OECD updates COVID-19 guidance on displaced persons and tax treaties

January 27, 2021

In brief

The OECD has published *Updated guidance on tax treaties and the impact of the COVID-19 pandemic* that deals with:

- creation and continuation of a permanent establishment (PE), including home office, agency, and construction-site PEs
- change of residence, including by entities and individuals, plus the application of tie-breaker rules to dual residents
- income from employment, i.e. payments under stimulus packages, stranded workers, cross-border (frontier) workers, and teleworking from abroad.

The paper is a Secretariat view on the interpretation of various treaty provisions -- i.e. jurisdictions may adopt a different view and/or outcomes could be affected by different tax regimes (such as state/provincial taxes). It applies in circumstances where public health measures are in effect and extends previous guidance given the longevity of the crisis. Examples of guidance issued by individual tax authorities are set out (such as from Australia, Austria, Canada, Germany, Greece, Ireland, the United Kingdom, and the United States), and tax authorities are encouraged to issue further, consistent guidance.

In detail

Background

In April 2020, the OECD Secretariat issued Guidance on tax treaties and the impact of COVID-19 crisis that analysed specific circumstances involving temporary confinement and containment measures where people were in unexpected locations with a potential impact on various tax issues. As the pandemic has persisted, countries have continued with what the OECD's updated guidance (21 January 2021) refers to as 'public health measures' that continue to affect people's locations.

This revised guidance seeks to reflect the general approach of jurisdictions to date. The OECD analysis covers situations in which factual determinations by tax administrations are required and it states that "the guidance does not purport to replace the judgement of tax administrations in those cases." The guidance broadly outlines the application of existing rules and the OECD Commentary on the Model Tax Convention (MTC) in assessing bilateral tax treaty articles.

Its scope is limited to "circumstances arising during the COVID-19 pandemic when public health measures are in effect." Arguably, this still leaves uncertainty about the causality of the displacement, particularly where some countries' existing practices refer to something like location solely as a result of travel restrictions. The OECD specifically refers to measures covering curtailment of business operations and practical challenges for businesses and for workers. It clarifies that the guidance seeks to address (and avoid) instances of double taxation but cannot be relied on to create instances of double non-taxation.

Permanent establishment

The exceptional and temporary change of the location where employees exercise their employment because of the COVID-19 pandemic (as a result of a public health measure imposed or recommended by at least one of the governments involved), such as working from home, should not create new PEs for the employer. Further comments on home offices refer to the current OECD MTC commentary to Article 5 and note that if working at home continues beyond the cessation of public health measures, further analysis will be needed as to whether this creates a PE (the degree of permanence may not be sufficient).

Similarly, the temporary conclusion of contracts in employees' or agents' homes because of the COVID-19 pandemic should not create PEs for the business. If employees conclude contracts in a home office (or other temporary location not at the disposal of the enterprise) due to public health measures, it is unlikely to be regarded as habitual and rather is an extraordinary event, not an enterprise's requirement. If the employee was habitually concluding contracts in their home jurisdiction before such measures commenced, or continues to do so afterwards, a different approach may be appropriate.

A construction site PE would not generally be regarded as ceasing to exist when work is temporarily interrupted, but jurisdictions may consider 'stopping the clock' while public health measures are in force.

Domestic laws may require the registration of a business, and it may be subject to local taxes, both of which are not covered by the scope of any relevant double tax treaty.

Residence status

The OECD guidance addresses circumstances in which there is a residence issue as a result of a temporary displacement of an individual (or potentially more than one individual in relation to an entity). For residence generally, it refers to a temporary location change as an extraordinary and temporary situation due to the COVID-19 pandemic, but in cases of dual residence it seems to caveat that this is the result of a public health measure imposed or recommended by at least one of the governments involved. However, a different approach may be appropriate if the change in circumstances continues when the COVID-19 restrictions are lifted.

Domestic law is the starting point and if there is a double tax treaty, the OECD guidance suggests that applying the tie-breaker rules should not create an unforeseen tax residence position, although it recommends considering the facts and circumstances of each case.

