

## Remote Work vs. Corporate Income Tax: Relocating Our Understandings

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In this article, Petruzzi and Mainkar give an overview of the tax issues related to international remote work arrangements and provide example scenarios to illustrate potential solutions.

The opinions expressed in this article are the authors' and do not necessarily reflect those of any organizations with which they are affiliated.

### I. Introduction

The effect of the global COVID-19 pandemic was more invasive than initially perceived, affecting social, economic, and political systems globally. To some extent, it reinvented the way trade and commerce function. New concepts like remote working evolved, first as a necessity and then to create more flexible working arrangements. This had a ripple effect on various aspects of the employer-employee relationship, including the definition of “workplace,” both domestically and in cross-border situations, and the new normal became a rule rather than an exception. The key factor, however, is not the pandemic alone but rather the changed economic dynamics within multinational enterprises. A significant number of leased spaces and peripheral services and infrastructure, like in-house cafeterias, gymnasiums, and employee transportation, came to a grinding halt. The economic alleviation generated by these cost savings, as well as a perceived improvement in the quality of life because of employees' ability to reside in a more remote location, encouraged the remote working phenomenon to continue far beyond the pandemic. Working remotely has achieved a relative acceptance and gained impetus even after the pandemic's end.

Cross-border remote working involves individuals who reside in one country being employed by an employer or client located in another country. These workers are referred to by various terms, like “digital nomads,” “teleworkers,” “distance workers,” “hybrid workers,” or “telecommuting workers.” These individuals, usually possessing specialized skills, can work from almost anywhere with the help of technological devices and internet connectivity. For various businesses, offering flexible work

locations off-site has been instrumental in attracting a workforce that can perform pertinent functions in the “war for talent.”<sup>1</sup> The continuing restructuring of supply chains, the need to expand into new markets, and the rise of virtual organizations have substantially contributed to the increase in remote work arrangements.

Employers’ reliance on the remote working model has created a multitude of corporate compliance and structuring questions regarding the possible existence of permanent establishments, and led to considerations of personal tax payments, corporate income taxes, wage taxes, and social security contributions of the various subjects involved, as well as the application of social, immigration, and residence laws. Both national governments and international organizations have undertaken initiatives to generate solutions that address these concerns.

The OECD addressed the uncertainty in cross-border taxation of remote workers (e.g., telework and right of taxation, residency, PEs) in a guidance note issued in April 2020.<sup>2</sup> These initial guidelines were further revised in January 2021<sup>3</sup> and July 2021<sup>4</sup> to provide more clarity to cross-border workers and their employers by highlighting taxing authorities’ reconsideration of conventional applications of treaty provisions, and by explaining how, in practice and policy, adjustments could be made by the tax authorities to adapt. These revised guidelines addressed the issue of how to apply the existing rules related to the risk of creating a fixed place of business PE by sudden relocation of employees far from their original jurisdiction, which could remain even after the pandemic. Thus, it was clarified that an exceptional and temporary relocation of the employee’s worksite would not create a PE for the employer’s enterprise. If, however, the individual continued to work from home after the

government-imposed restrictions ceased, the test for establishing whether a PE existed because of the employee was whether there was a certain degree of permanency and whether the premises were at the disposal of the enterprise to carry on its business activities. If both tests were met, then there was the risk that a fixed place of business PE existed.

The United Nations also plays an important role in future policy developments on this topic. As part of the U.N. Tax Committee’s initiative to align international tax rules with the increasing digitalization of business activities, the committee presented a report on taxation issues related to the digitalized and globalized economy and discussed at the 26th session meeting of the committee held March 27-30, 2023, in New York. Workstream C of the U.N. Report addresses the cross-border taxation issues involving remote workers.<sup>5</sup>

Various tax administrations have addressed the complexities involved in remote work arrangements and strived to design policies, processes, and guidance to help ensure that, when applicable, these long-term arrangements are sustainable for the tax authorities as well as by individual employees.

The United Kingdom was a pioneer in its report of December 2022,<sup>6</sup> which explored the emerging trends and tax implications of remote work, identified the new tax policy and compliance issues, and provided plausible recommendations for HMRC to consider in favour of regulating remote working. These included creating an exemption from the definition of PE (which appears to be a reference to U.K. domestic law) in which an employee stays in the United Kingdom for a short term in connection with holidays; extending the exception for preparatory and auxiliary activities to back-office functions; allowing for a transfer pricing safe harbor when an employer arranges

<sup>1</sup>U.K. Office of Tax Simplification, “Hybrid and Distance Working Report: Exploring the Tax Implications of Changing Working Practices” (Dec. 20, 2022); Cevat Giray Aksoy et al., “Working From Home and Around the World,” NBER Working Paper 30446, at 18, 24 (Sept. 2022).

<sup>2</sup>See OECD, “Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis” (Apr. 3, 2020).

<sup>3</sup>See OECD, “Updated Guidance on Tax Treaties and the Impact of the COVID-19 Crisis” (Jan. 21, 2021).

<sup>4</sup>See OECD, “Towards Sustainable Remote-Working in a Post Covid-19 Environment” (July 19, 2021).

<sup>5</sup>See Annex E of the U.N Tax Committee, 26th Session of the Committee of Experts on International Cooperation in Tax Matters, CRP.1 Co-Coordinator report on Taxation of the Digitalized Economy (Oct. 2, 2023). Annex E of the U.N. Report has endeavored to describe the broad spectrum of factual situations for remote workers and the corresponding tax consequences.

<sup>6</sup>See U.K. Office of Tax Simplification, “Hybrid and Distance Working Report: Exploring the Tax Implications of Changing Work Practices” (Dec. 22, 2022).

for a remote worker to be employed by the employer's local subsidiary, which then charges the U.K. employer for the employee's salary; expanding the network of totalization agreements with other countries for social security contributions and benefits; allowing an exemption from withholding obligations (tax and social security) for stays in the United Kingdom of less than 60 days; and recommending that HMRC publish clear guidance as to tax and other issues for remote workers and their employers.

The Swedish Tax Agency published a statement<sup>7</sup> about PEs and remote working which emphasized whether there is an implicit requirement for employees to work from home. Additional considerations revolved around issues like whether work from home in Sweden provides a certain advantage to the company — for example, whether there are customers in Sweden that the employee services — and if there is any connection between the company's activities and the geographical location of the worker.

