TELECOMMUTING: GOOD INTENTIONS, BAD OUTCOMES

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Tags
Article 5
At the Disposal of the Employer
Dependent Agent P.E.
Fixed Place of Business P.E.
O.E.C.D. Model Convention
Remote Workers

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INTRODUCTION

In 2017, the O.E.C.D. stated that the question of whether a home office constitutes a permanent establishment ("P.E.") is rarely a practical issue because the majority of employees reside in the state where their employer has an office.[1] Although that observation was undoubtedly accurate at the time, today it is safe to say that it did not age well.

COVID-19 pandemic has disrupted our conventional *modus operandi* in the office, since being able to work remotely abruptly shifted from being a mere perk to becoming an absolute necessity. The mandated rise of remote working brought to light its benefits. While employers can reduce office expenses and expand the talent pool beyond the local area, employees save time and expense of commuting and improve work-life balance. In the aftermath of the pandemic, remote work arrangements persist in corporate business practices.

As the necessity for employees to be physically located in the office decreases, the physical distance between the remote workplace and the employer's workplace has increased in many instances. As the number of cross-border employees increased, practical challenges that were previously considered rare become more prevalent. That being said, employers now face challenges involving the existence of a potential foreign P.E. that results from an employee's presence abroad. The question arises whether the pre-pandemic international tax framework is still adequate in today's world of telecommuters.

In this article, we first provide a summary of the international tax implications of remote workers from a corporate income tax perspective, based on the O.E.C.D. Model Convention framework. Thereafter, we discuss a number of situations in which the current framework arguably does not result in a desirable outcome. We conclude by providing recommendations.

OVERVIEW OF THE CURRENT INTERNATIONAL TAX FRAMEWORK

Many jurisdictions impose a tax on profits derived by entities established within their borders, regardless of where those profits are generated. Additionally, countries may levy taxes on entities that have a P.E. within their borders, even though the corporate seat and headquarters of an entity are established elsewhere.

[1] O.E.C.D. Model Tax Convention on Income and on Capital, commentary on article 5 concerning the definition of a P.E., paragraph 19 (2017).

For employers who hire remote workers, it is essential to be aware of the potential tax implications of their employees' activities. If a remote worker's activities constitutes a P.E. under foreign law, an employer may have tax obligations in foreign jurisdictions, even though it may not be aware of the existence of a P.E. With respect to remote workers in particular, employers need to give careful consideration to their status and determine if their home office can be deemed a fixed place of business or whether the activities of the employee may constitute a dependent agent P.E.

Home Office: a Fixed Place of Business?

Within the O.E.C.D. Model Treaty framework, a place of business may exist if an enterprise merely has a certain amount of space at its disposal in a jurisdiction.[2] Whether a home office may constitute a place of business of the enterprise therefore boils down to question of whether such home office can be considered as being at the disposal of the employer.

In this regard, the O.E.C.D. commentary states that a home office may be considered to be at the disposal of the enterprise if it is used on a continuous basis for carrying on business activities for the enterprise and it is clear that the enterprise requires the individual to use that location to carry on the enterprise's business, for example by not providing an office. Reading between the lines of the O.E.C.D. commentary,[3] it could be argued that a home office is considered to be at the disposal of the employer if (i) there is a certain degree of continuity with respect to working from home and (ii) the employee is required by the employer to use the premises of the home as an office.

Remote workers could be considered to continuously work from home with minimal risk of creating a P.E. if that use reflects the choice of the remote worker, not the employer. However, the criterion of the employer requiring its employees to use their home office is far less obvious.

If, for example, an employer would assign an employee to a foreign country in the interest of the company but does not provide for an office space abroad, it could be said that the employee is required by the employer to use a home office. However, that same employee might also migrate for personal reasons, while continuing to work for the company from a home office abroad. In that fact pattern, it could not be said that the employee was required by the employer to use a home office abroad, as long as an office was still available in the state of the employer. The intention of the parties therefore appears to be decisive.[4]

In addition, the home office must be considered to be "fixed" in order for it to qualify as a P.E. In this sense, a certain degree of permanence is required. For remote workers in particular, this should entail that incidentally working abroad (on a non-recurring basis) should not result in the creation of a fixed place of business. The O.E.C.D. commentary does not identify an exact threshold that is considered as sufficiently permanent, but it does mention that experience has shown that P.E.'s generally are not deemed present in situations where the activities are maintained for fewer than six months.[5]

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2 O.E.C.D. Model Tax Convention on Income and on Capital, commentary on article 5 concerning the definition of P.E., paragraph 12.

3 *Id.*, paragraph 18.

4 *Id.*, paragraph 19.

5 *Id.*, paragraph 28.

Home Worker: a Dependent Agent?