1. Entities

The OECD guidance suggests that the COVID-19 situation likely would not create any changes to an entity's tax treaty residence status, being regarded as a temporary change in location of board members (or other decision-making executives) as a result of an extraordinary situation due to the COVID-19 pandemic.

The guidance also notes that in the case of dual-resident entities, the treaty residence tie-breaker should not be impacted when individuals who participate in the management and decision-making of an entity cannot travel as a public health measure:

- Where the place of effective management is the criterion (as in those pre-2017 MTC-led treaties that are not affected by agreement between the parties under the Multilateral Instrument (MLI)), in considering all relevant facts and circumstances there should be a focus on the usual and ordinary position.
- Where competent authorities consider a range of factors (as in 2017 MTC, MLI effective treaties or a general framework agreement), criteria such as the entity's HQ, day-to-day management, as well as board meetings, etc. should in many cases provide a suitable norm.

2. Individuals

A displacement because an individual cannot travel due to a public health measure of one of the governments involved should not by itself affect the individual's residence status for tax treaty purposes. The OECD guidance covers two circumstances:

- A person is temporarily away from their home and gets stranded in a holiday or temporary work / other jurisdiction and triggers dual domestic residence in two countries. In this case, the OECD guidance suggests that the treaty tie-breaker tests should lead to residence in their original location - either under the permanent home (as the other home would be temporary), or under the centre of vital interests tests - as any COVID-19 displacement should be discounted as exceptional.
- A person working in a jurisdiction has acquired residence status there, but temporarily returns to a previous home jurisdiction; in this case the individual may never have lost their status as a resident of their previous home location. The OECD notes that the position may be more difficult to reconcile under the tie-breaker tests, but comments that ultimately days spent due to travel restrictions should not result in a change in habitual abode.

Employment income

The right to tax employment income under most treaties is allocated between the employee's jurisdiction of residence and the place where they perform their employment according to specific criteria. If a stranded individual begins to exercise their employment in the host jurisdiction, a treaty may allow that jurisdiction to tax the income if the employer is also resident there (or has a PE there that bears the cost), or the employee passes the day count test (usually 183 days). The OECD guidance considers four specific situations:

- Wage subsidy and similar income received by cross-border workers that cannot perform their work due to restrictions should be treated as attributable to the work jurisdiction.
- A worker stranded in a jurisdiction where they are not resident but previously exercised an employment, who would otherwise have left that jurisdiction, should reasonably be able to exclude days there for the day count test (although the OECD recognises that some countries do not take that approach).
- 'Cross-border workers' may frequently commute for work from their residence jurisdiction to a neighbouring one, with no guidance to follow. The OECD notes that some jurisdictions have agreed on special treaty provisions and adjusted these in light of the pandemic.
- When a worker works remotely from a jurisdiction for an employer who is resident in another jurisdiction, the application of payroll withholding taxes can be complex. The OECD calls for an exceptional level of coordination between jurisdictions in relieving compliance and administration costs, including in relation to mutual agreement procedures (MAP) when disputes arise.

The guidance stresses that an individual who merely follows government recommendations to avoid unnecessary travel may fall outside the rules covering 'public health measures.'

The takeaway

The OECD has sought to provide a degree of certainty for taxpayers in relation to interpreting treaty provisions affected by the displacement of people as a result of public health measures that address the COVID-19 pandemic. The OECD guidance is in respect of Article 5 of the OECD Model and therefore does not cover a 'service PE' under the UN Model, but the reasoning in such cases could be the same as for a construction PE. However, much relies on the decision-making of the two jurisdictions when dealing with a bilateral treaty, although it is stated that the guidance was discussed in Working Party 1 in its Inclusive Framework configuration, which supports its publication.

In some respects, working arrangements post-COVID-19 may never be the same as they were before the pandemic. New ways of working virtually, different value chain arrangements, and the need for different locational presences may also change, leading to adjustments in revenue streams affected by nexus and income allocation rules. The current uncertainties likely are indicative of the many challenges that may lie ahead.

Employers will need to review carefully any employee displacements and work through any compliance obligations, particularly in light of different local tax authority positions. In particular, they will need to consider how COVID-19 driven displacements and changes may in fact now be the ‘new normal.’

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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