In Greece, to encourage remote workers, the legislators included the concept of digital nomads in the Immigration Code.<sup>8</sup> This policy permits remote employees from other countries to emigrate to Greece and offers them a 50 percent reduction in income tax and social security payments.

Notwithstanding the numerous tax and non-tax issues raised by the increasing reliance of employers and employees on remote work arrangements, this article focuses on analyzing the PEs and transfer pricing-related aspects. It attempts to cover issues concerning distribution of corporate income taxes based on commercial or financial relations between related parties or between head offices and their PEs, and issues arising from cross-border relations (although transfer pricing regulations in some domestic laws apply both to domestic and cross-border relations.) The authors do not exclude the possibility that applying some of the

considerations expressed below may be material to domestic relations as well.

However, it does not cover any issues specific to taxation of employees' income and companies' tax residency. The scope of this article is purely focused on the PE and transfer pricing analysis of the evolving field of remote work. The purpose of this article is not to cover every possible detail of the analysis, but rather to highlight some aspects that might be relevant for further work on the topic.

Section II provides a general background on the topic. Section III offers a scenario-based analysis of the issues at stake, while Section IV illustrates some relevant considerations by means of a case study. Section V formulates some conclusions and a proposal for future work on this topic.

## II. The General Background

For tax purposes, a remote worker can be defined as an employee or an individual contractor<sup>9</sup> working in a country other than the country in which the remote worker's employer or client is resident, has a PE, or has a fixed base.<sup>10</sup> From an employee's perspective, remote work arrangements could generate issues related to personal income taxes as well as other taxes and social contributions, and compliance with immigration and residence laws, among others. From the employer's perspective, remote working arrangements might generate issues related to direct and indirect taxes, apart from other non-tax considerations.

When focusing on the corporate income tax topics, issues concerning corporate residency, existence of PEs, and relationships between

<sup>9</sup> Independent contractor (whether legally or de facto independent) issues are not covered in this article, because they are usually not pertinent for a PE and transfer pricing analysis, based on the existing internationally agreed-upon rules and principles. The scope of this article is limited to the PE and transfer pricing issues related to global mobility of employees.

<sup>10</sup> See Annex E of the U.N. Tax Committee, *supra* note 5: for independent contractors, it is unclear whether the U.N. Report intends with this term a) contractors who are contractually independent but de facto dependent or b) contractors who are independent both contractually and de facto. If the latter, then it is unclear why the U.N. Report refers to the application of transfer pricing rules to relations between employers and independent contractors (in para. 6.2.1 of Annex E, U.N. Report) or in what circumstances an independent contractor should be considered not an independent agent (in para. 6.2.3 of Annex E, U.N. Report).

<sup>7</sup> See Skatteverket (Swedish Tax Authorities), "When Does the Work of an Employee at Home Result in a Foreign Company Becoming a Permanent Establishment?" Dnr: 8-1677220 (May 13, 2022) (translation by authors).

<sup>8</sup> Law 4251/2014 on Sept. 4, 2021, with Law 4825/2021 becoming effective on the same day.

related parties are the most relevant. Aside from corporate residency, and assuming that the domestic laws of a country are aligned with the OECD Model Tax Convention on Income and on Capital (OECD MTC)<sup>11</sup> and the United Nations Model Double Taxation Convention between Developed and Developing Countries (U.N. MTC),<sup>12</sup> a remote worker might generate for the employer issues related to:

- a. the existence of a PE based on the existing Article 5 of the OECD and U.N. MTCs;<sup>13</sup>
- b. the attribution of profits to a PE, based on the existing Article 7 of the OECD and U.N. MTCs;<sup>14</sup> and
- c. allocation of profits between associated enterprises, based on the existing Article 9 of the OECD and U.N. MTCs.<sup>15</sup>

### A. Issues Related to the Existence of a PE

The first issue concerns the existence of a PE. Once a PE exists under the domestic legislation of the remote working jurisdiction, based on Article 5 of the OECD and U.N. MTCs, activities of remote workers are likely to create a PE for the employer in the remote work jurisdiction in the following cases:<sup>16</sup>

- i. an employee has an office, including a home office or other fixed place of business in the country in which the employee is working, and the office or fixed place is permanent, at the disposal of the employer, and has some duration (e.g., it exists for at least six months<sup>17</sup>);<sup>18</sup>

- ii. an employee working remotely concludes contracts on behalf of the employer or plays the principal role leading to the conclusion of contracts;<sup>19</sup> or
- iii. an employee or independent contractor furnishes services for the enterprise in the country for more than 183 days.<sup>20</sup>

Also, activities which are preparatory or auxiliary in nature should be carefully considered, as they should not result in a PE for the employer.<sup>21</sup>

### 1. New Interpretations of PE Definitions on the Horizon?

When investigating the recent discussions about the existence of a PE, it appears that the most debated type of PEs in the context of remote work is the fixed place of business.<sup>22</sup> As mentioned, based on the OECD and U.N. MTCs, for a fixed place of business PE to exist, the employee's remote work location should constitute a place of business that is fixed, permanent, and at the employer's disposal.<sup>23</sup> Moreover, the employee's activities should not be characterized as preparatory or auxiliary for the employer.<sup>24</sup>

Considering that employees working from a remote location often work from places that are fixed (e.g., their own or rented homes, hotel rooms, and so forth) and permanent (for more than six months), most of the discussions have been focused on the "at the disposal of" test and on the non-auxiliary/preparatory character of the employees' activities. When analyzing those discussions, it seems that an evolution or a logical extension of the interpretation of these requirements is occurring in the aftermath of the pandemic in the context of remote work.

<sup>11</sup> OECD, "OECD Model Tax Convention on Income and on Capital" (2017).

<sup>12</sup> Office of Tax Simplification, "UN Model Double Taxation Convention between Developed and Developing Countries" (2021).

<sup>13</sup> This article assumes that a PE would exist under the domestic laws of the countries involved.

<sup>14</sup> This article assumes that the attribution of profits to a PE based on the domestic laws of the countries involved reflects the attribution of profits to a PE based on Article 7 of the OECD and U.N. MTCs.

<sup>15</sup> This article assumes that the allocation of profits between associated enterprises based on the domestic laws of the countries involved reflects Article 9 of the OECD and U.N. MTCs.

