



M2K UAE Knowledge Series

Permanent Establishment

ALERT #3

Preface

In the previous alerts of this series, we discussed that the income of a Non-Resident ('NR') that are included under the ambit of 'taxable income' in UAE includes the income derived by a Permanent Establishment ('PE') in the UAE.

This alert of the series aims to discuss the concept of 'Permanent Establishment' under the UAE Corporate Tax Law in detail.

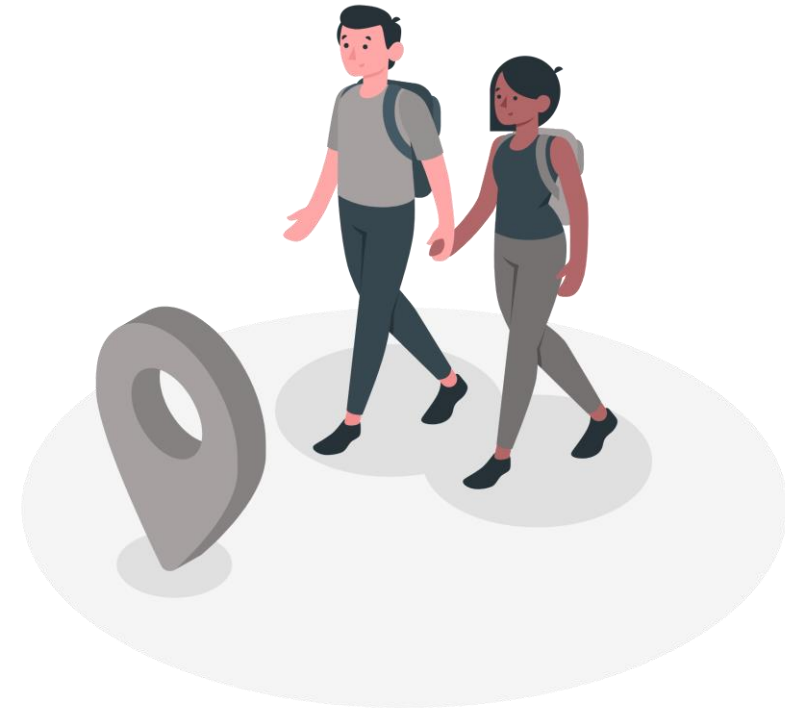


Background

Increase in the cross-border transactions have thrown open various challenges in the taxation front. If the foreign Company has extended period of presence in UAE for carrying out their business activity, the income derived by such foreign Company to the extent it is attributable to their presence in UAE will become taxable in UAE. **Extended Presence in UAE is regarded as a Permanent Establishment (PE).** PE is an expression involving two concepts - **Permanent and Establishment.**

Permanence indicates something which lasts long or is intended to last forever. Permanence is akin to infinity. It means everlasting.

Establishment could be understood as an economic unit which deals in goods or service. It is identifiable. Its identity is qua a location or action. In a PE, the former (permanence) deals with 'time span/duration' and the latter (establishment) with the 'identifiable element'.



Article 5 on Double Taxation Agreements (DTA) that UAE has signed with various countries thus defines the term PE as **"A fixed place of business through which the business of an enterprise is wholly or partly carried on."** The definition of PE as mentioned in the UAE Corporate Tax Law is broadly in line with OECD Model Tax Conventions ('OECD MC')

PE for Non-residents

Non-Residents (NR) is considered to have a PE in any of the following instances:



Where it has a **fixed or permanent place** in the UAE through which the Business of the NR, or any part thereof, is conducted.



Person **holds and habitually exercises power to conduct a Business** or Business Activity on behalf of a NR Person in the State.



Where it has any other form of **'nexus'*** in the State.

** Cabinet decision prescribing what constitutes 'nexus' is awaited.*

Fixed or Permanent place of business (1/2)

Fixed or permanent place of business includes:

1	A place of management where management and commercial decisions that are necessary for the conduct of the Business are, in substance, made.	A place of management is distinct from 'office'. It is a place from where the executive officers and senior management employees of the company or entity exercise day-to-day responsibility for more of the strategic, financial, and operational policy decision making for the company. The term must be interpreted widely, and it could also be a residential premise.
2	A branch	A branch is the most common establishment of a company through which it operates in a foreign country. It is any establishment carrying on either the same or substantially the same activities as that carried out by the head office of the branch. A branch is an extension or sub-division of an enterprise. It is place of business of the non-resident enterprise which is physical and separately identifiable.
3	An office	An office is a place where business is carried on. It may mean a room, a set of rooms or a building where the business usually is carried on.
4	A factory	It is a building for the processing/manufacturing of goods usually with the help of machines and equipment. Based on the nature of business activities carried on through it, a factory represented by a building, or a fixed place constitutes a PE.
5	A workshop	'Workshop' is a place where an industrial process is carried on. It may mean any place in which collective manual labour, under an employer is done by way of trade, making, repairing etc. Considering the aforesaid nature of activities, any place being used as Workshop would constitute a PE.
6	Land, buildings and other real property	The ambit appears to be very wide and seeks to cover the residual aspects.

