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TITLE

Taxation Of Permanent Establishment under Armenian Law

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Abstract

"When there is an income tax, the just man will pay more and the unjust less on the same amount of income" – Plato

In the modern business environment, and apparently that of Plato's time, organisations may wish to minimise their tax burden. In order to achieve same, entities may operate on a global scale and endeavor to locate taxable profits in low tax jurisdictions. The operation of business on an international scale is not always tax driven. An international presence may be required due to the nature of business undertaken. The locating of business activities through different jurisdictions can result in different authorities claiming taxing rights. The vast international network of tax treaties endeavors to eliminate the potential to double taxation. The keystone to these treaties is the concept of permanent establishment .

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LIST OF ABBREVIATIONS

BEPS	base erosion and profit shifting
EU	European Union
OECD	Organisation for Economic Cooperation and Development
RA	Republic of Armenia
VAT	value-added tax

INTRODUCTION

The concept of a PE is a fundamental idea, which is intrinsic to double taxation agreements. Essentially, it is the concept, which determines the right of a state to tax the profits of an enterprise of the other state. The existence of a PE is a minimum threshold which is required to be cleared in order for a country to tax non-resident's business profits derived from sources in that jurisdiction. The permanent establishment (PE)[1] threshold test, is contained in many countries' tax laws and double tax treaties. It determines whether a business has sufficient

[1]CormacKelleherEssay.pdf available at https://ttn-taxation.net/pdfs/prizes/CormacKelleherEssay.pdf (last visited oct 15 2018)

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activity in another territory to create a taxable presence in that other territory from a corporate tax perspective.

The existing PE rules were designed many years ago, without modern business in mind. Now many businesses can, and do, operate very remotely geographically from their customer base.[2]

There is a growing concern from tax authorities that they are not able to effectively tax the economic activity generated by these overseas businesses from the local customer base.

Why is it important?

The level of focus on this issue is now changing in response to the following:

• A variety of recent unilateral and multilateral changes to the PE concept, the latter including ongoing work by the Organisation for Economic Co-operation and Development (OECD) and the Base erosion and profit shifting (BEPS) agenda.

• The heightened pace of change in business models as more companies operate virtually and/or undertake value chain transformation.

• There is an increasing perception by tax authorities that PE arguments can provide an effective counter to tax-structured reductions in tax liabilities.

• Media attention on tax avoidance and certain business models where PE risk is materially higher.

• This combination of factors has led tax authorities globally to refocus resources on mounting more effective, and aggressive PE.

What shall/should be done to address the issue?

✔ Identifying existing arrangements which may give rise to heightened PE risk – for example through central contracting with customers or mobile workforce. Tax authorities are becoming much more focused on PE issues and there is a limited amount of comfort that should be taken from the fact that the issue has not been raised previously.

✔ Developing structural solutions, operating guidelines, process, and controls to monitor and mitigate risk on an ongoing basis.

[2] PWC. permanent-establishment-risk-what-it-means-for-you.pdf available at https://www.pwc.co.uk/assets/pdf/permanent-establishment-risk-what-it-means-for-you.pdf (last visited oct. 15,2018)

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- ✔ Taking a structured approach to tax authority engagement to manage both threshold PE issues and profit attribution.
- ✔ PE profit attribution assessment, documentation and Advance Pricing Agreements to give increased levels of certainty.[3][4]

CHAPTER 1

The Overview and Analysis of PE Taxation under Armenian Tax Law .Using Comments from OECD Commentary

Armenian Tax Code (Tax Code) was in force from January of 2018 and for the first time set characteristics for establishment of PE and regulation of its taxation

Meanwhile, tax regulation of PE under Armenian Tax Law is based on the OECD model. Although the OECD does not have any legal power in adoption of legal acts, but many of them are based on OECD model as it is considered as one of the main tax instruments [5], taxpayers and tax authorities often look to it for guidance in interpretation of PE arguable issues, especially when it is not clear from existing circumstances whether on residents should establish PE or not or how to distribute profits to it .

Taking into account the above mentioned circumstances and also lack of implementation of PE regulations in practice in Armenia, it will be more informative and comprehensive to analyse taxation of PE under Armenian tax Law in conjunction with the identification of gaps and how

[3] EUROPEAN COMMISSION Brussels, 21.9.2017 COM(2017) 547 final, 1_en_act_part1_v10_en.pdf available at https://ec.europa.eu/taxation_customs/sites/taxation/files/1_en_act_part1_v10_en.pdf (last visited oct. 15, 2018)
[4] ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT,48836726.pdf available at http://www.oecd.org/tax/treaties/48836726.pdf (last visited at oct. 18, 2018)
[5] OECD Legal Instruments available at https://www.oecd.org/legal/legal-instruments.htm (last visited oct.18,2018)

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they could be addressed by reference to the interpretation of Commentaries on the articles of the model tax conventions (hereinafter "Commentary").

The RA Tax Code defined non-resident companies and non-resident physical persons. Particularly, non-resident companies refer to thosenot based in the Republic of Armenia[6]. Non-resident physical person of the Republic of Armenia shall mean the physical person whose actual presence in the Republic of Armenia doesn't exceed 183 days[7]. For simplicity, hereinafter non-resident company and/or non-resident physical person are named as "non-residents".

