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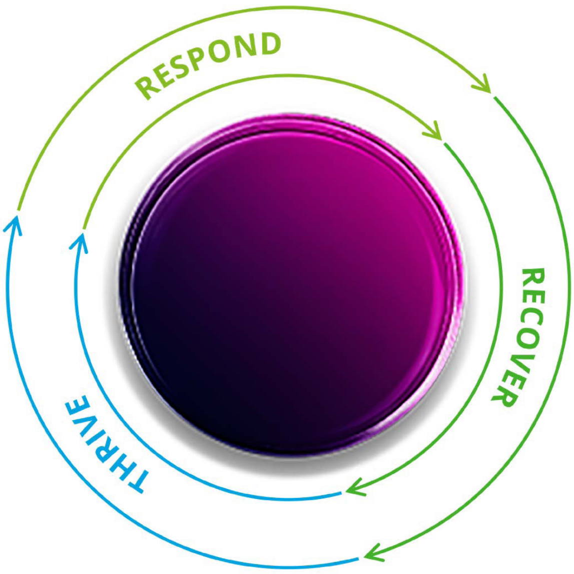
Future of Work
What a Difference a Day Makes



Introduction

The COVID-19 lockdown created the most extensive mass teleworking experiment in history. The highly contagious nature of this disease has resulted in severe social and travel restrictions being imposed by countries all around the world. This has led to a situation whereby employees and other personnel, including chief executive officers and senior executives, relocated and/or were obliged to perform their activities from a different country to that of their employer (hereinafter called their "home state"). Next to employment law, immigration and individual tax considerations – which fall outside the scope of this note – special attention should be paid to potential adverse corporate income tax consequences. Indeed, the role and activities of the remote worker may be substantial enough to create permanent establishment issues, could raise questions about the foreign employer entity's tax residency and could also trigger transfer pricing challenges. Nevertheless, as explained infra sub n° 1, we consider that companies should not be preoccupied by these issues as long as the remote working can be linked to the travel restrictions following the COVID-19 measures imposed or recommended by at least one of the governments of the jurisdictions involved.

Things become different, however, in the post COVID-19 world. If the lockdown measures are abolished and we can more or less go back to what we were used to, we will probably see a "new normal" emerging. As they have already adapted to a large extent to the new ways of working and got used to the flexibility that comes with it, employees may wish to continue (partially or wholly) teleworking away from their employer country. Looking from the employee's perspective, teleworking has obviously a lot of benefits: it reduces commuting time, increases the opportunity for workers to focus on their work tasks away from the distractions of the office, and can also lead to cost savings and an improved work-life balance. But it brings also a lot of benefits to the employers: real estate cost savings, access to new talent pools, increased employee engagement and, last but not least, a reduced carbon footprint. Hence, employers may consider implementing strategies that allow a more significant portion of their mobile workforce to continue teleworking after the COVID-19 pandemic. Such teleworking policies could, however, trigger corporate income tax exposures. The foreign employer entity could indeed face overnight multiple permanent establishment challenges, profit allocation or transfer pricing issues and maybe even tax residency exposures. These issues could lead to double taxation and the launch of mitigation efforts which might take years to settle. Therefore, we strongly recommend to monitor these risks closely. This will be dealt with infra sub n° 2.

This note does not strive to be exhaustive; rather we want to highlight some findings in practice and to identify some attention points. Our comments are especially relevant in bilateral situations where the foreign employer and the relocated employee(s) are residing in different countries that both adhere to the OECD Model Tax Convention ("OECD Model") and its commentaries.

1. COVID-19: Embracing the force majeure principle

A question that is top of mind with many multinational companies ("MNCs") is whether the remote working situation following the COVID-19 travel restrictions could trigger a taxable presence (in the form of a permanent establishment) or a change in the tax residency status of the foreign employer entity.

