Foreign Employers and Italy's Permanent Establishment Risk: What Hiring an Italian Remote Worker Really Means

Descrizione

A foreign company that allows even a single employee to work from Italy on a regular basis can, under Italian rules, end up with a permanent establishment (PE) in the country — and with it, Italian corporate tax, VAT registration, payroll obligations, and a tax filing footprint it never planned for. After several years of post-pandemic remote-work normalisation, the Italian Revenue Agency has made clear that home-based work for a foreign employer is not a neutral arrangement: it is a fact pattern that must be analysed carefully before anyone signs a contract.

The legal framework starts with Article 162 of the Italian Income Tax Code (TUIR) and the OECD Model Tax Convention's PE definition embedded in Italy's treaties. A PE arises whenever a foreign enterprise has a fixed place of business in Italy through which its activity is carried on in whole or in part — or whenever a person habitually concludes contracts on its behalf in Italy (the so-called agency PE). Both routes are now actively scrutinised in remote-work scenarios.

When Does a Home Office Become a Fixed Place of Business?

Italian Tax Authority guidance — most notably Circular Letter 33/E of 2020 and Ruling 596/2021, repeatedly cited in subsequent practice — sets out the framework. A home office is not automatically a PE, but it can become one if four conditions converge: the worker carries out core revenue-generating activities (not just preparatory or auxiliary support); the employer effectively has the home at its disposal (for instance, by reimbursing rent, requiring its use, or providing office equipment that turns the space into a de-facto branch); the activity is sufficiently continuous; and there is no genuine alternative workplace abroad.

What this means in practice is that the substance of the role matters far more than its label. A back-office IT engineer running internal systems is unlikely to create a PE. A sales director negotiating contracts with Italian or European clients from her Milan apartment almost certainly does. The Italian Revenue Agency consistently applies a "substance over form" test during audits, and Italian tax courts have followed suit.

The Agency PE Trap

Even more dangerous than the fixed-place test is the agency PE route. A foreign company can be deemed to have a PE in Italy if a person — even one without formal signing power — habitually plays the principal role in the conclusion of contracts that are then routinely approved by the foreign head office without material change. Post-2017 OECD updates, transposed into Italy's recent treaties, deliberately broadened this concept to capture commissionaire and similar arrangements. A remote sales manager living in Italy who manages the customer pipeline end-to-end is exposed even if all paperwork is signed abroad.

What an Italian PE Triggers

Once a PE is found, the consequences cascade. The foreign company must register a branch in Italy, allocate profits to it under transfer pricing principles, file Italian corporate tax (IRES at 24% plus IRAP at around 3.9%), register for Italian VAT and issue Italian e-invoices, and operate Italian payroll withholding for the local employee. Penalties for unregistered PEs are severe: undeclared income is subject to assessments going back up to seven years where no return was filed at all. Following the 2024 reform of the Italian penalty system (Legislative Decree 87/2024), the applicable penalties are now fixed rather than banded: 70% of the tax due for an understated return and 120% for an omitted return, replacing the former 90%–180% and 120%–240% ranges, which continue to apply only to violations committed before 1 September 2024. Criminal exposure remains once the omitted-tax threshold is crossed.

Practical Risk Mitigation

There is no single bullet-proof shield, but several measures materially reduce exposure: a written employment contract that confines the Italian role to internal or auxiliary functions; explicit prohibition on negotiating, finalising, or signing contracts with clients from Italy; absence of any “Italy office” designation on business cards, websites, or LinkedIn profiles; a clear alternative workplace abroad that the employee uses regularly; and avoidance of employer-paid rent or dedicated office equipment that could anchor a “fixed place” finding. For higher-risk roles, an Employer of Record (EOR) structure or a properly registered Italian branch is often the cleanest answer.

A Note for U.S. Citizens and U.S. Companies

The Italy–U.S. tax treaty contains its own PE article that broadly tracks the OECD model, but the U.S. dimension adds layers. A U.S. company with a hidden Italian PE has filing obligations on Form 8858 (for the Italian branch) and may face overlapping U.S. and Italian taxation that the foreign tax credit only partly resolves — particularly when state income tax is in play. For the U.S. citizen working remotely from Italy, the issue is reversed: even if the employer is shielded from PE because of careful role design, the individual still faces full Italian residence-based taxation on worldwide income, which is why the Impatriati regime, the new-resident lump-sum, or the 7% retiree regime are usually evaluated alongside the PE analysis.

Final Considerations

Italian PE risk is a quiet but expensive trap for foreign companies that adopt remote-work flexibility without legal review. The arrangement that looks costless to HR can produce a seven-year tax exposure for the parent. Before authorising an employee to work from Italy — even occasionally —

foreign companies should obtain a written PE risk assessment, document the role boundaries, and revisit the analysis whenever the worker's responsibilities expand. Specialist Italian tax advice is not optional in this area; it is the difference between a clean cross-border arrangement and a multi-year reconstruction.

Tag

1. Foreign companies
2. Working in Italy

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