Global Tax Update

GENERAL

The impact of global mobility on permanent establishment status - Responding to the OECD's base erosion and profit shifting action plan.

Globally mobile employees can provide the foundation for multinational companies to be successful, whether employees are foreign secondees, business travellers, project workers or employees with global roles. Understanding the work employees do and where they do it however, is a critical element of determining corporate tax planning, particularly in the wake of the Organisation for Economic Cooperation and Development's (OECD) introduction of a Base Erosion and Profit Shifting (BEPS) Action Plan.

International organisations with globally mobile employees that want to avoid risks associated with tax compliance issues should be aware of Action 7 of the BEPS Action Plan in particular, as this action item is focused on reducing the artificial avoidance of permanent establishment status. By understanding the OECD's position and expected initiatives relating to permanent establishment status, international companies will be better able to develop an effective compliance response.

The OECD's base erosion and profit shifting action plan

Over the past three years, member states of the OECD have been working together in order to reduce base erosion and profit shifting by international companies. BEPS refers to organisations using tax planning strategies that take advantage of gaps in tax rules to shift profits to low or no-tax jurisdictions where there is little or no business activity, resulting in their paying little to no corporate tax.

Over one hundred countries worldwide have agreed to the OECD's fifteen point BEPS Action Plan, recognising that tax avoidance by international companies can create an unfair competitive advantage over companies operating domestically. The use of BEPS also undermines the public's trust in both global and local tax regimes.

The BEPS Action Plan includes a number of initiatives aimed at establishing international coherence related to corporate income taxation, realigning international corporate tax standards and rules, and ensuring transparency while increasing certainty and predictability related to corporate taxation.

Reducing artificial avoidance of permanent establishment status

With the increasing focus on corporate tax avoidance, the OECD is working to counter key risks and gaps. One identified weakness relates to globally mobile employees in particular. This weakness is the use of permanent establishment status. Action 7 of the BEPS Action Plan focuses on countering artificial avoidance of permanent establishment status by ensuring core business activities cannot benefit from the exception, and that artificial arrangements related to the sales of goods and services cannot be used to avoid PE status.

Action 7 is also geared toward preventing the artificial fragmentation of business operations among multiple group entities in order to qualify for exceptions to permanent establishment status.

As a result of Action 7, there are four impending changes associated with permanent establishment status that companies with globally mobile employees should seek to understand and incorporate within their tax compliance regime moving forward. These changes focus on the following areas:

Dependent Agent Test

Currently, permanent establishment rules associated with the dependent agent test focus on habitual conclusion of contracts by the agent. The OECD plan is to shift this definition to include both habitually concluding contracts and habitually playing the principal role leading to the conclusion of contracts that are routinely concluded without material modification. This particular change could affect companies that have senior executives, sales representatives or contractors conducting activities related to the conclusion of a contract in other tax jurisdictions.

There are a number of elements associated with this change that have yet to be defined, including the definition of 'principal role' and what would constitute a material modification to a contract. International companies will need to monitor Action 7 updates in order to understand what definitions are agreed to.

Independent Agent Exemption

A second change associated with Action 7 includes the tightening of the definition of when an agent is considered to be independent. In the future, agents that act exclusively or almost exclusively for an enterprise to which they are closely related will no longer be considered to be independent under corporate tax structures. Closely related is intended to mean that there is either direct or indirect control of the beneficial interests of the organisation. This rule change may have the most impact for companies with agents that were initially hired on a contract basis during a global expansion, but whom have since been brought on as full-time employees.

Specific Activity Exemption

Changes to the specific activity exemption impact companies in the early stages of expansion into new jurisdictions. Under the current rules, a permanent establishment does not exist when a business is used specifically for storage, for maintenance of goods for storage, display, delivery or processing, for purchasing or for the collection of information. Under the new rules, these particular activities will only be considered exempt if they are preparatory (i.e. activities that have a short-term duration) or auxiliary (i.e. activities that support without being an essential part of a company's business activity).

One area that could be adversely affected by this rule is storage and delivery related to the fulfilment of online sales. Under the new rules, these activities would not be considered preparatory or auxiliary in nature, and so would not be exempt. Anti-fragmentation rules are also expected to be introduced in order to ensure companies cannot fragment their operating businesses into smaller operations in order to meet the new rules for specific activity exemptions. To assist with this, the activities of related parties will be viewed as a whole when evaluating the activities which should be exempt.

