Permanent Establishment & Role of Residency

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Scope

Corporate Income Tax is applicable to all UAE businesses and commercial activities alike, except for the extraction of natural resources, which will remain subject to Emirate level corporate taxation.

1. Corporate carrying on business activities in the UAE
2. Individuals carrying on business activities in the UAE - Freelancers, Social Media Influencer's
3. Individuals who are required to obtain a professional or commercial license under any Regulatory Authority for the provision of their activities
4. Non-Residents carrying on the business in the UAE through any means
5. Freezone Entities undertaking business activities in the UAE

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Basis of Taxation

This section of the Public Consultation Document sets out the proposed basis of taxation under the UAE CT regime.

The introduction of a federal CT regime will provide a basis for the UAE to execute its support of the global minimum effective tax rate as proposed under "Pillar Two" of the OECD Base Erosion and Profit Shifting project.

RESIDENTS

NON-RESIDENTS

PERMANENT ESTABLISHMENT (PE)

Residents

Residency is a key determinant of whether business profits will be subject to CT in the UAE.

For UAE CT purposes, a legal person incorporated in the UAE is automatically considered a 'resident' person. For the purposes of the UAE CT regime, any natural person engaged in a business or commercial activity in the UAE, whether in their own name or through an unincorporated partnership, will be considered a resident person.

If a foreign firm is properly managed and controlled in the UAE, it may be treated as a resident person. Whether or not an entity is effectively managed and controlled in the UAE is a matter of fact, however it is usually determined by looking at where the company's directors or other decision makers make critical management and commercial decisions.

Non-Residents

Non-residents will be subject to UAE CT, specifically:

1. Taxable income from their Permanent Establishment in the UAE

2. Income which is sourced in the UAE

Non-Residents

The concept of PE is an important principle of international tax law used in CT regimes across the world.

The activity threshold that will trigger a PE for a foreign company in the UAE will be determined by the following two main tests:

1. Fixed place of business test
2. Dependent agent test

Fixed Place of Business

A foreign company will have a PE in the UAE if it has a "fixed place" in the UAE through which the business of the foreign company is wholly or partly carried on.

ELEGIBLE TO PE

A fixed place of business will include a place of management, a branch, an office (including a temporary field office or an employee's home office), a factory, a workshop, real property, and a building site where activities are carried on for over 6 (six) months. Installations and structures used in the exploration of natural resources, as well as mines, oil or gas wells, quarries and other places of extraction of natural resources will also be considered PEs

NOT ELEGIBLE TO PE

If the actions carried out through the "fixed place" in the UAE are preparatory or auxiliary in nature, no PE may be incurred.
Examples of preparation and auxiliary activities are: Limited marketing and promotional activity, market research, and attending seminars or conventions.
It may also not be considered a PE if it is solely used to store, display, or convey the goods of a foreign company, or if it keeps a stock of goods for the sole purpose of transferring them to another person for processing.

Dependent Agent

In the absence of a “fixed place of business” in the UAE, the activities considered "dependent agent" in the UAE could still create a PE for a foreign company in the UAE

ELEGIBLE TO PE

When business travellers or UAE residents work on behalf of a foreign firm in the UAE and have, and regularly exercise, the right to execute contracts in the foreign company’s name, the “dependent agent test” may be met.
This includes circumstances where the person negotiates or settles contracts on behalf of a foreign firm in the UAE without the non-resident company’s involvement.

NOT ELEGIBLE TO PE

When a person conducts the foreign company’s business in the UAE in the usual course of their own business, a PE does not arise.
This “indipendenti agent exclusion” would only apply if the person is actually legally and economically indipendenti from the foreign corporation and does not work exclusively for it.
If a Free Zone Person has a PE in the mainland UAE, the same PE regulations and principles will apply.

Investment Manager Exemption

Given the UAE's status as a prominent investment and wealth management hub, the UAE CT system will allow regulated UAE investment managers to provide discretionary investment management services to overseas consumers without triggering a UAE PE for the foreign investor or foreign investment fund.

This exemption will be subject to requirements similar to those found in other major financial centers.