<sup>16</sup> See para. 6.1 of Annex E in the U.N. Report, *supra* note 5. Issues related to construction PEs (based on Art. 5(3) OECD MTC 2017 and U.N. MTC 2021) and insurance PEs (based on Art. 5(6) of the U.N. MTC 2021) will not be covered in this article. See also OECD, *supra* note 4, at paras. 9-27.

<sup>17</sup> Refer to OECD Commentaries to the MTC (2017), Art. 5, para. 6, at 95.

<sup>18</sup> See Art. 5(1) of the OECD MTC 2017 and U.N. MTC 2021.

<sup>19</sup> See Art. 5(5) and 5(6) of the OECD MTC 2017 and Art. 5(5) and 5(6) of the U.N. MTC 2021.

<sup>20</sup> See Art. 5(3b) of the U.N. MTC 2021.

<sup>21</sup> See Art. 5(4) of the OECD MTC 2017 and Art. 5(4) of the U.N. MTC 2021.

<sup>22</sup> Article 5, para. 1 of the OECD and U.N. MTCs.

<sup>23</sup> Fixed-place PEs would result from provisions equivalent to Article 5.1 of the OECD MTC or U.N. MTC.

<sup>24</sup> See OECD Commentaries to the MTC, Art. 5, para. 19; and U.N. Commentaries on the Articles of the United Nations Model Double Taxation Convention between Developed and Developing Countries to Art. 5, paras. 7, 10, and 11.

As for the requirement that a remote worker's activities have a non-auxiliary/preparatory character, the traditional view is that the test to distinguish between activities with a preparatory or auxiliary character and those without is undoubtedly difficult to interpret. According to the OECD commentaries,<sup>25</sup> the decisive criterion has been whether the activity of the fixed place of business in itself forms an essential and significant part of the activity of the enterprise as a whole. To this end, each case would have to be examined on its own merits. In any case, a fixed place of business whose general purpose is identical to the general purpose of the whole enterprise does not engage in a preparatory or auxiliary activity.<sup>26</sup>

Recently, some rulings have debated this issue in the context of remote work arrangements. For example, the Danish Tax Agency ruled<sup>27</sup> that employees' decision to work remotely from Denmark for their Swedish employer did not create a PE, because their functions were neither managerial nor customer-facing. Interestingly, the agency stated that "the employees don't constitute a PE for the company because their work is not directly tied to Denmark, therefore the company is not subject to limited tax liability in Denmark." A ruling of the Polish Regional Administrative Court<sup>28</sup> in Gliwice declared that a Danish company did not have a PE because of home-based office workers in Poland because the scope of the activities they performed was not the same as the object of the Danish company's business, nor did it constitute its essential or significant part. Thus, their home office tasks were characterized as preparatory or auxiliary activities.

However, the most debated requirement on remote work PEs is the "at the disposal of" test.

The analysis should make the preliminary clarification of whether the remote worksite is at the disposal of the employer and not of the employee.<sup>29</sup>

When establishing whether the remote worksite is at the disposal of the employer, a relevant element of the analysis is the decision-making process related to remote work. The decision to start working remotely might be initiated either by the employer or by the employee. In some cases, the employer might prefer having its employee in a different country, for example, to save costs (e.g., by offering lower compensation packages because of a lower cost of living in that country), or to simply be able to hire the best people for the job. In other cases, the employee might prefer working from a different location because of personal, economic, or professional reasons. Either way, employers are clearly competing for the best talent, and sometimes they must accommodate the preferences of these employees to start or continue a long-term employment relationship.

The views and guidance on these issues are under debate, both internationally and within specific countries. For example, based on the OECD's view, it appears that whether it was an "employer-driven decision" or an "employee-driven decision" to start the remote work arrangement is a relevant element of the analysis.<sup>30</sup> The Austrian tax administration has categorically asserted that a "home office used at the request of the employer may be regarded as a permanent establishment of the employer's enterprise."<sup>31</sup> This view is corroborated by the U.N. Commentary on Article 5. Further, the Swedish Tax Agency has stated that "no power of

<sup>25</sup> See OECD Commentaries to the MTC, Art. 5, para. 59; also refer to Klaus Vogel, *Klaus Vogel on Double Taxation Conventions* (5th Ed., 2022); see also Arvid A. Skaar, *Permanent Establishment: Erosion of a Tax Treaty Principle* (2nd Ed., 2020) at 279.

<sup>26</sup> See OECD Commentaries to the MTC, Art. 5, para. 19; and U.N. Commentaries on the Articles of the United Nations Model Double Taxation Convention between Developed and Developing Countries to Art. 5, para. 59.

<sup>27</sup> Danish Customs and Tax Administration, Tax Council Decision No. SKM2021.412.SR (Aug 16, 2021).

<sup>28</sup> Poland: Wojewódzki Sąd Administracyjny w Gliwicach [Regional Administrative Court in Gliwice], II FSK 1340/21 (Jan. 31, 2022).

<sup>29</sup> See OECD 2017 Model Convention Commentary on Article 5, para. 12 – "no formal legal right to use a particular place is required." Instead, it is stated that the enterprise will have to have "the effective power to use that location." The Commentary states that "where, however, a home office is used on a continuous basis for carrying on business activities for an enterprise and it is clear from the facts and circumstances that the enterprise has required the individual to use that location to carry on the enterprise's business (e.g., by not providing an office to an employee in circumstances where the nature of the employment clearly requires an office), the home office may be considered to be at the disposal of the enterprise."

<sup>30</sup> OECD, "Updated Guidance on Tax Treaties and the Impact of the COVID-19 Pandemic" (Jan. 21, 2021); and OECD, "OECD Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis" (Apr. 3, 2020).

<sup>31</sup> Austrian Federal Ministry of Finance, EAS 3415 (June 2019).

disposal of the company can be assumed if the home office activity takes place due to the employee's own wishes and the company has no business interest in or any advantage of the employee working from home (e.g. when the company is not active in the Swedish market)."<sup>32</sup> The Spanish General Directorate of Taxes recently held<sup>33</sup> that an employee's home office was not at the disposal of the U.K. parent company, thereby not creating a PE for the following reasons:

- the activity previously performed by the employee did not change because of his move to Spain;
- moving to Spain was a purely personal decision by the employee, and the U.K. parent company did not require or ask the employee to move to Spain for a specific business reason;
- the U.K. parent company did not bear any cost triggered by the employee's stay in Spain; and
- the U.K. parent company had an office in the United Kingdom which could have been used by the employee to complete his daily work without needing to be in Spain.

