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Tax Considerations of Remote Work Arrangements Around the World

Sept. 22, 2022, 3:45 AM

Remote work can make a company look more attractive to current and future employees, but it's also a gateway into an intricate maze of tax rules. In this edition of "A Closer Look," Baker McKenzie's Erik Christenson and Imke Gerdes look at the international cross-border taxation issues posed by remote work.

Prior to the pandemic, some companies had experimented with remote work arrangements. Those early adopters had mixed results, and formalized flexible work policies tended to be the exception rather than the rule. This dynamic changed dramatically when Covid-19 forced remote work onto businesses and employees.

If nothing else has become clear since early 2020, it's that employees value the flexibility remote work offers, and that companies have used "work from anywhere" as a tool to recruit and retain talent. The OECD also recognized this development and announced that it would consider tax issues related to remote work in the coming years.

In line with these trends, some companies have implemented policies allowing employees to work from anywhere in the world for a certain period, often for up to 90 days a year. Other companies are still reluctant, given the mountain of complexities with taxes, payroll, and time zone availability. This article only addresses the tax aspects, and only regarding international cross-border taxation, but businesses would be well advised to consider the broader range of complexities and practical obstacles, including employment and immigration.

Taxation of the Employee

The first question related to remote work is whether the arrangement creates a tax or social security liability for the employee, or whether it creates withholding obligations for the employer. The answer depends on whether a tax treaty exists between the country of the employer's residence and the country where the employee has temporarily relocated. Where no double tax treaty applies, taxation usually sets in on day one—as soon as the employee exercises employment in country. Depending on the local rules, this might trigger registration requirements for the employer to withhold wage tax, social security, or both.

In a double tax treaty context, Article 15 (2) of the OECD Model Tax Convention on Income and on Capital would allocate to the host country the taxation right for the salary paid to the individual under either of two scenarios: if the employee is present in country for more than 183 days or if the salary is borne by the employer's permanent establishment in the country. For the 183-day limit, a clear and regularly enforced company policy on the number of days allowed in country is essential. For the PE prong, the company policy should consider whether relevant treaties or local rules will separately assess the PE status of the separate locations where visiting employees might perform their job duties. For example, there must be commercial or geographic coherence.

An eternity pool with a sea view in the Club Dauphin of the Grand Hotel in St-Jean-Cap-Ferrat, on the French Riviera, circa 1960.
Photographer: Archive Photos/Getty Images

On the other hand, companies should consider the possibility that a long-term, multi-year remote work policy could result in a PE, even if, in any given year, the days spent might be less than 183. A PE also might arise from contract-concluding activities while in country. In light of these concerns, it becomes apparent that in many cases, the tax department will be challenged not to impede the business. While the business tends to desire a high degree of flexibility in operations, the tax department may want to mitigate PE risks by curtailing the scope of the activities an employee is allowed to carry out while being present in the host country.

On the employer side, wage tax withholding obligations in many countries apply only if the employer has a PE in the host country, such as in France, Greece, Spain, and the Netherlands. But some countries have a lower threshold, imposing withholding obligations even in the absence of a PE. For example, wage withholding applies in Germany if the employer has in Germany a permanent representative—such as an employee who does not need to rise to the level of a dependent agent but who carries out certain business activities for the employer company. Some countries deem a representative office sufficient (UK), while others require merely a physical presence through which the employment is carried out, such as a home office, regardless of whether there is a PE (Austria).

There can be other surprising results. Countries such as the Netherlands and Austria allow voluntary registration of foreign employers. And in Austria, even if no withholding applies, a foreign employer must, under certain circumstances, provide the Austrian tax authorities with an annual summary of the salary paid.

In addition to complying with wage withholding requirements, cross-border employment can trigger social security obligations as well—the two are frequently tied together. Double taxation can usually be avoided only if a Social Security Totalization Agreement is in place between the countries concerned. The US, for example, has concluded SSTAs with 28 countries. Within the European Union, Iceland, Liechtenstein, Norway, and Switzerland, European Council Regulation 883/2004 avoids double social security payments and ensures that the employee will have to contribute in only one member state, provided the formalities are met and the employee provides the necessary certificate of coverage.