1.1. Permanent establishment considerations

In many cases, displaced employees are working from their homes during the COVID-19 crisis. Where, in the interim, lockdown measures were released a bit, employees were / are also making use of an office in the premises of a local group company. In the guidance released by the OECD Secretariat (initially in April 2020 and revisited in January 2021 – collectively called hereinafter "the Joint Relief Guidance"), the OECD is quite affirmative in stating that teleworking from home should not create a permanent establishment for the foreign employer entity. The reason is quite simple. In general, a permanent establishment must have a certain degree of permanency and be at the disposal of the enterprise in order for that place to be considered a fixed place of business through which the business of that enterprise is wholly or partly carried on. Paragraph 18 of the Commentary on Article 5 of the OECD Model explains that even though part of the business of an enterprise may be carried on at a location such as an individual's home office, this should not lead to the conclusion that location is at the disposal of that enterprise simply because that location is used by an individual (e.g. an employee) who works for the enterprise. The carrying on of intermittent business activities at the home of an employee does not make that home a place at the disposal of the enterprise. Obviously, the same reasoning should apply with respect to the premises of an affiliated company that are used by the displaced employee(s).

But what if the usage of the (home) office by the stranded employees, due to the continued COVID-19 crisis, becomes more or less long-lasting? Could the foreign employer entity gradually be considered to have the foreign (home) office at its disposal? For a permanent establishment to exist, the activity should have a sufficient degree of permanency or continuity. Generally, the OECD applies a minimum threshold of six months as a rule of thumb (unless the nature of the business requires less time). Many countries do tend to follow this interpretation. Nevertheless, the exceptional and temporary change of the location where employees exercise their employment because of the COVID-19 pandemic tend to push the permanency test more into the background. Individuals who stay at home to work remotely are typically doing so as a result of public health measures: it is an extraordinary and temporary situation and not an enterprise requirement. Besides, it is not only about the permanency test; the foreign employer entity should also have access or control over the foreign (home) office. If this is not the case, the foreign employer cannot be considered having the (home) office at its disposal and hence, a main prerequisite for the existence of a fixed place of business permanent establishment will not be satisfied. In this respect, reference can be made to the OECD's point of view that as long as the foreign employer entity provides an office to the employee – and hence the employer has not 'forced' the employee to use his personal abode – the home office may not be considered at the disposal of the enterprise. This is even the case, following paragraph 19 of the Commentary on Article 5 of the OECD Model, if the office is in the absence of public health measures made available to the relevant employee in another state than this home state.

That being said, the question whether the foreign employer entity should be regarded as having a (or multiple) permanent establishment(s) in the employee's home state(s), should in our view be a non-issue anyhow. Indeed, during the COVID-19 crisis, individuals who get stranded and start working remotely are typically doing so as a result of imperative government directives. This is a clear situation of force majeure and not a condition imposed by the employer. Worded differently, the exceptional and temporary change of the employment location prompted by the COVID-19 crisis is the result of an act of God. In this respect, some countries have already published guidance explicitly confirming that the COVID-19 pandemic is to be treated as force majeure (e.g. Austria, Ireland and Finland). Although the notion of "force majeure" may have different meanings and could be subject to different criteria in various countries, there is a general sentiment that COVID-19 is an exceptional circumstance that allows for an extraordinary interpretation and treaty application. It would therefore be reasonable for tax authorities to take the view that this pandemic should not result into new permanent establishments for the employer.

Similarly, the temporary conclusion of contracts in the home of employees or agents because of the COVID-19 crisis should not create permanent establishments for the foreign employer / principal entity either. Paragraph 6 of the 2014 Commentary on Article 5 explains that a permanent establishment should be considered to exist only where the relevant activities have a certain degree of permanency and are not purely temporary or transitory. Paragraph 33.1 of the Commentary on Article 5 of the 2014 OECD Model provides that the requirement that an agent must "habitually" exercise an authority to conclude contracts means that the presence which an enterprise maintains in a country should be more than merely transitory if the enterprise is to be regarded as maintaining a permanent establishment, and thus a taxable presence, in that State. On that basis, the OECD Joint Relief Guidance concludes that an employee's or agent's activity in his/her home state is unlikely to be regarded as "habitual" if he or she is only working at home in that state for a short period.

