



# Know Before You Go: International Expansion & Permanent Establishment Risk



- Introductions
- Permanent establishment overview
- Implications of PE: Entity setup
- Gauging your PE risk
- Understanding fixed place of business
- Impact of employee participation in the sales process
- PE risk scenarios
- How to get on the ground overseas
- Questions



## Overview

- Leader in international business services
- 350+ customers, operating in more than 90 countries
- *HSP OverseasDirect* – all monthly activities companies must undertake in country
- *HSP OverseasConnect* – cloud-based portal to manage it all
- Advisory – connecting all the dots



### Overview

- World's leading provider of pioneering workplace solutions
- Products and services
  - Fully equipped offices
  - Professional meeting rooms
  - Business lounges
  - Largest network of videoconferencing studios
- 800,000+ clients a day in facilities spread across the globe
- 1,200 locations in 550 cities and 95 countries



### **Justin Smith**

Senior Director, Advisory Services  
High Street Partners

- Senior Director of Advisory Services at HSP with responsibility for the Americas
- Wealth of international experience, spanning more than 13 years assisting companies expanding abroad
- Prior to HSP, served in a variety of senior management level capacities with tax and economic consulting groups at Alvarez & Marsal, Duff & Phelps, and Arthur Andersen
- Co-founded and served as CEO of Altus Economics, a specialty international economic consulting boutique



**Scott Hartman**

VP, Global Accounts America  
Regus

- More than two decades of experience in logistics and facilities management industry
- Leads the Regus Global Accounts team for North America
- Team consults with US based multinational companies on:
  - Global new market entry
  - Company acquisition support
  - Cost reduction strategies for field offices
  - Deploying mobile worker strategies
  - Facilities outsourcing
  - Leveraging the worlds largest meeting room and video conferencing network



- Permanent establishment is created by any business activity that generates revenue in a country or contributes to group entity revenue
- Local tax authorities will generally assess corporate tax on a deemed revenue arising in-country
- PE will generally not be deemed to have been created where the activity is truly representative in nature (i.e. marketing activity where no revenue can be attributed)

***A determination of permanent establishment gives local authorities the power to assess income or a value-added tax***



*In most countries, PE must be formally registered under a corporate entity*

### Representative Office

- One of the easiest ways to get setup overseas
- Allows a company to establish a minimal presence
- Employees cannot engage in sales or contractual matters

### Branch Office

- An extension of a parent company, serving a certain geographic area
- Can engage in core activities, sales, etc.
- Not a separate legal entity; foreign parent subject to all liability
- Potential for taxation of overseas profits in U.S.

### Subsidiary

- A separate legal entity for engaging in business overseas
- Provides a layer of protection between the interests of the parent and the on-the-ground entity
- Long setup and registration time; heavy oversight



- A gray area, open to interpretation by local authorities
- Indicators vary country-to-country, but there are common elements
- Indicators are usually defined in domestic tax legislation, tax treaties or some combination

### Ask yourself...

- ***Are you operating out of a fixed place of business?*** (does not necessarily mean a formal office)
- ***Are your employees receiving commission or bonuses?***
- ***Do your employees have revenue-generating job titles/descriptions?***
- ***Are local employees negotiating contracts with customers in-country?***



- Formal brick and mortar office will generally create a fixed place of business
- May also include a local employee's home office if the following conditions are met:
  - Dedicated business phone and/or fax line
  - Home address being used for business cards
  - Home address being used as postal address for company correspondence
  - Utility accounts being registered and paid directly by out-of-country entity



- Level of participation by a local employee will influence PE determination
- Determination of where contract is concluded will not hinge on technicality of whether or not a local employee can sign off on a contract
  - Look to the employee’s involvement in the identification of the customer
  - Employee can be deemed to be substantially involved in negotiating and concluding a contract
  - Tax authorities on the lookout for “rubber stamping” of contracts

