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Implications of the COVID-19 crisis in applying provisions of Double Taxation Conventions

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Analysis from the OECD on the impact of the COVID-19 crisis in applying Double Taxation Conventions, specifically, those concerning permanent establishment, tax residence, and the situation of cross-border employees.

The Secretariat of the Organisation for Economic Co-operation and Development (OECD) has prepared a document, which was published on 3 April, in which it carried out an analysis of the impact of the COVID-19 crisis when applying the provisions of Double Taxation Conventions concerning permanent establishment, tax residence, and cross-border employees and makes recommendations on the application or interpretation of said provisions by States, in circumstances affected by the crisis.

In the document, the OECD cites examples of positions adopted in some States such as the United Kingdom, Ireland and Australia. However, in Spain, thus far, the tax administration has not made any rulings on the matter.

The main recommendations of the document, which could be taken into consideration in the analysis of situations covered by double taxation conventions, are as follow:

1. In relation to the possible existence of permanent establishment in a State (Article 5 of the OECD Model Tax Convention), the following situations may arise, caused by the COVID-19 crisis, in which the following recommendations should be followed:

a) The fact that certain employees are required to remain at the residences, located in some instances in States other than those in which they habitually perform their work, may imply the existence of a permanent material establishment in the States of their residence. This would imply the obligation to comply with the complex formal and administrative obligations in the State in which the employees perform their work from their residence.

In these cases. the OECD considers that performing economic activities for a company from the residence of an employee intermittently and exceptionally, as a result of an extraordinary event as is COVID-19, does not imply that said residence is available for the company. Thus, for an office established in a residence to constitute the permanent establishment of a business, it must be a habitual and continuous situation, in that the business requires the use of the means available at said office in general and not exceptionally. In this regard, the fact that as a result of the COVID-19 crisis, individuals are required to remain at their homes, using the means available thereat to work, it is a result of the governmental provisions and, thus, of an event of force majeure and not the result of a requirement of the company.

The OECD mentions Ireland's case, where tax authorities have issued guidelines which do not take into account, for corporate income tax purposes, the presence of any employee thereof in Ireland or in other States, as a result of the restrictions adopted in the context of the COVID-19 crisis. Thus, companies must keep evidence of such a circumstance for the public authorities.

b) The same telework circumstance can result in a permanent establishment of a company in another State, if employees enter into agreements on behalf of the company, and thus, act as a dependent agent.

Similarly, the OECD concludes that in these cases, the existence of a permanent establishment of a State requires these types of functions be performed permanently and habitually and not sporadically, exceptionally or temporarily.

c) For cases of permanent establishment arising from construction works whose duration exceeds 12 months, the OECD warns that a temporary interruption of

this type of work as a result of the COVID-19 crisis must not be considered for the purposes of calculating such a period, as established by Paragraph 55 of the Commentary on Article 5(3) of the Model Convention of the OECD.

2. In reference to determining tax residence in a Contracting State (Article 4 of the Model Convention of the OECD), the OECD makes the following recommendations:

a) With regard to tax residence of companies, the COVID-19 crisis may result in modifications with regard to the Contracting State in which the effective management is performed, is if the directors and/or members of the governing body cannot travel to the State in which said management is habitually performed. This implies, on occasion, that in accordance with the internal regulations of a State, companies may be considered tax residents thereof.

Regarding these situations, the OECD considers, provided that the provisions of a Double Taxation Convention are applicable, that a modification of the tax residence status of a company must not occur. In this regard, the OECD recommends that the circumstances are analysed from a perspective that habitualness and generality are required, in a way that only if the effective management of the company is performed usually and ordinarily in a Contracting State, vs. extraordinarily and exceptionally, may it be concluded that said company is a tax resident in said State in accordance with the applicable Convention.

Again, the OECD mentions Ireland, where the tax authorities have issued instructions to not consider a director or member of a governing body of a company, in Ireland or in another Contracting State, if it is the result of restrictions arising from the COVID-19 crisis.

b) For individuals, the OECD notes that two situations may occur, with the following recommendations for each one:

- A person may temporarily remain in a State different than where they have their fixed habitual residence owed to the fact that, having travelled there for employment reasons or holiday, they cannot return due to the COVID-19 crisis. In these circumstances, although in accordance with internal legislation of some States, this person could be considered a tax resident thereof, applying a criteria of permanence during a certain period, applying the provisions of a Double Taxation Convention would prevent such a consideration. This is because, also, in accordance with the rules on maintaining a residence or centre of vital interests, the Conventions contain a criteria of habitualness, which is contrary to remaining in a State for exceptional reasons.

- A person may have acquired the tax residence in a State as a result of travel thereto to perform work and, however, have been required to remain in their State of prior residence due to the COVID-19 crisis. In these cases, also for exceptional reasons, it is unlikely that the person may be considered a tax resident in the State where they were resident prior to travelling, with a Double Taxation Convention applying.

The OECD expressly mentions the cases of the United Kingdom, Australia and Ireland, where express instructions have been issued to not consider these exceptional circumstances to determine tax residence of individuals in these States.

3. Finally, in relation to cross-border employees, the OECD makes a distinction between the following relevant matters:

a) In some States, stimulus measures have been adopted granting certain subsidies to employers to keep their employees on the payroll during the COVID-19 crisis. Under these circumstances, the OECD believes that the amounts employees will receive would be similar to termination payments. In accordance with paragraph 2.6 of the Commentary on Article 15 of the Model Convention, such amounts would be considered to have been obtained in the State where the employees performed their work prior to the COVID-19 crisis, although as a result, they would have been obliged to remain in their residence, located in another Contracting State.

b) In the cases in which the Double Taxation Convention contains special provisions applicable to cross-border employees, the OECD warns that the COVID-19 crisis could have an impact, as said provisions often contain limits relating to the number of days that the employee may work outside the State in which they regularly work before triggering a change in the taxation of their earnings.

c) Finally, the OECD highlights that, in accordance with Article 15 of the Model Convention, the income that the employee receives from the employer may only be subject to taxation in the State of residence of the employee, even if the employment is performed in the other Contracting State, if the employee has remained in the Contracting State less than 183 days in the calendar year and the employer does not have a permanent establishment therein nor is the remuneration borne by an entity established there. Thus, it could be the case that an employee that had planned to remain in a State other than that of his or her residence more than 183 days per calendar year to perform his or her employment in such a State, due to COVID-19 does not fulfil such a period. This could result in situations in which the employee would have borne withholdings in the State where the employment was performed which, in the end, not

having fulfilled the conditions in the Double Taxation Convention, they should not have borne.

In the OECD's opinion, situations like this call for a special level of coordination between Contracting States to prevent and mitigate effects of excessive formalities necessary to re-establish the situation of taxpayers.