Taxation of non-residents in Armenia is different and depends on the fact whether they have a PE in Armenia or not. If the non-resident has no PE in Armenia and receives income from Armenian sources, gross income will be taxed. In this case, tax agent (if any) is liable to withhold and pay the taxes to the state budget. In case the non-resident has PE in Armenia, taxable income is defined to be the difference between gross income and deductible expenses. The income is attributed to PE only when the supporting documents of income are issued in the name of the PE. The same approach applies to costs.

Services supplied in Armenia by non-residents that have no PE in Armenia are subject to application of a VAT reverse charge. The reverse charge is the amount of VAT the Armenian company would have paid on that service if it had bought it in Armenia. The company has to add that amount not only to the total of VAT liability to the state budget that month, but also to the amount of VAT the company is going to reclaim in that month. That means the company does not pay anything extra to the budget or reclaim anything extra from it.[8][9]

[6] (Arlis) Tax Code article 22 available at http://www.arlis.am/DocumentView.aspx?DocID=121309 (last visited oct.18,2018)
[7](Arlis) Tax Code article 25 available at http://www.arlis.am/DocumentView.aspx?DocID=121309 (last visited oct.19,2018)
[8] EY, Peculiarities of non-residents taxation in Armenia,EY-Non-residents-Taxation-in-Armenia.pdf available at http://www.ey.com/Publication/vwLUAssets/EY-Non-residents-Taxation-in-Armenia/$FILE/EY-Non-residents-Taxation-in-Armenia.pdf (last visited oct.19,2018)
[9] GLOBAL SPC, INVEST IN ARMENIA, available http://investinarmenia.am/en/87-contents/taxation-and-accounting?start=2 (last visited oct.19,2019)

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Characteristics for establishment of PE set by 27 article of the Tax Code.

Particularly, PE shall be one of the places of the operation of the business in the Republic of Armenia, registered with the tax authority as a taxpayer through which the non-resident conducts entrepreneurial activity, irrespective of the period of performance of the following activities:

- ✔ any place of production, processing, consolidation, re-packaging, packaging and/or supply of goods;
- ✔ any place of management;
- ✔ any place of geological investigation of the subsurface, exploration, preparatory works for extraction of mineral resources and/or extraction of mineral resources and/or performance of works, provision of supervision and/or monitoring services over exploration and/or extraction of mineral resources;
- ✔ any place of conduct of the activity related to the installation, adaptation and exploitation of gaming machines, computer networks and communication channels, amusement rides, as well as related to transport or other infrastructure;
- ✔ place of sale of goods in the territory of the Republic of Armenia;
- ✔ any place of performance of construction activities and/or construction and installation works, as well as of provision of supervision services over performance of these works;
- ✔ location of the representative office or the branch office, except for the representative office which exclusively performs the activity;
- ✔ location of an organisation or a natural person carrying out brokerage activities in the Republic of Armenia on behalf of a non-resident organisation or a natural person in accordance with the Law of the Republic of Armenia "On insurance and insurance activities".

As follows from the above-mentioned list of activities, the main condition for establishment of PE is the place of business. The RA Tax Code does not give clear explonation of "place of business". The meaning of "place of business" is also arguable under OECD commentary.

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Article 5(1)[10] of the Model Convention provides that a PE is taken to mean: "....a fixed place of business through which the business of an enterprise is wholly or partly carried on." The definition put forward in the UN Convention is similar to the one above. This definition involves three following requirements in order for a PE to be present:

1) the existence of a "place of business",

2) the "place of business" must be of a fixed nature and

3) the enterprise shall fulfill its activitiesthrough the fixed place of business.

Thus, The term "place of business" covers any premises, facilities or installations used for carrying on the business of the enterprise whether or not they are used exclusively for that purpose. A place of business may also exist where no premises are available or required for carrying on the business of the enterprise and it simply has a certain amount of space at its disposal. It is immaterial whether the premises, facilities or installations are owned or rented by or are otherwise at the disposal of the enterprise. A place of business may thus be constituted by a pitch in a market place.

As noted above, the mere fact that an enterprise has a certain amount of space at its disposal, which is used for business activities, is sufficient to constitute a place of business. No formal legal right to use that place is therefore required. Thus, a permanent establishment could exist where an enterprise illegally occupied a certain location where it carried on its business.

Just the presence of an enterprise at a particular location does not mean that that location is at the disposal of that enterprise. Whether a location may be considered to be at the disposal of an enterprise to constitute a "place of business" will depend on the power of the enterprise to use that location, the extent of the presence of the enterprise at that location and the activities that it performs there. This concept is illustrated by the following examples:

Where an enterprise has an exclusive legal right to use a particular location, which is used only for carrying on that enterprise's own business activities (e.g. it has legal possession of that location), that location is clearly at the disposal of the enterprise. This will not be the case,

[10] OECD. Article5(1), ARTICLES OF THE MODEL CONVENTION WITH RESPECT TO TAXES ON INCOME AND ON CAPITAL [as they read on 28 January 2003] 1914467.pdf, available at http://www.oecd.org/tax/treaties/1914467.pdf (last visited oct.19.2018)

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however, where the enterprise's presence at a location is so irregular or incidental that the location cannot be considered a place of business of the enterprise (e.g. where employees of an enterprise have access to the premises of associated enterprises which they often visit but without working in these premises for an extended period of time). It should be noted that even if a location is a place of business through which the activities of an enterprise are partly carried on, that place will not be deemed a permanent establishment if it relates to the activities which are treated as exceptions to the general definition, even if the activity is carried on through a fixed place of business. The common feature of these activities is that they are, in general, preparatory or auxiliary activities.