In a scenario where the employee's home office is not considered a P.E., nonetheless a P.E. may still be constituted if the employee's activities result in the creation of a dependent agent P.E. In short, a dependent agent P.E. may arise where an employee acts on behalf of the enterprise and, in doing so, habitually concludes contracts or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise. In that instance, a physical location is not required because it is the specific activity of the remote worker that places the employer at risk. This contrast with the fixed base P.E., where it is the combination of premises and any activity that placed the employer at risk.

DOES THE O.E.C.D. FRAMEWORK PROVIDE FOR REASONABLE OUTCOMES FOR REMOTE WORKERS?

Above we discussed the current international tax framework for employers of remote workers. Although the framework may successfully avoid double taxation, still it can be contended that the existing system – in particular in relation to the constitution of a P.E. – does not always produce outcomes that could be considered fair or desirable.

Intentions Resulting in Disparities

Based on the current O.E.C.D. commentary and as discussed above, an employee dispatched abroad by an employer could be said to be required by the employer to use a home office, whereas an employee who voluntarily works abroad may not. In the latter case the employee's home office may not result in a P.E., whereas in the first case it would.

The main benefit of such interpretation is that a company only has tax obligations in those jurisdictions where it actually intends to conduct business. At the same time, it could result in a disparity of taxation for cases with a more or less similar fact pattern within any one jurisdiction. Suppose there are two companies with employees in a foreign jurisdiction, and both employees carry out identical activities. In such a case, if one company dispatched its employee, it would constitute a P.E., while the other company, due to a lack of intention, may not. It could be argued that for the purpose of determining a P.E. presence, the assessment should be limited to the factual activities being conducted in that jurisdiction (objective test), regardless of whether the employer intended those activities (subjective test).

Artificial Avoidance of P.E.'s

Based on the current guidance, it appears that a home office P.E. can be avoided by not requiring employees to use their home office. In other words, a P.E. would not ordinarily exist if the employer provides office space to the remote worker.

This was the case in a Spanish tax ruling from 2022.[6] In summary, the case concerned a U.K. employee of a U.K. company who continued working for the company

[6] SG de Fiscalidad Internacional, Nº de consulta V0066-22, 18 January 2022.

while stranded in Spain due to the then applicable COVID-19-related travel restrictions. As a result, the employee exceeded the 183 days threshold and became a Spanish tax resident. Following the lift on travel restrictions, the employee decided to remain in Spain even though the company asked him to return to the office in the U.K. This eventually led to the employee's resignation when he refused to move back. The U.K. company approached the Spanish tax authorities to confirm that no permanent establishment was constituted either on the basis of a fixed place of business or the existence of a dependent agent.[7]

For the duration of the travel restrictions, the tax authorities concluded that no permanent establishment was constituted in this case, as the activities lacked a sufficient degree of permanence. For the period following the lift of restrictions, the authorities concluded that the home office was not at the disposal of the U.K. company and therefore did not constitute a permanent establishment. In this respect, the authorities particularly considered the facts that the worker unilaterally decided to remain in Spain, the U.K. office remained available to the employee – meaning that he was not required to use his home office – and the U.K. company did not bear any expenses for the home office.

The Spanish ruling sheds some light on the tax implications for remote workers from a Spanish perspective. Nevertheless, the question remains within which boundaries the mere availability of office space in the employer's resident state should lead to the conclusion that telecommuters are not required to use their home office abroad. It would be all too easy of employers to simply avoid a foreign P.E. by offering local office space to their cross-border workers, which means an empty desk in the home office of a company.

This would result in the somewhat odd situation that activities conducted in the employer's state could impact the presence of a P.E. in the other state, whereas one might expect the presence of a P.E. to be determined on its own merits.

Dependent Agents Provision Outdated?

To expand its market to foreign territories, a company may have dependent agents or employees habitually conclude contracts in those territories. In those instances, it seems reasonable that the foreign jurisdiction would impose corporate income tax on the profits resulting from the company's activities within its borders. The O.E.C.D. Model Treaty also facilitates this by considering a dependent agent as a P.E., and allowing for taxation of the foreign company.

However, for remote telecommuters the aforementioned condition may work out somewhat arbitrarily. For instance, where a law firm permits a senior associate and a junior associate to work remotely from a foreign country, in principle both lawyers would probably continue to do the same work for the same clients, meaning that their physical location is irrelevant to the firm's operations. Indeed, clients may not even be aware of the names or physical location of the attorneys working on their matters. However, if the senior associate habitually seeks new clients based in the country and elsewhere, and to that end negotiates retainers with prospective and existing clients through digitals means, a P.E. in the foreign country may exist even

[7] For a discussion of this and other recent cases, see Sunita Doobay, "Tax Cases Affecting Remote Workers and Their Employers," *Insights* Vol. 9, No. 5 (September 2022).

though the prospective clients are based elsewhere. This would not apply to the junior associate – who is typically not involved in generating new assignments – even though otherwise their situations would be comparable. Thus, despite the fact that both lawyers would essentially perform the same activities and would likely not compete locally, only the senior associate might qualify as a P.E. This may trigger tax implications due to a relatively minor difference in the actual activities. The method of allocating such income to a P.E. is beyond the scope of this article.