Splitting Up Contracts

BEPS Action Plan changes are also expected to limit the ability of companies to split contracts artificially into shorter periods in order to benefit from the construction site exemption. While the rules associated with these changes have not yet been defined, the effects could be significant. Limitations on contract splitting could also affect the permanent establishment provisions related to the interpretation of services. Companies that may be using split contracts should understand the exact terms of any arrangements and monitor specific rule changes as they are clarified.

Ramifications Of Non-Compliance

While a number of the rules associated with the BEPS Action Plan are still being formulated, multinational organisations need to act now in order to manage the future risks associated with permanent establishment status claims. By developing the processes and procedures associated with tracking the activities of globally mobile employees, companies can ensure they will be able to respond effectively to any additional reporting requirements that may be introduced in the future. This could help companies respond to the expected increase in scrutiny from tax authorities worldwide and, therefore, reduce their reputational risks and the potential risks associated with penalties for non-compliance.

Starting The Journey

For international businesses, ensuring compliance with the OECD's Base Erosion and Profit Shifting Action Plan as it relates to permanent establishment status could help reduce corporate tax risks associated with globally mobile employees. In order to become more compliant with the BEPS Action Plan, companies with globally mobile employees should consider the following key actions:

- Understand where you are today - by evaluating the activities of globally mobile employees and current tax strategies, companies can develop more concrete plans to address their risk exposure to expected rule changes
- Plan ahead - by establishing processes and procedures to track and monitor globally mobile employees, companies can create the structure they will need to address future compliance requirements
- Establish specific rules - by establishing country-by-country specific rules, companies can ensure they will be able to comply with the reporting requirements in each jurisdiction in which they do business, thereby minimising their risk exposure
- Document effectively - by ensuring robust assignment and inter-company documentation is in place, companies can ensure they have the information needed to respond to increased scrutiny from tax authorities so as to avoid potential penalties
- Ensure transfer pricing compliance - by assessing cost recharge arrangements relative to globally mobile employees to ensure policies adhere to transfer pricing guidelines, companies can ensure they remain onside of any corporate tax requirements in the jurisdictions in which they do business.

BDO Comment

The OECD's BEPS plan has already had huge focus placed on it by the global tax community and tax authorities will rigorously enforce this. Companies monitoring of their globally mobile force is just a small but crucial part of the overall obligations arising in this area. Global Revenue authorities are including the tracking of business travellers and settling any income tax due as part of their programme of clamping down on tax avoidance.

GERMANY

Social Security for workers in the United Kingdom

On 29 March 2017, the UK informed the European Council of their intention to leave the EU. By invoking Article 50 of the EU contract the UK has two years to exit the EU from the date of notification. There are EU social security regulations governing the position for workers posted between EU member states and A1 certificates are issued to formalise the country in which social security is payable. Due to this planned exit the German authorities have announced that no A1 certificates will be issued for periods past 29 March 2019. Where assignments are expected to go beyond this date, the A1 certificate will only run to 29 March 2019.

BDO Comment

It is currently unclear what regulations will apply for the application of German social security obligations for mobile individuals working in the UK beyond this date, hence the German authorities stance on issuing A1 certificates which go past the two year period. This is likely to be one of many tax and social security related implications which arises as a result of the UK leaving the EU.

INDIA

India/Germany Social Security Agreement

The Comprehensive Social Security Agreement (SSA) between India and Germany has come into force from 1 May 2017. India had entered into two SSAs with Germany, namely:

- Limited SSA signed on 8 October 2008 and in force from 1 October 2009 to 30 April 2017
- Comprehensive SSA signed on 12 October and in force with effect from 1 May 2017.

While both SSAs were signed, only the Limited SSA was in force until April 2017. The Comprehensive SSA has come into force now and the Limited SSA ceased to be in effect from 30 April 2017.

Some of the key features of the Comprehensive SSA are listed below:

- Unlike the Limited SSA which covered only the detachment benefit, the Comprehensive SSA is aimed at providing all three general benefits of a SSA i.e. detachment, totalisation of periods, exportability of benefits
- Employees working in the other country for a period up to 48 calendar months could avail the benefit of detachment. A detached employee on obtaining a valid Certificate of Coverage (COC) from the home country would be required to contribute only to the home country social security scheme and detach himself from the social security scheme of the host country
- The Comprehensive SSA covers only the below social security schemes:
  - In India: Employees' Provident Fund, Employees' Pension Scheme, Employees' Deposit Linked Insurance Scheme
  - In Germany: Statutory Pension Insurance (excluding Health Insurance and Nurse Care Insurance), Steelworkers' Supplementary Insurance and the Farmers' Old Age Security.

