic PE is a branch, separate subdivision or any other economically autonomous subdivision or other place of business through which a foreign company regularly carries out business activities in the territory of the Russian Federation.

Agency PE

An agency PE is formed if a foreign company carries out business activities through a person (entity or individual) which represents its interests in Russia (concludes contracts on behalf of that foreign company; negotiates significant contractual conditions on behalf of that foreign company), thereby creating legal consequences for that foreign company. As for the practical aspect, an agency PE in Russia may be created without any fixed place of business for the foreign company to act through.

Construction PE

A construction PE is formed if the foreign company carries out activities in the territory of the Russian Federation related to the construction or repair of real estate (except for airplanes, ships and space objects) and the construction or repair of floating and drilling rigs, as well as different machines and equipment which require fixation on foundations, or elements of buildings.

Russian tax law does not set a minimum term for the period of a construction PE. Therefore, a taxpayer has to apply the minimum period considered in the corresponding double tax treaty. A construction PE is recognised as formed from the beginning of regular business activity if there is no DTT between Russia and the country of the foreign company acting through the PE in Russia.

A permanent establishment of a foreign company is recognised as the taxpayer of the following Russian taxes:

- Corporate income tax (CIT)
- Value added tax (VAT)
- Excise duties
- Corporate property tax
- Land tax
- Transport tax



through a person (entity or individual) which represents its interests in Russia

related to the construction or repair of real estate

minimum period considered in the corresponding double tax treaty

continued on the next page

Taxation features of a Russian PE

CIT

The amount of PE corporate income tax should be calculated based on one of the following approaches:

- taxation of PE profit (PE income reduced by expenses)
- expense-based taxation

PE expenses should be used as the tax base if a foreign company carries out activities of a preparatory or auxiliary nature in the interests of third parties, without any remuneration.

Irrespective of the mentioned approaches, the amount of CIT should be calculated at 20% of the corresponding tax base.

VAT and other taxes

The taxation of Russian PEs regarding VAT and other taxes is based on general Russian tax laws. Sales of goods and services performed by a Russian PE are subject to Russian VAT, and the amount of VAT should be calculated at a rate of 18% (10% for specified goods).

when the Russian PE performs activities of a preparatory or auxiliary nature in the interests of third parties, without any remuneration. One example of this is case No. A40-155695/12. According to this tax dispute, a foreign company carried out promotion activity through its Russian PE for goods which were sold by the Russian subsidiary company (distributor) of said foreign company. As a result, the distributor benefited from free promotion provided by the parent company. The promotion expenses should be subject to CIT in Russia.

The application of agency PEs in Russia is developing very slowly. Russian tax authorities currently do not have the tools to recover tax from income of a foreign company which has an agency PE in Russia. As a result of tax disputes, the Russian tax authorities can deprive the Russian taxpayer recognised as a dependent agent of its right to deduct income paid to a foreign company. This approach was adopted in the largest agency PE case: No. A40-138879/14 ("LLC Oriflame Cosmetics" vs. the Russian tax authorities)

The concepts of Service PE and Server PE are not implemented in Russian tax law, and there is no draft law reflecting such PE concepts either.

the distributor benefited from free promotion provided by the parent company

tax authorities can deprive the Russian taxpayer recognised as a dependent agent of its right to deduct income paid to a foreign company

CIT should be calculated at 20% of the corresponding tax base

VAT should be calculated at a rate of 18%

Current application of PE concept in Russia

tax disputes

There are wide-ranging tax disputes regarding Basic PEs and Construction PEs in Russia. For example, the Russian tax authorities sometimes cast doubt over the accuracy of documented confirmation of expenses transferred by the foreign company's head office to the Russian PE (case No. A40-121559/16-20-1035; A40-3279/14).