While having the mandate to negotiate contracts may seem a reasonable criterion for dependent agent P.E.'s engaging in traditional business, this may not necessarily be the case for employers of telecommuters. Especially where the employees' activities are completely unrelated to their physical location and employees do not compete locally, the mere fact that one has a mandate to negotiate and conclude contracts may not be an obvious distinction in determining a company's taxable presence.

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E-Commerce and Remote Working: Two Sides of the Same Coin?

In literature, it has been argued that due to the digitalization of the global economy, the current P.E. standards which attribute significant value to physical presence should shift to an approach which uses tests of economic presence or digital presence at the location of consumption.[8] Currently, digital companies may conduct business in a jurisdiction electronically without the need for a physical presence. As a result, the classical P.E. criteria do not allow countries to tax those results.[9] This phenomenon also led to the discussion of so-called "digital P.E.'s."[10]

If it is considered fair to tax a company's profits solely because it has a digital P.E. from competing in the local market through electronic means, but without a physical presence (outside activity, but inside sale), one could also argue that there should not be a P.E. in the opposite case, *i.e.*, where a company does have a physical presence, but does not compete locally as the employee is only working remotely through electronic means (inside activity, but outside sale).

In any case, the introduction of a digital P.E. would entail a radical overhaul of the current P.E. definition, as it would attribute little value to physical presence and focus more on where the service or product is eventually consumed. It is also not unimaginable that the international community will distance itself from the idea of a digital P.E. and shift toward source-based taxation instead.[11]

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8 Benjamin Hoffart, "Permanent Establishment in the Digital Age: Improving and Stimulating Debate Through an Access to Markets Proxy Approach," 6 *Nw. J. Tech. & Intell. Prop. 106* (2007).

9 Polezharova & Krasnobaeva, "E-Commerce Taxation in Russia: Problems and Approaches," *Journal of Tax Reform*. 2020;6(2):104–123.

10 O.E.C.D. (2001), *Attribution of profit to a permanent establishment involved in electronic commerce transactions*, a discussion paper from the technical advisory group on monitoring the application of existing treaty norms for the taxation of business profits.

11 See: Spinosa & Chand, "A Long-Term Solution for Taxing Digitalized Business Models: Should the Permanent Establishment Definition Be Modified to Resolve the Issue or Should the Focus Be on a Shared Taxing Rights Mechanism?" *INTERTAX*, Volume 46, Issue 6 & 7.

PROPOSED IMPROVEMENTS FOR TELECOMMUTERS

The existing international framework was established to cater to conventional businesses. To operate in foreign territories, companies had to establish a physical presence or assign a representative to conclude local market contracts. Clearly, this approach did not take into account the current ease and prevalence of telecommuting, which could lead to the establishment of a P.E. with activities that are not necessarily related to the jurisdiction asserting the existence of a P.E. In order to modernize the current rules and have them lead to a more desired outcome, several adjustments can be made.

First of all, it could be considered to include a *de minimis* rule for P.E.s. This could greatly reduce the risk for employers of remote workers not meeting their tax compliance obligations, especially in cases where they have few employees in a jurisdiction. Such a *de minimis* rule could for example entail a minimum number of employees, revenue, transactions, or time spent.

It is currently uncertain whether a home office can be considered a fixed place of business. The determining factor appears to be whether the employer requires its employees to use a home as an office space. However, this criterion is open to interpretation and may be interpreted differently by various legal systems. It is recommended that a clear decision is made on this matter, either considering the home office as a fixed place of business, or not. Preferably, such assessment should be made based on its own merits, without taking into account external factors such as the availability of other office spaces or the reason for using a home office in the first place.

Moreover, the requirement of an employee being authorized to negotiate and finalize contracts as a means of establishing a dependent agent permanent establishment may lead to undesirable consequences, particularly in situations where employees do not effectively operate in the market of their home jurisdiction. In such cases, the criterion may work out quite arbitrarily.

CONCLUSION

The increase in remote work has prompted concerns about the effectiveness of the existing global tax system, especially for employers with telecommuting employees. While the O.E.C.D. Model Convention offers guidance on classifying a home office as either a permanent establishment or a dependent agent, it remains difficult to apply these standards to remote workers.

Employers must assess the status of each remote worker and whether that worker's home office qualifies as a fixed place of business or a dependent agent, but this could lead to unjust results under the current framework. As remote work becomes more prevalent, policymakers should review the global tax framework and establish more precise and practical regulations that are equitable to all parties involved.