

TRENDS IN REDEFINING THE CONCEPT OF PERMANENT ESTABLISHMENT

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Redefining the concept of Permanent Establishment (PE) is currently on OECD's agenda and represents one of the measures taken against the aggressive fiscal optimization measures adopted by the BEPS Action Plan (results: end of 2015). BEPS intends to redefine the PE in order to fight against the cases where the status of a PE is artificially (and not necessarily illegally) avoided. Updating the concept is at the same time, the object of a new OECD project regarding the interpretation and enforcement of the Comments to Article 5 with respect to the Permanent Establishment of the Model Tax Convention („OECD Project”). The Project was amended during 2011-2013 and it is envisaged that the amendments and clarifications introduced by the Project to be included in the next updated version of the OECD Comments to the Model Tax Convention (expected in 2014). Although Romania is not an OECD member, it is very likely that such amendments shall influence Romanian legislations as well (considering the similarities of the definition of the PE and the references to the Norms of the Fiscal Code).

Although there is no definitive test to establish whether a non resident generates a PE in Romania, there are however certain elements which can be verified in order to determine if an activity is suspected to generate a PE, considering the type of PE.

With regards to the first type of PE, the PE constituted by a fixed place, the following shall be considered: (i) the existence of a place of business/place where the activity is exercised; (ii) the existence of the right to use such a place, respectively to what extend the place is at the disposal of the non resident; (iii) the fixed nature of the place of business; (iv) the degree of permanency of the place of business; (v) if the non resident exercises its activity through the respective place. Also, the activities carried out through the respective place must not fall into the category of activities which are treated as exceptions, of preparatory or auxiliary nature, which are not deemed to be a PE.

With regards to the second type of PE (specific), respectively a PE given by a construction site, a construction, assembly or installation project, or relating supervision activities, the only element which must be considered is the degree of permanency.

In case of the last type of PE, the one generated by an agent, it must be considered, first, that only a dependent agent can generate a PE, and not an independent agent. We shall verify in this case, if (i) the agent/person is authorized and exercises in Romania the powers to conclude contracts in the name of the non resident, or if (ii) he maintains in Romania a quantity of products of which he makes deliveries in the name of the non resident, or if (iii) it carries out activities entirely or almost entirely for the non resident, as part of its usual activity, and if the commercial and financial relations between the agent and the non resident have different terms and conditions as opposed to those between independent persons.

In order to verify in fact whether a certain activity generates or not a PE, we have selected a few examples from the OECD Project. A first example is that of a consultant (Authorised Private Individual resident in Austria) carrying out training activities for the personnel of a Romanian company for a period of 20 months. The training is carried on in several buildings of the Romanian company, located in an Office Building. With respect to the aspects above mentioned, we notice that there is a place of business (the buildings), the consultant has the right to use the place, the degree of permanency is complied with (20 months) and the consultant carries out its activity through the respective place. With respect to the fixed nature of the place of business, it must be verified if each place (building) constitutes a separate PE or if there is a single fixed place. Since the Office Building represents a distinct location incorporating all the buildings, and can be identified as a unit both from the commercial and the geographic point of view, the activities carried on in such a place for a single client shall be considered as carried on through a single place of business, regardless whether they are in fact carried on only in certain areas of the place.

The second example refers to an employee transferred in Romania for a period of 24 months, carrying out field work and office work for his non resident employer with respect to several independent construction sites. The activity exercised by the employee on each construction site does not exceed 3 months, and the office work is carried on in his Romanian home place. Since the employee is not present on any of the construction sites (distinct places of business) for more than 3 months, none of the sites shall constitute a PE for the non resident employer. The activity carried out at the Romanian home place can however be analyzed separately from the perspective of an PE since it fulfils the conditions necessary in order to constitute a fixed place of business, through this fixed place it can be considered that the company carries out its activity and the place is maintained for a sufficient period of time. However it is not clear if the Romanian home place of the employee is at the disposal of the non resident employer. The home may be used especially in order to avoid making available another space (not necessarily in order to avoid the status of PE, but rather for cost purposes). Such a space, if leased by the non resident employer, would be considered at its disposal, and thus constitute a PE. The OECD Project tries to clarify such a case, stating that: when a person's home is regularly and continuously used for carrying out activities for a company, and when it is clear from the facts and circumstances that the company requested the person to use the home place for carrying out activities of the company (for instance, by not providing an office space when the nature of the activity requires it) the home place may be considered at the disposal of the company.