Also, a Russian PE of a foreign company may find itself subject to the focused attention of the Russian tax authority

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Tax authorities increase the focus on PE existence

Author: **Bojan Radojičić**

Since the Republic of Serbia signed the Multilateral Agreement in June 2017, which governs the implementation of BEPS regulation measures, changes in the Serbian regulation of PE status can be expected in near future. Namely, BEPS Action 7 states that where a person is acting in a Contracting State (Serbia) on behalf of an enterprise (non-resident entity) and in doing so, habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts are:

- in the name of the enterprise or
- for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use or
- for the provision of services by that enterprise

*shall be deemed
to have a
PE in Serbia*

such enterprise shall be deemed to have a PE in Serbia in respect of any activities which the Serbian resident undertakes for the enterprise (non-resident entity).

Current regulation of PE

*determined by
mandatory conditions*

The existence of the PE is determined by mandatory conditions prescribed in Article 4, Paragraph 1 of the Corporate Income Tax Law that says: a PE is any permanent place of business through which the non-resident conducts its business, in particular: branch; plant; representative office; place of production, factory or workshop; mine, quarry or other place of exploitation of natural resources.

*last more than
6 months*

A PE may also comprise a permanent or movable site, construction or assembly work if they last more than 6 months, including:

- one or several construction or assembly projects executed concurrently, or
- several construction or assembly projects executed one after the other without interruption.

In addition, according to Article 4, Paragraph 3 of the Corporate Income Tax Law, if in representing a non-resident taxpayer, a person has a power of attorney to conclude contracts on behalf of that taxpayer, it shall be deemed that the non-resident taxpayer has a PE with regard to the operations performed by the representative on behalf of the taxpayer. In other words, if the resident person representing the non-resident taxpayer conducts commercial activities and makes a sales deal with a local customer,

but the director of the non-resident entity signs the contract, formally there is no PE risk given that the local person did not sign the contract.

Special tax authorities view

However, according to Article 9 of the Law on Tax Procedure and Tax Administration, tax authorities estimate tax facts in accordance with their economic nature. Accordingly, if the commercial representative makes a sales deal, tax authorities may assume that this person basically concludes the agreement with the local customer, which means a PE is created, regardless of the fact that the agreement is formally signed with the director of the non-resident entity.

A PE shall not be created if the non-resident taxpayer conducts its business through a commissioner, broker or any other person which, in conducting its own business, acts in its own name and for the taxpayer's account. A PE shall not be created either when:

- keeping stocks of goods or materials belonging to any non-resident taxpayer exclusively for purposes relating to storage, presentation and delivery, or using premises intended for such purposes exclusively;
- keeping stocks of goods or materials belonging to any non-resident taxpayer exclusively for the purpose of them being processed in another enterprise or by a sole proprietorship;
- keeping a permanent place of business exclusively for the purpose of procuring goods or collecting information for the needs of a non-resident taxpayer or for the purpose of engaging in other activities of a preparatory or ancillary nature for the needs of a non-resident taxpayer.



WTS in Serbia

*tax authorities
estimate tax facts in
accordance with their
economic nature*

*commissioner, broker
or any other person*

*storage, presentation
and delivery*

*being processed in
another enterprise*

*procuring goods or
collecting information*

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Lukáš Mokoš
Assistant of
Tax Advisor

More stringent definitions related to permanent establishment

Author: **Lukáš Mokoš**

The local definition of a new type of permanent establishment was introduced by the Tax Reform Law for 2018.

Digital platforms

Carrying out business through a digital platform used to habitually conclude contracts for the provision of transportation and accommodation services in the Slovak Republic will result in the creation of a permanent establishment.

new definition of a digital platform

The new definition of a digital platform covers a hardware or software platform required to create and administer applications. Legislators are pursuing the identification of a modern technological business model.

since 1 January 2018

Since 1 January 2018 foreign operators of digital platforms for such services must register a PE in the Slovak Republic, otherwise, the Slovak tax resident using the platform to sell their services must deduct tax from the payments made to the platform for the intermediary service provided.

