Tax liability when companies cross national borders

TAX:WATCH NO. 8
30-08-2019

CONTENT

When a company begins operating in another country, tax liability in the country of the new activities depends on whether the activities constitute a permanent establishment. This is subject to an individual assessment.

By Anders Kiærskou, aek@bdo.dk

If the activities in another country is carried out through a local subsidiary, the subsidiary will generally be subject to tax in that country from the first day of operations.

Often, however, activities in another country start at a slightly lower level, which makes it a bit more difficult to determine whether tax liability commences due to the creation of a permanent establishment.

A permanent establishment can exist in different ways - for example in the form of a building site or construction or installation project, or through an office, a shop, a workshop or another place of business.

A permanent establishment can also be created by hiring a salesperson, an agent or representative, or conclusion of other agreements with such persons.

A place of business can include a home office of an employee such as a salesperson or another representative. Whether the salesperson is authorized to conclude agreements on behalf of the company is not in itself decisive.

Danish case law

The Danish tax authorities' view on when a permanent establishment exist can be illustrated by a ruling from the National Tax Board.

The case concerned a Swiss company that wanted to establish itself on the Danish market and therefore hired a Danish resident salesman. The salesman had a home office, and his job consisted of looking for leads.

He was not authorized to conclude binding agreements, however. All contracts where concluded between customers and the company in Switzerland. Nonetheless, the National Tax Board ruled that the Swiss company had a permanent establishment in Denmark and consequently, the company was liable to Danish tax on the profits from the activities in Denmark.

According to the ruling, the responsibilities of the salesman constituted a significant and essential part of the Swiss company's Danish activity, and the salesman's home office constituted a permanent place of business for the employer. It was irrelevant that the salesman was not authorized to conclude binding agreements.

Foreign case law

The above described case may have had another outcome in other countries. The view on when a permanent establishment exist – including in relation to employment of sales personnel – is not identical in all countries.

However, also in Sweden, a home office is considered to be a place of business. Hence, companies should investigate the issue before commencing businesses in other countries in order to be aware of their tax position and responsibilities.

Tax liability in another country seldom poses the biggest problem. This is rather the often heavy administrative burden that the tax liability entails in relation to bookkeeping, payroll taxes, VAT returns and tax returns.

Few fines for tax evasion

Contrary to popular belief, tax revenues from tax and VAT evasion are relatively modest. For example, they make up only a fraction of the Treasury's income from speeding tickets. Few companies are fined.

By Anders Kiærskou, aek@bdo.dk

In most cases, tax evasion is penalised by a fine, the size of which depends on the amount of taxes evaded and the nature of the income. Read more about fines in the July 2019 issue of tax:watch.

The Tax Administration's so-called transparency report for 2017 shows that this year, the administration issued 1,511 fines to citizens and businesses, while the courts imposed fines in 215 cases for violating the tax law.

The total of 1,726 fines included not only fines for the avoidance of income tax, but also fines for VAT evasion and for violating the rules on withholding taxes etc.

The fines, according to information from the Tax Administration, provided a total income to the Treasury of DKK 61.84 million. Thus, the average tax fine in 2017 amounted to DKK 35,829.

The vast majority of the fines were given to employees and self-employed individuals.

Less than 10 pct. of the total amount of fines can be attributed to companies etc.

Given the media's repeated writing about the extent of undeclared income and the use of tax havens etc., many will probably be surprised at the relatively modest number of fines that are issued in the tax area.

The total income from fines in 2017 amounted to less than 10 pct. of the police revenues from automatic traffic control, which yielded DKK 871 million in the same year.

There is no doubt that the politically agreed addition of further resources to the Tax Administration will lead to more scrutiny and thus also more fines, but the vast majority of tax and VAT cases end without fines.

Thus, doubling the number of employees of the Tax Administration would not result in a corresponding increase in the number of fines.