Permanent Establishment Risk Review

What it means for you

While multinational groups may have found that PE issues were not a key area of focus for many tax authorities 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, which relates to addressing the perceived artificial avoidance of PEs by multinational corporations.

Why action should be taken now

The increased interest in PE rules as a result of the OECD's proposals, coupled with the pace of change in the complexity of global business models and with increasing numbers of internationally mobile staff, is expected to lead to tax authorities worldwide focussing resources on mounting more effective PE challenges.

The risk of inadvertently creating a PE is therefore a key risk area for multinational corporations, and the effective control of PE risk, including a Permanent Establishment Risk Review, can form an essential part of a multinational corporation's wider tax control framework.

What are the indicators of PE risk?

Under the current treaty definition of PE, the threshold of activity of an enterprise in one territory that results in the creation of a PE in another territory is determined by two forms of presence as follows:

- **Fixed place of business test** – An enterprise has a PE in another territory if it has a fixed place of business there through which it carries on its business, subject to a number of specific activity exemptions.
- **Dependent agent test** – An enterprise has a PE in another territory where a person (other than an independent agent) is acting on its behalf, and habitually exercises an authority to conclude contracts in its name, in that other territory.

In addition to the above, some double tax treaties include the concept of a services PE, which can be created where an enterprise in one territory performs services in another territory through one or more individuals over a defined period of time. In practice, this type of PE is less common but should still be considered for the purpose of managing PE risk.

What are the benefits of getting this right?

Pro-actively managing PE risk can provide the following:

- comfort on a potentially high-profile area of challenge;
- reduction of the risk of unexpected tax payments by minimising the risk of errors, including penalties and interest charges;
- identification of opportunities for tax efficiencies and/or improvements to the internal control framework; and
- the ability to make appropriate disclosures to tax authorities showing that reasonable care has been taken to manage PE issues, reducing the risk of challenge and penalties.

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What happens if PE risk is not managed correctly?

PE risk that is not managed correctly can result in:

- damage to reputation;
- unfunded and "cliff edge" corporate tax liabilities;
- potential indirect tax cost in a territory if VAT is not correctly accounted for;
- more audits by tax authorities resulting in an increase in management time being spent and in cost being incurred;
- penalties and interest charges;
- issues left unaddressed for a long time possibly triggering the requirement to restate financial accounts;
- employer reporting obligations including payroll, tax and social security elements;
- employee reporting obligations including tax and social security elements;
- immigration considerations for employees; and
- regulatory issues (for certain industries).

Some practical steps you can take now

Ensuring you are able to maximise value in a cost-effective manner according to factors such as territory and/or business line complexity, known issues and the perceived level of risk is important. We can help you ensure that your specific needs across the relevant markets and territories are met by means of the following:

- **Full-scope review** – Interviews and discussions with relevant individuals, alongside desktop reviews, are used to drill down into the operational practice of documented policies and procedures and to assess and challenge the methodology of each business unit and the approach to governance of operational risk against current tax standards applied by the business.

- **Desktop review** – Where the level of PE risk is considered to be low, a full-scope review may not be the most cost-effective option. Sufficient coverage could instead be provided through a rules-based desktop review of the policies, procedures and processes applied in each territory and business line, benchmarked against central governance requirements and those of the local territory.

- **Focussed-scope review** – For areas where the level of PE risk is perceived to be moderate, the focussed-scope review replaces detailed interviews with the use of standard questionnaires/surveys addressed to key personnel, alongside a desktop review of the policies and procedures applied by the business to manage PE risk.

An alternative focussed-scope option is to adopt the full-scope approach but limit the detailed analysis of risks identified to a smaller, pre-agreed set of risks.

The above approaches reflect, where required, our multidisciplinary expertise brought through direct, indirect and personal tax experts.

Find out more

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