Construction sites

interconnected taxpayers

The definition of the so-called construction (assembly) permanent establishment was amended too, in order to avoid an artificial division of the activities of interconnected taxpayers into several shorter activities. The location for implementing construction and assembly projects will result in the creation of a PE in Slovakia if these activities take more than 6 months on aggregate.

So, when assessing a construction PE, the entire period for completing the construction will be considered as well as the construction and assembly projects and the involvement of related parties.

Dependent agents

Amendments also cover the definition of so-called agent permanent establishments, to avoid the misuse of commissioning structures. The activity of a dependent agent in Slovakia, acting on behalf of an enterprise, will result in the creation of a permanent establishment if this person plays a main role in the contract conclusion without any fundamental change of this contract at the end.

Miscellaneous

Income of a non-resident from Slovak sources should also be considered income from payments from residents and Slovak permanent establishments of non-residents for:

- commercial, technical or other advisory services,
- data processing,
- marketing services,
- management or mediation services.

Irrespective where the services are provided, as far as expenses on such payments are tax deductible expenses the income is subject to withholding tax.



irrespective where the services are provided

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Mateja Babič
Partner Tax

Dependent agent rule in the past and in the future

Author: **Mateja Babič**

Slovenia is a small market with only 2.1 million inhabitants. The purchasing power of the individual is high, but the cumulative purchasing power of the inhabitants and businesses combined is comparatively small relative to other European countries. This is also the reason that foreign enterprises see the potential for selling products on the Slovene market, but not enough to establish a company in Slovenia.

Rare tax inspections in the past

Most foreign enterprises are present in Slovenia through agents, whose activity on the Slovene market is just to represent the foreign enterprise and present its products on the Slovene market. Agents are normally Slovene residents, acting solely for one foreign enterprise. Up until recently, the Slovene fiscal authorities tested the dependent agent rule based on contracts only. The authority would contact Slovene customers of the foreign enterprise to check what the role of the Slovene dependent agent was:

- Did the Slovene agent only present the products or also negotiate prices and delivery terms?
- Does the sales contract bear the signature of the agent or the foreign company's representative?
- Does the business card of the agent include information about the foreign company and that the agent is a salesperson?

*tax inspections
were rare*

Tax inspections on the dependent agent PE were rare in the past in Slovenia, due to the:

- high procedural costs in determining the tax base and proving the PE status of the dependent agent by the tax authorities,
- lack of knowledge about PE taxation by the tax administration and last but not least
- understaffed tax administration.

Current and future definitions

Article 6/3 of the Slovene CIT Act provides for a PE in the case of a person acting on behalf of an enterprise and who has and habitually exercises an authority to conclude contracts in the name of the foreign enterprise, unless the activities of such person are limited to activities of a preparatory or auxiliary character.

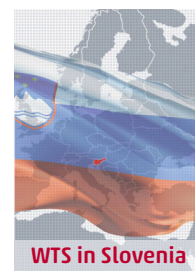
The current wording in the Slovene national legislation is aligned with the "old" definition in Article 5 (5) of the OECD Model 2014.

Will the legislator in Slovenia align Article 6 (3) of the CIT Act to the new wording in international taxation, which is embedded in Article 5 (5) of the OECD Model 2017, saying that a PE shall be deemed to exist when a person is acting on behalf of a foreign enterprise and, in doing so, habitually concludes contracts, or habitually plays the principal role leading to the conclusion of the contracts that are routinely concluded without material modifications by the enterprise, and these contracts are in the name of the enterprise, or for the transfer of the ownership of property, or for the granting of the right to use property owned by the enterprise or that the enterprise has the right to use that property, or for the provision of services by that enterprise.

Just a matter of time

It is important to point out that the Slovene tax authority already has all the information, systematically organised, on "future" dependent agents, especially those who have an employment contract with the foreign enterprise. Those dependent agents already submit monthly reports to the tax administration for the calculation of social security contributions and income tax because the foreign enterprise is not considered to be a payer in Slovenia.