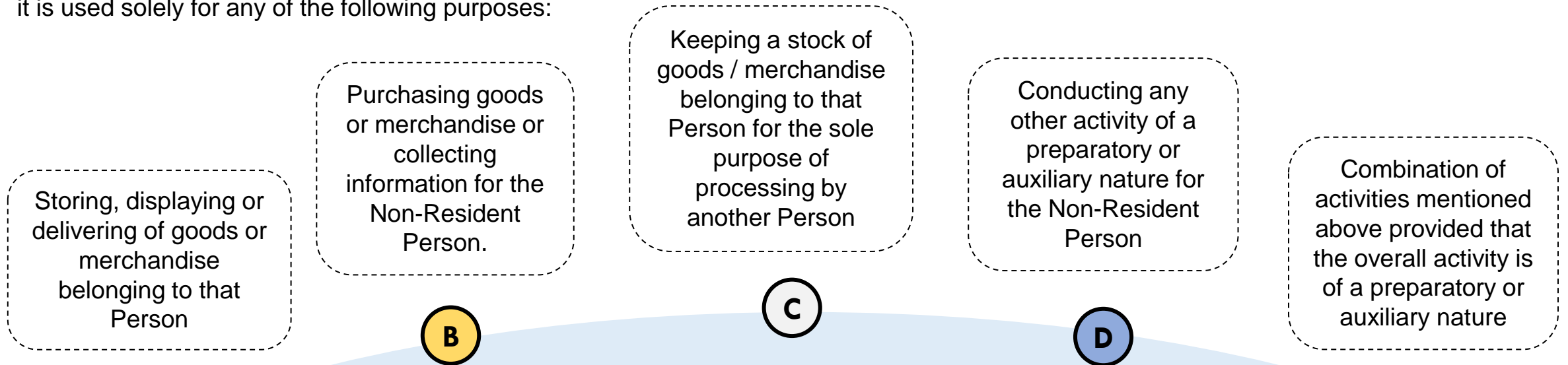
Fixed or Permanent place of business (2/2)

Fixed or permanent place of business includes:

7	An installation or structure for the exploration of renewable or non-renewable natural resources.	
8	A mine, an oil or gas well, a quarry or any other place of extraction of natural resources, including vessels and structures used for the extraction of such resources.	The phrase "any other place of extraction of natural resources" is broad and would include all places of extraction of hydrocarbons or minerals embedded in earth. The term "quarry" means the place of extracting building stones, slate, limestone, marble, etc. Therefore, any place identified as Mine, Oil or Gas Well, Quarry or any other place of extraction of natural resources under the laws of a country would qualify as PE in such country.
9	A building site, a construction project, or place of assembly or installation, or supervisory activities in connection therewith, but only if such site, project or activities, whether separately or together with other sites, projects or activities, last more than (6) six months, including connected activities that are conducted at the site or project by one or more Related Parties of the NR Person.	<p>The ambit has been clarified by explicitly including supervisory activities into the definition as the same is not mentioned in the OECD MC but available in the Commentary to OECD which clarifies that the expression "building site, construction and installation project" includes (besides construction of building):</p> <ul style="list-style-type: none">• Construction of roads, bridges or canals, etc.;• Renovation work that is more substantive than mere maintenance or redecoration of buildings, roads, bridges or canals etc.;• Laying of pipelines, excavation work and dredging projects; and• On-site planning and supervision of erection of building, etc. <p>The aspect of supervisory PE is explicitly covered, and the service is not explicitly covered under the definition of PE.</p>

Exceptions to Fixed or Permanent place as PE for NRs (1/2)

Notwithstanding the foregoing provisions, a fixed or permanent place in the State shall not be considered a PE of a NR Person if it is used solely for any of the following purposes:



Preparatory activity generally refers to an activity that is carried out in contemplation of the essential activities of the enterprise. It generally precedes the essential activities and short lived, depending on the nature of essential activity. Auxiliary activities generally refers to support activities, without being part of, essential and significant activity of the enterprise. The definition also provides that when a series of activities are undertaken by a NR in UAE, such activities will be regarded as a preparatory or Auxiliary (PoA), only if the combination of all activities is of PoA, else benefit cannot be granted. This is inline with the position introduced consequent to BEPS Action Plan - 7

Exceptions to Fixed or Permanent place as PE for NRs (2/2)

Previously mentioned **exceptions** ([refer Slide #7](#)) **will not apply to a fixed or permanent place** in the state used or maintained by a NR Person if the same NR Person or its Related Party conducts a business or business activity at the same or another place in the UAE where **all of the following conditions are met:**

- That same or another place is PE of NR or related party.
- Combination of the activities carried out by the NR Person and its Related Party at the same or other places form a cohesive Business operation.

