

## Permanent establishment risk: working from home



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**I have a US client which sells complex machinery to business clients across Europe. It plans to employ sales people in the UK and in a variety of other European countries. These sales people will work from home, travelling to see clients as and when needed. There is a recognition that if the sales people are materially involved in agreeing the sale, they may create a taxable presence as a 'dependent agent' and we are assured that they do not do so. Will these arrangements create a taxable presence for the purposes of corporation tax in those jurisdictions?**

Whether the US corporation will be exposed to foreign corporate taxes will depend largely upon whether, under the terms of the relevant tax treaty, a 'permanent establishment' (PE) is created. Generally speaking (following articles 5 and 7 of the OECD model treaty), a PE is created where one of two tests are met:

- the fixed place of business test, i.e. where the foreign corporation has an office, factory or some other form of fixed place of business in the source state. Exemptions apply for certain activities, such as warehousing and activities, which are viewed as preparatory, auxiliary and non-core; and
- the dependent agency test, i.e. where a person who is legally and/or economically dependent upon the foreign principal acts as an agent, traditionally with the power to bind the principal into contracts.

The second of the two tests is the one which has had the high profile review as part of the BEPS project and the scrutiny of the press following the case of Google, in particular. The OECD BEPS recommendations in this area included the widening of the definition of a dependent agent to those situations where a person 'habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the

enterprise'. In addition, there is now an anti-fragmentation concept which would prevent foreign corporations breaking up activities to obtain qualification (wholly or in part) for some of the treaty exemptions provided in article 5 typically.

If the local sales people are genuinely not caught by the current dependent agent clause or the extended one suggested by the OECD following the BEPS project, the crucial question is whether a home office from which the sales person operates is actually a fixed place of business.

### Interpretations and indicators

While there is no specific mention on the matter in the commentary to the OECD model treaty, the issue was discussed in the OECD's broader review of the PE article in October 2012, which looked at many practical issues involving PEs, and covered the use of a home office in particular (see *OECD model tax convention: Revised proposals concerning the interpretation and application of article 5 (permanent establishment)*, 19 October 2012). In that document, focus was given to when a property might be 'at the disposal of' a foreign corporation; and specifically whether working from home had to be expressly required by the foreign corporation or whether there needed to be a formal rental agreement or licence to occupy.

Typically, a local sales person is required to travel extensively to possible and existing customers, demonstrate products, discuss technical requirements, discuss price lists, deal with after sales issues, review the competition, assess the marketplace and so on. Typically, much of this will be done on the road, with some activities undertaken from the home office. As has been described above, the actual conclusion of sales contracts is generally avoided for tax purposes. Arguably, those activities undertaken in the home office are therefore preparatory and non-core to the main overall activity of the foreign business. This was a view expressed in the 2012 OECD document by some contributors.

The 2012 OECD document proposed four different examples which merited further consideration, including one where a corporation had two different shareholders and directors, one resident in another state and working from home. In that case, it is hard to see how all of the activities undertaken would be preparatory and non-core, as with a more typical salesperson working for a large multinational; and directors do not solely undertake non-core activities, generally speaking. This is a view taken by HMRC in other areas of tax, such as employer compliance matters. Likewise, in general, the PE clause in a tax treaty specifically includes a place of management as a fixed place of business.

It is interesting to note that although the 2012 OECD document suggested a number of changes be made to the OECD commentary to article 5, none of these were incorporated when the most recent version of the commentary was published in 2014.

The Swedish tax agency published a statement in July 2015, which set out its view on the circumstances where an employee's work at home may result in a PE, and indicated what factors needed to be considered, including:

- if it has been agreed that the employee should perform work from home, or if there is an implied agreement that the employee should work at home;
- if the employee has an office or workplace in another country where he or she can perform work;
- the amount of work performed from the employee's home;
- the permanency of the work performed from the employee's home; and
- the type of work that is performed from the employee's home.

As expected, the Swedish tax agency also makes it clear that the actual circumstances must be reviewed and not to rely simply on what the employment contract states.

More recently, the outcome of a

2017 Danish case involving *Aska GmbH* (SKM2017.213.SR) is of interest, as it highlights once again the problematic area of whether an employee's home can create a PE for a foreign enterprise.

In this case, a Scandinavian sales manager was required under the terms of his contract to work from home in Denmark. Although he spent the majority of his employment duties travelling and visiting clients, the Danish tax board ruled that the manager's use of a home office for administrative work (for which he was not reimbursed) constituted a PE of his German employer.

The Danish tax board ruled that it was irrelevant whether the home office was owned or rented or in any other way made available to the foreign corporation. As long as the business of the non-resident entity was carried out effectively and habitually (and these activities were not preparatory), then a PE was in existence.

On the matter of what constituted 'preparatory' and 'auxiliary', the Danish tax board determined that the administrative work was directly related to the main business of the company and could not be said to be non-core or preparatory. It was also emphasised that there must be

recurring work from the home office – not just occasional or sporadic work.

Two previous Danish tax cases from 2015 (KM2015.53.SR) and 2013 (SKM2013.273.SR) on a similar (but not identical) set of facts also concluded that the home office constituted a PE. In the 2015 case, more work was undertaken outside the home, while in 2013 more work was undertaken inside the home.

It therefore seems clear that as far as the Danish tax board is concerned, a salesperson working partly from home is going to find it hard to argue that all of their work is preparatory and/or auxiliary to the main activity of the foreign corporation such that a PE is avoided. Other tax authorities may take a similar view, although it has to be said, from experience, that the Danish approach is a very strict interpretation of the provisions within the model treaty and is not necessarily a view shared by all tax administrations.

### UK pointers

From a UK perspective, it is interesting to review HMRC's manuals in respect of 'taxable presence' for PAYE purposes where a non-resident employer is concerned, which is based on the outcome of *Clark v Oceanic Contractors* [1982] 56 TC 183. While this is not strictly the same as the definition of a PE, there are some significant similarities.

Of interest is that HMRC's *PAYE Manual* at PAYE81610 states that: 'For example, an overseas concern may employ sales staff in the UK who simply travel around from their private residences to seek orders. We would not say that there was an employer tax presence at the private address.' Thus, a salesperson working from home would not seem to create taxable presence for PAYE purposes; however, the same manual extract does confirm that whether there is also liability to UK corporation tax is not relevant in assessing PAYE presence.

### Final thoughts

It is therefore important to consider each situation on a case by case basis and seek local advice where there is a perceived risk of the home office creating a PE. Whether or not a material amount of tax can be attributed to such a PE is another consideration. While individually this may not be the case, where a foreign corporation has a network of sales people globally the collective impact with penalties and interest may be worthy of closer inspection. One must also not forget that in the post-BEPS world, the dependent agent PE is more easily created and that must be considered as carefully as the potential for a 'home office PE', if not more so. ■



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