In our opinion it is just a matter of time before the new wording from the OECD Model Tax Convention 2017 is adopted into national legislation, and therefore the range of foreign enterprises which will suddenly have a PE in Slovenia will increase dramatically.



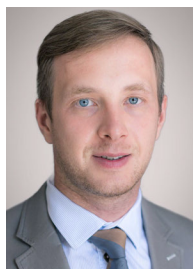
OECD Model 2017

*Slovene tax authority
already has all the
information on
"future" dependent
agents*

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Ivan Shynkarenko
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Extension of transfer pricing control to PEs of non-residents

Author: **Ivan Shynkarenko**

The Ukrainian law "on the amendment of the Tax Code and some other legislative acts to balance budget revenues for the year 2018" amended the Tax Code in such a manner that transfer pricing (TP) control applies to PEs in Ukraine starting from 1 January 2018.

As such, transfer pricing rules may now apply, inter alia, to transactions between a non-resident entity and its permanent establishment, and, possibly but not definitely, to transactions between permanent establishments inside Ukraine.

Both documented and non-documented transactions or deemed transactions are subject to TP control. This means that although from a civil law point of view there are no transactions between the PE and non-resident as such, "deemed" transactions between the PE and its non-resident are identified for TP purposes.

Legal basis for TP control of PEs

Such an approach follows the principle of distinct and separate taxpayers, as envisaged in paragraph. 141.4.7 of the Tax Code of Ukraine. In accordance with this principle, a PE for tax purposes is deemed to be a taxpayer, which conducts its own business activity separately from the non-resident.

For instance, Article 7 of the Double Taxation Treaty between Ukraine and Germany of 3 July 1995 envisages a similar approach. Paragraph 2 establishes that a PE for the purposes of attributing profits should be treated as "...a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment".

Alongside supplementing the list of business transactions for TP purposes the law also added the special valuation threshold for recognising controlled transactions between the PE and the non-resident entity (paragraph 39.2.1.7 of Article 39 of the Tax Code).

According to this rule, transactions between the PE and the non-resident fall under TP control provided that the annual value of

such transactions exceeds UAH 10 million (around EUR 386,000 at the current exchange rate).

Moreover, the recent amendments of TP rules also envisage the established value threshold being calculated not just based on accounting records but taking into account the arm's length value of transactions, including deemed transactions.

For the purposes of TP control, "deemed" transactions between the PE and non-resident shall be determined which may include (1) functions of the PE in Ukraine conducted for the benefit of the non-resident and (2) support from the non-resident to the PE.

Such functions of PE/support from non-resident would be considered "deemed" transactions between the PE and its non-resident for TP purposes, irrespective of whether they are documented as a transaction or not.

Based on current legislation and previous practice we conclude that the transactions between PEs are not yet considered to trigger TP control in Ukraine, yet this may still change.

Implications of new TP rules for PEs

In general, the introduction of TP control for PEs in Ukraine triggers the need for PEs to comply with Ukrainian TP rules, which means conducting a TP analysis, preparing and submitting the Report on Controlled Transactions and the TP Documentation detailing the TP analysis.

In the absence of official guidelines regarding TP analysis for the PEs, we tentatively conclude that the authorised OECD approach on the attribution of profits to PEs may be applied. Thus, the purpose of extending the TP rules to PEs is to ensure the fair attribution of profits to the PEs.

As such, TP analysis would require identifying all the functions of the PE in Ukraine and attributing the proper amount of profit for such functions applying the TP tools.

During the process of TP analysis we expect it would be necessary to define the functions of the PE and use TP tools compute the arm's length remuneration of such functions.



