O n 5 October 2015 the OECD published its final package of 15 action plans designed to prevent tax base erosion and profit shifting. One of the actions, which could become relevant to Ukrainian companies in the near future, is changes to the permanent establishment (further — “PE”) concept.

### Why the BEPS project amends the PE definition

A foreign company may have different levels of business presence in Ukraine and some of the activities may be considered as a PE creating a taxable presence in Ukraine.

The Ukrainian Tax Code defines PE as a fixed place of business through which the business of an enterprise is wholly or partly carried out. In particular, PE includes a place of management, a branch, an office, a factory, a workshop, a mine, an oil or gas well. There are some exempt activities which are excluded from the PE definition (so-called “auxiliary and preparatory” activity).

PE may also arise if there is a dependent agent — a person who acts on behalf of an enterprise and concludes contracts in the name of the enterprise (even without having a fixed place at the disposal of such non-resident enterprise). No PE risk should arise if there is an independent agent who acts for the benefit of the non-resident enterprise in the ordinary course of its business.

The above definition is completely in line with the PE description outlined in the OECD Model Tax Convention. The OECD is currently facing new challenges created by developments in modern ways of conducting business, including active use by multinational corporations of the discrepancies and gaps in the national tax systems so as to reduce or avoid paying tax in the country where business is conducted. Therefore, the OECD has produced the recommendations on how to prevent base erosion and profit shifting (BEPS). In this article we will discuss a new approach to PE definition suggested in BEPS Action 7 “Preventing the artificial avoidance of PE status”.

### Why is it important?

BEPS recommendations will significantly influence the developments in national legislations and tax practices worldwide and it will not be possible for Ukraine to stand aside from global tax developments.

Having BEPS reports as guidance for action, the Ukrainian tax authorities may become much more sophisticated in treating international tax issues, including PE risks identification.

### BEPS changes to agency PE

The OECD has reviewed traditional PE tests to determine if the company creates a taxable presence in a foreign state and suggested their amendments.

— A widening of the dependent agent test

The current version of the OECD Model Tax Convention provides that an “agency PE” can exist only where a person in one state is “concluding contracts in the name of” an enterprise resident in another state. Moreover, “agents of independent status” will not constitute a PE.

According to BEPS reports, the concept of agency PE is changed. A representative may create an agency PE if his activity leads to the conclusion of contracts between a foreign company and a customer.

The OECD is also drawing attention to the use of commissioner arrangements by multinational enterprises, which shift their profits from high-tax jurisdictions to low-tax jurisdictions by using a commissioner to conclude contracts for sale of the non-resident’s goods and services. To prevent artificially-made commissioner schemes the report says that a commissioner would be considered as a dependent agent if contracts are concluded in his name, but are for transferring title for the goods/services of principal.

The wording of Article 5 (paragraph 5) is amended in the following way (table 1).

### Example of an agency PE

A company ABC, resident of State A, distributes various products worldwide through its website. Em-

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<th>Table 1</th>
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<tr>
<td><strong>Current version of OECD Model Tax Convention</strong></td>
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<td><strong>BEPS proposed amendments</strong></td>
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<td>Dependent agent — acts on behalf of enterprise and concludes contracts in the name of the enterprise</td>
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<tr>
<td>Dependent agent — acts on behalf of enterprise and habitually concludes contracts or leads to the conclusion of such contracts which are concluded by enterprise without a material modification</td>
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<td>contracts are either in the name of enterprise or for the transfer of title to property owned by enterprise/for provision of services by the enterprise</td>
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employees of company RBC, resident of State R, which is a fully-owned subsidiary of ABC, conduct different activities in order to promote the products of ABC (write e-mails, visit potential clients, negotiate contracts). When the customer is ready to buy a product a contract is concluded online between the customer and ABC. Such conclusion of the contract was a direct result of RBC’s employees activity. In view of the amended version of Article 5 such employees’ activity leads to the conclusion of contracts and as such creates a PE risk.
— A narrowing of the independent agent exemption

To determine if the person was acting as an independent agent it is necessary to analyse the scope of obligations which the person has vis-à-vis the enterprise. We also need to consider:
— if the agent bears entrepreneurial risks
— if the agent is subject to significant control by the principal
— if the duration of activities is a long period (an agent acting exclusively for one enterprise for a short period of time would possibly be considered an independent agent).

Another step in defining the independent status proposed by BEPS is introduction of the notion of “close relation”. In particular, the OECD is suggesting taking into consideration whether a person acts exclusively or almost exclusively for one or more enterprises to which it is closely related. Close relation to an enterprise is defined as a direct or indirect possession of more than 50% of the company’s shares.

The wording of Article 5 (paragraph 6) is amended in the following way (table 2).

**BEPS changes to the list of specific activities**

Activities which were considered as preparatory and auxiliary nowadays may correspond to core business activities due to changes in the way modern business is conducted. Therefore, in order to address such changes the OECD has introduced some amendments to the list of exempt activities.
— Tightening of specific activity exemptions from PE status

The OECD proposes changes to the list of exceptions for specific activities (such as maintenance of stocks of goods for storage, display, delivery or processing, and purchasing) under which a fixed place of business is treated as not creating a PE (paragraph 4 of Article 5).
— Who may be affected by such changes?

Historically, the exemption for activities, such as warehousing, was considered as preparatory or auxiliary. Modern ways of doing business, such as Internet sales, have made warehousing a logistics centre. Other activities are also viewed from the perspective of economic developments. As an example, below we present some types of activities which may trigger PE risk under BEPS approach (table 3).

In addition, large businesses may structure their operations in such a way that a cohesive operating business is fragmented (divided) into several small operations so as to argue that each part is engaged in preparatory and auxiliary activity.

BEPS proposes to address this issue by amending part 4 of Article 5. There will be no exemption if the overall activity from the combination of activities of related enterprises (which form part of a cohesive business operation) is not of a preparatory or auxiliary nature.

**Next steps**

Since BEPS project increases the attention to the permanent establishment issue, controlling the PE risks could be a challenge for a tax manager. Thus, it is of key importance to analyse all types of activities, which the company performs abroad (or a non-resident company performs in Ukraine) and to monitor the presence of employees in foreign states. In case PE risks are identified, it is necessary to elaborate on key mitigating factors to address the issue properly and comply with current BEPS requirements.