REMOTE WORK AND THE ALLOCATION OF TAXING RIGHTS OVER CORPORATE INCOME

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Agenda

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2. International Tax Law and Permanent Establishments: Fundamentals
3. Remote work as a challenge to the PE
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5. Comparative practices
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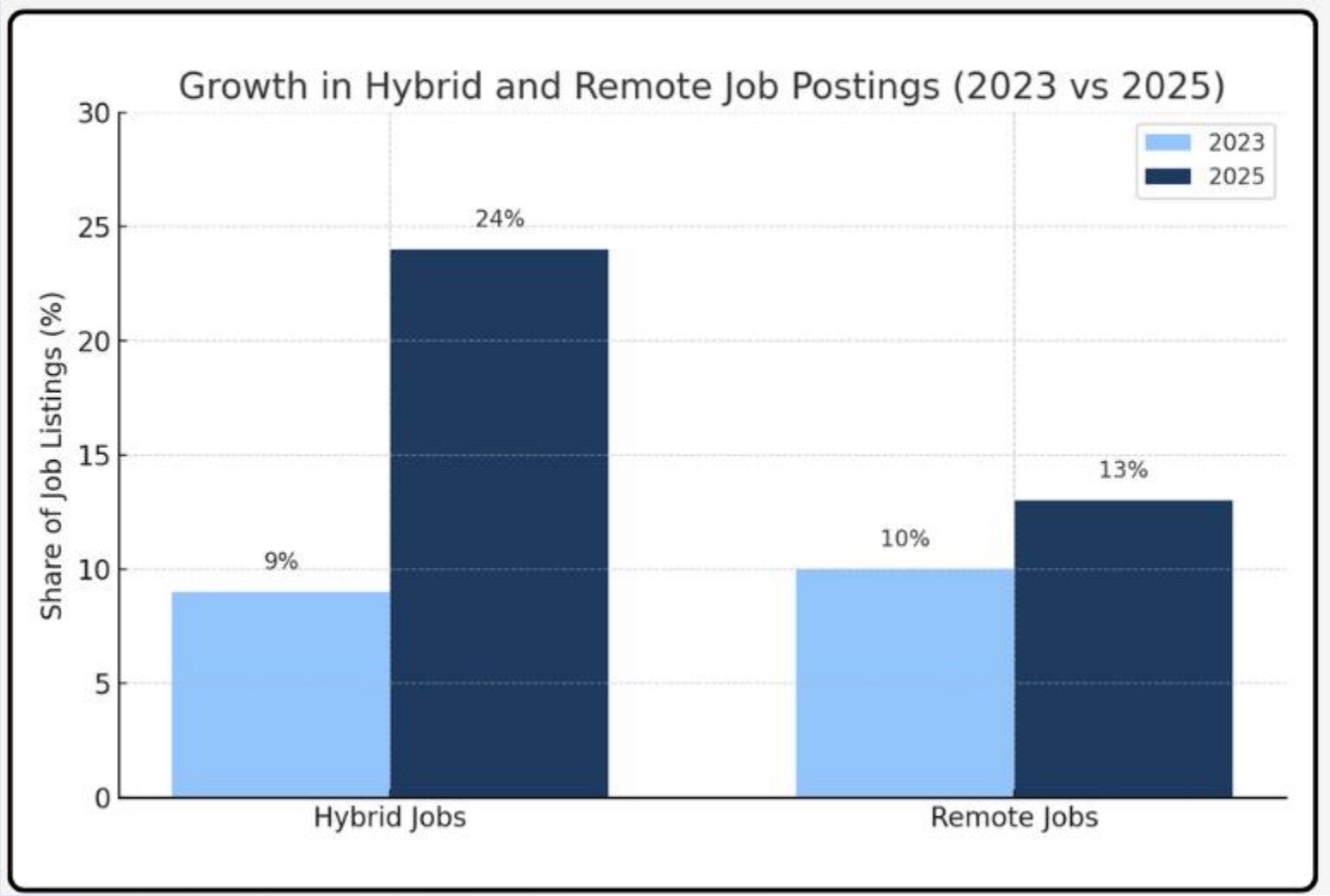
Introductory remarks

- During the COVID-19 crisis: the “new normal” of remote work

- Post-pandemic time: the number of remote and hybrid work models has stabilized
  - Stronger increase of hybrid work as compared to „full” remote work
  - For employers this flexibility of the workplace is part of the „war for talent” – how to recruit and retain mobile professionals?

