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OECD Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis

# The impact of the COVID-19 Crisis

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## 1. Introduction

1. The COVID-19 pandemic has forced governments to take unprecedented measures such as restricting travel and implementing strict quarantine requirements. In this difficult context, most countries are putting stimulus packages in place, including measures to support employment, for example, taking on the burden of unpaid salaries on behalf of companies suffering from the economic effects of COVID-19 pandemic. As a result of these restrictions, many cross-border workers are unable to physically perform their duties in their country of employment. They may have to stay at home and telework, or may be laid off because of the exceptional economic circumstances.

2. This unprecedented situation is raising many tax issues, especially where there are cross-border elements in the equation; for example, cross-border workers, or individuals who are stranded in a country that is not their country of residence. These issues have an impact on the right to tax between countries, which is currently governed by international tax treaty rules that delineate taxing rights.

3. At the request of concerned countries, the OECD Secretariat has issued this guidance on these issues based on a careful analysis of the international tax treaty rules.

## 2. Concerns related to the creation of permanent establishments

4. Some businesses may be concerned that their employees dislocated to countries other than the country in which they regularly work, and that working from their homes during the COVID-19 crisis will create a "permanent establishment" (PE) for them in those countries, which would trigger new filing requirements and tax obligations.

5. As explained below, it is unlikely that the COVID-19 situation will create any changes to a PE determination. The exceptional and temporary change of the location where employees exercise their employment because of the COVID-19 crisis, such as working

from home, should not create new PEs for the employer. Similarly, the temporary conclusion of contracts in the home of employees or agents because of the COVID-19 crisis should not create PEs for the businesses. A construction site PE would not be regarded as ceasing to exist when work is temporarily interrupted.

6. However, the threshold presence required by domestic law (including state/provincial legislation) to register for tax purposes may be lower than those applicable under a tax treaty and may therefore trigger corporate income tax registration requirements. In addition, not all income taxes are covered by the applicable double tax treaty, (e.g. state income taxes in the United States of America). Tax administrations are therefore encouraged to provide guidance on the application of the domestic law threshold requirements, domestic filing and other guidance to minimise or eliminate unduly burdensome compliance requirements for taxpayers in the context of the COVID-19 crisis.

7. For example, Ireland's Revenue has issued guidance[1] to disregard the presence of an individual in Ireland - and where relevant, in another jurisdiction - for corporate income tax purposes for a company in relation to which the individual is an employee, director, service provider or agent, if such presence is shown to result from travel restrictions related to COVID-19. The individual and the company should maintain a record of the facts and circumstances of the bona fide relevant presence in the State, or outside the State, for production to Revenue if evidence that such presence resulted from COVID-related travel restrictions is requested.

Explanation

Home office

8. In general, a PE must have certain degree of permanency and be at the disposal of an enterprise in order for that place to be considered a fixed place of business through which the business of that enterprise is wholly or partly carried on. Paragraph 18 of the Commentary on Article 5 of the OECD Model explains that even though part of the business of an enterprise may be carried on at a location such as an individual's home office, that should not lead to the conclusion that that location is at the disposal of that enterprise simply because that location is used by an individual (e.g. an employee) who works for the enterprise. The carrying on of intermittent business activities at the home of an employee does not make that home a place at the disposal of the enterprise. Also, for a home office to be a PE for an enterprise, it must be used on a continuous basis for carrying on business of an enterprise and the enterprise generally has to require the individual to use that location to carry on the enterprise's business.

9. During the COVID-19 crisis, individuals who stay at home to work remotely are typically doing so as a result of government directives: it is force majeure not an

enterprise's requirement. Therefore, considering the extraordinary nature of the COVID-19 crisis, and to the extent that it does not become the new norm over time, teleworking from home (i.e. the home office) would not create a PE for the business/employer, either because such activity lacks a sufficient degree of permanency or continuity or because, except through that one employee, the enterprise has no access or control over the home office. In addition, it provides an office which in normal circumstances is available to its employees.