But again, it is not so much the short period or not meeting the "habitually" (i.e. permanency) test that keeps the foreign employer away from permanent establishment status. Rather, we believe that the OECD has elevated force majeure as an overall principle that affects the traditional reasoning under the distributive rule of Article 7 juncto 5 of the OECD Model. The COVID-19 pandemic is an exceptional situation; the subsequent mandatory government measures are extraordinarily impacting the employee's or agent's normal routine and should therefore not create involuntary permanent establishments for the foreign employer / principal entity. Obviously, a different approach may be appropriate if the employee was habitually concluding contracts on behalf of the enterprise in his/her home jurisdiction already before the COVID-19 pandemic. Likewise, if the employee continues those activities after the public health measures cease to apply, it would be more likely that the employee would be considered to habitually conclude contracts on behalf of the enterprise as well.

1.2. Residency considerations

The relocation, or inability to travel, of senior executives or members of the Board may raise concerns about a potential change in the "place of effective management" of a company. The concern is that such a change may have as a consequence a change in the company's tax residence under relevant domestic laws and affect the country where a company is regarded as a resident for tax treaty purposes.

In its Joint Relief Guidance, the OECD Secretariat seems to suppress that position. Indeed, the OECD Secretariat is stating that a temporary change in location of the chief executive officers and other senior executives is an extraordinary and temporary situation due to the COVID-19 crisis and such change of location should not trigger a change in residency, especially once the tie breaker rule contained in tax treaties is applied. Although the OECD Secretariat is not referring to force majeure here (as in the two previous cases), it is clear that the "act of God"-theory makes an entry with respect to the tax residency issue as well. The relocation of the company's management springs from an event which is independent from human will and which man could not predict nor prevent. Therefore, the OECD encourages countries to examine all relevant facts and circumstances to determine the "usual" and "ordinary" place of effective management, and not only those that pertain to an exceptional and temporary period such as the COVID-19 crisis.

Consequently, in the Secretariat's view it is unlikely that the COVID-19 situation will create any change to an entity's residence status under a tax treaty. The fact that a few board meetings are (virtually) held in the home jurisdictions of the management during the pandemic, or because some key management decisions are taken in said home jurisdictions over that period of time, should not alter this position.

2. Teleworking in a post COVID era

If the lockdown measures get abolished and we can more or less go back to what we were used to, talent mobility will probably have undergone a make-over. Many MNC's are currently considering to institutionalize teleworking policies for their foreign employees to work – at least partially – from their home state (either home office or premises of local subsidiary).

However, companies are well advised to monitor their remote operations closely and understand the permanent establishment and transfer pricing consequences upon implementing long-term remote working arrangements. Indeed, if the foreign employer / principal entity can be considered to have a fixed place of business or an agent in the home states of their employees, they may going forward encounter multiple permanent establishment challenges and from that, potentially also profit allocation and/or transfer pricing exposures. We should not believe that teleworking will keep unnoticed or stay under the radar. On the contrary, many countries face difficult budgetary situations due to the COVID-19 crisis and therefore, tax authorities will undoubtedly be instructed to take the necessary actions to retrieve the relevant information (through inter-departmental or cross-border exchange of information) to assess the tax position of foreign employer / principal entities on their territory. We were informed already that this is high on the agenda of some countries.

Whether or not these exposures will also materialize, is obviously depending on the actual facts. The facts and circumstances will determine whether there is a permanent establishment and also the amount of profit that would have to be allocated to it.

2.1. Fixed place of business PE

A home office, especially when the foreign employer entity is not paying for the usage thereof and is not requiring the individual to use that location to carry on the enterprise's business, should often not trigger a permanent establishment. However, if the employees are allowed to use the premises of the local subsidiary, it may already be more difficult to uphold the non-permanent establishment status if the facts would show for example that, based on an intercompany agreement, the group affiliates put mutually their offices at the disposal of the global talent team.