PE Risk Considerations

The PE threshold test is contained in many countries' domestic tax laws and double tax treaties. While multinational groups may have found that PE issues were not a key area of focus in the past, this position is now changing in light of the OECD's proposals outlined in Action 7 of the Base Erosion and Profit Shifting (BEPS) project.

In addition to the fixed place of business test and the dependent agent test, some double tax treaties include the concept of a service PE.

A PE risk that is not correctly manage can result in:

Unfunded and corporate tax liabilities	1
Potential indirect tax costs if appropriate VAT registrations have not been made	2
Employer reporting and social securities obligations	3
Damage to reputation and increased audits from tax authorities	4
Penalties and interest charges	5
Regulatory issues for certain industries	6

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PE Risk Considerations

CORE BUSINESS ACTIVITIES

Even if activities of employees are preparatory and auxiliary to the main trading activities of the company, the core business activities should not be fragmented with the aim to meet the preparatory and auxiliary exemption under Art. 5 OECD Model (Action 7)

GREY AREAS

Grey Areas - Customer service employees, software engineers, depending of the core activity of the company

RISK MITIGATION

Risk Mitigation – Regular monitoring of functions performed by the employees and how long such functions have been performed to identify the need to establish a legal entity in the source country

PE Profit Attribution

Direct Method – maintaining separate accounts for the PE and the Head Office (the OECD PE report 2010, the OECD Model 2010, OECD Comm. Art 7 2008).

PE can be profitable even if a company report losses

DIRECT METHOD

Indirect Method – allocating profit by way of apportionment (prior to the OECD PE Report 2010, the OECD Model 2008.

If a company as a whole is loss making, no profit can be allocated to PE

INDIRECT METHOD

Allocation of assets, free capital and profits under the functionally separate entity approach (the authorised OECD approach AOA) should be made by applying the direct method

APPROACH AOA

Authorised OECD Approach (AOA)

The AOA considers the Head Office and the PE as if thet were separate and independent entities.

Allocation of profits to PE under the AOA is based on a two-step process:

1. Functional analysis to identify where the “significant people functions” are located and what dealings exist between the Head Office and the PE

2. Transfer pricing analysis to determine the arm’s length remuneration between the Head Office and the PE by applying the TP methods under the OECD TP Guidelines

   Net profits of PE can be nil or even loss can be attributed to PE (the OECD PE Report 2018)

Authorised OECD Approach (AOA) - Issues

The AOA applies if double tax agreements (DTAs) include the latest version of Art. 7 OECD Model.

Many DTAs still include an older version of Art. 7 OECD Model, even those signed after 2010, and some countries concluded additional agreements governing the application of the AOA, e.g. USA/Germany

Although the AOA was already included in the OECD Comm. 2008, the AOA may not be applicable under the pre-2010 DTAs if static instead of dynamic interpretation is followed, e.g. Austrian DTAs are based on an older version of Art. 7 OECD Model

Authorised OECD Approach (AOA)

The concept of “significant people functions” (SPFs) – Key entrepreneurial risk taking (KERT) represents the functions requiring active decision making with respect to the assumption and management of such risks

SPFs are not represented exclusively by senior management but rather by the role actively involved in day-by-day decisions

Identification of active decision-making could be based on e.g. RACI matrix (responsible, accountable, consulted, informed)

Non-SPFs are not necessarily routine functions and should therefore not be ignored

Examples of SPFs in the OECD Report 2010 par. 83-91, 92-5,96-7

Executive Functions

Executive functions can take various formats, e.g.

- Board Members (usually more the strategic functions, typically registered in commercial registers)
- C-level employees, CEO, CFO, COO etc. (leaders, decision-makers, usually more operating functions)
- De facto executives (functions and activities like executives, no clear definition, employers vs contractors)

Assessment where decisions are taken depends on jurisdiction and corporate structure / governance structure

Corporate Dual Residence

Executive mobility can lead to corporate residence

If dual residence: place of effective management - OECD MT 4(3) / Commentary n. 24 (2010) & Commentary 24.1 (2017)

Case-by-case analysis e.g. Estonian E-Residence Project

The competent Authorities shall endeavour to determine by mutual agreement

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Thank You