Depending on the nature of the business activities being undertaken, the "place of business" may move around. Activities, which by their nature require movement between locations may still constitute a single place of business and may be identified as a single unit both geographically and commercial. However, where the geographical and commercial unit cannot be identified multiple Pes may exist. In situations where there are deemed to be multiple PEs this can result in an increased tax cost to the non-resident. Neither the OECD nor UN treaties provide for the offset of losses incurred by one PE against taxable profits incurred by a related PE. This can result in the non-resident incurring a higher tax liability in the foreign jurisdiction. Depending on the jurisdictions in question, this can result in a higher real tax cost to the organisation, as it may not get the full benefit of credits in its home jurisdiction.

The issue related to the constitution of multiple PEs is resolved by Armenian Tax Code in the following way: where the activity carried out by the non-resident leads to the formation of two or more permanent establishments, only one of the permanent establishments shall be subject to registration.

Article 5(2)[11] of the OECD treaty provides specific examples of what will constitute fixed places of business. Specifically, the list includes ; "a place of management, a branch, an office, a factory, a workshop; and a mine, an oil or gas well, a quarry or any other place of extraction of

[11] OECD. Article5(2), ARTICLES OF THE MODEL CONVENTION WITH RESPECT TO TAXES ON INCOME AND ON CAPITAL [as they read on 28 January 2003] 1914467.pdf, available at http://www.oecd.org/tax/treaties/1914467.pdf (last visited oct.19.2018)

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natural resources." These examples reinforce the idea that a physical facility is required in order for a PE to be present. It is generally accepted that it is irrelevant as to how long a non-resident has been operating in a state. In the majority of cases, it should be apparent whether a physical presence exists or not.

Article 5(3)[12] provides that a PE will exist where: "A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months." This article is commonly adopted and provided for in tax treaties. However, depending on the treaty in question this twelve month period can be reduced to as little as three months. The twelve-month duration will apply to each individual project. Difficulties may arise in determining if a project is within the twelve-month timescale given that it may be difficult to identify when the project commences. It is considered that the twelve-month clock begins to tick when the contractor startstheir preparatory work in the foreign jurisdiction. Once the work commences the project is considered ongoing and active until it is completed. The site will not be considered to cease where there are periods of temporary discontinuance. Such periods may occur due to factors beyond the contractors control, e.g. weather conditions, third party agencies or indeed industrial disputes. In order to circumvent the twelve-month criteria, contractors may endeavor to subcontract out elements of the project to third parties. Unfortunately, even in these circumstances the principal contractor may still have a foreign PE. The time spent by the sub-contractors is taken into account in determining if the principal has a PE. The twelve-month test applies to each individual project / site. In establishing the duration of each contract and whether a PE exists, no account is taken of time spent on unconnected projects. However, a project may be regarded as a single project by virtue of its commercial and geographical unity. This can be irrespective of the fact that there may be multiple contracts. It is understandable why this provision should apply.

Historically, entities would have endeavored to circumvent the twelve-month provision by splitting an overall contract amongst multiple connected parties. The twelve-month test may

[12] OECD. Article5(3), ARTICLES OF THE MODEL CONVENTION WITH RESPECT TO TAXES ON INCOME AND ON CAPITAL [as they read on 28 January 2003] 1914467.pdf, available at http://www.oecd.org/tax/treaties/1914467.pdf (last visited oct.19.2018)

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appear to be the most straightforward method of determining if a PE exists. However, as indicated above this test comes with its own difficulties. The fact that there is no provision for temporary absences, perhaps due to circumstances beyond the non-residents control, can give rise to a PE. One would contend that this should not be the spirit of the treaty. Whilst it may be difficult to monitor and enforce, it is necessary that there should be a provision to cover such circumstances.

It is worth to mention that Armenia has entered into double tax treaties (DTT) with 45 countries. [13] The definition of PE and conditions to establish PE under DTT can differ from the Armenian tax Law. Moreover, the provisions of international treaties prevail over the provisions of local tax Law[14]. For clarity, consider an example:

Under Armenian tax Law any place of performance of construction activities by non-resident establish PE irrespective of the period, but under DTT with Canada a building site, a construction, assembly or installation project or supervisory activities in connection therewith establish PE but only where such site, project or activities continue for a period of more than nine months. In this case, non-resident can apply DTT and establish PE after nine months.[15]

In case of performance of works and/or provision of services in the territory of the RA not mentioned above, a PE shall be the place where the works are performed and/or the services are provided by employees and/or other staff hired by a non-resident where such activities are carried out in the territory of the Armenia for at least 183 calendar days in a tax year, starting from the day of commencement of the entrepreneurial activity within the framework of one or more related projects.

[13] Tax Service Of Republic of Armenia, available at http://www.petekamutner.am/Content.aspx?itn=tsTLDoubleTaxationAvoidance&pt=parent (last visited oct. 17,2018)

[14] (Arlis) Law on Legal acts of RA (article 21) available at http://www.arlis.am/DocumentView.aspx?DocID=120733(last visited oct. 20, 2018)

[15] Tax Service Of Republic of Armenia, available at http://www.petekamutner.am/Content.aspx?itn=tsTLDoubleTaxationAvoidance&pt=parent (last visited oct. 17,2018)

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For the purposes of PE, related projects shall be those the contracts on which are considered to be interconnected or interdependent.

Related contracts shall mean the contracts which meet all of the following conditions:

- ✔ the same works are performed for the same tax agent or an organisation or a natural person by the same non-resident,
- ✔ the period between the day of completion of performance of works and/or provision of services prescribed by one contract and the day of entering the other contract does not exceed the uninterrupted period of twelve months.