In the authors' view, one can assume that the relevant elements that may be instrumental in the employer-driven decision to start remote working may include, *inter alia*, considerations like:

- *Requirement to be present on-site*: whether the role assumed by the employee requires frequent in-person interaction or not.
- *Nature of the functions performed*: whether the role assumed by the employee entails the management and execution of significant functions for the employer or is a routine role.
- *Knowledge of the local market/business needs*: whether the location requires an employee who possesses specific skills and/or expertise, for example, knowledge of the local market or culture.
- *Cost-effectiveness*: whether the location allows the employer to save employment costs relating to the employee's salary, office space, and so forth.

<sup>32</sup> Swedish Tax Agency, dnr: 8-1677220, para. 4.1 (May 13, 2022).

<sup>33</sup> Spanish General Directorate of Taxes, V0066-22 (Jan. 18, 2022).

On the other hand, the relevant elements for the employee-driven decision to start remote working remotely may include, *inter alia*:

- *Employee responsibility*: whether the employee has a high level of responsibility.
- *Nature of the functions performed*: whether the role assumed by the employee entails the management and execution of significant functions for the employer or is a routine role.
- *Performance*: whether the employee has performed well in the past and whether they would keep (or improve) their performance from the remote work country.
- *Tenure*: whether the employee has been working for the organization for a long period of time.

Notwithstanding the above, in the authors' view, it is doubtful whether this decision-making process should always (or ever) play a significant role in the analysis of the "at the disposal of" test because, *de facto*, whether it is initiated by the employer or by the employee, the employer always has to accept the remote work arrangement (that is, it either has to agree with the arrangement or it must refrain from preventing it), for the remote work to commence.

Even when the decision-making person (whether the employer or employee) is considered to determine whether a PE exists in the remote work country, there are other equally pertinent aspects that may have a significant bearing on this, such as:

- frequency and duration of home office work;<sup>34</sup>
- ownership of the equipment used at the home office;<sup>35</sup> and

<sup>34</sup> OECD Commentaries to the MTC Art. 5, para. 12; and U.N. Commentaries on the Articles of the United Nations Model Double Taxation Convention between Developed and Developing Countries to Art. 5, paras. 18 and 19.

<sup>35</sup> This becomes pertinent if a typical home office situation is taken into consideration, when an employee is active with digital company devices at their private premises. In this case, the tendency (of, for example, the Austrian Tax Administration) has been that even the fact that the employer has provided a laptop or a mobile phone to the remote employee, should lead to a place of business which clears the 'at the disposal' test of a permanent establishment. Notably, if the employer has power of disposal over digital work devices, their operational use by the remote employee would cause the likelihood of a PE. *See, cf.*, Austrian Federal Ministry of Finance, EAS 3415; Austrian Transfer Pricing Guidelines 2021, para. 262; Commentary on Article 5 OECD MTC 2017, para. 18f.

- the nature of home office work (i.e., whether the employee's activity qualifies as auxiliary or preparatory).

Clearly, the above considerations are of great relevance because they could influence not only the determination of whether a PE exists, but also the attribution of profits to these remote worksite PEs. Considering the apparently ever-evolving interpretations on the PE requirements under recent regulations, case law, and guidance from international organizations, the authors encourage more work at the OECD and the U.N. level aimed at creating specific guidance in the commentaries.

## B. Issues Related to Attributing Profits to a PE

Once it has been determined that a PE in the remote work jurisdiction exists, profits should be attributed to this PE.<sup>36</sup> This attribution will be determined in line with the domestic laws of the remote work jurisdiction as well as Article 7 of the OECD and U.N. MTCs. To this end, it is crucial to note that if a company's employees are working in a foreign jurisdiction and the factual analysis suggests that their activities could create a PE, then this PE would need to be remunerated in line with the arm's-length nature of the activities of the employees who exercise their duties abroad.<sup>37</sup>

When analyzing the OECD background on the topic, there are significantly different applications of this concept depending on which version of Article 7 is considered. Up until the 2005 OECD MTC, the relevant business activity (RBA) approach, in which deviations from the arm's-length principle are allowed to a large extent, is applicable.<sup>38</sup> Based on the 2008 OECD MTC, the application of the authorized OECD approach (AOA), in its "light" version (illustrated in the 2008 Report on the Attributions of Profits to Permanent Establishments),<sup>39</sup> leads to the RBA/functionally separate entity approach, in

which deviations from the arm's-length principle are allowed to a limited extent.<sup>40</sup> Based on the 2010 OECD MTC, applying the AOA in its "full" version (illustrated in the 2010 Report on the Attributions of Profits to Permanent Establishments)<sup>41</sup> leads to the application of the functionally separate entity approach, in which deviations from the arm's-length principle are not allowed, with some minor exceptions.<sup>42</sup>

Based on this latter approach, the profits attributed to the PE are those that the PE would have expected to generate if it were a separate and independent enterprise carrying out the same or similar activities under the same or similar conditions, considering functions performed, assets used, and risks assumed. Within this AOA framework, the OECD relies on the concept of significant people functions to designate the functions that the PE assumes.<sup>43</sup> Significant people functions are key for generating profits conducted by PE personnel.<sup>44</sup>

When analyzing the U.N. background on the topic, attribution of profits to PEs should be based on the above application of the RBA approach.<sup>45</sup>

<sup>40</sup> See Holzinger, *supra* note 38.

<sup>41</sup> See OECD, "Report on the Attribution of Profits to Permanent Establishments," CTPA/CFA(2010)38 (2010). On March 22, 2018, the OECD released a final report containing additional guidance on attribution of profits to PEs. It sets forth high-level principles for attributing profits to PEs, following the two discussion drafts published in July 2016 and June 2017. The report provides further guidance on how the existing rules on attributing profits to PEs (under Article 7 of the OECD model tax convention) should apply further to the changes introduced to the PE definition under the BEPS initiative (that is, in light of the "Report on Preventing the Artificial Avoidance of Permanent Establishment Status," published in 2015 in the context of BEPS action 7).

<sup>42</sup> See Holzinger, *supra* note 38, at 299.

