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Avoiding the unintended creation of permanent establishments and income tax-related problems due to cross-border remote working

Dear Mrs. Rosenbaum,

Over the last few months, remote working has considerably gained importance for the future of work, especially during the COVID-19 pandemic, which further accelerated previous developments. In business practice, cross-border remote working also became increasingly important. However, cross-border remote work raises various taxation issues, especially in cases where employees live or stay abroad for an extended period of time. Consequentially, the employer may face the issue of an “unintended creation of a permanent establishment (PE)”.

If cross-border remote work results in the unintended creation of a PE abroad, the employer generally faces a limited tax liability under foreign law. This leads to extensive registration and declaration obligations abroad, as well as requirements for profit delimitation, with the additional possibility of sanctions in the event of non-compliance. Additionally, obligations in the taxation of wages arise abroad and, depending on the structure of the double taxation agreement (DTA), possibly for the employee as well – which requires the implementation of additional internal processes. For example, the days which have been worked abroad from must be determined for all employees (where applicable), wage taxes must be paid, or other arising tax consequences (including the avoidance of double taxation) must be considered. Employees can also face a high administrative effort in order to counter double taxation risks. After the Covid-pandemic, cross-border remote work may also lead to a change in the employee's social security status, which involves complex procedures with foreign authorities.

These problems especially arise in cases where a foreign state has lower requirements for the establishment of a PE (i. e. Germany and Austria). For example, the Austrian Federal Ministry of Finance already stated in 2019 that an employee's home could constitute a PE, if the home is used for company purposes. According to the ministry, if employees work – after coordinating this with their employer – from their home, an employee de facto provides the employer with power of disposition over the premise (EAS information "Home office as permanent establishment" of June 27, 2019).

In order to avoid the unintended creation of PEs during the pandemic, the OECD published a – legally not binding – recommendation ("Updated guidance on tax treaties and the impact of the COVID-19 pandemic," January 21, 2021), according to which temporary remote work, that is necessary due to the Corona pandemic, should not create a PE abroad. This recommendation was for example implemented in the bilateral consultation agreements between Germany and Austria on January 15, 2021 and Germany and Switzerland on April 27, 2021. As a result, remote work, that is only caused by the pandemic situation, does not lead to the creation of a PE, as "the degree of permanence of the activity or the power of disposition of the enterprise required for the assumption of a PE is lacking".

A continuous importance of cross-border remote work – which will not be limited by the duration of the pandemic – can already be expected. In order to achieve legal certainty for all parties involved and to accommodate the desires of employees for cross border remote work as well, a permanent regulation is needed. For employers it is of utmost importance to have a defined set of comprehensible criteria. This enables them to decide in which cases no PEs are created by cross-border remote work and in which cases respectively do create PEs.

However, with the nature of cross-border relevance, unilateral regulations are not sufficient. Rather, an internationally coordinated approach is required. To this end, a common, legally binding understanding of the countries involved should be found at least at the EU level, or even at the OECD level. In this context, already existing, practice-oriented explanations in the OECD Model Commentary 2017 on the OECD Model Convention 2017 can be referenced.

We kindly ask you to support and promote such an internationally coordinated approach. Regarding details on our proposals for regulations which avoid the unintended creation of PEs in the context of cross-border remote work, we refer to the attachment.

We have sent an identical letter to the European Commission.

Yours sincerely,

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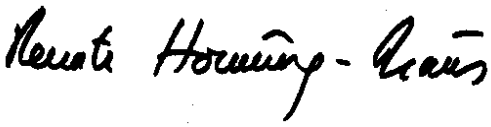

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A. Unintended creation of permanent establishments

For the assessment of a permanent establishment (PE) in an international context it is generally not sufficient if the business facility serves the activities of an enterprise. A purely national view leads to the denial of the company's power of disposition, particularly in the case of a work place in the employee's home – with the consequence that this does not constitute a PE. Yet a different legal classification may very well be made in other countries. Such differences in national requirements lead to taxation risks, since it is unclear which factors need to be considered to determine tax liability. If a foreign country takes the stand "activities of a remote working employee from his home constitute a PE", it would lead to a considerable administrative burden in the form of registration, declaration and other recording and documentation requirements, as well as the risk of double taxation.

To avoid the unintentional creation of PEs in the context where employees carry out their activities from abroad, under which remote work from the private study would fall, but also in the context of other forms of cross-border remote work, there is an urgent need for standardized and practical regulations which must be applied by all concerned states. For companies it is crucial that remote working outside the company’s premises, e.g., from an employee's home or a hotel, does not automatically lead to the **creation of a PE**.

With regard to a practicable solution, two approaches are expedient:

I. Basic exclusion of the creation of a PE

The following regulation is easy to administer both for business practice and for the tax authorities:

If an employer provides an employee with **work premises** in the country of employment (as has been the case up to now) while permitting the employee at his **own personal request** to work on a cross-border remote basis **for short periods of time** (e.g. up to 120 working days or 183 days in a 12-month time frame) a PE should not be constituted – especially since the employer generally does not have access to the premises. Due to the short period of time involved, this situation should not result in a PE of the business, nor should it establish a representative PE abroad, nor should it result in a place of general management.