In case of sale of goods at exhibitions and fairs organised in the territory of the RA, a non-resident shall create a PE if the activity is carried out for more than thirty days.

Performance of preparatory and/or support activities carried out by a non-resident in the territory of the RA other than the principal activities of a non-resident shall not lead to the creation of a permanent establishment if the activities are carried out for a period of less than three years. Moreover, preparatory and/or support activities must be carried out directly for the given non-resident and not for another organisation or a natural person.

Notwithstanding the above mentioned conditions, where a non-resident carries out entrepreneurial activity in the territory of the Republic of Armenia through the organisation or the natural person considered to be a dependent agent, it shall be then considered that the non-resident has a PE in the territory of the Republic of Armenia with regard to any activity which the dependent agent carries out for that non-resident. For this purposes a dependent agent shall be the organisation or the natural person who meets all of the following conditions:

- ✔ it is authorised — based on the contractual arrangements — to represent the interests of the non-resident in the Republic of Armenia, act on behalf and at the expense of the non-resident , act and/or carry out certain legal actions;

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- ✔ the activity mentioned above is not carried out within the scope of the activity of customs representative, specialised participant in securities market and other brokerage activities (except for insurance broker's activity);

The mentioned characteristics are common to agent agreement. According to the Civil Code of RA[16] principal has all rights and liabilities, which rises from the agent's action. Agent is acting on behalf of the principal and at his cost. It is quite another matter when a non-resident acts in Armenia through commissionaire arrangement. According to the Civil Code of RA[17] the commissionaire acts on behalf of itself. No contractual relationship is created between customers and principal, and customers have a right of recourse against the commissionaire only. Consequently, in general, PE is formed if non-resident acts on the basis of agent agreement and does not form PE in case of commissioner arrangement. Meantime it is worth to noting, that there are sufficient examples in international practice when tax authorities attempted to charecterise a commissionaire as a dependent agent. We would like to quote just one of the decisions of the French administrative Supreme Court[18], which clarifies certain issues concerning permanent establishment status and more precisely the notion of dependent agent PE. The concept of PE through dependent agent is similar to Armenian tax Law underthe light of the discussed case. In this particular case, a Swiss company commercialised its products in France through a commissionaire who was located there. The French tax authorities alleged that the French-based commissionaire was a dependent agent of the Swiss company and thus characterised it as a permanent establishment of the Swiss company in France, on the ground of the France-Switzerland tax treaty. Indeed, in addition to an alleged dependency of the commissionaire on the Swiss principal, the French tax authorities considered that the commissionaire had, in particular, the authority to bind, within the framework of its activities in

[16] (Arlis) Civil Code of RA Article 782 available at http://www.arlis.am/DocumentView.aspx?DocID=121322 (last visited nov. 11,.2018)

[17](Arlis) Civil Code of RA Article 791 available at http://www.arlis.am/DocumentView.aspx?DocID=121322 (last visited nov. 11, 2018)

[18] European Tax Newsletter available at http://bakerxchange.com/rv/ff00194ef40e6db1dc2836e99147b677c9f0f611/p (last visited nov. 12, 2018)

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France, the Swiss company on behalf of which it proceeded in a business relationship relating to the latter's own activities.[19]

On the dispute related to the reassessments charged to the alleged permanent establishment of the Swiss company, the administrative lower Court ruled that a "commissionaire cannot in principle constitute a permanent establishment of the principal, deriving only from the fact that by executing its commissionaire agreement it sells, while signing the contracts in its own name, goods or services of the principal on its behalf, except if it results from either the commissionaire agreement terms, or from any other elements of the instruction of the case that despite the qualification of commission given by the parties to the contract by which they are linked, the principal is personally bound by the contracts concluded by its commissionaire with third parties." This decision is in line with the Zimmer case-law (French administrative supreme Court, March 31st 2010 Sté Zimmer Limited).

Summing up the above, it must be empasised that it is not obvious in many cases whether all conditions are met to establish a PE. Contractual relationships should be analysed not only de jure but also de facto to mitigate the risk of forming PE by non-resident in a state.

A non-resident which renders services of providing foreign labor force to an organisation or a natural person carrying out its activity in the territory of the Republic of Armenia, including a non-resident conducting activities through the permanent establishment, no permanent establishment shall be created in the territory of the Republic of Armenia with regard to the services where:

- ✔ the labor force acts on behalf and in the interests of the organisation or the natural person carrying out its activity in the territory of the Republic of Armenia;

[19] LEXOLOGY, French tax authorities fail in an attempt to characterise a commissionaire as a dependent agent PE Available at https://www.lexology.com/library/detail.aspx?g=4fe6e476-f3f7-431a-affa-2ddc2c0a1c6f (last visited nov.17,2018)

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- ✔ the non-resident organisation or the non-resident natural person rendering services of providing foreign labor force does not bear responsibility for the results of the work performed by the labor force.

Where the activity carried out by a non-resident in the Republic of Armenia has the characteristics of a permanent establishment, that non-resident shall be record-registered with the tax authority as a taxpayer.

The non-resident may be registered with the tax authority also in casesthe activity carried out thereby in the Republic of Armenia is not yet characterised as a permanent establishment.

Where the activity carried out by a non-resident in the Republic of Armenia is characterised as a permanent establishment but that very non-resident has not been registered with the tax authority as a taxpayer, the tax and fees calculation and payment regulations that are applicable with regard to a non-resident on having no permanent establishment shall be applicable with regard to that non-resident. The RA Tax Code does not provide for fine in case non-resident does not register a PE when all circumstances for its establishment are met.