<sup>43</sup> OECD Commentaries to the MTC, Art. 7, para. 16. OECD, "Report on the Attribution of Profits to Permanent Establishments" (2010), para. 50; Philip Baker and Richard Collier, "General Report," 91b *Cahiers de droit fiscal international* 26 (2006); Mary Bennett and Raffaele Russo, "Discussion Draft on a New Art. 7 of the OECD Model Convention," 16 *International Transfer Pricing Journal* 73, 76 (2009).

<sup>44</sup> See an analysis in Wolfgang Schön, "Attribution of Profits to PEs and the OECD 2006 Report," *Tax Notes Int'l*, June 4, 2007, p. 1059, at 1065-1068. See also Erik Kamphuis, "Significant People Functions and Functional Ownership: The New Motto in Transfer Pricing," 17 *Tax Management Transfer Pricing Report* 300, 304 (2008); E. Reimer, "Article 7. Business Profits" in Klaus Vogel on *Double Taxation Conventions*, para. 90 (2022).

<sup>45</sup> See Holzinger, *supra* note 38, at 299.

<sup>36</sup> See Art. 7 OECD MTC 2017.

<sup>37</sup> See OECD, Commentaries to the Model Tax Convention Article 7, para. 2. See Jacques Sasseville and Vann, "Article 7: Business Profits," in *Global Tax Treaty Commentaries*, section 1.1.2.2 (IBFD 2019).

<sup>38</sup> Raphael Holzinger, "Chapter 9: Attribution of Profits to Permanent Establishments" in *Fundamentals of Transfer Pricing: General Topics and Specific Transactions* 298 (2021)

<sup>39</sup> See OECD, "Report on the Attribution of Profits to Permanent Establishments" (July 17, 2008).

### C. Issues Related to Allocating Profits Between Associated Enterprises

Finally, remote work arrangements might require reconsideration of the transfer pricing analysis of commercial or financial relations between related parties, in light of Article 9 of the OECD and U.N. MTC, their commentaries, and the guidance provided under the OECD transfer pricing guidelines (OECD TPG)<sup>46</sup> and the U.N. transfer pricing manual.<sup>47</sup> In this context, the following questions might become relevant:

- Does the new remote work arrangement affect the accurate delineation of the actual transactions in place between related parties?
- Does the new remote work arrangement require consideration of the commercial rationality of the relationships between the related parties?
- Is the method that is considered the most appropriate for remuneration of the relations between the related parties still the most appropriate after the new remote work arrangement?
- Should this method be applied differently in light of the new remote work arrangement?

Given this background, some relevant questions might be whether there are contractual clauses that prevent the initiation of remote work, whether there are provisions in the commercial law of the remote work jurisdiction that would prevent the remote work activities, whether the decisions pertaining to remote work are supported by commercial rationality, and whether there is a shift of profit potential from one country to the other.

Those questions might involve all the commercial or financial relations between related parties regarding particular services, financing, intangibles, and business restructuring. All of these issues must be analyzed on a case-by-case basis.

<sup>46</sup> See OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* 2022.

<sup>47</sup> See "UN Practical Manual on Transfer Pricing for Developing Countries" (2021).

### III. A Scenario-Based Analysis

Having set the general background on the topics discussed in this article, it is worth performing a scenario-based analysis to reach some more specific conclusions. In reality, numerous situations might occur regarding remote work arrangements. The authors do not have the unrealistic aim of analyzing all possible situations. However, considering that PE and transfer pricing analyses often depend on the specific facts and circumstances of a case, the authors have attempted to cover each of the three aforementioned topics in hypothetical scenarios in Table 1. Those scenarios consider the employer-driven versus employee-driven decision as a relevant factor and do not explore other aspects that might be relevant (e.g., frequency and duration of home office work, ownership of the equipment used at the home office, the nature of home office work, etc.).

#### A. Scenario A

Under Scenario A, Company A (resident of Country X) decides to hire a new employee (who will work for Company A) in Country Y. Company A has a presence in Country Y because of the existence of a PE or a related-party entity (Company B) in Country Y.

As far as issues related to the existence of a PE are concerned, analyzing the case in which an employee commences employment in a country for an employer resident in that country (i.e., Company B) or for a nonresident's PE in that country that pays the employee's salary or wages (i.e., Company A's PE in Country Y) may not seem relevant, because that employee is already attributed to Company B or Company A's PE in Country Y.<sup>48</sup> However, when further investigated, if the employee is working for Company A (and not for Company A's PE or for Company B) in Country Y, assuming that the conditions of Article 5, paras. 5-7 of the OECD and U.N. MTCs are met, a new agency PE of Company A in Country Y might exist, beyond the preexisting presence of Company A in Country Y. Further, if all other conditions of Article 5, para. 1 of the OECD and U.N. MTCs are met, the employer-driven decision

<sup>48</sup> See U.N. Report, *supra* note 5, at para. 5.4.2.



**Table 1. Hypothetical Scenarios of Possible Remote Work Arrangements**

	New Employee		Existing Employee	
	Employer-Driven Decision to Start Working Remotely	Employee-Driven Decision to Start Working Remotely	Employer-Driven Decision to Start Working Remotely	Employee-Driven Decision to Start Working Remotely
Employer's presence (either via PE or via related-party entity*) in the remote work country	A	B	E	F
Absence of employer's presence (either via PE or via related-party entity) in the remote work country	C	D	G	H
*Obviously, the related-party entity is technically not a presence of the employer, but of the group to which the employer belongs. However, to simplify, in the following scenarios we will refer to a "presence of the employer" also when a related-party entity belonging to the same group as the employer exists in the remote work country.				

to hire a new employee from Country Y might play a crucial role to determine of the existence of a fixed place of business PE of Company A in Country Y beyond its existing presence.<sup>49</sup>

As far as issues related to the attribution of profits to a PE are concerned, if the newly hired employee's presence in Country Y creates a new PE of Company A, then Company A must determine how much of its profit is reasonably attributable to that PE. That question must be answered considering the different versions of Article 7 of the OECD and U.N. MTCs and their interpretations. Of course, an analysis of the facts and circumstances of the specific case should be made. When attributing profits to the PE based on the RBA and the AOA "light" approaches, this attribution will be highly affected by the deviations from the arm's-length principle. When instead attributing profits to the PE based on the full AoA approach, the full application of the arm's-length principle allows for conclusions based on the relevance of the functions performed<sup>50</sup> by the employee.