Since no permanence can be assumed in the case of cross-border remote work, this approach is comprehensible as well practice-oriented, and no fixed establishment with access to company premises is thus created. For these reasons, there must also be no creation of a PE if employees work from premises of a foreign subsidiary for a limited period of time.

Within the aforementioned time period, it is generally assumed that no PE is created. If this period is exceeded, a PE is not necessarily or automatically created. It is rather necessary to define appropriate criteria in order to determine from which point in time a PE is assumed to exist.

II. Limit the risk of unintentionally creating PEs through the definition of comprehensible criteria

Accordingly, the existing regulations on the delimitation of a PE with regard to remote work must be further specified and designed to meet the needs of employees as well as employers.

Both the OECD Model Convention as well as various DTAs, and national regulations contain **three delimitation criteria** for assessing when cross-border remote work leads to the creation of a PE:

- temporal criterion (duration),
- legal criterion (location, power of disposition),
- qualitative criterion (type of work activity).

These criteria should be defined in a sufficiently clear and verifiable manner so that, in the event where various criteria would be cumulative applicable, a legally sound decision can be made on the creation of a PE. The criteria should be interpreted and applied uniformly by all countries concerned. Regarding management and representative PEs, additional specifications may be necessary, especially concerning the temporal and qualitative criteria.

The creation of legal certainty is crucial for businesses. With regard to the necessity of various criteria being applicable for the creation of a PE, it should be clear, that no PE is constituted, if a single of the above-mentioned criteria is not met.

1. Temporal Criterion

The time criterion is particularly suitable for a legally secure delimitation as well as particularly useful for documentation and verification purposes; for example by documenting the number of days of remote work. In the event of inquiries from the tax authorities, corresponding extracts for each employee can be submitted. These documentation requirements should be satisfied if the employee records his or her days of cross-border remote work.

Temporary or occasional cross-border remote work cannot constitute a PE, as the requirement of permanence is not met. For a practical, clearly defined delimitation, a time limit should be specified in order to avoid time-consuming individual case examinations:

- **Cross-border remote work for a continuous period of up to six months does not meet the criterion of “permanence”.**
- In the case of recurring cross-border remote work (e. g. 2 to 3 days every week from the employee’s private home in the foreign country of residence, etc.), the number of actual days of cross-border remote work should be taken as a determination base. For example, based on existing income tax regulations, it could be stipulated that occasional cross-border remote work of up to **120 working days or 183 days of stay per 12-month period does not constitute a PE**.

To simplify matters, the basic prima facie evidence should apply that a PE is not established in any case until the number of working days in the country of residence is exceeded. However, the creation of a PE should not automatically be the consequence if the number of working days is exceeded, rather there should be prima facie evidence that can be refuted by the other two criteria.

2. Legal Criterion

In determining whether a so-called home office qualifies as a PE, the employer’s power of disposal over the employee’s premises is of importance. The power of disposal requires that the so-called telework is not only temporarily available to the employer for the purposes of the business. The employer's power to dispose of the employee's premises can only be assumed in exceptional cases. The retention of the employee's power of disposal of, for example, his own home will regularly be the case. The following aspects speak in favour of this:

- The premises where the mobile work is performed are **not provided by the employer**. The employee chooses the place of work at his/her personal request. There is **no reimbursement** of costs by the company. However, subsidies from the company, e.g. for electricity costs or for the employee's telephone and internet charges, are unobjectionable.

- The company may only have a **limited right of access to the employee's premises**, exclusively for the purpose of checking statutory labour law requirements (after prior notification).

- The employer's power of disposal also does not apply if spouses, life partners or children working for the same employer live in the same flat as the employee. This should also apply if two or more employees of the same employer live together in a shared apartment.

- Even if an employee does **most of his or her work** in his or her home or other premises in another state and not in the premises provided by the employer, this should not result in

a PE - even if the above-mentioned periods are exceeded: The decisive factor is that the company has not requested (which is clearly evident from the provision of an office workplace) that premises of the employee are used for business activities. Thus, these premises are not at the disposal of the enterprise. Note: The right of taxation on income from non-self-employed activities may, however, accrue to the State in which the activity is carried out under the 183-day rule, even if no PE is established in these cases.

Furthermore, the following aspects must be taken into account:

- **Workplace equipment** for mobile work or in the so-called home office: If the company provides work equipment (e.g. laptop, mobile phone) and, if applicable, office furniture (e.g. desk) for the performance of the activity, no fixed local plant or equipment should be assumed to establish a PE. A fortiori, mere subsidies from the company do not lead to the creation of a PE. The fact that the employee claims his own costs in the context of his taxation should not lead to the creation of a PE.

- Another argument against the employer's power of disposal is if the employee has his **own workplace at the contractual place of work**. In this context, so-called open space solutions are also considered to be a separate workplace, whereby a workplace is not permanently assigned to an employee, but rather workplaces are made available for a certain proportion of employees.