It worth referring tosome deficiencies of the RA Tax Code related to the regulations of PE. Owing to the general nature of the instructions, they do not provide sufficiently clear guidelines for dealing with problems encountered in practice. Let us discuss some of them.

- ✔ In many States, a foreign enterprise may be allowed or required to register for the purposes of a value added tax (VAT) regardless of whether it has in that State a fixed place of business through which its business is wholly or partly carried on or whether it is deemed to have a permanent establishment in that State.

  Changes were introduced in Armenia on 1 January 2018, which may give rise to the requirement for non-resident suppliers of B2C digital services to recipients in Armenia to be liable to VAT register and account for Armenian VAT on these supplies. According to Tax Code[20] the obligation for VAT calculation shall be borne by a non-resident (without a

[20] (Arlis) Tax Code of RA Article 70 available at http://www.arlis.am/DocumentView.aspx?DocID=121309 (last visted nov.20,2018)

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permanent establishment in Armenia) where a party to contractual relations is not deemed a VAT payer and the place of activity for the supplied service is Armenia.

In case of B2B where contractual relations is with VAT payer, reverse charge VAT mechanism is applied. The reverse charge is the amount of VAT resident would have paid on that service if it had bought it in Armenia from VAT payer. Resident have to add that amount to the total of VAT it is going to pay to state budget that month, but also to the amount of VAT it is going to reclaim in that month. That means resident VAT payer does not pay anything extra to state budget or reclaim anything extra from it.

If non-resident registers in tax authorities for fulfilment, its VAT liability there is a risk for non-resident to be considered as PE as there is no clear under Armenian tax Law is it acceptable to register in tax authorities as VAT payer without PE establishment.

- ✔ As already mentioned above, Armenia has DTT with many countries. Based on the provisions of DTT about privileged conditions of taxation and residency certificate from the source country tax agents don't withhold taxes in Armenia or apply lower rates of taxes provided by DTT. This mechanism works in case non-resident has no PE in Armenia. There can be cases in which activities of non-residents in Armenia satisfy requirements for establishing PE but non-residents do not register it. It is unclear how tax agent should know about the activities of non-resident, particularly with other counterparties, in order to use residency certificate of non-resident. Another approach is that tax agent can use the certificate in all cases when non-resident has not registered PE.

  We considerthat all above-mentioned issues need improvements and clarifications.

Chapter 2 Attribution of profits to PE

The taxation of Business Profits under the Double Taxation Avoidance Agreement (DTAA) in Article 7 is directly linked to the concept and the creation of Permanent Establishment in accordance with Article 5 of the DTAA. The basic rule of Taxation of Business Profits of the Enterprise in the Country of Residence under goes a shift where the Enterprise carries on business in the other Contracting State through a PE. Therefore, the PE criterion is the litmus test to determine whether the Income is to be taxed in the Country of Source. While Article 5 seeks

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to set the various tests determining the establishment of a PE it does not clearly provide the ways and means to determine the quantum of Profits to be taxed at the hands of the PE. This is provided in Article 7 – Business Profits. Business Profits are not defined in most of the DTAA which Qatar has entered into. Therefore, the meaning of 'Business Profits' is to be given a meaning as found in the local Tax Laws in the 'Country of Source'.[21] Where, the source of profit income is say, Armenia, the profits would have to be arrived at in accordance with the Tax Code. [22] **entrepreneurial income** — increase in asset or decrease in liability attributed to the activity carried out by an organisation, individual entrepreneur or notary, which, taken separately, results in the increase in own capital of an organisation or in increase of net assets of an individual entrepreneur or notary except for the cases prescribed by the Code. Within the meaning of this point, the income received from the entrepreneurial activity of a natural person who is not considered to be an individual entrepreneur and notary, shall also be deemed to be an entrepreneurial income[23]

Once it is determined that a PE exists, one of the main issues is the distribution of income to PE. Where a non-resident of the RA has a record-registered PE in the RA, the non-resident shall be obliged to maintain separated accounting of the taxable objects, tax bases, tax amounts, as well as deductions and offset (reduced) amounts prescribed by the Tax Code with regard to the record-registered PE.

The income will be attributable to the PE, if the accounting documents supporting the income would be issued by the Branch.

Where the incomes of a non-resident profit taxpayer carrying out activities in the Republic of Armenia through a PE are not attributed to the PE, the profit tax against the tax base formed with regard to those incomes shall be calculated from the gross income at the rates prescribed by Tax Code for non-residents carrying activity without PE. Within the meaning of the Code, it shall be

[21] BUSINESS_PROFITS.pdf available at http://aksaa.qa/images/PDF/BUSINESS_PROFITS.pdf (last visited nov. 20,2018)

[22] Problems Involving Permanent Establishments: Overview of Relevant Issues in Today ' s International Economy Leonardo F.M. Castro Milbank, Tweed, Hadley & McCloy, available at https://engagedscholarship.csuohio.edu/cgi/viewcontent.cgi?referer=https://www.google.ru/&httpsredir=1&article=1000&context=gblr (last visited nov.20,2018)

[23] (Arlis)Tax Code Article 24 available at

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deemed that incomes of non-resident profit taxpayers carrying out activities in the RA through a permanent establishment are not attributed to the PE, where the accounting documents supporting those incomes have not been issued by the PE, irrespective of whether or not the PE is indicated in the contracts concluded between the non-resident profit taxpayer carrying out activities in the Republic of Armenia through a PE and the other party to the transaction as an income receiver[24].