For example, assuming that Company A has hired the new employee in Country Y to be responsible for the overall marketing, brand, and reputation in that country, and that the business of Company A in Country Y is expected to grow

manifold because of the new employee's efforts, the employee's performance of such significant functions in Country Y could attract substantial nonroutine profits generated by Company A being attributed to the new PE in Country Y. Assuming instead that the role played by the newly hired employee in Country Y is merely back-office functions or simply the delivery of Company A's products or services and, in fact, Company A's decision to encourage remote work is aimed purely at saving costs, it may be deduced that the employee is not performing significant functions for Company A. So the profits attributable to the new PE in Country Y would probably be of a routine nature. Thus, the idea revolves around assessing how relevant the functions are performed by the employee in Country Y. The selection and application of the transfer pricing methods to quantify the profits to attribute to the new PE of Company A in Country Y should follow this functional characterization. The United Kingdom, for example, assumes that a low-value-adding service which the home office PE renders to the headquarters can be remunerated using the cost-plus method, adding a profit markup of 5 to 10 percent to the total costs.<sup>51</sup> Finally, business restructuring issues might need to be analyzed, especially when the employee performs important functions.

<sup>49</sup> See discussion in Section II.A.

<sup>50</sup> For all examples, keep in mind assets employed and risks assumed.

<sup>51</sup> U.K. Office of Tax Simplification, *supra* note 1, at paras. 430f.

Finally, as far as issues related to the allocation of profits between associated enterprises are concerned, if we assume that Company A has, in Country Y, an associated enterprise (Company B) and that the new employee will perform their work in the interest of Company A but be hired by Company B, Article 9 of the OECD and U.N. MTCs might come into play. Therefore, the arm's-length principle should be applied to allocate the profits out of the commercial or financial relations between Company A and Company B and involve the role of the new employee. Some of the principles expressed above regarding the attribution of profits to PEs, as well as those indicated in the OECD TPG and the U.N. manual, will be relevant.<sup>52</sup> For example, if the new employee performs significant functions for Company A in Country Y, Company B will have to be remunerated accordingly. To this end, an analysis of any development, enhancement, maintenance, protection, and exploitation (DEMPE) functions performed by the new employee might have to be conducted. If, instead, the new employee does not perform significant functions for Company A in Country Y, Company B might have to receive a routine remuneration. Finally, business restructuring issues might need to be analyzed, especially when the employee performs important functions.

## B. Scenario B

In Scenario B, Company A (resident of Country X) decides to hire a new employee (who will work for Company A). The employee requests to work from Country Y and Company A accepts. Company A has a presence in Country Y because of the existence of a PE or a related-party entity (Company B) in that country.

As far as issues related to the existence of a PE are concerned, the same conclusions of Scenario A apply. Further, if all other conditions of Article 5, para. 1 of the OECD and U.N. MTCs are met, the employee-driven decision in the hiring process may play a crucial role in determining the existence of a fixed place of business PE of Company A in Country Y, in addition to its

existing presence.<sup>53</sup> For example, assuming that 1) the newly hired employee is the key person responsible for concluding sales operations on behalf of Company A in Country Y for its products or services, 2) while being hired, the new employee insisted on working remotely from Country Y and not from the headquarters of Company A in Country X, and 3) considering the employee's vast expertise and their strong knowledge of the local market in Country Y, Company A conceded to the employee's remote work request, the degree of dependence on the employee in the remote work jurisdiction might lead to the creation of a PE in Country Y.

As far as issues related to the attribution of profits to a PE are concerned, the same conclusions of Scenario A apply. In this context, for example, it might have to be investigated whether the decision regarding remote work, initiated by the employee and agreed-to by Company A, implies that the employee performs important functions for Company A. In that situation, Company A may have to apportion substantial profits to the PE because of the functional analysis of the newly hired employee's remote work arrangement.

Finally, as far as issues related to allocating profits between associated enterprises are concerned, the same conclusions of Scenario A apply. Also, as mentioned, it might have to be investigated whether the fact that the decision regarding remote work was initiated by the employee and agreed by Company A implies that the employee performs important functions for Company A.

## C. Scenario C

Under Scenario C, Company A (resident of Country X) decides to hire a new employee (who will work for Company A) in Country Y. Company A does not have a presence in Country Y because there is neither a PE nor a related-party entity in that country.

As far as issues related to the existence of a PE are concerned, the activities of an employee working remotely in a country other than the employer's resident country can have significant

<sup>52</sup> See Section II.

<sup>53</sup> See discussion in Section II.A.

PE consequences for the employer in the country in which the employee is working.<sup>54</sup> In this case, it must be further investigated whether (and how) the employer-initiated decision to hire the employee in the remote work country plays a role in assessing the requirements for the existence of a PE.

As far as issues related to the attribution of profits to a PE are concerned, as mentioned in the scenarios so far, if the newly hired employee's presence in Country Y creates a PE of Company A there, Company A must determine how much of its profit should be attributed to that PE. To this end, the same conclusions of Scenario A apply.

Finally, as far as issues related to allocating profits between associated enterprises are concerned, because of the absence of a related-party entity in Country Y, transfer pricing rules should not apply.

#### D. Scenario D

Under Scenario D, Company A (resident of Country X) decides to hire a new employee (who will work for Company A). The employee requests to work from Country Y and Company A accepts. Company A does not have a presence in Country Y because of the absence either of a PE or a related-party entity in that country.

As far as issues related to the existence of a PE are concerned, the same conclusions of Scenario C apply. It will need to be further investigated whether (and how) the remote work decision was initiated by the employee, because this plays a role in assessing the requirements for the existence of a PE.

Regarding the attribution of profits to a PE, the same conclusions of Scenario B apply.

Finally, concerning the allocation of profits between associated enterprises: because of the absence of a related-party entity in Country Y, transfer pricing rules should not apply.

#### E. Scenario E

Under Scenario E, Company A (resident of Country X) decides that one of its existing employees, who works in Country X, will soon be

working remotely for Company A in Country Y. Company A has a presence in Country Y because of the existence of a PE or a related-party entity (Company B) in that country.

Relocating an existing employee from Country X to Country Y should render the existing employee on the same footing as a new employee hired to work remotely from Country Y, meaning the same conclusions of Scenario A should apply. However, further analyses might have to be performed. For example, business restructuring issues might be more relevant than in the previous scenarios, especially if the employee performs important functions.