***Involvement in any revenue-generating activity by in-country employees can put your business at PE risk***



## Background

- U.S. parent company sells industrial equipment to manufacturers in Asia
- There is an engineer on the ground in-country servicing contracts performing installation and repairs and maintenance
- Contracts were concluded by the U.S. parent company

## The Result

- Revenue can be attributed at the group level, and ***a PE may have been created***



## Background

- U.S. parent company sells pharmaceuticals to third party distributors throughout Europe
- A sales rep is on the ground in country, is heavily involved in customer negotiations, but cannot physically sign contracts
- Sales rep has a job title which contains the word “sales” and part of his/her compensation package includes sales related commissions

## The Result

- His/her activities are business activities and ***a PE may be created***



## Background

- U.S. parent company sells B2B software to customers in Latin America
- Company works through independent sales contractors that work exclusively for them
- Have business corporate business cards and corporate credit cards
- Independent contractors work in countries that don't have the concept of a non-resident employer

## The Result

- Independent contractors become deemed employees ***triggering a PE***



- It depends... rules vary in different countries
  - PE may or may not be created
- Benefits of an in-country physical presence:
  - Professional address for marketing activities
  - A person to answer phones in local language
  - Space for meetings with clients
  - Source for administrative/operational needs



*'Property' and 'People' are key perceived obstacles to international expansion*

- **34%** of firms say the biggest obstacle to overseas expansion are the challenges of setting up a physical presence in a foreign country
- **63%** of companies also say that property commitments have to be very short term when setting up a foreign operation, as they do not know how quickly or slowly they will grow
- Opinion is split over the where senior management for overseas operations should hail from, with **53%** favoring a mother country manager, and **47%** opting for a local manager



### *Opening an office can create long term liabilities...*

- Leases can require 3-7 year commitment
  - Intimidating when you only want to explore the market
  - Costly if you break the lease and leave
  - Can have additional legal implications that seem subtle now but have a big impact later
- Certain countries have strict employee termination rules
  - Countries like Germany and France have very strict rules to terminate an employee
- The lease can represent about **40%** of the overall cost to open the market
  - Furniture, space build out/improvement
  - IT, telecommunication, etc
  - Legal fees to negotiate contracts



- Due process and the rule of law can vary
  - Misinterpreted provisions in overseas lease agreements can create legal issues and large overruns in cost
  - Limited recourse in many jurisdictions
  - Rule of law is unclear or confusing on preliminary requirements for signing a lease



*What type of commitment do you have and what are your options?*

## Getting Started: Business Centers

- A place to work and meet while developing your business
- Lower operational costs
- Less likely to create PE

## Expanding Your Presence: Virtual Office

- Flexibility to have space in multiple countries with a handful of employees
- Rent space by the hour for when you are in town
- Gray area for creating PE – pay attention to contributing factors

## Committing to the Market: “Permanent” Office

- A dedicated space in a single location
- Best for a larger office with many employees on the ground
- Reduced risk: no capital outlay, can quickly expand/contract
- Typically creates PE



### Background

- U.S. parent company decides to open an office and sign a lease in Russia
- Company signs lease agreement
- After lease execution, landlord raises the rate per square foot by \$4.00 U.S.
- U.S. company threatens to file a lawsuit but realizes the due process of going to court will take 5-7 years

### The Result

- The U.S. company was left to scramble 30 days before the operations were to go live, creating a large expense and drag on management resources
- There will be a long term legal liability that will not be resolved for 5-7 years



### Background

- A U.S. based mid-size telecommunications firm was acquiring a division of a much larger firm. They had field offices in 21 different countries that needed to be relocated out of the former parent company
- They needed to pull the French team out of the existing office space in Paris
- During the due diligence in preparing for the new office space, the French labor counsel's law governing how far an employee may be asked to relocate was not taken into account

### The Result

- 3 weeks prior to closing on the acquisition, the company had to take a new office resulting in a 400K Euro write off during the acquisition



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Q&A



# Questions?

[www.hsp.com](http://www.hsp.com)



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