When determining the tax base for the non-resident profit taxpayer carrying out activities in the RA through a PE, only the expenses (including those made outside the Republic of Armenia), in the supporting settlement documents whereof the relevant data on the PE (name, tax identification code etc.) are mentioned as data relating to the person acquiring the product, accepting the work and/or service, shall be deducted from the gross income[25].

It is also worth noting that the allowances for the reduction of expenses and losses incurred by a non-resident for the purpose of its PE in the Republic of Armenia in respect of the activities carried out in the RA are no longer permitted by Tax Code. However under DTT provisions in the determination of the profits of a permanent establishment, there shall be allowed those deductible expenses which are incurred for the purposes of the permanent establishment including executive and general administrative expenses, whether incurred in the State in which the permanent establishment is situated or elsewhere under. As we have already mentioned, provisions of DTT prevail over that of local Law.

Another main regulation, which can directly affect taxation of PE in the RA, is Transfer pricing , which was in force by the Tax Code. Transfer pricing is the setting of the price for goods and services sold between controlled (or related) legal entities. Whithin the meaning of transfer pricing regulation two and more taxpayers shall be considered as related where[26]:

(1) one of the taxpayers is directly or indirectly involved in the management, supervision of the other taxpayer or has a participation (stock, share, unit) in the authorized or share capital of the other taxpayer;

[24] (Arlis)Tax Code Article 125 available at http://www.arlis.am/DocumentView.aspx?DocID=121309 (last visited nov.21, 2018)
[25](Arlis) Tax Code Article 133 available at http://www.arlis.am/DocumentView.aspx?DocID=121309 (last visited feb. 18, 2018)
[26] (Arlis)Tax Code Article 362 available at http://www.arlis.am/DocumentView.aspx?DocID=121309 (last visited feb.20.2018)

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(2) the same taxpayer is directly or indirectly involved in the management, supervision of two or more taxpayers or has a participation (stock, share, unit) in the authorized or share capital thereof.

2. Within the meaning of the above mentioned , it shall be considered that a taxpayer is directly or indirectly involved in the management, supervision of another taxpayer or has a participation (stock, share, unit) in the authorized or share capital of another taxpayer where:

(1) 20 and more percent of the stocks, share, units of the authorized or share capital of the other taxpayer directly or indirectly belongs to the taxpayer;

(2) The taxpayer practically controls the business decisions of the other taxpayer.

3. Within the meaning of point 2 of part 2 of this Article, a taxpayer shall be considered as practically controlling the business decisions of the other taxpayer irrespective of participation in the authorized or share capital of that taxpayer where any of the following conditions is met:

(1) The taxpayer directly or indirectly owns or controls 20 and more percent of the voting equity securities of the other taxpayer;

(2) The taxpayer directly or indirectly controls the process of formation (election) of the executive board or the board of directors of the other taxpayer;

(3) The sum total of the loans directly or indirectly provided and/or secured by the taxpayer to the other taxpayer exceeds 51 percent of the book value of the total assets of the latter;

(4) more than 80 percent of the entrepreneurial income of the taxpayer during a given tax year was derived from the transactions on supply of goods to, performance of works for and/or provision of services to the other taxpayer, except for incomes and interests drawn from transactions on lease and/or gratuitous use of property, alienation of intangible assets;

(5) more than 80 percent of the expenditures of the taxpayer during a given tax year was made on transactions on acquisition of goods, acceptance of works and/or services, except for the

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expenditures arising from transactions on lease and/or gratuitous use of property, acquisition of intangible assets and interest payment;

(6) The taxpayers have concluded a contract on joint activity prescribed by Article 31 of the Code under which the taxpayer has invested more than 50 percent of his or her assets in the joint activity;

(7) the taxpayers have concluded a contract on gratuitous use of property under which the taxpayer (borrower) uses the property of the other taxpayer (lender) by the right of gratuitous use for a period of more than one year and the value of said property exceeds 51 percent of the book value of the total assets of the borrower. This point shall apply also to contracts on lease and financial lease of property.

4. Taxpayers not meeting the relatedness criteria prescribed by parts 1, 2 and 3 of this Article shall be considered as unrelated.

Pursuant to the provisions of this Article, transfer pricing regulations prescribed by this Chapter with regard to transactions considered as controlled shall be applicable where the sum total of all the controlled transactions carried out by a given taxpayer during a given tax year exceeds AMD 200 million.

For example[27], if a subsidiary company sells goods to a parent company, the cost of those goods paid by the parent to the subsidiary is the transfer price. Legal entities considered under the control of a single corporation include branches and companies that are wholly or majority owned ultimately by the parent corporation. Certain jurisdictions consider entities to be under common control if they share family members on their boards of directors. Transfer pricing can be used as a profit allocation method to attribute a multinational corporation's net profit (or loss) before tax to countries where it does business. Transfer pricing results in the setting of prices among divisions within an enterprise.

