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A tax headache is looming if Scotland gets more powers from Westminster

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Tax trouble in store? Dooder

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Most people have heard of the Organisation for Economic Co-operation and Development (OECD) and are probably aware it wants to make the world a "better" place. Its work is probably of little interest to most companies based in the UK. But this would change if constitutional arrangements between Scotland and the rest of the UK change. This could be through independence, but equally through Scotland gaining full fiscal autonomy or even taking control of corporation tax.

In such circumstances, tax residence would become a big issue for companies operating in both jurisdictions. They would have to seek advice to avoid being taxed twice, make sure they were taxed in the most favourable regime and reduce business complexity by aiming to deal with only one tax authority. Meanwhile Scotland and the rest of the UK would have to sign a double-taxation treaty to standardise the tax position for such companies.

What the OECD convention says

It is extremely likely this treaty would be based on the OECD Model Taxation Convention, which is used by most countries around the world as a template for such arrangements. An arcane section that deals with something called “permanent establishment” (Article 5) would quickly become of critical interest to any companies affected.

Under the convention, the profits of a company are taxable in the country in which it is resident unless it does business in another country through a “permanent establishment”. A “permanent establishment” is defined as being a “fixed place of business through which the business of an enterprise is wholly or partly carried on”. It covers a “place of management”, branch, office, factory, workshop, mine, quarry, oil or gas well, or “any other place of extraction of natural resources”.

So far, so simple. If you’re there, you’re taxed there. But it’s more complicated because the convention has a number of exclusions. This includes facilities solely for storing, displaying or delivering goods that belong to the enterprise; or for buying goods or collecting information; or for carrying on “any other activity of a preparatory or auxiliary character”. It also excludes goods owned by the enterprise for the purpose of processing by another enterprise.

In short, physical presence does not always give rise to a tax liability. A company can enter into arrangements that will ensure it is not liable for tax in another country where it does business. This gives companies quite a lot of latitude to operate in a particular country without incurring tax liability.

The exclusions do not apply if either an office or an employee within the country in question can accept orders from customers, however. This was a major issue for many companies, particularly those dealing with the general public, but the internet has allowed businesses to deal directly with their customers no matter where they are located. With online retailing a significant market in the UK and still experiencing rapid growth, this means that it is possible to be in a country for business but not there for tax.

The UK dimension

So how does all this affect Scotland? The Scottish National Party (SNP) has not included a commitment for a referendum on independence for Scotland in its 2015 UK election manifesto, and its leader Nicola Sturgeon has appeared to rule out full fiscal autonomy while the party remains in the UK.

But the chances of this changing, or of pressure mounting to shift corporation tax control to Edinburgh, will no doubt increase if the prospect of a large number of SNP MPs in Westminster comes to pass after May 7. At that point, companies would have to consider their positions carefully. They would have to determine their tax residence and consider the implications of their commercial arrangements.

It’s not possible to try and wish away something you don’t like. The issues around "permanent establishment" would have major implications for any tax negotiations between Scotland and the rest of the UK, since each country would want to maximise its corporation tax revenues.

Watch oot, Nicola's aboot. Danny Lawson/PA

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