

# Lockdown and Tax Treaty Issues

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Measures to prevent the spread of coronavirus have impacted on every aspect of life. While the degree of enforced isolation and immobility varies from country to country, the basic elements remain the same: Most people are compelled to stay at home and to work from there if possible. The speed with which the pandemic has spread has also meant that many people are immobilised in a place that is not of their own choosing. The near halt of cross-border travel of every kind has put an end to some kinds of business and work activity. Other activity takes place at locations that are different from where they would be undertaken in normal times. Activity that would have taken place face-to-face has universally migrated to electronic communications media.

As with all other areas of law, these extreme circumstances place special pressure on the application of tax treaties.

## Fiscal domicile

Involuntary immobility will impact on the residence of individuals and other legal persons. Since the amount of time spent in a country is perhaps the prime residential connecting factor, the likelihood of otherwise mobile individuals exceeding time thresholds imposed by domestic law may mean individuals becoming resident in states where they might not in normal circumstances. Dual residence within article 4(1) of the OECD Model may follow.

The tie-breaker in article 4(2) should resolve such cases. Relatively short periods of presence are unlikely to impact of an individual's centre of vital interests in article 4(2)(a). The habitual abode test in article 4(2)(b) is not satisfied by simply determining in which of the two states the individual has spent more days during that period. The OECD Commentary observes that habitual abode is determined by 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.

Dual residence of others such as companies is likely to be problematical, mostly as a result of the rule introduced by article 4(1) of the MLI and now found in article 4(3) the 2107 OECD Model. Treaties that retain the traditional "place of effective management" tie-breaker, will at least allow companies and other legal persons to consider where essential decisions are made to assess the application of the rule.

Initial guidance released by some countries such as Ireland and the United Kingdom on corporate residence may be indicative of a more tolerant approach where businesses are forced to make changes in response to the Covid-19 pandemic. The Irish Revenue have indicated that they will disregard the actual presence of directors in or outside the state which result from travel restrictions. In the UK, HMRC indicate that occasional UK board meetings or participation in such meetings from the UK does not necessarily result in central management and control in the UK. Such approaches, when applied to the place of effective management may also mean that changes in management caused by the pandemic would not alter the application of the tie-breaker either.

Where the tie-breaker in article 4(3) is modified by the MLI, the competent authorities of the contracting states are required to endeavour to agree on the residence of the entity. Failing agreement, a dual resident entity is not entitled to treaty benefits except as the competent authorities may agree. Management changes resulting from the pandemic make the difficulties with this rule more acute. Hard pressed competent authorities may take more time than usual to deal with such cases resulting in longer periods of uncertainty and dual residence.

Since meetings by telephone or video conference are now the norm, many will consider it unfortunate that the OECD abandoned its 2001 project on 'The impact of the communications revolution on the application of "place of effective management" as a tie-breaker rule'.

## Permanent establishments

The impact of the pandemic on the existence of permanent establishments within article 5 may also be wide ranging. One of the difficult and, largely unanswered, questions around the amount of time needed for a permanent establishment to exist, may be brought into play in conjunction with other issues. The only clear time requirements in article 5 are for construction sites and installation projects in article 5(3) and for service permanent establishments in article 5(3)(b) of the UN Model.

The OECD Commentary considers that periods of temporary interruption (such as bad weather) should be included in determining the life of such sites. On this basis, time periods would continue to run notwithstanding that sites are shut down voluntarily for the protection of workers or compulsorily by law. Would the time threshold be exceeded for an installation project, measured by the term of a contract, result in a permanent establishment if the contract was extended beyond the time threshold as a result of pandemic induced interruptions or if additional work was necessitated by the interruptions?

## Home working

Home working by many people will also raise the controversial question, whether the home of an employee required to work there, is a fixed place of business of an enterprise within article 5(1). OECD Commentary introduced in 2017 is noncommittal on this subject. The Tax Court of Canada ruled in *Knights of Columbus v. The Queen*, 2008 TCC 307 (CanLII), that the home offices of Canadian insurance agents of a US insurer were not at the disposal of the enterprise and therefore did not give rise to a fixed place of business in Canada.

In contrast the Swedish Tax Authority's Statement No. 131 160469-15/111 takes the view that a Swedish resident working from home for a foreign company may create a permanent establishment for the foreign company, even if the employee's home is not at the disposal of the employer, if the work is not sporadic and there are reasons for working from home, such as that the employer does not provide another work place for the employee.

## Fees for technical services

Treaties that adopt provisions similar to article 12A that permits taxation of gross receipts for services in the state of receipt of the service, encourage service providers to establish a permanent establishment in the state where the services are received. This would permit taxation of net profit under article 7. If workers have been repatriated because of the pandemic and provide the services from the state of residence of the enterprise, that will permit gross instead of net taxation of the service provider. This may make service contracts unprofitable where the gross tax equals or exceeds the margin on the contract.

## Employment income

In order to benefit from the exemption in article 15(2), an employee must, among other things, not be present in the source state for 183 days in any 12-month period. In contrast to the requirement for a services permanent establishment in article 5(3)(b) of the UN model, where services must be provided for 183 days in any 12 month period, commencing or ending in the fiscal year concerned, an employee loses the protection of article 15(2) by mere presence in the source state. The effect of this rule may be long lasting because, in effect, the period of presence must be tested for almost a year before and the year after the fiscal year concerned.

The OECD Commentary indicates that presence even for sickness, or death or sickness of a family member is sufficient for this purpose. The OECD Commentary expresses the view that only sickness of the employee that prevents the individual from leaving, if the employee would otherwise qualify may be disregarded. Were that to accurately interpret the provision, few employees stranded by the pandemic would benefit from article 15(2).

## Will you judge me tomorrow?

Pronouncements by both governments and tax administrations to assist in managing the impact of the pandemic indicate an accommodative approach. An assumption may be built into these and other measures, that the pandemic will be of relatively short duration. Many of these issues, however, will be judged in the future. Ultimately, the costs of dealing with the pandemic will be borne by taxpayers. Whether the same approach will apply at that time, when governments are in serious need of revenue remains to be seen.