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Micro-PEs and Global Mobility: Balancing Risk and Pragmatism

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Global workforce activity is triggering a proliferation of PE risk for companies, and as tax regulators start to address the risks and compliance burdens created by PEs with little substance (micro-PEs), companies face balancing exposure and tax risk while supporting business strategy and growth, says a Grant Thornton practitioner.

Companies are engaging talent internationally with a diversity of approaches, from operating on a fully-remote basis to allowing remote working. With a complex patchwork of rules across different countries, businesses need to balance the risks of having employees in multiple countries and the possibility of being subject to taxes in those countries. Start-ups, high-growth, and mid-sized businesses may disproportionately be impacted by the high costs of managing corporate taxes and employer tax compliance in new country locations where they may have limited employee headcount, quite possibly creating a "micro-permanent establishment" (micro-PE). While micro-PEs give rise to compliance obligations and potential corporate income tax liabilities, lack of knowledge of domestic taxes or the expensive costs of managing compliance across multiple countries may result in micro-PEs not being declared and taxes not paid.

In 1963, the Organization for Economic Cooperation and Development published a draft of its first model double tax treaty which was intended to form the basis of double taxation agreements between member countries and to provide a framework for the management of international tax issues between countries. The original draft model treaty contained articles addressing contemporary global workforce matters, including how a company may create a "permanent establishment" (PE), a corporate taxable presence in another country due to cross-border work, as well as the cross-border taxation of employees. The draft model treaty, and its successor model treaties, have for decades defined how taxes are applied to global workforces.

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New editions of the model treaty were published in 1977 and 1992, with the last comprehensive update in 2017. (The 1992 model has been updated nine times since its initial publication). While the treaty has been redrafted multiple times and the commentary updated, the core provisions applying to employee and employer cross-border working arrangements are fundamentally unchanged in the 54 years since the 1963 draft model treaty to the most current version published in 2017. The provisions conceive of global workforce issues arising in a binary working arrangement where an employee performs services in a country other than the one in which they are employed and are a resident in.

Back To The Future — Mobility 61 Years Later

Fast forwarding to 2024, the profile of global workforces has evolved beyond recognition from 1963, the year the first draft model treaty was published, as technology has transformed how business is done over 54 years:

- Start-ups and high-growth companies may operate borderlessly as fully remote organizations.
- "Remote-first" companies have limited or reduced office space with employees working from home or another location they choose.
- "Pop-up" offices provide temporary workspaces as business needs dictate.
- Personal preferences and lifestyle choices are accommodated in remote working policies and "work-from-anywhere" programs allowing for temporary periods of international working.
- Digital nomad visa arrangements provide technology-enabled employees to relocate anywhere to work.
- Independent contractors and contingent labor are hired in countries where a company has no corporate presence.
- Employers of Record (EORs) act as local employers to manage tax compliance on behalf of a business.

The fluidity and rationales for cross-border working reflect the continuing globalization of business, in particular how start-up through mid-sized businesses operate and approach international growth. These arrangements, however, do not fit neatly into a binary view of cross-border working inherited from the 1960s. As businesses scale and talent sits across borders in different ways, they also face the potential that their employees could create a corporate taxable presence in countries where they do not have a legal entity or formal operations. This in turn could trigger employer obligations including tax withholding, the provision of statutory benefits, and company employment taxes. While businesses focus on strategy, growth and innovation, international growth and engaging talent has the potential to generate risk and constrain activities due to the tax exposure and compliance requirements that can arise.

How Treaty Provisions Have Evolved

For the taxation of employees working across borders, the changes highlighted in bold below amend only the period in which an employee’s days of presence may result in a tax liability. However, not all tax treaties have adopted the language and many in force today retain the language drafted in 1954 to reflect how employee global mobility was seen as binary moves from one country to another.

1963 Draft Article 15(2)	2017 Draft Article 15(2)
Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of employment exercised in the other Contracting State shall be taxable only in the first-mentioned state if: a) the recipient is present in the other state for a period or periods not exceeding in the aggregate 183 days **in the fiscal year concerned**, and b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other state, and c) the remuneration is not borne by **a permanent establishment or a fixed base** which the employer has in the other state.	Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other contracting state shall be taxable only in the first-mentioned state if: a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in **any 12-month period commencing or ending in the fiscal year concerned**, and b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other state, and c) the remuneration is not borne by **a permanent establishment** which the employer has in the other state.

By contrast, the PE article in the draft double tax treaty has changed with new language added since 1963 and has become more reflective of activities businesses undertake in other countries. Key changes summarized below clarify where PE exposure should or should not exist. However, these provisions still lag behind the reality of how business operations have evolved.

With the ease and speed of international travel for business, and the need for just a laptop or tablet and Wi-Fi signal, technology allows seamless and integrated working irrespective of an employee's location. Accordingly, the way in which businesses are enabled to operate across borders allows for the different scenarios for engaging talent discussed above.

2017 Draft Article 5	What This Means
…the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) to e), provided that such activity or, in the case of subparagraph f), **the overall activity of the fixed place of business, is of a preparatory or auxiliary character**.	Certain activities carried on by employees not in the normal course of business, that are supportive, or minor, in nature, are specifically excluded from triggering corporate tax exposure.
…where a person is acting in a Contracting State on behalf of an enterprise and, in doing so, habitually concludes contracts, **or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts are** **a) in the name of the enterprise, or** **b) b) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or** **c) for the provision of services by that enterprise,** that enterprise shall be deemed to have a permanent establishment…	Employees actively involved in the generation of business in a country, other than where they and their employer are resident, may create PE risk. The description of activities has expanded beyond just exercising signatory authority in recent years, reflective of executives traveling more frequently to conduct business across borders.
…where the person acting in a Contracting State on behalf of an enterprise of the other Contracting State carries on business in the first-mentioned State as an independent agent and acts for the enterprise in the ordinary course of that business. **Where, however, a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, that person shall not be considered to be an independent agent within the meaning of this paragraph with respect to any such enterprise.**	An individual acting on behalf of a company that substantively has the character of an employee (dependent agent) can trigger PE risk based on their business undertakings even if the form of their agreement indicates they are independent.

