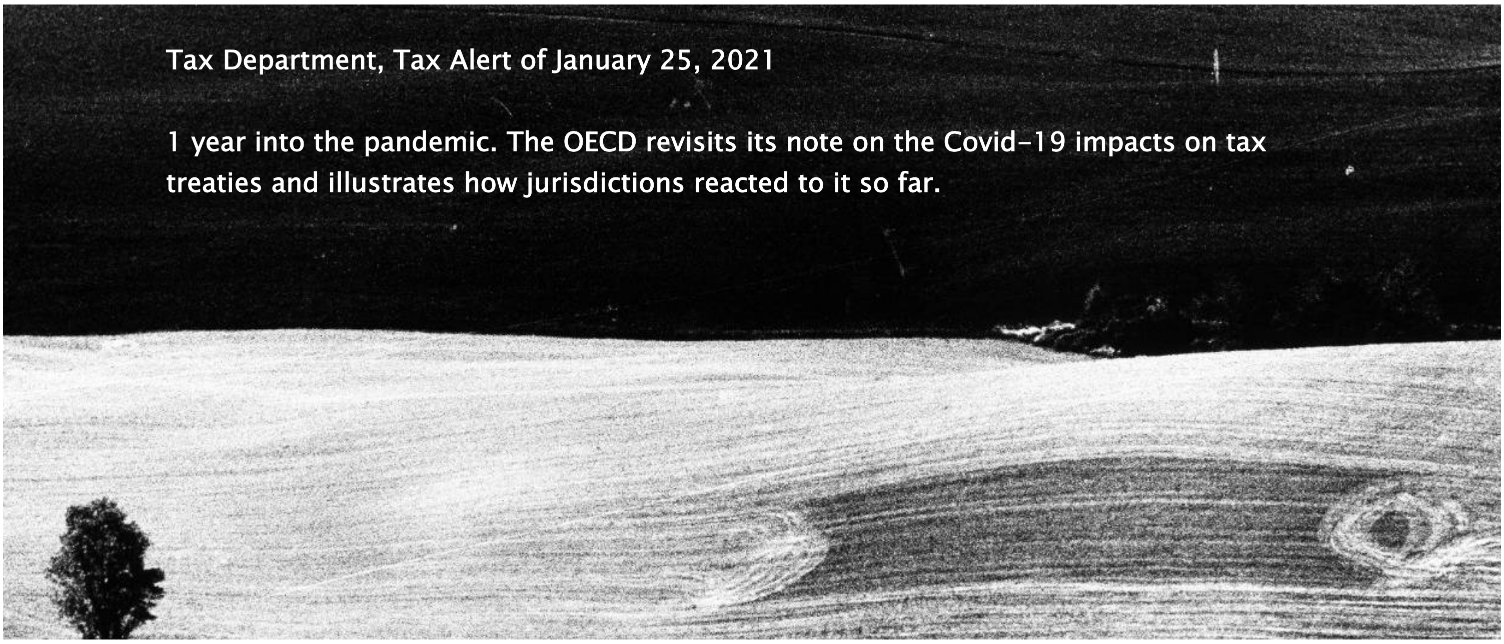
Tax Department, Tax Alert of January 25, 2021

1 year into the pandemic. The OECD revisits its note on the Covid-19 impacts on tax treaties and illustrates how jurisdictions reacted to it so far.



On January 21, 2020, the OECD returned to address the relationship between the COVID-19 pandemic and the international tax treaties by publishing a note (the "**Note**") that updates the previous guidance released under the responsibility of the Secretary General of the OECD, in April 2020[1].

While the previous guidance was meant to be an urgent response to the unprecedented measures that changed (at that time, shut) international mobility, the Note aims at providing taxpayers with further certainty on the interplay between the extraordinary public health measures still in place throughout the world and the provisions of international tax treaties.

The Note illustrates the approaches and reactions that some jurisdictions put in place during the emergency as to tackle the impact of the pandemic on tax situations for individuals and employers, outlining the application of the existing rules and the OECD Commentary to the Model Convention on concerns such as, *inter alia*, (i) the creation of permanent establishments, (ii) the application of "tie-breaker" rule to dual residents of companies and individuals and (iii) the tax treaty treatment of income from employment.

Permanent Establishment exposure

The main concerns when it comes to Permanent Establishment ("**PE**") exposure are related to the possibility that the forced and prolonged presence in a jurisdiction of one or more employees of a non-resident employer can lead to the creation of a PE in the form of a material PE and/or a dependent agency PE. This of course comes with unexpected tax obligations and filing requirements.

