Covid-19 and the international double tax conventions

TAX:WATCH NO. 4
24-04-2020

CONTENT

The OECD has issued a guiding statement on the ways in which the double tax conventions are influenced by the fact that employees and managers of companies are working from home and perhaps even perform their jobs in another country than usual.

By Finn Madsen, fnm@bdo.dk and Arne Riis, ari@bdo.dk

In the statement, the OECD relates to several questions including the following:

- Will a new permanent establishment in another country arise, because the employees of the company are stranded there and performing their job – including if they are entering into binding agreements from, for instance, their home in the other country (Article 5 regarding permanent establishment)?

- Will the company become liable to tax in another country pursuant to the provisions on the place of effective management, because the management is in another country and controls the company from there (Article 4)?

- Are employees now liable to tax in their country of residence, because of being stranded there, working from home - if they reside in one country and work in another under normal circumstances, for instance through daily commutes between Denmark and Sweden or Germany (Article 15)?

- Will it have any consequence for the determination of the country in which an individual is resident for tax purposes if the individual temporarily resided in another country (Article 4)?

The statement only takes a stand regarding the principles covered by the double tax conventions. The Danish tax authorities have not yet made any statements regarding these matters.

Further, the Danish tax authorities have not yet issued guidelines as to whether involuntary presence in Denmark due to the government's recall of Danes will count relating to the 42-day regulation of the Danish Tax Assessment Act, Section 33A. Nor have they yet issued guidance regarding the question, whether the involuntary presence in Denmark will count relating to the 180-day regulation and the 3-month regulation in the case of a decision concerning tax residence.

Permanent establishment (Article 5)

It is the general assessment of the OECD that the limitation of the mobility of employees, a consequence of the measures against Covid-19 taken by individual countries, should not be leading to the emergence of a permanent establishment in the country in which the employee is forced to reside temporarily. This applies, irrespectively whether it is a home office or a

dependent agent, who enters into agreements from the other country on behalf of the client. The assessment of the OECD is based on an interpretation of the comments already applicable to Article 5.

With regards to contract work, the OECD concludes that the duration of a temporary break in the work because of Covid-19, will be included in the determination of how long the period of the contract work has extended in reference to the 12-month period, following the OECD Model Convention.

Moreover, the OECD recommends for the countries to issue a guidance regarding the understanding of national provisions, which potentially deviate from the double tax conventions. The purpose is to limit administrative burdens imposed on the taxpayers involved.

The guidance from the OECD does not seem to state a direct answer to, what the consequences might be to the size of the income, which can be attributed to an already existing permanent establishment in a country (pursuant to Article 7) if, as a result of the Covid-19 measures, increasing or decreasing business activities are taking place in the relevant country as a consequence of more or fewer employees working in the country at the time compared to normal circumstances.

Place of effective management (Article 4)

In case two countries disagree on which country is entitled to tax a company's income, usually the determining factor for the right of taxation is the location of the actual management of the company.

In case the management of a company – following the restrictions against Covid-19 – is temporarily unable to manage the company from the country from which the company is managed under normal circumstances, the following question can arise: Should the company be seen as having moved to the country from which the management actually takes place while the restrictions are still in force? This can have significant tax implications for the company - especially with regard to exit taxation in the country where the company is seen as having relocated from and concerning the future right to tax the company in the country where the company is now managed.

According to the perception of the OECD, such a temporarily changed management situation - as a potential consequence of the Covid-19 restrictions - should not be considered as relocating the place of effective management of a company in the context of a double tax convention.

This applies regardless of whether the provision on the place of effective management (Article 4) is made in accordance with the OECD Model Convention before or after the 2017-amendment. It is true for both cases that where both countries (the temporary as well as the permanent country of management) claim to be entitled to tax the company, the attention must be drawn to the country from where the company would be managed under normal circumstances. This assessment will usually lead to a conclusion that the country from where the company was managed before the Covid-19 restrictions is deemed the country of residence of the company, even while the Covid-19 restrictions take place.

Mobile Employees (Commuters) (Article 15)

The right of taxation according to Article 15 depends on the location at which work is carried out, on whether it is related to an economic employer in the country of work, and on the number of days in which the employee is present in the country of work.

In particular, this is applicable for commuters crossing Øresund and those commuting between Denmark and Germany.

The OECD states that to the extent the work is completed in the home country, and the presence there is involuntary and a consequence of the measures and restrictions performed by the countries following Covid-19, the taxation of the salary should still take place in the country, where the work would normally be carried out before the Covid-19 crisis.

According to the statement from the OECD, this applies to salary when the employee continues working for the company from home as well as to cases in which the employee does not work but has merely returned to the home country still receiving salary.

In its statement, the OECD encourages the countries to mitigate the consequences in cases where the employer would become liable to withhold or report income according to a general interpretation of the provisions of the country.

Further, please refer to the previous section regarding permanent establishment.

Tax residence of individuals (Article 4)

Determination of an individual's tax residence or of the place to which the individual is the most closely connected, personally as well as financially, is an exercise of utmost complexity. This exercise must be performed in all situations involving tax residence in two countries.

According to the OECD, some countries have already stated that presence in a country different from the one in which a person would stay under normal circumstances – due to Covid-19 – will be deemed as extraordinary, exceptional and similar to force majeure. On this background, the involuntary presence should be disregarded when determining in which country the individual is resident for tax purpose.

In particular, this will be applicable in the following two scenarios:

1. An individual resides temporarily in a different country than the normal country of residence - due to vacation or work - and ends up getting stranded.

2. An individual normally resides and works in one country but due to Covid-19, the individual returns to his actual home country and stays there.

The OECD states that in both scenarios, the tax residence of the individual should not be affected by the temporary Covid-19 inflicted presence in the other country.