Although the certificate of coverage is easily obtained in the employee's home country, it often is forgotten. In any case, if either the required formalities are not adhered to, or if there's no bilateral or other form of agreement, duplicative social insurance contributions may be required both in the employer's country and the employee's temporary location. A recently relocated employee likely would not be entitled to receive benefits from the social insurance agency in their new host country, as most countries require a minimum contribution period of five years or more.

Taxation of the Employer

If the employee's presence in the host country rises to the level of a taxable presence for the employer entity, the company would be subject to corporate income tax—on the profit attributable to this PE based on Article 7 (1)-(4) and 5 (1)(5) of the Model Tax Convention.

Broadly speaking, two different types of PE can be created: a fixed place of business PE (FPOB PE) and a dependent agent PE (DAPE). In designing a remote work policy, it's challenging to get a handle on where the remote employees are likely to want to be and then get a sense of whether the pairings between employer country and host country will be treaty-protected. In the latter case, the tax consequences of the arrangement will be governed only by domestic law, often with a much lower threshold for finding a taxable nexus for the employer entity.

Fixed place of business PE. A FPOB PE exists if the foreign enterprise has a fixed place of business at its disposal through which it wholly or partially carries on its business. For a fixed place to constitute a PE, it has to have some permanence; intermittent use is not sufficient. In addition, a PE would not arise unless the premises are at the disposal of the foreign enterprise. In this context, it is important to distinguish between a remote working arrangement, in which the employee works from a home office in the host country, and a situation in which the employer company has a subsidiary or affiliate in the host country and the employee may want to use such premises.

Based on OECD standards, a home office should not constitute a FPOB PE if the employer does not require the employee to work in the host country, offers an office in the home country, and does not pay for maintaining the home office or its infrastructure, as in this case the home office is not at the disposal of the employer. As noted above, no PE should be found unless there is sufficient permanence, defined in the applicable OECD Model Tax Convention and Commentary as six months in a given year. This means that if the home office is maintained for less than 183 days in a given year, the risk of FPOB should be reduced. Employers should keep these standards in mind when designing a work from home policy.

In cases where the employee uses the premises of an affiliate of the employer company located in the host country, such premises might constitute a FPOB PE if the employee has unfettered access to these premises or has a specific workplace designated to them, and the use is not just intermittent.

Dependent agent PE. A DAPE arises if a dependent agent acts on behalf of the foreign enterprise and has, and habitually exercises in the host country, an authority to conclude contracts in the name of the enterprise. Under the 2017 changes to the PE definition in the model treaty, a PE may exist if a person habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the employer company. The latter definition only applies if implemented in the relevant treaty through the multilateral instrument. But countries including France, Austria, and Israel appear to have adopted the broader definition as local practice, even if they did not formally sign on to this specific provision of the MLI .

Under both versions of the treaty definition, a PE can exist if there is contract negotiation in country—even in the absence of final or formal conclusion—if the execution of the agreement by the contracting company is a mere rubber-stamping exercise. On the other hand, under both definitions, a DAPE is created only if the agent exercises their authority habitually and not just occasionally. Depending on the role the respective employee has, a DAPE potentially can be avoided by placing strict limitations on their activities—a move that might not be possible depending on the business's needs. Similar to the comment in the discussion of FPOB PE above, where no double tax treaty applies, a dependent agent might be found using a much lower standard imposed under local law.

An issue that companies often overlook is the concept of a dual resident entity, applicable to civil law countries that recognize companies by either being legally established or having their place of management in that country. If the sole decisionmaker of the day-to-day business works remotely in a different country that adopts a place of management test for residence, the permanent (or regular, extended) presence of this person in the foreign country could make the employer company become a resident in the host country. In these situations, the employer company might consider creating a board of directors that requires a majority vote, with the majority of the board members residing in the company's country of residence.

A general view of Oude Kerk, Oudekerksplein, a canal and boat from on the Oudekerksbrug bridge and Oudekennissteeg on May 11, 2016, in Amsterdam.
Photogarpher: Dean Mouhtaropoulos/Getty Images

Other Tax Aspects

Transfer pricing and profit attribution. In a treaty situation and where a DAPE or FPOB PE exists, the next task is to determine if the profit is attributable to this PE. Under the authorized OECD approach, one would have to delineate the transaction and treat the PE as a separate enterprise.