- In cases where the employee's place of work is contractually divided between the office and the so-called home office, without the employee being provided with a workplace in the office on the home office days (e.g. in the case of desk sharing in the company), the employer also does not have the power to dispose of the so-called home office. The employer cannot require the employee to perform work in the home office on the fixed days of presence in the office. There is therefore no permanent availability.

3. Qualitative criterion

The following aspects regarding the nature of the activity contradict the assumption of establishing a PE:

- The activity of the employee in the context of mobile working essentially comprises **preparatory and auxiliary activities**, i.e. administrative activities in the internal relationship, the work results of which are either

  - not geared to the core business of the enterprise in terms of their objective, or
  - cannot be used directly, i.e. without further activities of other employees, for the core business of the enterprise.
- Activities which therefore only concern the internal relationship of the enterprise are in most cases preparatory and auxiliary activities. The same applies to employees who perform group functions. Preparatory and auxiliary activities should not constitute a PE even if these activities are charged to other group companies in the context of group apportionments or services and thus constitute a turnover-generating activity of the enterprise, unless this is the main activity of the respective company.
- It should be clarified that a representative also does not establish a PE abroad by carrying out such auxiliary and secondary activities (Art. 5 para. 5 OECD Model Tax Convention 2017).
- The entitlement to (cross-border) **employee management** should not give rise to an indicative effect that speaks against preparatory and auxiliary activities.
- The employee or representative does not have **power of attorney for concluding contracts** that **concern the company's core business** and does not take a leading role in concluding contracts. The power of attorney for contracts relating to internal procurement (goods, services) is irrelevant.

A **different interpretation** of which **activities are to be classified as preparatory or auxiliary** and thus exclude a PE (Art. 5 para. 4 OECD Model Tax Convention 2017) should be **avoided through international coordination**. The MLI with its provisions on PEs (Art. 12 - 14) could be a good implementation tool.

III. Supplementary requirements for management permanent establishments, representative permanent establishments and service permanent establishments (UN Model Convention)

- The above-mentioned principles (temporal, legal, qualitative criterion) **should also apply to managing directors and other executive employees** in order to avoid the unintended creation of a management PE. The decision-making of **individual managerial orders** in the context of remote working from abroad must not lead to the creation of a management PE.
- In addition, it should be clarified that **short-term work by executive employees** (e.g. a few days per month) from a foreign place of residence does not constitute a PE, even if management activities are carried out.
- The **assumption of a representative PE** should be based on a certain duration of the representative's activities. A minimum duration of six months could serve as a reference

point. Following the analyses of the OECD, the criterion of ordinariness could also be applied, with the consequence that the requirement of ordinariness is missing in the case of non-established circumstances. An exceptional activity in extraordinary situations should not automatically lead to the establishment of a PE.

- **Supplement of the qualitative criterion for representative PEs**: The employee has (comprehensive) power of attorney to conclude contracts on the basis of the employment contract. However, according to a "home office agreement", concluding contracts or taking a leading role in concluding contracts that affect the company's business model as well as conducting preparatory negotiations are prohibited in the context of mobile working.
- The above mentioned principles and criteria should also apply to **service PEs** in order to avoid the unintended creation of a service PE. As a rule, the criterion of an essential activity for the creation of a PE (183 working days in 12 months) will not be fulfilled by service PEs anyway. Here, days of stay of individual employees should not be added together, but each employee should be considered individually.

Several permanent establishments

It should be clarified that in cases where several employees of a company work on a mobile basis at different places of residence in the same foreign state, neither one nor several PEs abroad are established within the framework of the above principles.

B. Income-tax related problems due to cross-border teleworking situations

Irrespective of the existence of a PE according to the provisions of the double taxation treaties (DTTs), income-tax related obligations can be triggered abroad in the case of cross-border work by employees. Particularly in the case of DTA residency of the employee abroad and/or in the case of cross-border commuters, there are considerable tax consequences if working days are performed in a country that differ from the country of activity.

During the COVID-19 pandemic, numerous memoranda of consultation were concluded and extended by the Federal Republic of Germany with several states in order to avoid double taxation or the change of taxation right with regard to the wages of cross-border commuters. According to these agreements, working days for which wages are received and which are paid to cross-border employees for work performed, for example, in a so-called office at home, are considered working days spent in the contracting state in which the employees would otherwise have performed their work, i.e. without a pandemic situation.

This approach should be further developed for the period after the pandemic, so that

- on the one hand, beyond home office in the narrower sense, occasional or regular mobile work from abroad, regardless of location, is covered and
- on the other hand, the personal scope of application is no longer limited to cross-border commuters but is extended to employees in general.

As a result, working days exercised in a foreign remote office, for example, would be able to be considered as working days spent in the contracting state in which the employees would otherwise have exercised their activity, as long as a certain number of days is not exceeded. It would be particularly helpful here to ensure consistency with the above-mentioned days limit for the establishment of permanent structures/locations for income tax purposes (cf. page 1) in order to avoid additional complexity.

Accordingly, the states involved should agree that in these cases no wage tax obligations arise on the part of the employer due to mobile working in the other state. An extension of the scope of application of the aforementioned agreements to mobile working abroad, irrespective of the existence of a PE, would be welcome in order to avoid disproportionate investigation costs for both the tax authorities and the employer.