Agency PE

10. The question may also arise whether the activities of an individual temporarily working from home for a non-resident employer could give rise to a dependent agent PE. Under Article 5(5) of the OECD Model, the activities of a dependent agent such as an employee will create a PE for an enterprise if the employee habitually concludes contracts on behalf of the enterprise[2]. Thus, in order to apply Article 5(5) in these circumstances, it will be important to evaluate whether the employee performs these activities in a "habitual" way.

11. An employee's or agent's activity in a State is unlikely to be regarded as habitual if he or she is only working at home in that State for a short period because of force majeure and/or government directives extraordinarily impacting his or her normal routine. Paragraph 6 of the 2014 Commentary on Article 5 explains that a PE should be considered to exist only where the relevant activities have a certain degree of permanency and are not purely temporary or transitory. Paragraph 33.1 of the Commentary on Article 5 of the 2014 OECD Model provides that the requirement that an agent must "habitually" exercise an authority to conclude contracts means that the presence which an enterprise maintains in a country should be more than merely transitory if the enterprise is to be regarded as maintaining a PE, and thus a taxable presence, in that State. Similarly, paragraph 98 of the 2017 OECD Commentary on Article 5 explains that the presence which an enterprise maintains in a country should be more than merely transitory if the enterprise is to be regarded as maintaining a PE in that State under Article 5(5).

12. A different approach may be appropriate, however, if the employee was habitually concluding contracts on behalf of enterprise in his or her home country before the COVID-19 crisis.

Construction site PE

13. It appears that many activities on construction sites are being temporarily interrupted by the COVID-19 crisis. The duration of such an interruption of activities should however be included in determining the life of a site and therefore will affect the determination whether a construction site constitutes a PE. In general, a construction

site will constitute a PE if it lasts more than 12 months under the OECD Model or more than six months under the UN Model. Paragraph 55 of the Commentary on Article 5(3) of the OECD Model explains that a site should not be regarded as ceasing to exist when work is temporarily discontinued (temporary interruptions should be included in determining the duration of a site). Examples of temporary interruptions given in the Commentary are a shortage of material or labour difficulties.

3. Concerns related to the residence status of a company (place of effective management)

14. The COVID-19 crisis may raise concerns about a potential change in the "place of effective management" of a company as a result of a relocation, or inability to travel, of chief executive officers or other senior executives. The concern is that such a change may have as a consequence a change in company's residence under relevant domestic laws and affect the country where a company is regarded as a resident for tax treaty purposes.

15. It is unlikely that the COVID-19 situation will create any changes to an entity's residence status under a tax treaty. A temporary change in location of the chief executive officers and other senior executives is an extraordinary and temporary situation due to the COVID-19 crisis and such change of location should not trigger a change in residency, especially once the tie breaker rule contained in tax treaties is applied.

16. In this line, for instance, Ireland's Revenue has issued guidance to disregard the presence of an individual in Ireland - and where relevant, in another jurisdiction - for a company in relation to which the individual is a director, if such presence is shown to result from travel restrictions related to COVID-19 (see paragraph 7).

Explanation

17. This potential change of circumstances may trigger an issue of double residency (in cases where the change in the place of effective management results in a company being considered resident in two countries simultaneously under their domestic laws). However, as recognised by the Commentary on the OECD Model, situations of dual residence of companies are relatively rare.[3]

18. But even in situations where there would be double residence of an entity, tax treaties provide tie breaker rules ensuring that the entity is resident in only one of the states. If the treaty contains a provision like the 2017 OECD Model tie-breaker rule, competent authorities deal with the dual residency issue on a case-by-case basis by mutual agreement. This determination will take into consideration all of the facts and circumstances over the determination period. In particular, paragraph 24.1 of the OECD

Commentary on Article 4 illustrates the range of factors that the competent authorities are expected to take into consideration to make their determination, which includes: where the meetings of the company's board of directors or equivalent body are usually held; where the chief executive officer and other senior executives usually carry on their activities; where the senior day-to-day management of the company is carried on; where the person's headquarters are located; etc. It is also possible for competent authorities to agree to more general frameworks for such determinations, for example where particular fact patterns are present, under the authority of Article 25(3).