At times, Multinational Enterprises (MNEs) have attempted to circumvent the PE classification by dividing a coherent operational firm into several small operations, claiming that each element/operations is solely engaged in preparatory or auxiliary activities and thus benefitting from the exceptions in Art. 5 (4).

The Anti-fragmentation rules introduced inline with Article 13 of Multilateral Instrument, prohibits the development of exceptions from PE status for operations that, when seen separately, are PoA in character but, when regarded collectively, represent entrenched business activity in UAE.



Agency PE



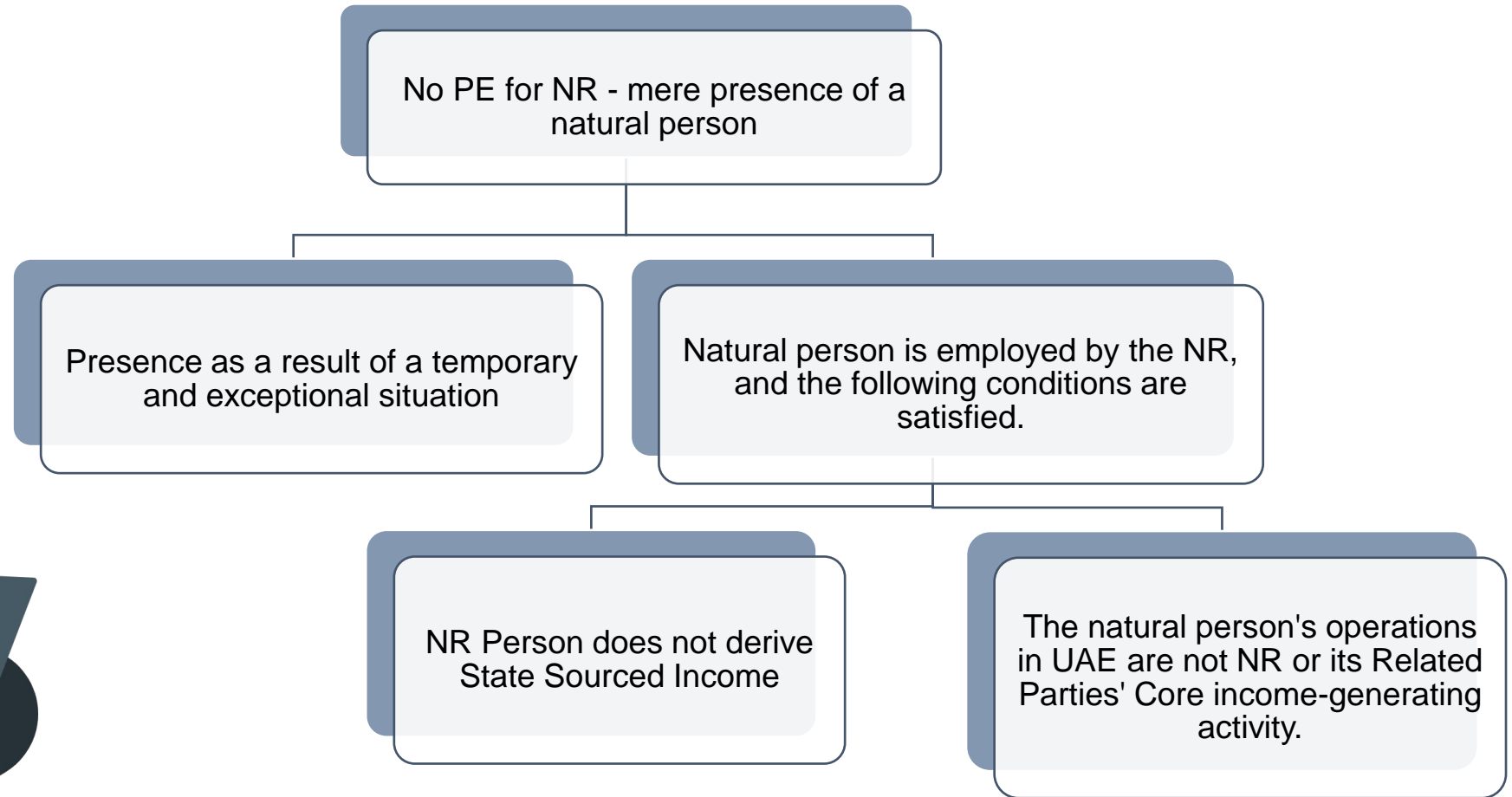
- 💰 A person shall be considered as having and habitually exercising an authority to operate a Business in the UAE on behalf of a NR Person if any of the following conditions are met :
 - Habitually concludes contracts on behalf of the NR Person
 - Habitually negotiates contracts that are concluded by the NR without the need for material modification by NR
- 💰 If an agent acts exclusively or almost exclusively on behalf of the NR, or where he cannot be considered legally or economically independent from the NR Person, he will constitute PE in the state and will not be considered independent.
- 💰 An agent would be considered Independent from the NR if he acts in the ordinary course of business and would therefore not constitute a PE in the state.