The taxable income for a DAPE would be determined regularly on the basis of the profit generated by the contracts concluded. Audit practice in some countries, such as Spain, only consider agreements concluded with customers located in the host country. Other countries, such as Austria and France, do not differentiate and take into account agreements concluded with customers located anywhere.

Where a FPOB PE exists, the transaction between the employer company and the FPOB PE would need to be characterized and an arm's length compensation assessed. In most cases involving a remote work arrangement, the transaction between the FPOB PE and the employer company will be a service transaction, which most likely can be compensated on a cost-plus method and a markup of a certain percentage. However, where the employee performs sales activities—and in some cases, marketing—the local taxing authority in some countries would want to see a certain return on sales by applying the transactional net margin method.

Remorte work also could haveimplications on the development, enhancement, maintenance, protection, and enforcement (DEMPE) of intangibles. If a chief technology officer usually located in the US works for a considerable period of time in Mexico, the Mexican authorities might argue that intellectual property was created or enhanced while that person worked in Mexico and thus is attributable to the FPOB PE.

One possible consequence is that the necessary markup for the service transaction would be higher than a mere routine service provider would usually be entitled to. Depending on the facts of the case, another result might be that the employer entity suddenly has a PE in Mexico that has a claim to valuable intangible property, which might trigger more substantial tax consequences. Transfer pricing results are potentially more difficult to discern if the person's presence does not rise to the level of PE but the in-country activities include control over DEMPE functions. What is the result if the CTO manages DEMPE functions while in Mexico, but not through a PE, and if the employer entity does not otherwise have a taxable presence in country?

VAT/GST. Value added tax and goods and services tax issues often are overlooked. If the employer entity has a PE in the host country, it might mean that it has a fixed establishment for VAT purposes, potentially attracting VAT on the sales and services made to consumers in or possibly outside of the host county. But a PE for corporate income tax purposes does not automatically result in a FE for VAT purposes.

Under European law, an FE for VAT only exists if there is a suitable structure with a minimum degree of stability "derived from the permanent presence of both the human and technical resources necessary for the provision of given services. It thus requires a sufficient degree of permanence and a structure adequate, in terms of human and technical resources, to supply the services in question on an independent basis."

Where relocated employees create a VAT FE, any services rendered or supplies made through these individuals might be attributable to the VAT FE, triggering domestic VAT. Likewise, services rendered or supplies made to that VAT PE might also trigger domestic, potentially requiring the employer company to register for VAT purposes in that country. These rules can be different in non-European countries, but close attention should be paid to prevent triggering substantial fines.

Clouds hang in the blue sky over a rapeseed field not far from the small Bavarian village of Schoengeising, near Munich, during a warm sunny day on May 16, 2017.
Photo credit should read Christof Stache/AFP via Getty Images

Where Do We Go From Here?

Remote work is here to stay. Technological advancements have produced a viable alternative to in-person, in-office presence. Video conferencing and other sharing platforms make it easier than ever to work remotely. But if not planned and monitored carefully, tax ramifications of remote work can be severe. On the employee side, individuals working in another country may become subject to tax in the host country, triggering registration requirements and withholding obligations for the employer entity. Double taxation can generally only be alleviated if there is a double tax treaty.

For tax departments designing or maintaining a remote work policy (or simply providing tax input on the company's policy), it might be advisable to identify approved and prohibited countries for remote work. Drafting the written policies and designing the procedures to monitor compliance require careful thought. Do's and don't's for employees should be circulated, and adherence should be periodically reviewed. Companies should contemporaneously collate certain information about employees working abroad, such as the position the employee worked in, including a job description, and other helpful information that might be difficult to obtain at a later time but which can be crucial in a PE defense.

Remote work can increase the attractiveness of a company as employer, improving recruiting and retention of talent. But it is also a gateway into an intricate maze of tax rules, and losing one's way can have substantial consequences.

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