- Different categories of **mobile workers**, each carrying specific legal and tax implications
  - hybrid workers, digital nomads, expats, frontier workers, posted workers, etc.
  - Definition of **remote workers** (UN Tax Committee, 2023): employee or individual contractor working in a country other than the country in which his employer or client is resident or has a permanent establishment or fixed base

Introductory remarks (2)



Introductory remarks (3)

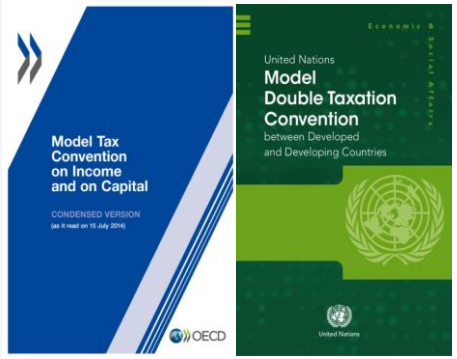
- decoupling of the territorial congruence between the employer's place of business (e.g. an office) and the employee's place of work
  - another layer of complexity added to the discussions on how to reform the framework of taxing cross-border business profits

- Two categories of questions raised:
  - Interpretative level (*lex lata*)
  - Policy level (*lex ferenda*)

ITL and PEs: Fundamentals

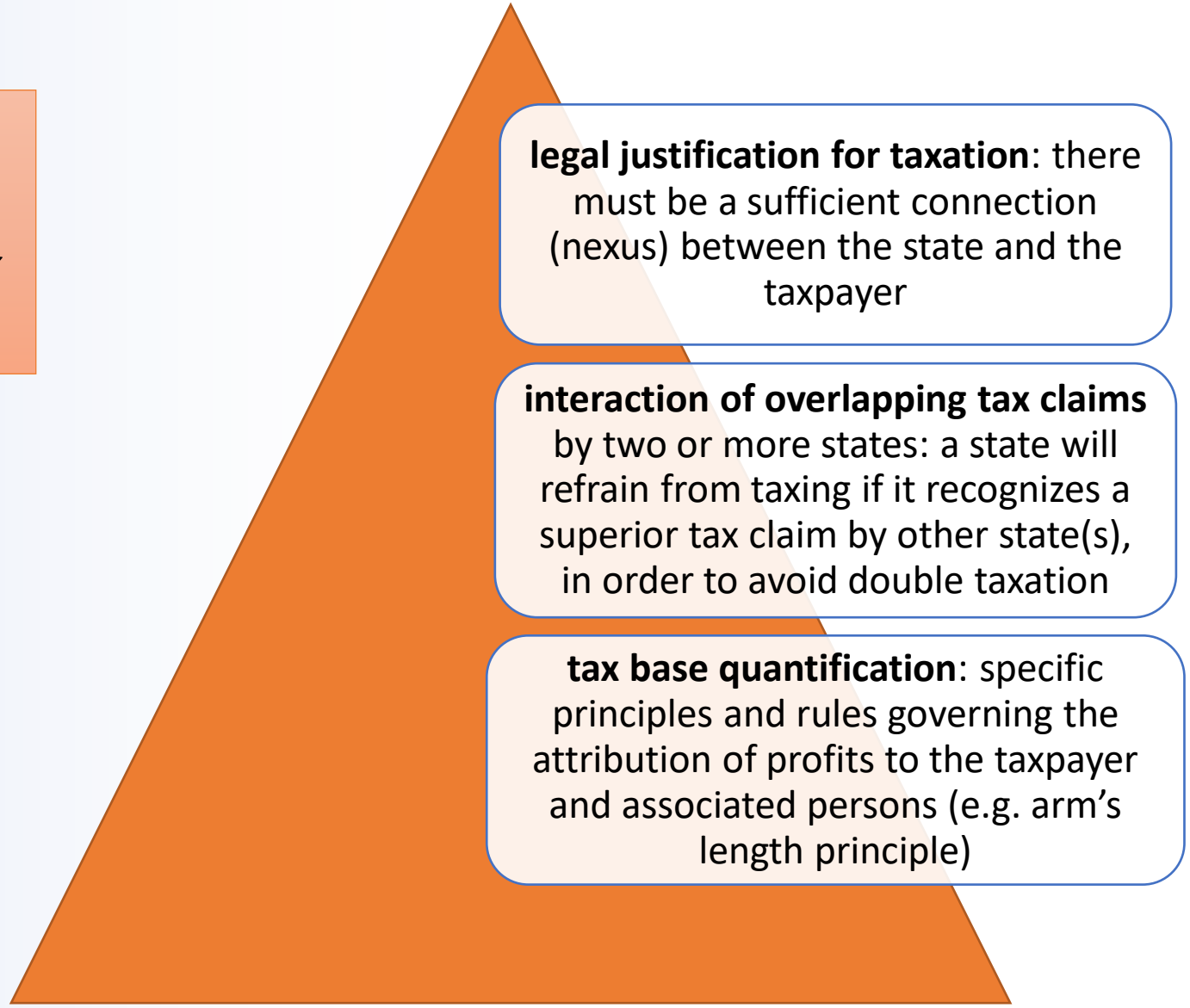
- what is "international tax law"?
  - *"(...) all international as well as domestic tax provisions relating specifically to situations involving the territory of more than one State, so-called 'cross-border situations"* (Klaus Vogel on Double Taxation Conventions, 2012)