19. In situations where the treaty contains the pre-2017 OECD Model tie-breaker rule, the place of effective management will be the only criterion used to determine the residence of a dual-resident entity for tax treaty purposes. According to paragraph 24 of the Commentary on Article 4 of the 2014 OECD Model, the place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made. All relevant facts and circumstances must be examined to determine the place of effective management. Paragraph 149 of the Commentary on Article 29 of the 2017 OECD Model explains that the concept of "place of effective management" was interpreted by some States as being ordinarily the place where the most senior person or group of persons (for example a board of directors) made the key management and commercial decisions necessary for the conduct of the company's business.

20. Therefore, all relevant facts and circumstances should be examined to determine the "usual" and "ordinary" place of effective management, and not only those that pertain to an exceptional and temporary period such as the COVID-19 crisis.

4. Concerns related to cross border workers

21. Where a government has stepped in to subsidise the keeping of an employee on a company's payroll during the COVID-19 crisis, the income that the employee receives from the employer should be attributable, based on the OECD Commentary on Article 15, to the place where the employment used to be exercised. In the case of employees that work in one state but commute there from another state where they are resident (cross border worker), this would be the state they used to work in.

Explanation

22. Article 15 (Income from employment) of the OECD Model governs the taxation of employment income, distributing the right to tax between the employee's state of residence and the place where they perform their employment.

23. The starting point for the rule in Article 15 is that "salaries, wages and other similar remuneration" are taxable only in the person's state of residence unless the

"employment is exercised" in the other state. The Commentary on Article 15 explains that this means the place where the employee is "physically present when performing the activities for which the employment income is paid." But there are conditions attached to the place of exercise test. That other state (the source state) may exercise a taxing right only if the employee is there for more than 183 days or the employer is a resident of the source state, or the employer has in the source state a permanent establishment that bears the remuneration.

24. Some stimulus packages adopted or proposed by governments (e.g. wage subsidies to employers) are designed to keep workers on the payroll during the COVID-19 crisis despite restrictions to the exercise of their employment. The payments that employees are receiving in these circumstances most closely resemble termination payments. These are discussed in paragraph 2.6 of the Commentary on Article 15 of the OECD Model, which explains that they should be attributable to the place where the employee would otherwise have worked. In most circumstances, this will be the place the person used to work before the COVID-19 crisis.

25. Where the source country has a taxing right, the residence country must relieve double taxation under Article 23 of the OECD Model, either by exempting the income or by taxing it and giving a credit for the source country tax.

26. A change of place where cross-border workers exercise their employment may also affect the application of the special provisions in some bilateral treaties that deal with the situation of cross-border workers. These provisions apply special treatment to the employment income of cross-border workers and may often contain limits on the number of days that a worker may work outside the jurisdiction he or she regularly works before triggering a change in his or her status.

27. More widely, if the country where employment was formerly exercised should lose its taxing right following the application of Article 15, additional compliance difficulties would arise for employers and employees. Employers may have withholding obligations, which are no longer underpinned by a substantive taxing right. These would therefore have to be suspended or a way found to refund the tax to the employee. The employee would also have a new or enhanced liability in their state of residence, which would entail returning that income. Exceptional circumstances call for an exceptional level of coordination between countries to mitigate the compliance and administrative costs for employees and employers associated with involuntary and temporary change of the place where employment is performed. The OECD is working with countries to mitigate the unplanned tax implications and potential new burdens arising due to effects of the COVID-19 crisis.

5. Concerns related to a change to the residence status of individuals

28. Despite the complexity of the rules, and their application to a wide range of potentially affected individuals, it is unlikely that the COVID-19 situation will affect the treaty residence position.

29. Countries have already issued useful guidance and administrative relief on the impact of COVID-19 on the domestic and tax treaty determination of the residence status of an individual. The UK for example issued guidance on whether days spent in the UK can be disregarded for purposes of determining residency due to exceptional circumstances.[4] Australia has also published guidance[5] stating that where a person that is not an Australian resident for tax purposes is in Australia temporarily for some weeks or months because of COVID-19, she will not become an Australian resident for tax purposes. Ireland's guidance provides for "force majeure" circumstances where an individual is prevented from leaving Ireland on his or her intended day of departure because of extraordinary natural occurrences.[6]

30. Two main situations could be imagined:

1. A person is temporarily away from their home (perhaps on holiday, perhaps to work for a few weeks) and gets stranded in the host country by reason of the COVID-19 crisis and attains domestic law residence there.

