The Equus Compliance Engine
The Accidental Taxable Presence

Having a dynamic global workforce presents many advantages as well as unintended pitfalls. One of the costliest pitfalls is accidentally creating a permanent establishment (PE) in the host country.

As remote work and business travel become the new normal, understanding PE is no longer a niche concern reserved for multinational corporations. It is a crucial issue for every employer with cross-border activity.

What is a PE?

PE is a legal concept that determines whether an employer has enough business activity in a country to warrant corporate tax and compliance obligations. The level of activity that triggers PE varies by country.

The U.S., for instance, lacks a formal minimum activity threshold. Even limited operations can expose an employer to corporate obligations - an approach clearly unfavorable to cross-border mobility.

To mitigate the harshness of domestic rules and to provide some international consistency, most countries, including the U.S., use income tax treaties to define what qualifies as a PE.

Why PE Matters for Global Businesses

Employers commonly create a PE intentionally by opening a brick-and-mortar location in a foreign country, preparing for the expected tax and compliance obligations.

Today, the surge in business travelers, remote work, and globally dispersed teams increases the risk of unintentionally creating a PE. Key risk factors include:

Lack of Visibility

Employers often have less awareness of where their employees are working.

Decentralized Operations

With the increase in remote work, operations are decentralized and spread across multiple countries.

Increased Scrutiny

Governments are becoming more vigilant in enforcing compliance and re-evaluating what constitutes PE.

Employees as a Pathway to PE

Most treaties address three main PE concepts:

1. Fixed Place of Business
Despite the name, an employer can have a Fixed Place of Business PE without owning or leasing an actual space. All it requires is a location within a country where business is conducted regularly.

- Existence of some place of business: Because the space does not have to be an employer-owned location, Governments are now heavily scrutinizing the use of home offices. Countries have not reached a consensus on this issue.

In Germany, a home office can establish a PE if the employer has control over the employee's home, such as having rights to enter it or dictate its use. Employers can mitigate this risk by treating the employee's home as a private space and only accessing it when invited.

The situation can be more complex under the Netherlands-Belgium treaty. If a Dutch employer without an office in Belgium hires a Belgian remote employee, effectively requiring that employee to work from home, the Dutch employer may unintentionally create a PE in Belgium.

- Degree of permanency: PE does not automatically attach to any business location; it requires a certain level of permanency.
    - Example: If a Dutch manager visits Belgium to interview a potential employee in a rented co-working space, the short-term use will not trigger a PE. But, if the Dutch employer leases the co-working space for an extended period, the usage may be treated as permanent, resulting in a PE.
    - Construction sites are often considered permanent business locations after a certain time under tax treaties, even if they only exist temporarily, to prevent employers from avoiding their corporate obligations.
- Employee Activity: Employee activity can also determine whether a PE is established, with special emphasis on executive managers. As such, handling routine support tasks is usually less of a concern. In contrast, if an executive makes key business decisions from that location, it starts to look like a local office, raising the chances of creating a long-term business presence in the country.
    - The Dutch manager, temporarily in Belgium, may create a PE simply through their day-to-day management activities and responsibilities.

2. Dependent Agent PE
An employer cannot avoid PE by simply not providing a physical office space. An employee's action can independently create a PE. The risk arises when an executive employee has the authority to sign and negotiate contracts on behalf of the employer. A Dutch manager who regularly signs contracts in Belgium may create a PE for the Dutch employer even if the contracts are signed at various clients' offices rather than at a Belgian office location of the Dutch employer.

3. Service PE
Service PE creates a particular pitfall. Under certain tax treaties, any employee – not just executives – can trigger a PE by providing services in a foreign country for a certain amount of time. The exact length of time required to trigger a Service PE varies between the tax treaties, highlighting the importance of accurately tracking employees' time spent in a country.

Consequences of Creating an Accidental PE

Mismanaging or failure to identify PE risks can have serious consequences for an employer, including:

- Unexpected Tax Liability: A PE exposes corporate profits and the personal income of traveling employees to taxation.
- Compliance Obligations: The employer must now adhere to all labor laws, register in-country, maintain financial documents, and submit annual tax filings.
- Increased Scrutiny and Audits: Having an unrecognized PE leads to more audits, consuming significant time and resources.

Mitigating PE Risk Through Proactive Management

PE is a complex, fact-specific issue. The rules are not clear-cut, and even the slightest change can trigger the establishment of PE. An increased risks can arise from various common scenarios, such as:

- A change in an employee's role or location.
- A manager conducting business while traveling.
- A project extending beyond its anticipated duration.
- Employees rotating through a shared workspace.

Proactive management is key. While developing precise assignment and remote work policies may be a great starting point, continuous tracking of employee activity is necessary to minimize risk in a landscape of ever-changing regulations.

How the Equus Compliance Engine Helps:

Equus provides employers with ongoing visibility into employee activities, helping them stay ahead of global compliance challenges and better manage PE risks. The Equus Compliance Engine:

- **Navigates complex global compliance regulations automatically, ending the need for manual research and tracking.**
- **Conducts real-time risk assessments when employee location or activity changes.**
- **Monitors employee travel and workdays across multiple jurisdictions.**
- **Standardizes compliance requirements by applying consistent risk criteria, thereby minimizing errors.**

Interested in learning more about how other mobility professionals address PE concerns? Check out Equus Community, a new space to share all kinds of mobility-related questions and content and keep up with the latest news in global mobility! Available to all Equus clients.