---

[1] Chiomenti Tax Department Newsletter on the April OECD note can be found here: https://www.chiomenti.net/approfondimenti/newsalert-tax-stay-safe-stay-home-and-do-not-worry-about-taxes-or-not-

In April, the OECD already expressed the view that the temporary and extraordinary nature of the situation should prevent the tax authorities of a jurisdiction to identify a PE, unless any other Covid-19 unrelated elements shall be evaluated.

Many jurisdictions followed this line of reasoning, as the Note illustrates a variety of measures that were introduced by the different public authorities to grant certainty to taxpayers from a PE standpoint.

Interestingly enough, in some cases the jurisdictions authorities leveraged on the “force majeure” concept to prevent that the forced permanence of foreign employees in the country could configure a PE under article 5 of the OECD Model Convention. In other cases, the authorities chose to outline a number of conditions that, if met, avoid that the force permanence due by the Covid-19 emergency alone would result in the identification of a PE. This is, for instance, the example of Australia.

The Note furtherly reiterated the concept in respect to home office, agency and construction site PE’s stating that:

- Home offices created as a consequence of a public health measure imposed or recommended by at least one of the governments of the jurisdictions involved would not create a fixed place of business PE for the business/employer;

- The activity of agents shall not be considered as “habitual” if they work at home in a jurisdiction due to a public health measure and provided that they do not continue their activities after the public health measures cease to apply;

- Construction sites PE would not be generally regarded as ceasing to exist when work in the site is “temporarily” interrupted, but jurisdictions should take into consideration, also based on actual fact and circumstances, that certain periods where the activities are interrupted should be excluded from the calculation of time thresholds for construction site PE.

Place of effective management of companies

The relocation, or inability to travel, of board members or other senior executives may raise concerns about a potential change in the “place of effective management” of a company. This may entail a change in a company’s residence under the relevant domestic laws and affect the jurisdiction where a company is regarded as a resident for tax treaty purposes.

Indeed, the restrictions imposed by temporary law public health measures during the Covid-19 pandemic may trigger an issue of dual residence where the change in the place of effective management results in a company being considered a resident of two jurisdictions simultaneously under their respective domestic laws. In any case, this issue should be dealt according to the provisions of the applicable tax treaty entered into by the jurisdictions involved.

If the relevant tax treaty provides a 2017 OECD Model Convention tie-breaker rule, competent authorities should deal with the dual residence issue on a case-by-case basis by mutual agreement through an analysis of all of the facts and circumstances over the period under scrutiny (*e.g.*, 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 instead the tax treaty contains the pre-2017 OECD Model Convention 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: 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.

According to the OECD, a temporary change in location of board members or other senior executives due to the Covid-19 emergency is an extraordinary and temporary situation and such change of location should not trigger per se a change in tax residence pursuant to a tax treaty. All relevant facts and circumstances should be examined to determine the "usual" and "ordinary" place of effective management, and not only those that relate to the Covid-19 emergency.

This being said, a company's place of residence under the tie-breaker provision included in a tax treaty is unlikely to be impacted where the individuals participating in the management and decision-making of that company cannot travel as a public health measure imposed or recommended by the government of at least one of the jurisdictions involved.

Residence status of individuals

The OECD was and remains of the view that the ordinary tie-breaker rule provided by Article 4 of the OECD Model Convention shall be already effective in determining the residence status of individuals, also in this emergency situation. Indeed, when speaking of residence status, the OECD is confident that despite the complexity of the rules governing this subject matter, it is unlikely that the COVID-19 situation shall affect the treaty residence position.

The Note addresses two main possible situations:

I. an individual is temporarily stuck in a State different from his home State and acquires the tax residence status of such State pursuant to the relevant domestic law residence there; and

II. an individual acquired residence status in a given State, but temporarily returns to his "previous home State" because of the COVID-19 situation, and regains residence status on his return.

The tie-breaker provision of OECD Model Convention shall help in untangling the knot for both these scenarios.

In the first case, the tie breaker rule should award treaty residence to the home jurisdiction, unless the individual has an available permanent home (even if rented) in the host one. In such case, things get more even though the remaining tie-breaker test (centre of vital interest, place of habitual abode and nationality) should lead the home jurisdiction to prevail.

In the second scenario, the application of the tie-breaker rule would produce a more uncertain result because the person's attachment to the previous home jurisdiction is stronger.