WTS in Ukraine

taking into account
the arm's length value

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absence of official
guidelines

documented and
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subject to TP control

special valuation
threshold for
recognising controlled
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*special rules for
calculating the
taxable profit of
PEs of non-residents*

For the sake of completeness, the Tax Code of Ukraine contains special rules for calculating the taxable profit of PEs of non-residents (paragraph 141.4.7 of the Tax Code). Thus, there are options for such a calculation:

- direct calculation;
- if the non-resident does not calculate the PE profit, a separate balance sheet of activities via the PE should be drafted subject to approval of the fiscal service;
- if such an estimate of PE profit is not possible, then "deemed" profit is calculated as 30% of the revenue of the PE.

This conclusion is also confirmed by representatives of the State Fiscal Service, who stated that changes to these rules are expected.

We will monitor the possible changes and follow up with updates. At the same time, since the above-mentioned provisions are new and there is little real experience on the matter, it is highly recommended to start such an analysis now, as soon as possible, in order to ensure respective PEs located in Ukraine are compliant with the new Ukrainian requirements.

little real experience

Alignment of new rules with rules on profit taxation of Pes

*starting from
1 January 2018*

These rules of the Tax Code were amended in connection with extending TP control to PEs. According to these amendments, starting from 1 January 2018 the above calculations of PE profits should be done with due consideration of TP rules, as set forth in Article 39 of the Tax Code.

However, we tend to conclude that the existing rules (as well as the regulations detailing the procedure of profit tax reporting by PEs) are not entirely aligned with the new approach that relies on TP principles and rules.

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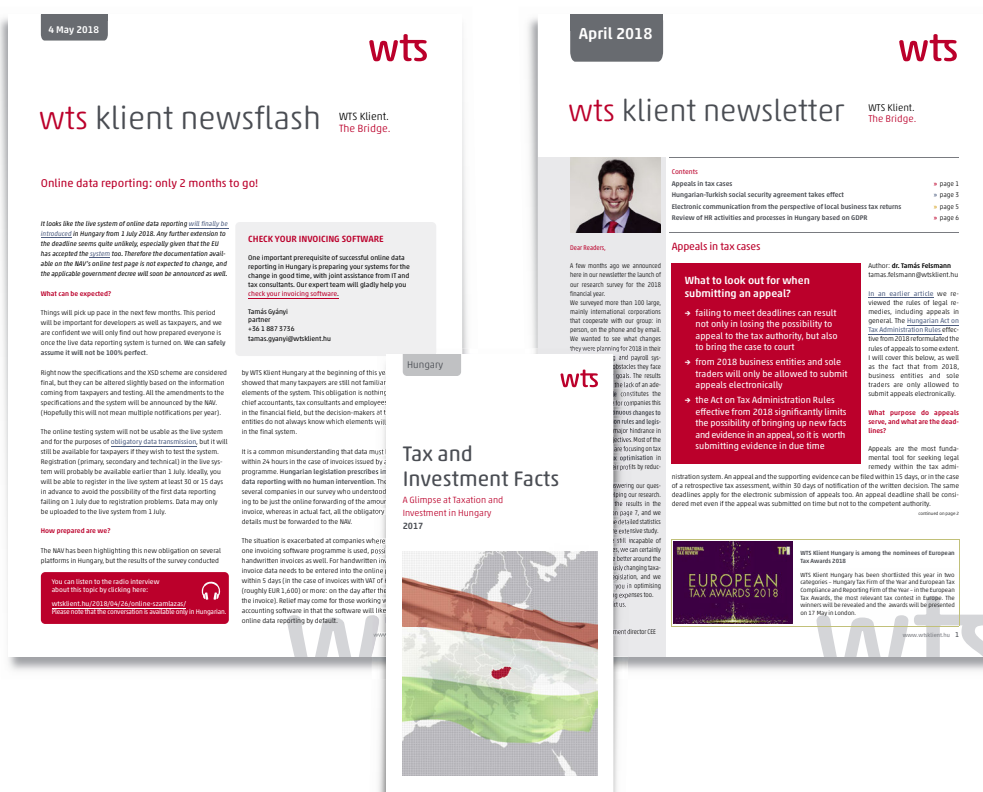
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