- subject-matter of international tax law (ITL) is taxation of **cross-border economic activities**
  - most important sources of ITL are found in domestic law of respective countries and in double tax treaties (DTTs)



ITL and PEs: Fundamentals (2)

3-level legal framework for allocation of tax jurisdiction



ITL and PEs: Fundamentals (3)

- Hard to generalize – more than 3.000 DTTs currently in force
- however, with regard to business income, a vast majority of DTTs follow the pattern laid out in **Article 7 OECD MC 2017**
- Additional importance of Articles 7, 12A and 12B of the UN MC 2021
- *Leges speciales* – diverse tax treaty practice as regards to various sub-types of business income

ITL and PEs: Fundamentals (4)

- most important rule on allocating the rights to tax cross-border business profits – Art. 7 OECD MC 2017:
  - Profits of an enterprise of a Contracting State *shall be taxable only* in that State *unless* the enterprise *carries on business* in the other Contracting State *through a* ***permanent establishment*** situated therein.
  - If the enterprise carries on business as aforesaid, the profits that are *attributable to the permanent establishment* in accordance with the provisions of paragraph 2 may be taxed in that other State

ITL and PEs: Fundamentals (5)

- **Basic PE rule** - Art. 5(1) OECD MC
  - For the purposes of this Convention, the term ‘permanent establishment’ means a fixed place of business through which the business of an enterprise is wholly or partly carried on
  - elements of the PE:
    - Place of business
    - At disposal of the enterprise
    - Fixed (geographically)
    - Fixed (permanent in temporal terms)
    - Through which business is carried on

  - List of typical PEs – Art. 5(2) – e.g. place of management, office, workshop, factory, etc.
  - excluded: auxiliary and preparatory activities – Art. 5(4)

- **„agency PE”** – Art. 5(5) and 5(6) OECD MC

ITL and PEs: Fundamentals (6)

- where a UK resident service provider (here: aircraft engineer) has at the premises of a German service recipient designated facilities for personal use (here: **locker in common rooms on the airport premises**) in **connection with rendering their services (here: maintenance work on aircraft)**, a PE in Germany exists under domestic law and article 5(1) of the Germany-United Kingdom tax treaty. Further, the Court held that the services in question were not activities within the scope of article 5(4)(a) or (e) of the tax treaty (i.e. activities of a "subordinate nature") considering that, based on the overall circumstances, the services provided at the (third-party) premises represented the main business activity of the taxpayer
- the fact that the **taxpayer had at their disposal a designated locker at the premises of a third-party service recipient used for the storage of their personal belongings (private clothing) during working hours**, in the context of the provision of services to that third party in Germany, was sufficient for a German permanent establishment of the taxpayer to exist both under domestic law and article 5(1) of the tax treaty law.