The next example refers to a non resident entrepreneur who subcontracts all the terms of an contractor agreement for construction works executed in Romania and who is not directly present in Romania. In this case, the risk of constituting a PE is analysed only in relation to the degree of permanency, which in this case could not be relevant since the works are executed entirely by subcontractors. Subcontracting all the aspects of a contract entirely and the lack of a presence in Romania should lead to the conclusion that the non resident contractor does not constitute a PE in Romania. The OECD Project includes a proposal to extend the concept of a PE to this case of complete subcontracting, which generated negative reactions from the business environment, considering that such a proposal would

lead to the situation where a PE is generated in the absence of the activity actually carried on / an actual presence.

The fourth example refers to the case of 2 Austrian companies that become partners in a company without legal personality in order to execute a construction project in Romania for a duration of more than 12 months. The case raises the question of establishing whether the activities of the Austrian companies are of such nature to generate a PE when one of the companies carries out activities in Romania for 8 months and the other for a period of 10 months. The example is clarified by the OECD's comments regarding the PE. As such, the test of the degree of permanency shall be considered with respect to the partnership, and not to each partner separately. Therefore, both companies shall constitute a PE, considering the activity of the partnership exceeds 12 months (DTT RO – Austria). Through this OECD Project it is desired to clarify the fact that there are cases when 2 companies can exercise activities in a common project, separately, without sharing the profits resulted from such activities (only the incomes), in which case these companies must be considered separately, and the risk of generating a PE should be considered separately.

The last example is that of an Austrian insurance company which sells insurance policies in Romania through agents who are not employees of the Austrian company and carry out their activity from home. The activity of the agents consists of offering insurance policies, receiving requests from clients and sending such to the Austrian company, the agents not being involved in concluding the insurance contracts. From the point of view of a PE constituted by a fixed place and with reference to the previous example regarding working from home, it is not likely that the activity of the agents be of such nature to constitute a PE, the Austrian company not having at its disposal a fixed place of business in Romania. With respect to a PE constituted by an agent, considering that the agents in question do not have the authority to conclude contracts in the name of the Austrian company, it shall not be considered that their activity may generate a PE.

In addition to the clarification brought by the OECD Project, above mentioned, the following aspects are also relevant:

1. Clarifying the concept of „place at the disposal of the non resident”. According to the OECD Project, in analysing this concept one must consider both the actual power to use the respective place by a non resident, as well the duration of the non resident's present in the respective place and the activities carried out through such place.
2. Clarifications regarding the degree of permanency in the context of recurrent activities. The OECD Project gives as example the case of drilling operations in areas where climate conditions do not allow for execution of works for a period longer than 3 months per year but the operations are envisaged to be performed for a period of 5 years, considering the nature of the activity in the respective location, it may be considered that the degree of permanency is met in order to constitute a PE considering the recurring nature of the activity, even if any continuous presence lasts less than 6 months. Periods shorter than 3 months as mentioned above could have the same effects if required by the nature of the activity.

3. Clarifications regarding the time of closing a construction site and the additional works executed on a construction site. According to the OECD Project, in practice, handover of the building or installations to the client represents normally the end of the working period, provided the contractor and the subcontractors cease to execute any works on the construction site after the handover of the building for the purpose of its completion. At the same time, with respect to the works carried out after the construction works were completed, based on a guarantee which required the execution of remedy/repairing works, such works should not be included in principle in the initial period. However, given the circumstances, such activities, if carried out for a long period of time, could be analyzed separately from the point of view of a PE.

Some of the clarifications proposed by the OECD Project raised, however, negative reactions from the business environment. Thus, it remains to be seen if and how the clarifications above mentioned shall be included in the updated version of the Comments to the Model Tax Convention.

Should you require any further information, please feel free to contact us:

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