#### F. Scenario F

Under Scenario F, Company A (resident of Country X) has an employee in that country who requests to work from Country Y. Company A accepts. Company A has a presence in Country Y because of the existence of a PE or a related-party entity (Company B) in that country.

Shifting an existing employee from Country X to Country Y should render the existing employee on the same footing as a new employee hired to work remotely from Country Y, meaning the same conclusions of Scenario B apply. However, further analyses might have to be performed. For example, business restructuring issues might be more relevant than in the previous scenarios, especially if the employee performs important functions.

#### G. Scenario G

Under Scenario G, Company A (resident of Country X) decides that one of its existing employees, who works in Country X, will soon be working remotely for Company A in Country Y. Company A does not have a presence in Country Y because of the absence either of a PE or a related-party entity in that country.

Shifting an existing employee from Country X to Country Y should render the existing employee on the same footing as a new employee hired to work remotely from Country Y, meaning the same conclusions of Scenario C apply. However, further analyses might have to be performed. For example, business restructuring issues might be more relevant than in the previous scenarios, especially if the employee performs important functions.

<sup>54</sup> See para. 6.1.1 of the U.N. Report.

**Table 2. Degree of Risk for the Existence of a Remote Work PE in Hypotheticals**

	New Employee		Existing Employee	
	Employer-Driven Decision to Start Working Remotely	Employee-Driven Decision to Start Working Remotely	Employer-Driven Decision to Start Working Remotely	Employee-Driven Decision to Start Working Remotely
Employer's presence (either via PE or via related-party entity*) in the remote work country	Medium risk	Low to medium risk	Medium risk	Low to medium risk
Absence of employer's presence (either via PE or via related-party entity) in the remote work country	High risk	Medium to high risk	High risk	Medium to high risk
*Obviously, the related-party entity is technically not a presence of the employer, but of the group to which the employer belongs. However, to simplify, we will refer to a "presence of the employer" also when a related-party entity belonging to the same group as the employer exists in the remote work country.				

## H. Scenario H

Under Scenario H, Company A (resident of Country X) has an existing employee in that country who requests to work from Country Y. Company A accepts. Company A does not have a presence in Country Y because of the absence either of a PE or a related-party entity in that country.

Shifting an existing employee from Country X to Country Y should render the existing employee on the same footing as a new employee hired to work remotely from Country Y, meaning the same conclusions of Scenario D apply. However, further analyses might have to be performed. For example, business restructuring issues might be more relevant than in the previous scenarios, especially if the employee performs important functions.

## I. Summary

Table 2 summarizes the risks related to the existence of a remote work PE based on the scenarios discussed above. As mentioned, the main difference between scenarios involving a new employee and scenarios related to an existing employee is the higher risk of business restructuring issues for the latter.

## IV. A Case Study

Having discussed the consequences related to some possible scenarios, this section provides an

analysis based on a hypothetical case study. Obviously, the conclusions presented in this section do not apply to every case and are to be understood as illustrative only; all cases require an extensive and in-depth analysis.

## A. Part A

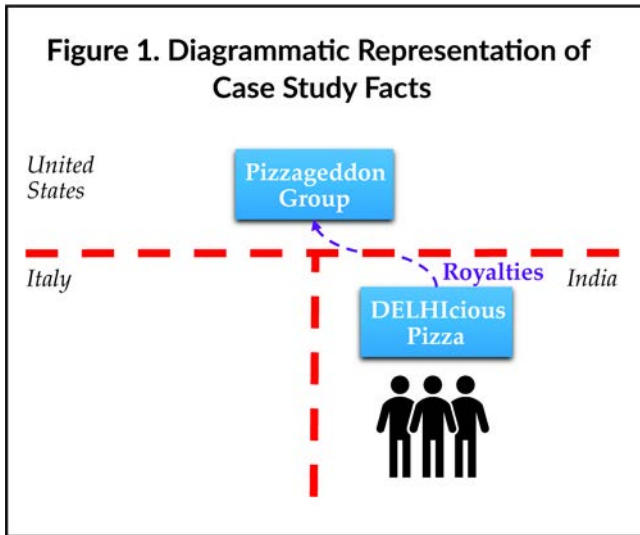
### 1. Facts of the Case

DELHIcious Pizza is the Indian subsidiary of Pizzageddon Group, a U.S. MNE producing and selling pizza all over the world. The group is famous for the unique taste of its dough and employs 10,000 pizza makers in 50 different countries.

DELHIcious Pizza employs 500 pizza makers. Of those, 20 are Italian pizza makers specifically hired in DELHIcious Pizza's local R&D department to customize the taste of the pizzas for the local market.

Based on the transfer pricing documentation, DELHIcious Pizza is functionally characterized as a full-fledged manufacturer and distributor of pizza. It pays royalties to its U.S. parent company to receive the famous original recipe of its pizza; however, based on the DEMPE analysis, DELHIcious Pizza is entitled to part of the R&D-related returns coming from the Indian sales, because the 20 pizza makers significantly contribute to the local recipe improvement.

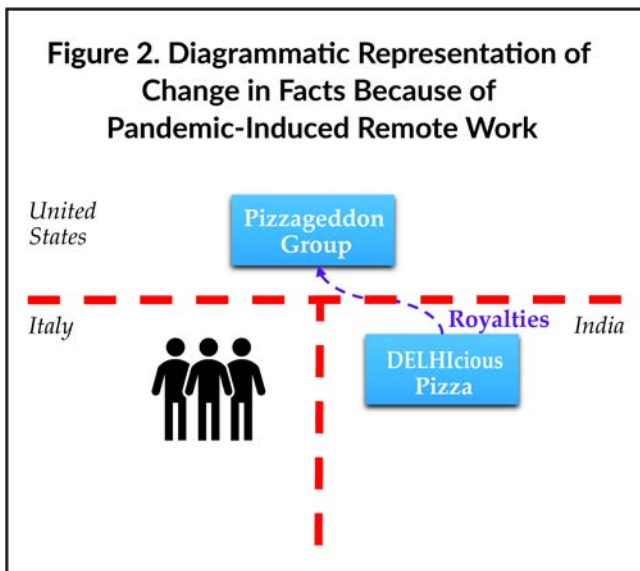
Figure 1 represents these facts.