DE Bundesfinanzhof (Federal Tax Court) I R 47/20, 7 June 2023

ITL and PEs: Fundamentals (7)

- the main object of the RPC and the relevant provisions of the ALA was to grant to the Indian company the rights to promote the F1 events in India, and the use of the trademarks and related intellectual property rights were merely incidental. The Indian company was not permitted to use any such intellectual property in respect of any merchandise or service offered by the Indian company (…) the consideration could not be characterized as "royalty" under Art. 13(3) of the treaty
- the Indian company was obliged to take all action necessary to ensure that the pit, paddock buildings and surrounding areas within the circuit and land were open to receive the competitors, the taxpayer company, its affiliates, contractors, and licensees during the above-mentioned three-week period. Further, the Indian company was obliged to authorize access to parts of the circuit not open to the public only through the passes issued by the taxpayer company (…) the Indian company's ability to act independently was extremely restricted (although the Indian company was the promoter of an F1 event in India) (…) though the taxpayer company's access to the Indian company's premises was limited to "up-to six weeks at a time during the F1 Championship season", it satisfied the duration test for the existence of a fixed place PE (…) the taxpayer company's income from the F1 events in India was taxable in India under Art. 7 (Business profits) of the treaty, and the Indian company was obliged to withhold tax on the payments to the taxpayer company

W.P. (C) No. 10307/2016, Formula One World Championship Ltd. v. CIT

Remote work and the PE

- the rise of remote work raises new questions on the aptness of PE thresholds to guide taxing rights allocation

- At the interpretative level – both MNC's and tax authorities had to grapple with the question whether and under which conditions the use of work-from-home and other remote work models may lead to the creation of new PEs, in light of Article 5 OECD Model

- Main issue related to the „home office PE": can a home office of an employee create a PE for the employer?

Remote work and the PE (2)

- Interpretation of the conditions for creation of a PE under Article 5 OECD MC:
  1) there must be a place of business (POB) and it must also be at the enterprise's disposal;
  2) the POB must be 'fixed' both geographically and temporally; and
  3) business activity must be conducted through that POB

  - Also: important to consider the carve-out for preparatory and auxilliary activities!

- in practice: the decision on whether there is a „home office PE" revolves around the „at the disposal" requirement!

OECD's work

- Pre-pandemic era: the home office PE was discussed by WP1 in 2011-2012 and 2015-2017
  - this subject was deemed as having little practical relevance

- Addition of new paragraphs 18 and 19 to OECD's Commentary of Art. 5 OECD MC 2017:
  - the fact that an enterprise's activity is carried out by a staff member through his home office should not automatically lead to the conclusion that that office is at the employer's disposal
  - the home office constitutes a PE if (i) the office is used on a continuous basis to carry on non-resident company's business [rule of thumb/6 months] and (ii) it is clear from the facts and circumstances that company has required the employee to use the home office to carry on its business, e.g. by not providing an office where the nature of the employment clearly requires an office

OECD's work (2)

- During the pandemic:
  - **OECD's Notes issued in April 2020 and January 2021** offered some guidance on the „home-office PE" issues and „agency PE" triggered by remote work

  - OECD rather easily dismissed the possibility of the creation of new PEs: in most cases, the degree of permanency of doing business in the home office will not be sufficient
  - the OECD contends in a rather casual fashion that employees who work from home during the pandemic do so out of *force majeure,* not on the employer's requirement, coming to the conclusion that a home office does not create a PE for the employer
  - In any case: all facts and circumstances need to be taken into account and the emphasis should be on the employer's initiative or requirements regarding teleworking

  - agency PE – triggered if the employee continues to work from home for a non-resident employer after the pandemic, on a habitual basis and continues to conclude contracts on behalf of the enterprise (OECD's 2021 Note)

Comparative practices

- Divergent views on elements inherent to Art. 5(1) OECD Model taken in different countries
  - Interpretative positions taken by domestic tax authorities range from a rather strict approach (e.g. Germany, Belgium) to a more liberal approach (e.g. Austria, Norway)

- general remarks:
  - Most jurisdictions agree that the mere fact that an employee works from home is insufficient for the creation of a PE
  - In line with OECD's Commentary, tax authorities put emphasis on the conditions of ***continuity*** and ***the effective power of the employer to use the office***

Comparative practices (2)