[27] https://www.linkedin.com/pulse/transfer-pricing-meaning-examples-risks-benefits-shivangi-agarwal (last visited feb.20.2018)

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Transfer pricing multi-nationally has tax advantages, but regulatory authorities frown upon using transfer pricing for tax avoidance. When transfer pricing occurs, companies can book profits of goods and services in a different country that may have a lower tax rate. In some cases, the transfer of goods and services from one country to another within an interrelated company transaction can allow a company to avoid tariffs on goods and services exchanged internationally. The international tax laws are regulated by the OECD, and auditing firms within each international location audit financial statements accordingly[28]

The main principal of transfer pricing regulation is that income of a permanent establishment can be defined by the 'arm's length principle', derived both from Armenian's internal Law and tax treaties between states. The 'arm's length principle' refers to the obligation of associated enterprises (companies of the same group), in accordance with provisions of Tax Code to observe terms and conditions in joint transactions which mutually independent parties in similar situations would have otherwise agreed to. These requirements should also be observed in the dealings between the enterprise and its permanent establishment. Implementation of transfer pricing regulation can lead to the adjustment of the corporate income tax liability (CIT), value added tax liability (VAT). [29]

An important part of transfer pricing regulation is documentation requirements. Documentation of transfer pricing refers to a written explanation by the taxpayer concerning the pricing of transactions between associated enterprises. The documentation obligation also concerns transactions by the PE in Armenia, as well as dealings with the head office. The foreign enterprise and its PE located in Armenia must prepare the same kind of documentation, which the independent company would prepare under similar circumstances in which the operations would be practiced under a separate enterprise, and this separate enterprise would have transactions with the foreign associated enterprise.

I also want to mention that general regulation of transfer pricing was in force by the Tax Code but secondary Law has not been adopted yet so that the implementation is delayed.

Chapter 3 Current developments in PE taxation

"When innovations threaten your business, you must adapt or die."

[28] PWC International Transfer Pricing 2013/14 available at https://www.pwc.com/gx/en/international-transfer-pricing/assets/itp-2013-final.pdf (last visited feb.20.2018)
[29] VERO SKATT. General Guidelines for the Attribution of Income to Permanent Establishment available at https://www.vero.fi/en/detailed-guidance/guidance/59583/general-guidelines-for-the-attribution-of-income-to-permanent-establishment/ (last visited apr.5.2018)

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(Paul Sloane)

Still, there is an opinion that the definition of PE stipulated by OECD and UN is obsolete and has nothing in common with modern business environment. To address this the OECD has made corrections in its current edition of the Commentary

One of the key objectives of the OECD/G20 BEPS initiative is to ensure taxation where the significant economic activities take place and value is created. To this end, the OECD/G20 BEPS initiative proposed numerous measures, including amending the definition of a PE existence through the fixed place of activity, a dependent agent activity and through providing digital services.

In this context, Action 7 of the OECD/G20 BEPS initiative deals with the artificial avoidance of PE status and has proposed amendments to the definition of a PE, intended to address the tax challenges of the digital economy and the related issue of the inability of countries to tax profits derived from digital activities due to the lack of a sufficient nexus. The key changes to the definition of a PE can be summarized as follows:[30]

- ✔ Dependent agent PE. OECD widened the cases of establishing PE through the activity of dependent agent. It also includes situations in which an agent habitually plays the principal role leading the conclusion of contracts that are then routinely concluded without material modification by the enterprise.
- ✔ Specific activity exemptions. Under the current regulations, a PE deemed not to exist when a place of business is engaged solely in certain activities (such as collection of information). Now it is intended to apply exclusion only for the activities, which are related to preparatory or auxiliary in relation to the business as a whole.
- ✔ Splitting up of contracts. In order to prevent splitting up contracts artificially into shorter periods, the OECD propose a principle purposes test, or a specific provision that allows for combining the activities of the related enterprise carried out at one construction site

[30]Implications of the new permanent establishment definition on retail and consumer multinationals available at https://www.pwc.com/gx/en/tax/publications/transfer-pricing/perspectives/assets/tp-16-implications.pdf (last visited mar.5.2018)

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during different periods of time, each exceeding 30 days, when determining the duration of work.

- ✔ E-commerce services and digital presence PE.

The influence of e-commerce on permanent establishment is significant and potentially can change the all concept of PE.[31]

The key characteristics of e-commerce are the following:

- Potentially virtual-the presence of the enterprise in another country may be wholly based on the hosting of a web-site on a server located there
- Disintermediated and less labor intensive- the main enterprise no longer requires intermediaries in foreign countries to be able to conduct a business there. Moreover, business activities require far less human intervention, if any, than that otherwise required to trade by in a traditional manner.
- Global- the scope of market penetration is unlimited and knows no borders
- Anonymous- business is transacted on a non-face to face basis and therefore the seller and the customer may not know each other[32].

As mentioned above the crucial principals of PE is boiled down to the determination of the fixed place of business in the source country to identify the mechanism of taxation for enterprises. The internet gave a mess to this rule, fully changing the traditional business model. Henceforth it is no longer necessary to present physically in the country where the business is being conducted. This positively challenges the notion of PE oriented on the physical presence of an entity in the jurisdiction.

Earlier multinational companies set up physical intermediaries in the country they were planning to penetrate to. In majority of cases, this concerned sales departments located in the targeted countries. And these physical intermediaries usually constituted PEs under tax treaties. The internet changed the business model and expelled the necessity of some intermediaries.

Amazon.com is one of the most prominent examples of e-tailors, which are doing their large part of business through a web site. That brought possible thanks to the latest internet technologies, which allow companies to execute many tasks automatically or remotely, such as: contract negotiation, payment collection or order collection, for example.