During the COVID-19 lockdown, DELHicious Pizza realized that the 20 Italian pizza makers can work from anywhere and continue customizing the taste of the pizzas for the Indian local market while working from other countries. The 20 Italian pizza makers are happy to work from Italy, because they prefer to live close to “la mamma.”

Therefore, DELHicious Pizza and the 20 Italian pizza makers agree that they can work from their families’ homes in Italy. However, the Pizzageddon group does not have any presence in Italy.

Figure 2 represents these changes.



## 2. Possible Solution

The first question to answer is whether the fact that the Italian pizza makers work from their homes in Italy generates a PE in Italy for DELHicious Pizza. Considering that it could be reliably assumed that those pizza makers are carrying on DELHicious Pizza’s business activities, their Italian homes are fixed, their stay in Italy is permanent and, likely, their activities are not of a preparatory or auxiliary character, most of the discussion will focus on whether the Italian pizza makers’ homes are “at the disposal of” DELHicious Pizza.

As mentioned, some might consider the decision-making process as relevant in making a determination. However, from the facts of the case it is unclear who started the process of the decision to relocate the Italian pizza makers to Italy. In many instances, it is not easy to conclude with certainty (and to properly document and demonstrate) this process. Moreover, the authors do not find it a decisive factor, because DELHicious Pizza must agree with the Italian pizza makers’ relocation to Italy for it to happen.

Some might consider the availability of the employer’s IT equipment as a relevant factor to answer this question. Also, from the facts of the case, it is unclear whether the Italian pizza makers use their own IT equipment or equipment provided by DELHicious Pizza.

Assuming that the Italian pizza makers’ homes are not considered “at the disposal of” DELHicious Pizza, no further analysis is needed.

Assuming instead that the Italian pizza makers’ homes are considered “at the disposal of” DELHicious Pizza, it must be clarified how much of the profits should be attributed to the newly established PE. Considering that a) the Italian pizza makers were specifically hired in DELHicious Pizza’s local R&D department to customize the taste of the pizzas for that market, and b) they significantly contribute to the local improvement of the recipes, to the point that, based on the DEMPE analysis, DELHicious Pizza is entitled to part of the R&D-related returns coming from the Indian sales, it’s likely the newly established PE will have to be remunerated with a correspondingly nonroutine amount of profits.

In this context, it is questionable whether business restructuring issues must be assessed,

considering that under this situation the Indian tax authorities might be losing taxing powers on the profit potential that is now (and will be) taxed in Italy.

Finally, because there is no associated enterprise of DELHicious Pizza in Italy, no transfer pricing issues must be assessed.

The issues above might become exacerbated in the following additional scenarios:

- DELHicious Pizza already had an office (fixed place of business PE) in Italy, but the Italian pizza makers still work from their homes.
- DELHicious Pizza already had an office (fixed place of business PE) in Italy, and the Italian pizza makers work out of that office.

Clearly, these two alternative scenarios (especially the latter) emphasize the risk of the Italian pizza makers creating a PE of DELHicious Pizza in Italy and its related profit attribution.

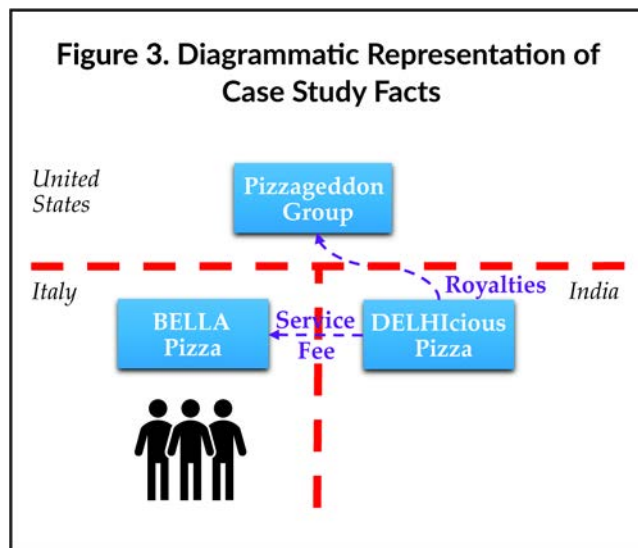
## B. Part B

### 1. Facts of the Case

After some discussions with the in-house tax team, the Pizzageddon Group decides that, because of various issues (Italian labor law, reduction of PE risks, and so forth), it is better for the 20 Italian pizza makers employed by DELHicious Pizza to be employed by a newly established Italian company (BELLA Pizza), that will provide R&D services to DELHicious Pizza.

From a transfer pricing perspective, DELHicious Pizza will not perform DEMPE functions any longer and, consequently, all the R&D-related returns coming from the Indian sales will be attributed to BELLA Pizza (via the R&D service fee).

Figure 3 represents these facts.



## 2. Possible Solution

Clearly, the presence of an associated enterprise of DELHicious Pizza in Italy and the existence of an intragroup arrangement (i.e., the service agreement) will require an assessment of the transfer pricing issues generated by the commercial or financial relations between the two related parties. This requires an accurate delineation of the intragroup arrangement, recognition of this arrangement, and selection and application of the most appropriate method to determine the remuneration for the arrangement.

Moreover, business restructuring issues will be exacerbated by the application of Article 9 OECD and U.N. MTC (considering Chapter IX of the OECD TPG and chapter 8 of the U.N. manual).

Also, the risk of a PE existing in Italy (and the determination of the related profit attribution to it) might still have to be analyzed. However, this risk is much lower compared to the previous scenarios, considering that the Italian pizza makers are not performing any agency function in Italy.

## V. Conclusion and the Way Forward

In this article, the authors have attempted to illustrate some of the complexities surrounding corporate income tax issues for remote work arrangements. The analysis of the background on the topic (including recent case law and guidance

provided by international organizations and local tax administrations), scenario-based examples, and a case study clearly highlight the need for further work on these issues. The authors propose that, from a policy perspective, it would be pertinent for relevant international organizations like the OECD and the U.N., in addition to individual governments, to articulate solutions that clarify both PE and transfer pricing issues to provide certainty in the application of the law. It

appears that concrete, underlying guiding principles must be developed to ascertain the circumstances in which a remote work location should be considered to be “at the disposal of” the employer. This would mitigate the possibility of diverging interpretations and disputes by jurisdictions, solidifying the foundation of the policy considerations for this rising stream of remote workers. ■