2. A person is working in a country (the "current home country") and has acquired residence status there, but they temporarily return to their "previous home country" because of the COVID-19 situation. They may either never have lost their status as resident of their previous home country under its domestic legislation, or they may regain residence status on their return.

31. In the first scenario, it is unlikely that the person would acquire residence status in the country where the person is temporarily because of extraordinary circumstances. There are however rules in domestic legislation deeming a person to be a resident if he or she is present in the country for a certain number of days. But even if the person becomes a resident under such rules, if a tax treaty is applicable, the person would not be a resident of that country for purposes of the tax treaty. Such a temporary dislocation should therefore have no tax implications.

32. In the second scenario, it is again unlikely that the person would regain residence status for being temporarily and exceptionally in the previous home country. But even if the person is or becomes a resident under such rules, if a tax treaty is applicable, the person would not become a resident of that country under the tax treaty due to such temporary dislocation.

Explanation

33. For the purpose of a tax treaty - which governs the allocation of taxing rights over employment income - an individual can be resident in only one country at a time (their "treaty residence"). The rules are set out in Article 4 of the OECD Model. The starting point is domestic law. If the person is resident in only one country, that is the end of the matter. If they are resident in both countries being tested, the tie-breaker rules in Article 4 of the OECD Model are applied. There is a hierarchy of tests, starting with the question in which state does the person have a permanent home available to them.

34. In the first case above, it seems likely that the tie breaker test would mostly award treaty residence to the home country. This is because it is probably unlikely that the person would have a "permanent home" available to them in the host country. But if they did (and an apartment rented for a sufficiently long period would count), and they had rented out their dwelling in their home country, they would be treated as treaty resident of the host state. Where the person had a permanent home in both states, it seems likely that the other tie-breaker tests (centre of vital interests, place of habitual abode, and nationality) would award residence to the home state. No remedial measure is suggested.

35. In the second case, the same treaty rules apply, but their application produces a more uncertain result because the person's attachment to the previous home country is stronger. In cases where the personal and economic relations in the two countries are close but the tie breaker rule was in favour of the current home state, the fact that the person moved to the previous home country during the COVID-19 crisis may risk tipping the balance towards the previous home country. This would usually be decided using the test of "habitual abode". According to paragraph 19 of the OECD Commentary however, the habitual abode of a person is where the individual lived habitually, in the sense of being customarily or usually present; the test will not be satisfied by simply determining in which of the two Contracting States the individual has spent more days during that period. "Habitual abode" refers to the frequency, duration and regularity of stays that are part of the settled routine of an individual's life and are therefore more than transient. Also, the determination of habitual abode must cover a sufficient length of time for it to be possible to ascertain the frequency, duration and regularity of stays that are part of the settled routine of the individual's life.

36. Because the COVID-19 crisis is a period of major changes and an exceptional circumstance, in the short term tax administrations and competent authorities will have to consider a more normal period of time when assessing a person's resident status.

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[1] See: https://www.revenue.ie/en/corporate/communications/covid19/corporation-tax.aspx

[2] Or in the 2017 version of the OECD Model, habitually concludes contracts or habitually plays the principal role leading to their conclusion. But the main point is that it has to be habitual.

[3] Paragraphs 21 and 23 of the Commentary to Article 4 of the 2017 OECD Model.

[4] See https://www.gov.uk/hmrc-internal-manuals/residence-domicile-and-remittance-basis/rdrm13200

[5] See https://www.ato.gov.au/Individuals/Dealing-with-disasters/In-detail/Specific-disasters/COVID-19/?anchor=COVID19frequentlyaskedquestions#COVID19frequentlyaskedquestions

[6] https://www.revenue.ie/en/corporate/communications/covid19/compliance-with-certain-reporting-and-filing-obligations.aspx