- **Germany**
  - Pre-WWII case law of the BFH: basic premise that the home office is mostly not at the disposal of the employer
  - it must be recognized that the right of disposal of an office is permanent and undisputed (BFH, 1993)
  - BFH (1998): there is no right of disposal in a situation where regional managers were contractually obliged to make certain rooms in their residences available to the enterprise in which it placed IT equipment
    - right of disposal was not undisputed because the managers could still use the rooms (in part) for private purposes (even though the ability to do so was effectively limited) and could always refuse unrestricted access of other company employees to those rooms
  - Administrative guidance related to home office Pes (2024): no PE even if the employer does not provide the staff member with another place of work or if he and the staff member enter into a rental agreement with regard to the home office, unless this implies that the employer effectively acquires the free right of disposal (e.g., by being allowed to admit other employees to the home office or to enter it at all times)
    - The fact that the employer bears the costs of home office is not important!

Comparative practices (3)

- From a comparative perspective, these factors play a role in finding a home office PE:
  - Does the employee claim the expenses related to the use of home office? (Austria, Spain)
  - Provision of material and equipment to the employee? (Poland)
  - Does the work confer any advantages to the employer? (Finland, Sweden)
  - Is remote work an „employer-driven" decision? (Spain)
  - Ratio of home office work time of the employee, e.g. a 50% threshold (Austria)
  - Free choice of employee to sell the HO or terminate the lease? (Germany, Belgium)

- question: when is remote work mandatory?

Comparative practices (4)

- November 2023 – conclusion of an interpretative agreement between Belgium and the Netherlands on Article 5 of their DTT
  - Draws clear distinction between 3 scenarios:
  1) 'occasional home working' – never a PE!
  2) 'structural home working with the possibility of working on location' - never a PE!
  3) 'structural and mandatory home working' – may lead to a PE!

- Mandatory nature of home working may be construed factually
  - Is the employee, legally or factually, obliged to work from the home office?
  - the employee does not have the practical availability to work in an office or other location;
  - the employee cannot stop the use of its home office unilaterally, for example because the employee cannot perform its activities adequately or conform its employment agreement if not performed at its home office

- „gateway" criteria: if an employee works less or up to 50% of his/her working time from home for a 12-month period for the employer (located in another country), it can be presumed that the home office does not constitute a PE
  - also: exemption for preparatory/auxilliary activities

Broader policy concerns

- new reality of work is riddled with fact patterns that put the normative viability of the whole PE concept to a serious test

- Important to go back to the policy fundamentals of the PE:
  1) Reflection of inter-nation tax fairness – level of participation of economic life of the „source country" that justifies taxation
  2) Administrative concerns and limitation of compliance costs

Broader policy concerns (2)

- Pre-pandemic debates on the PE – strong voices view in tax scholarship that the PE as a „nexus norm" has become obsolete
  - While it probably made sense in the economic environment of the early 20th century, it is not fit for today's digitised economy!
  - Assertions that the PE leads to a „digital tax gap"

- Potential solutions – mostly lead to a re-allocation of taxing rights towards the „market"
  - OECD's work on Pillar One
  - Article 12B of the UN Model Tax Convention

Broader policy concerns (3)

- while the pre-COVID debate focused on the failure of the PE to capture the demand side of value creation (e.g. the market), the controversy over 'home offices' may be taken as evidence that the new economic environment diminishes the ability of the PE to accurately capture even the supply-side factors!
  - Which market(s) are remote workers actually serving?

- Risk of proliferation of „micro-PEs" in the new environment
  - High compliance costs
  - Little revenue potential for source countries – problem of profit attribution!
  - Not clear from the „justification to tax" perspective!

Concluding remarks

- Criticism of the PE concept reached a new stage in the digital age we are living in today – even more accentuated by the pandemic and remote work arrangements
  - "*Is it not time to accept that the corollary to the recognition of a significant digital presence is that an insignificant physical presence at a home office should not constitute a permanent establishment and a sufficient nexus for taxing profits in a country?*" (Philip Baker, 2020)

- Potential way forward
  - Update of the OECD Commentary regarding new patterns of work and the PE
  - Introduction of „safe harbors" based on objective criteria such as number of remote employees in a country, % of remote employees in a country, local costs incurred with remote working, etc.

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