The seniority of the employees may also be a relevant factor. Key employees and senior management members that are allowed to work remotely could indeed trigger a permanent establishment as they could be considered to manage (part of) the foreign employer entity's business. In this respect, it should be noted that in some countries a management permanent establishment is assumed to exist even if not all conditions of article 5(1) of the OECD Model are met (especially not the requirement of having a fixed place of business at the disposal). Worded differently, in these countries the consistent presence of personnel that has a decision-making power over (part of) the company's business is sufficient to claim the existence of a management permanent establishment.

Finally, one should be careful with allowing employees to carry out commercial activities in their home state through premises that are at the disposal of their foreign employer. For a fixed place of business permanent establishment to exist, it is indeed not required that the employee has an authority to negotiate or conclude binding contracts upon its employer entity. Hence, unless these commercial activities have only a preparatory or auxiliary character (e.g. advertising, providing of product information, market research, etc.) that fall under the exception provision of Article 5(4) of the OECD Model, they could well create a permanent establishment.

2.2. Agency PE

Even if the MNC has no offices or premises at its disposal in the employee's home state, a permanent establishment could still be identified in that state if the facts show that the employee is regularly negotiating or concluding binding contracts on behalf of its foreign employer entity. In that case, an agency permanent establishment may surely be recognized.

In this respect, it should be reiterated that the agency permanent establishment concept has been broadened substantially further to the BEPS project. Under the Multilateral Instrument, as applied by some countries, the agency permanent establishment concept covers also the situation whereby an employee is involved in the making of a contract, even if the final contract is ultimately concluded by the foreign employer entity. In other words, post-BEPS there is an increased risk that teleworking employees that are "playing a principal role in the conclusion of" customer contracts for their foreign employers would be considered to create a permanent establishment.

2.3. Profit allocation

If a permanent establishment would be identified in the employee's home state due to teleworking, the foreign employer's entity will likely be required to file a non-resident income tax return on an annual basis. Consequently, an appropriate part of the enterprise's profit (or loss) is to be allocated to this permanent establishment, which would then become taxable in that state (mostly at the standard corporate income tax rate). At the same time, measures need to be taken to ensure the avoidance of double taxation in the employer's entity state of residence.

The arm's length principle is the guiding standard to determine the appropriate amount of (taxable) profits to be allocated to the permanent establishment. It will be necessary to determine the profits that would have been realized if the permanent establishment had been a separate and distinct enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the rest of the enterprise. In different terms, a correct allocation of profits to a permanent establishment requires the hypothesation of that permanent establishment as a company independent from the foreign employer entity and/or other permanent establishments belonging to the same enterprise.

The OECD Report of 22 July 2010 on the Attribution of Profits to Permanent Establishments ("2010 Report") describes this so-called "functionally separate entity approach" as a two-step analysis:

- **Step 1** – Functional and factual analysis: based on this analysis, it should become clear which functions, assets and risks are attributable to the permanent establishment and whether so-called "internal dealings" have occurred between the permanent establishment and its head office.
- **Step 2** – Allocation of profits: based on a comparability analysis, it should be possible to determine which profits are to be attributed to the permanent establishment, taking into account the functions, assets and risks as well as the possible "internal dealings" that have been identified under step 1.

This two-step analysis is also known as the "Authorized OECD Approach" ("AOA") to which many countries adhere. In summary, if the functional and factual analysis would show that critical business decisions or key risk taking decisions are taken within the permanent establishment, the (economic ownership of the) assets involved and profits derived thereof should be allocated to that permanent establishment. Consequently, the state where the so-called "significant people functions" ("SPFs") are located will be eligible to a significant portion of the profit (or the loss) while routine functions would typically lead to a lower (stable) remuneration for the PE.