Hence, an employee holding a valid COC would be excluded from making contributions to the aforesaid mandatory social security schemes of the host country.

- There are certain additional conditions to the detachment qualification included in the Comprehensive SSA. Some of them are:
  - The work of detached employees should correspond to the employer's business operations in the sending country
  - The employee has worked in the sending country for more than 6 months after termination of the last detachment period; etc.

It is imperative that such conditions are read in detail prior to application of COC.

- The benefits of the Comprehensive SSA shall also be available if the home country company sends its employees to the host country from a third country. For instance, an Indian company sending employees to Germany from Singapore
- The process for application of COC remains the same as compared to the Limited SSA
- For persons who have already availed the detachment benefit under the Limited SSA, the period of coverage shall be later of the below:
  - Date of detachment or
  - Date of force of Limited SSA (1 Oct 2009).

The Comprehensive SSA additionally includes the totalisation and exportability features which play an essential role at the time of withdrawal of contributions under the SSA.

BDO Comment

Globally mobile employees can continue to avail themselves of the social security benefits of detachment while moving on an assignment to India or Germany. The terms of the secondments should be reviewed to ensure it is clear whether a COC is applicable.

NETHERLANDS

Mortgage interest relating to a home outside the Netherlands

In the Netherlands it is possible for non-resident taxpayers to opt to be treated as a resident taxpayer. As of 1 January 2015, the regulations have changed with regard to these qualifying non-resident taxpayers. In order to qualify under these rules, a non-resident taxpayer needs to earn at least 90% of their worldwide income from the Netherlands. If this is the case, they are able to qualify for certain personal deductions.

This Dutch regulation is an interpretation of European case law ("Schumacher"). The European case law dictates that where a taxpayer who is living in one EU country and is earning (almost all of) his income from another EU country, and as a result is not able to effect personal deductions in his home country, he should be granted the possibility by the working country to claim personal deductions from the taxable income in that working country.

On 9 February 2017, the European Court of Justice made a decision with regard to a taxpayer living in Spain. In Spain, he was paying mortgage interest on his own house located in Spain. The taxpayer was not working in Spain, earning 60% of his income from the Netherlands and 40% of his income from Switzerland. The question was whether the taxpayer should be allowed to deduct the mortgage interest relating to the home in Spain from his Dutch taxable income according to Dutch national tax laws, even when he was not earning almost all of his income from the Netherlands. The European Court of Justice decided that since the taxpayer is not able to effect his personal deductions in Spain, he should be allowed to claim these personal deductions in the working country. As he was earning 60% of his income from the Netherlands, the Netherlands should allow a deduction of 60% of the paid mortgage interest relating to the Spanish home from the income that is considered taxable in the Netherlands.

BDO Comment

As a result of the above, even in cases where a non-resident taxpayer is not earning at least 90% of his income from the Netherlands, but still is earning almost all of his taxable worldwide income outside his home country, the taxpayer may still be able to deduct a part of certain personal deductions from taxable income in the Netherlands.

SWITZERLAND

Social Security Agreement with China

On 19 June 2017, the social security agreement between Switzerland and China entered into force. The agreement was concluded already in 2015, but the approval process in both countries was time consuming.

The agreement is very similar to other social security agreements Switzerland has recently concluded (e.g. India and South Korea), and follows international standards regarding the coordination of social security systems. Its main benefit for global mobility practitioners is the option that posted workers can remain in the home social security system for up to 72 months and are excluded from the host country system.

Previously it was often a requirement to pay social security contributions in both countries when workers were assigned from Switzerland to China or vice versa.

Action required:

If workers are currently on assignment from China to Switzerland (or from Switzerland to China), it is necessary to apply for a Certificate of Coverage from the home country social security authority within 3 months of the agreement entering into force (i.e. until mid-September). Such a certificate issued by the competent Swiss or Chinese authority, will allow an exclusion from the host social security system.

The agreement will not apply for Hong Kong and Taiwan.

BDO Comment

Many companies have waited a long time for this agreement to enter into force. It is now imperative that the required actions are taken in a timely manner in order to benefit from the new rules.

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