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Cross-border home working: a taxable presence for employers?

The restrictions recently introduced by governments to counteract the spread of the coronavirus (COVID-19) are forcing employees to work from home. Sometimes the work is performed in a country that is different from that in which the employees are normally based and in which the relevant employer is located.

For employers, deciding to allow employees to work from abroad needs to take into account several issues, including tax, employment and social security contributions for both the employer and employee.

In particular, employers need to consider whether having the employee working abroad means the employer has a permanent establishment (the PE) in the tax jurisdiction where the employee is located. For instance, it could be relevant for non-Italian investment firms having Italian nationals working from home on deals relating to non-Italian resident portfolio companies.

Should a PE of the employer be deemed to exist, this could result in the employer being liable to pay foreign corporate and employment taxes, among other tax obligations.

Below we consider the notion of PE and the circumstances under which cross-border home working may create a taxable presence.

The concept of 'permanent establishment'

Article 5 of the OECD model tax treaty defines the concept of PE as either:

- a 'physical PE', being an office, factory or some other form of fixed place of business that is available to the foreign company in the source state to carry on its business activity. Exemptions apply for certain activities that have a mere preparatory and auxiliary character; and
- an 'agent PE', being a person who is legally and/or economically dependent upon the foreign principal and has the power to bind the foreign company into contracts.

Physical PEs

Whether the home office of a resident employee of a foreign company could be considered a PE of the foreign company was discussed by the OECD in 2012-13 and subsequently reflected in the 2017 OECD commentary on article 5.

The OECD's position is that, even though part of the business of a company may be carried on at an employee's home office, that should not automatically mean that that location is at the disposal of the foreign company, thus giving rise to a physical PE.

In particular, the OECD's view is that no physical PE should be deemed to exist if:

- the home office is used on an intermittent or incidental basis;
- the foreign company did not require that home be used for its business activities; or
- the activities carried on at a home office are merely auxiliary.

Additional guidelines may be found in a statement issued in 2015 by the Swedish tax authorities setting out the criteria for determining whether an employee's home office may constitute a PE of the employer (eg presence of an implied agreement, the amount and type of work performed, etc).

Whether or not a home office could constitute a location at the disposal of the foreign company should be based on the actual facts and circumstances of each case. To mitigate the risk, the employee should avoid hosting business meetings or client entertainment at their home (which is likely to be of particular relevance in a sales context).

However, a strict approach by the tax authorities cannot be entirely excluded. For example, in a 2017 Danish case, the court decided that the use by an employee of a home office for administrative work constituted a PE of the foreign employer since administrative work is directly related to the main business of the company, ie the work could not be said to be auxiliary or preparatory.

Agent PEs

Generally, the issue of whether an employee may give rise to a PE of the foreign company is dealt with in relation to sales people or consultants who travel across various countries and visit local potential buyers.

Normally, such individuals may give rise to an agent PE of the foreign company if they:

- are involved in the conclusion of contracts on behalf of the foreign company; or
- play the principal role leading to the conclusions of contracts that are routinely concluded without material modification by the company.

In addition, an anti-fragmentation rule has been introduced preventing foreign companies from breaking up activities that, if taken separately, could be regarded as having an auxiliary character.

Accordingly, no agent PE issues should arise for the foreign company if the employee, when working from abroad, does not have the authority to conclude contracts with local clients in the name of the foreign company and does not negotiate the terms of the contracts, thus leading to the conclusion of the contract.

Should the employee perform these kinds of activities, one would need to consider if they are done 'habitually' or 'frequently' in the local jurisdiction. The OECD treaty does not have detailed rules and the commentary acknowledges that the 'habituality' test depends upon 'the nature of the contracts and the business of the principal. It is not possible to lay down a precise frequency test'.

An ad hoc analysis should accordingly be carried out to consider the specific feature of the case at hand and the approach adopted by the local tax authorities on the matter.

Conclusions

An employee working from home on a cross-border and continuous basis over an extended period of time may result in a PE of the foreign employer if:

- the employee exercises the power to bind the foreign company into contracts with local clients;
or
- the home office is regarded as a fixed place where the employee carries on activities not having an auxiliary or preparatory character.

How important this issue is clearly depends on the amount of income that should be attributed to such a PE (and, accordingly, the taxes due).

However, this is not the only tax aspect to be taken into account, as spill-over effects may arise, for instance in terms of withholding tax obligations on the income earned by the employee, VAT and other tax reporting obligations.

Recently the OECD issued guidelines to clarify the circumstances under which a PE should no be deemed to exist.