The above is not without interest for MNCs operating under a centralized business model, either as a group (e.g. central entrepreneur or principal operating company) or as a function (e.g. central procurement or IP / R&D). The entrepreneur-entity should employ or 'host' the SPFs, i.e. the highly skilled workforce that effectively exercises the decision making powers in relation to the relevant function (not only at a strategic level, but also in the day-to-day management). If the SPFs are allowed to work remotely, the company might in a worst case scenario be confronted with a global profit split claim. No need to say that such a claim would make it difficult for the company to manage its effective tax rate and its tax cash position and would highly complexify the compliance burden.

Exactly this proves that it is crucial for a MNC, whenever a teleworking policy is considered, to not only gear this from a talent mobility perspective (having regard to the employee's personal income tax and social security position), but rather to open the debate and get aligned with the finance and/or tax department on the corporate tax and transfer pricing consequences as well.

2.4. Future solutions are multiple

To mitigate multiple permanent establishment and transfer pricing challenges, different parameters could be used to develop a decision tree framework to cope with current teleworking requests. For that matter, a separate strategy for key employees (SPFs) and other staff could be relevant. The functional profile of the employer entity could also be a distinguishing feature: if the entity has a mere routine function (e.g. limited risk distributor, toll/contract manufacturer, contract R&D company), the amount at stake is probably much lower compared to the situation of a centralized business function. However, any permanent establishment assessment is always a question of facts. The facts and circumstances will determine whether there is a permanent establishment and also the amount of profit that would have to be allocated to it.

When referring to the long term potential actions a MNC could contemplate in the context of future teleworking policies, we believe that several alternatives are available. The most easy and less invasive option for the MNC is just to proactively report multiple permanent establishments in all countries where employees are working remotely and are carrying out a (part of the company's) core business activity. The company could also consider to put the teleworking employees on the payroll of a local subsidiary and have a service level agreement in place. Thirdly, although maybe more difficult to implement in practice, one could also consider to split the employee's payroll and make a distinction between his strategic function (for which the employee will remain on the payroll of the foreign employer entity and for which he will also travel consistently to the employer state) and his mere executional role (for which he gets a local contract in his home state). Finally, we have noticed that MNCs are reflecting on 'Global Employment Company' constructs as well, to group all their remote workforce in one entity and subsequently 'lease' them to the relevant group companies. No need to say that each and every option needs to be closely planned for and monitored, as it will have different permanent establishment, compliance, transfer pricing and employment law consequences.

More holistically, and where relevant, the company may also contemplate to review its current operating model. Especially in centralized business structures, one could wonder whether it is still feasible to have one (global) principal or whether the proliferation of SPFs justifies the set-up of several regional principals. This might be easier said than done and attention should be paid not only to potential "business restructuring" settlements, but also to the indirect tax and systems impact.

Conclusion

Although we do not have a crystal ball, it is reasonable to assume that COVID-19 will remain a challenge for some time longer. However, It is not clear whether the OECD will keep updating its Joint Relief Guidance. As demonstrated, the OECD Secretariat's underlying point of view is that the current pandemic is a case of force majeure. Consequently, this should not cause adverse tax consequences for foreign employer entities. This conclusion could be considered valid as long as travel and healthcare restrictions due to governmental measures apply. And as long as countries have not issued guidance to the contrary.

MNCs that are planning to allow remote working in a post COVID-19 era, should plan this well ahead. Indeed, it is clear that a more flexible approach to remote working means that there might be significant ramifications in terms of taxable presence, tax compliance, potential double taxation and the group's transfer pricing arrangements. The more senior teleworking employees are (cf. SPFs), the more severe the potential permanent establishment exposures and transfer pricing consequences could be. Every potential way of dealing with these challenges has its merits and should be considered taking into account all different angles (the factual position, individual tax, social security, permanent establishment, economic ownership of assets, allocation of profits, transfer pricing, etc.). Unfortunately, also in the new normal there will be no 'one answer' nor a 'one size fits all' solution. Preparation is the key to success (Alexander G. Bell).

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