The tax residence status of individuals is undoubtedly one of the hottest topic when it comes to analyzing the impacts of the pandemic, as proven by the different reactions and approached that jurisdictions adopted in this respect.

While certain countries' authorities noted that the Covid-19 pandemic shall not affect the way to determine an individual's tax residence under their respective domestic laws or under tax treaties, other jurisdictions, such as the UK, explicitly noted that although a person may become resident in the UK under the domestic statutory residence test, their residence under a treaty will not change due to a person's temporary dislocation.

The tax residence issue surely has a particular importance in Italy, as acquiring and maintaining the Italian tax residence is the condition that shall be fulfilled to benefit from many different beneficial tax regimes destined to individuals. Lamentably, Italian tax authorities did not provide specific indication to address this field.

Income from employment

The Note also concentrates on the taxation of employment income, governed by article 15 of the OECD Model Convention which generally awards the taxing rights to the employee's jurisdiction of residence, allowing the jurisdiction where the activities are performed to exercise taxing rights only if the employee stays there for more than 183 days in a given tax period or the employer (or its PE bearing the remuneration) is resident thereof.

Three fact patterns are considered in the Note to address tax treaties' related issues connected to income from employment:

- Wage subsidies and similar income received by cross-border workers that cannot perform their work due to restrictions;
- Workers stranded in a jurisdiction where they are not resident but previously exercised an employment;
- Workers working remotely from a jurisdiction for an employer who is resident in another jurisdiction.

The OECD approach towards wage subsidies and similar income adopted in April 2020 remains unchanged in the Note. Coherently with paragraph 2.6. of the Commentary to article 15 of the OECD Model Convention, stimulus packages that government may have adopted or proposed to keep workers on the payroll during the COVID-19 crisis shall resemble termination payments, and accordingly, shall be attributable to the place where the employee would otherwise have worked (most likely, the jurisdiction where he worked prior to the disruption of the COVID-19).

Similarly, the solution to the second issue considered in the Note shall be found in paragraph 5 of the Commentary to article 15 of the OECD Model Convention, whereby it is stated that sick days that prevent the individual from leaving a jurisdiction – provided that the individual would have otherwise qualified for the exemption – shall not be counted towards the days of presence test in Article 15(2)(a) of the OECD Model Convention,

Amongst the jurisdictions that enacted guidance and measures to address this issue cited in the Note, many of them chose to comply with the OECD approach, and accepted that a non-resident shall not be liable on employment income relating to employment exercised in such jurisdiction during a period of unexpected enforced stay due to the COVID-19 pandemic.

Other jurisdictions, such as Finland, went into a different direction and upheld that the pandemic should not affect the way tax authorities interpret tax treaties on income from employment. It shall be said, however, that Finnish domestic force majeure rules is at disposal for taxpayer to prevent distorting effects deriving from a forced and unwanted permanence in the country.

Finally, the remote working/teleworking scenario seems to be the most problematic one. Indeed, the Note addresses cases in which a change in the place where the employment is exercised gives rise to a change in the allocation taxing rights under the treaty rules. These situation is unanswered by the tax treaty provision, and the OECD confirms that addressing the change will result in compliance and administrative costs for both the employer (that could lose its taxing rights) and the employee (for whom new taxing obligations could arise in the new jurisdiction.

***

The OECD renewed effort to provide further clarifications in such an unpredictable and uncertain time is appreciable. Credit should also be given to the Note as it illustrates in a comprehensive manner how many jurisdictions reacted the possible conflicts between the pandemic and the application of the international tax treaties' provisions.

Some of them relied on domestic provisions such as the force majeure rules to prevent harmful consequences for taxpayers. Some other enforced guidance and agreements in compliance with the previous indication provided at OECD level in April 2020 to reach the same goal.

So far, Italy continues to rely on the solidity of the provisions of the tax treaties and did not feel the need to address the concerns with specific guidance or law provisions.

The only official intervention was put forward by the Italian Ministry of Economy and Finance that on December 3, 2020, addressing a parliamentary inquiry, generically expressed its favorable opinion towards the approach of the OECD.

As the end of the emergency seems still a long way away, doubts persist that this can be enough to counter undesirable effects for taxpayers dealing with tax treaties' provisions with Italy.

For any further clarification please do not hesitate to contact Chiomenti's Tax Department at tax@chiomenti.net

Contacts:

tax@chiomenti.net