💰 *The language used above is in line with the OECD MC as for a Dependent Agent PE under the OECD model convention, there should not be any material modification of the contract by the non-resident enterprise. The final scope in which the contract is executed should not be very different from what the agent had strived for. Such a condition is also being made evident in the Act. Therefore, the scope is wide to cover any contract if accepted on "as-is" basis.*

💰 *The scope of the agent offering services exclusively or almost exclusively (over 90% as per OECD MC) on behalf of the NR is restricted to NR person alone, unlike in the OECD MC where PE gets attracted if the same services are offered exclusively or almost exclusively on behalf of one or more enterprise to which it is closely related.*

Presence of Natural Person

The Minister may prescribe the conditions under which the mere presence of a natural person in the State does not create a PE for a NR Person in any of the following instances:



It is a welcome clarification that mere employee's presence in the state would not constitute a PE.

Investment Manager - Independent Agent

An investment manager shall be considered **an independent agent when acting on behalf** of a Non-Resident Person, **if he satisfies the following conditions:**

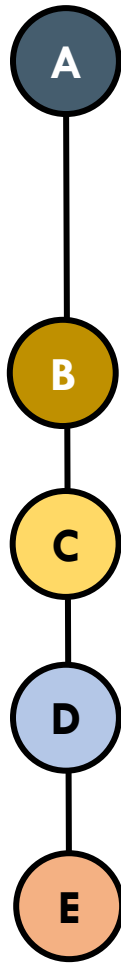


- Engages in the business of providing investment management or brokerage services
- Subject to the regulatory oversight of the competent authority in the State.
- Carries out transaction in the ordinary course of the Investment Manager’s Business
- Acts in relation to the transactions in an independent capacity.
- Transacts on an arm’s length basis with the NR Person and receives due compensation for the provision of services
- Investment Manager is not the NR Person’s representative in the State in relation to any other income or transaction that is subject to CT for the same Tax Period.
- Any such other conditions as may be prescribed in a decision issued by the Cabinet at the suggestion of the minister.
- Engages in the business of providing investment management or brokerage services

As specified in the above conditions, the **agent enters into various transactions**. The term “**Transactions**” refers to:

- In commodities, real property, bonds, shares, derivatives or securities of any other description
- Buying or selling any foreign currency or placement of funds at interest.
- Other transactions allowed to be carried out by the Investment Manager on behalf of a NR under the applicable legislation.

Foreign PE Exemption



Resident Persons have been provided with an option **not to include the revenue and related expenses** of its Foreign PE (PE Outside UAE in respect of Resident) in calculating Taxable Income in UAE. The following shall not be considered for determining its Taxable Income Tax Period: (a) Losses of its Foreign PE * (b) Positive income and associated expenditure* and (c) Foreign Tax Credit

For this purposes, "income and associated expenditure" of a Taxable Person's PE during a Tax Period is the sum of income and associated expenditure in all relevant foreign jurisdictions.

Each Foreign PE of a Resident Person shall be treated as separate and independent Persons.

A transfer of assets or liabilities between a resident person and its Foreign PE is considered as having occurred at Market Value on the date of the transfer for the purposes of calculating the Resident Person's Taxable Income.

The said exemption shall be availed by the resident person if all Foreign PE's of that resident person are subject to Corporate Tax or a tax of a similar character under the applicable legislation of the relevant foreign jurisdiction at a rate not less than the rate specified under UAE CT Law (9%).

* Calculated as if the relevant Foreign PE were a Resident Person under this Decree-Law

Stay tuned for more updates on UAE!

Please find below the list of completed & upcoming alerts from the series. In case you have missed the previous alerts, click on the hyperlink for the completed alerts to refer the same.

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