While the language addressing, defining, and mitigating a PE has evolved, the language remains ill-fitted to accommodate some of the new approaches now being used to deploy talent internationally. New operating models for global workforces can therefore trigger PE exposure quickly where there are employees in a country with no legal entity, often either through the services being undertaken by employees, the location they're working from, or the responsibilities assigned to their role.

Different forms of PE could arise from the activity of a mobile employee. Fixed Place PE may be established when a foreign company has a fixed place of business in another country through which it conducts business. While this could include an office or a workshop, but possibly also a home office where employees are contracted to work away from an office. An Agency PE could occur when a person has the authority to act on behalf of a foreign company and habitually exercises that authority to conclude contracts or negotiate the essential terms of contracts.

A Services PE generally arises when a company provides services in another country through its employees or other personnel. The exact threshold for creating a Services PE can vary depending on the

tax treaty but generally involves the continuous or cumulative presence of employees for a certain number of days (often 183 days within a 12-month period).

Global Workforce Operating Model	Type of PE
Fully remote organizations	Services PE and/or Agency PE
"Remote-first" companies, limited, or reduced office space	Fixed place of business
"Pop up" offices	Fixed place of business
Remote working policies	Services PE and/or Agency PE
"Work-from-anywhere" programs	Services PE and/or Agency PE
Digital nomad visa schemes	Services PE and/or Agency PE
Independent contractors and contingent labor	Services PE and/or Agency PE
Employers of Record (EORs) acting as local employers	Fixed place of business, Services PE and/or Agency PE
Home office working as a contractual requirement	Fixed place of business

Therefore, as businesses enter or grow in countries where there is no local legal entity, remote employees could trigger corporate tax exposure from their first day of activity depending on their role.

Solving the Issue of 'Micro-PEs'

While a PE could exist, whether it has material financial exposure for a company relative to turnover and profit poses a dilemma when businesses consider how to manage their risk and compliance. Start-ups, high-growth and mid-sized businesses may disproportionately be impacted by the high costs of managing corporate tax and employer tax compliance in new country locations where there may be limited employee headcount.

The presence of a PE or deemed corporate entity may require allocating employees' direct costs for compensation and benefits as income with a transfer pricing mark up. Depending on an employee's role and involvement in profit generating activity, tax authorities may seek to allocate a portion of the parent company's revenues and profit.

In many cases, this may ultimately result in limited amounts of attributable profit and, in turn, limited tax exposure. With an average OECD corporate tax rate at 23.73%, a company growing to 50 employees earning on average $50,000 a year could face a tax exposure of a little over $115,000. A company with just five employees could by contrast have corporate tax exposure of approximately $12,000.

For tax authorities, identifying, investigating, auditing, and assessing tax on a non-resident company without the legal jurisdiction to pursue will take a considerable amount of time and resources. While such "micro-" or "mini-" PEs give rise to compliance obligations and potential corporate income tax liabilities, lack of knowledge of domestic taxes or expensive cost to manage compliance across multiple countries may result in PEs not being declared and taxes not paid. Pursuing audits of domestic taxpayers, both corporate and individual, may allow for higher levels of tax authority revenue generation and easier means of collection. If tax authorities do not give priority to pursuing, or have limited capacity to pursue, PEs at non-resident start-ups and mid-tier companies undertaking expansion, for example, may consider the cost-risk benefit in trying to ensure compliance in every location they have employees.

The issue of micro-PEs is getting attention. The OECD Mobile Workforce workstream getting underway in 2024 is addressing how to manage compliance, corporate tax exposure, and related transfer pricing issues. While the outcomes of the workstream are yet to be seen, solutions such as the following may enable companies to engage talent globally without triggering tax exposure and keeping compliance costs and tax liabilities low so that authorities may be less active or interested in pursuing audits:

- Including more business activities in an expanded exemption for not triggering a PE beyond “preparatory and auxiliary activity” — for example, the activity of employees in non-market facing roles during a defined period of initial growth and operations.
- For countries assessing PE and/or individual income tax based on 183 days of physical presence, the definition of a “day” could be changed to a working day rather than simply a day of physical presence in a country.
- Businesses may engage a very small employee population in initial growth stages with activity performed by an employee population up to a specified number excluded from creating PE.

For the above exemption, applying a cap on the company size defined by global turnover or industry, for example (the latter specified by a country tax authority), recognizes that high-growth to mid-sized businesses may need to deploy talent internationally differently than large corporates. Australia’s concept of a “significant global entity” for employment tax non-compliance penalty exposure purposes provides an example.

How U.S. Businesses Can Respond

The coming years will see tax regulators addressing tax risks arising from global workforces with organizations like the OECD potentially exploring how risk and compliance burdens may be mitigated. Many U.S. businesses have diversified the ways they engage talent globally as well as defined how those working arrangements are set up and where people work from. Both engaging on potential changes and pursuing channels to voice preferences on how regulations may be drafted will be important in enabling businesses to effectively plan their global workforce strategy, and in turn how they execute on their growth strategy.

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