Moreover, the Internet provides the anonymity of transactions, as a result tax authorities lose their ability to detect taxable business activities. To address this emerging problem the OECD

[31] See footnote 30

[32] INTER-LAWYER available at http://www.inter-lawyer.com/lex-e-scripta/articles/e-commerce-pe.htm (last visited mar.10.2018)

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Committee on Fiscal Affairs in 1999 set up the Technical Advisory Group on Monitoring the Application of Existing Treaty Norms for Taxing Business Profits (TAG). This new entity is chargeable for basic standard technical reflection concerning the taxation of e-commerce activities. TAG stated that though it is fair difficult to trace the location from which e-commerce transactions are performed, there are a number of methods to do it: (a) pinpoint a server in a low-tax jurisdiction; (b) divide business functions related to a commercial transaction between separate servers; and (c) have websites hosted by Internet Service Providers (ISPs). Therefore, the transformation of business model led by the Internet entailed transformation of PE concept. In addition, the Committee realizing the transformational trends stated that a web site could not, in itself, constitute a permanent establishment. Moreover, paragraphs 42.1 and 42.2 of the Article 5 Commentary have been added to OECD MC in order to further confirm its position. The most important ones are cited below:[33]

- 42.2 Whilst a location where automated equipment is operated by an enterprise may constitute a permanent establishment in the country where it is situated (see below), a distinction needs to be made between computer equipment, which may be set up at a location so as to constitute a permanent establishment under certain circumstances, and the data and software which are used by, or stored on, that equipment. For instance, an Internet web site, which is a combination of software and electronic data, does not in itself constitute tangible property. It therefore does not have a location that can constitute a "place of business" as there is no "facility such as premises or, in certain instances, machinery or equipment" as far as the software and data constituting that web site is concerned. On the other hand, the server on which the web site is stored and through which it is accessible is a piece of equipment having a physical location and such location may thus constitute a "fixed place of business" of the enterprise that operates that server. [34]
- 42.3 The distinction between a web site and the server on which the web site is stored and used is important since the enterprise that operates the server may be different from the enterprise that carries on business through the web site. For example, it is common for the web site through which an enterprise carries on its business to be hosted on the server of an Internet Service Provider (ISP). Although the fees paid to the ISP under such arrangements may be based on the amount of disk space used to store the software and data required by the web site, these contracts typically do not result in the server and its location being at the disposal of the enterprise, even if the enterprise has been able to determine that its web site should be hosted on a particular server at a particular location. In such a case, the enterprise does not even have a physical presence at that location since

[33] http://www.oecd.org/berlin/publikationen/43324465 (last visited march 20.2018)

[34] OECD COMMENTARY ON ARTICLE 5 available at http://www.oecd.org/berlin/publikationen/43324465.pdf (last visited march 20.2018)

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the web site is not tangible. In these cases, the enterprise cannot be considered to have acquired a place of business by virtue of that hosting arrangement. However, if the enterprise carrying on business through a web site has the server at its own disposal, for example it owns (or leases) and operates the server on which the web site is stored and used, the place where that server is located could constitute a permanent establishment of the enterprise if the other requirements of the Article are met.

- 42.4For computer equipment to constitute a fixed place of business it must meet the requirement of being fixed. For example, in the case of a server it is not relevant whether it is possible to move the server, but whether it is indeed moved. 79 A server must be located at a certain location for a sufficient period of time in order to become fixed within the meaning of paragraph 1 of Article 5 of the OECD model tax convention.[35]

And now it says that even the presence of computer equipment in the certain location can be regarded as a premise of PE in this jurisdiction. Still there is a solid difference between computer equipment and the software and the data used by that equipment in the jurisdiction in question. This difference is major as it determines whether it should be referred to PE law or not. For example a website should not be considered as PE under current definition as it has not a fixed place of business. However, the server has its specific physical location and comprises of a fixed piece of equipment that is why unlike website it would give rise to a PE.

It is well known that frequently internet service providers host websites. That means that usually neither the servers nor their location is at the disposal of the trading enterprise. In other words, more than frequently the enterprise that operates a server and the enterprise which carries on business through a web site hosted on the server are not the same legal entity. Therefore, in this situation the server would not be regarded as a fixed place of business of the enterprise, which carries on the trade. Evidently, the operations through the website cannot be recognized as a PE of the enterprise. Thus, without fixed place of business of the entity no PE can be recognized.

To address this matter the Australian Taxation, for instance, stipulates that - place of business‖ should be determined by looking to the functions performed at that place[36]. The OECD as well considered that peculiarity of e-commerce entities and stated the following:

[35] See footnote 34

[36] TP WEEK EU digital tax will require changes to OECD transfer pricing guidelines available at https://www.tpweek.com/articles/eu-digital-tax-will-require-changes-to-oecd-transfer-pricing-guidelines/arlppxzh (last visited april 10.2018)

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A web site will not constitute a PE. A web site hosting facility should not result in a PE for the entity carrying on business through the web site. For example it clarified by Armenian tax authorities that non-resident can be registered as VAT payer in Armenia without establishing PE, in case when the conditions for PE stated by tax code are not met. An internet service provider should not constitute an agent and give rise to a PE A server located in a jurisdiction for a sufficient long period may be considered "fixed" and constitute a PE[37].

Conclusion.

The concept of a PE is a one of the hot topics in international taxation. This concept determines the right of a contracting state to tax the profits of an enterprise in another jurisdiction. Based on the OECD model Armenian tax code first regulated taxation of PE. Guidance produced by the OECD and UN is useful but is in no way conclusively addresses all issues. It may be concluded that the concept does not properly reflect the current business environment and need to be revised continuously to reflect modern business environment.

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