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Do Mobile Workers Create Permanent Establishment, TP Challenges?

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As greater global mobility and connectivity continue to reshape where employees and senior executives are based, KPMG surveyed 22 member firms to examine the transfer pricing challenges arising across jurisdictions — and what businesses need to know, write KPMG's Alistair Pepper, Jessie Coleman, and Phil Roper.

Global mobility frequently appears as a potential area of concern for transfer pricing professionals. For example, executives may be told to avoid signing contracts in foreign jurisdictions because doing so might create a permanent establishment, or PE. The global dispersion of senior management may also prompt questions about how a group's transfer pricing policies should be structured, particularly in an age when less weight is given by some tax administrations to capital allocation and asset ownership.

What is also clear is that the number of instances where tax administrations assert the existence of an undisclosed PE is low; the number of situations where this assertion is upheld is even lower. Many tax administrations are focused on the remuneration of entities that employ senior management, while some might argue that senior executives in their jurisdictions should be rewarded with higher cost-plus returns, others may favor the profit split method, at least in some circumstances.

To better understand these issues, KPMG surveyed professionals across 22 jurisdictions in its global transfer pricing network to identify, based on their experience, which issues arise locally and which don't. These jurisdictions were Australia, Belgium, Canada, China, Denmark, France, Germany, Hong Kong (SAR), China, India, Ireland, Italy, the Netherlands, Norway, Poland, Portugal, Singapore, Spain, Sweden, Switzerland, the United Arab Emirates, the UK, and the US.

These jurisdictions were selected to cover a range of jurisdictions from around the world, including most major economies and key investments hubs, but with a focus on Europe where cross-border work is particularly frequent.

PE Assertions

The first question we asked our member firms was whether they were aware of their tax administration asserting that the presence of a foreign company's employee in the jurisdiction constituted a fixed place of business. Thirteen were aware of such an assertion, while nine weren't.

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Next, we asked how frequently member firms saw an undisclosed fixed place of business PE asserted by their jurisdiction's tax administration on the basis of employees working remotely. Only three jurisdictions — Norway, Poland, and Sweden — considered such assertions frequent. The remainder considered them infrequent, never having occurred, or were uncertain about the frequency.

Finally, we asked whether member firms expected the updated OECD Commentary on remote working to be applied by their tax administration when examining fixed place PE issues under an applicable treaty. The Organization for Economic Cooperation and Development Secretariat's view is that these updates should be used to interpret existing treaties which contain the relevant language from Article 5 of the OECD Model Tax Convention (MTC), as the changes in the Commentary to Article 5 of the MTC were clarificatory.

Sixteen of the jurisdictions expected the updated Commentary to be applied. India doesn't expect the guidance to be applied, based on India's reservations to the Commentary. The remaining five jurisdictions indicated they were uncertain, as their local tax administration hadn't yet published a formal position.

What conclusions should we draw from these questions? The risk of a tax administration asserting an undisclosed PE varies across jurisdictions. If businesses have employees of foreign companies working in Norway, Poland or Sweden, they should be particularly cautious.

Some tax administrations have formal or informal policies to rely primarily on transfer pricing to resolve disputes, rather than to explore the PE route. This may offer an easier route to resolving disputes where they arise. This may be feasible when a group has a local entity in a jurisdiction but isn't when a group doesn't have a local entity.

For remote working specifically, the updates to the Commentary to the OECD MTC are helpful and will be even more helpful when reflected more broadly in domestic guidance.

Senior Executives

The next set of issues that we focused on is disputes around senior executives.

We asked member firms whether they were aware of their jurisdiction's tax administration asserting that executives in senior or global roles, although employed by a local operating entity, were economically employed by a foreign entity and constituted a PE of that entity. In our survey, seven of the jurisdictions had seen economic employer issues, fifteen hadn't. As senior executives seek greater flexibility to work across borders, businesses should think carefully about the risks and opportunities when structuring these arrangements.

Next, we asked whether member firms were aware of their jurisdiction's tax administration challenging the use of a typical cost-plus return to remunerate the local entity employing senior executives. This was much more common, with 16 respondents having seen this. Of those jurisdictions that hadn't, two were investment hubs and two were headquarters jurisdictions, where the tax administration may be concerned that raising these types of challenges will adversely affect their multinationals in future.

Where typical cost-plus remuneration had been challenged, we asked what alternative returns tax administrations had argued for. Thirteen jurisdictions reported arguments for a higher cost-plus return, ten for a share of residual profit (higher than we might have anticipated), and seven for a revenue share.

Finally, we asked whether member firms were aware of their tax administrations agreeing, through advance tax rulings or advance pricing agreements, or APAs, concluded since 2020, to cost-plus remuneration for dispersed global management functions. Six were aware of such agreements.

This doesn't necessarily indicate that other tax administrations would reject such APAs; it may instead suggest that businesses consider the risk of challenge, and therefore the benefit of seeking an APA, to be low.

Exit Taxes

The last question we asked was whether jurisdictions' tax administrations had asserted that an arm's-length compensation payment, based on future profits, would be due when a limited number of senior individuals with decision making authority relocated or ceased to be employed by a local entity. Eight European jurisdictions, Denmark, Germany, Ireland, Italy, Netherlands, Portugal, Switzerland, and the UK had seen such assertions.

It isn't surprising to see Germany, with its transfer-of-functions guidance that explicitly provide for this approach, on this list. More striking is that similar arguments have arisen elsewhere, perhaps reflecting increased interest in, and focus on, the guidance in Chapter I on control of economically significant risks and the business restructuring guidance in Chapter IX of the OECD Transfer Pricing Guidelines.

Takeaways

More mobile workers will continue to create questions for transfer pricing professionals, who want to support businesses to achieve their commercial objectives, while minimizing potential tax risks.

Our survey of KPMG member firms shows a real risk of tax administrations challenging arrangements that don't adequately account for geographically mobile workers or the dispersal of senior management. However, it also shows that tax administrations' concerns vary, opening up the potential for more flexible mobility policies for jurisdictions where the risk of local challenge is lower.

Global mobility isn't going away, and the transfer pricing questions it raises are no longer limited to big businesses. Indeed, the issues faced by small businesses, particularly as founders move between jurisdictions, can be among the most challenging.

While it is important to consider the potential transfer pricing risks associated with these arrangements, tax departments can support the business by proactively considering the local environment.

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