Where do I lay my hat?

Ben Jones and Kunal Nathwani consider tax residence and permanent establishments in the time of Covid-19.

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The current Covid-19 crisis is bringing to the fore various novel international tax issues that have not previously needed to be considered either by taxpayers or tax authorities. Rightly, the focus of governments and businesses has been on health, safety and, from a pure tax perspective, fiscal stimulus and cash flow measures. However, as businesses and tax authorities come through the initial reactive stage, consideration will need to be given to some of the wider implications of the global containment measures.

A key issue will be the impact of such measures on:

- corporate tax residence;
- the existence of taxable permanent establishments; and
- individual tax residence.

These issues are dependent on where individuals are physically located and what they do in those locations. Further, these matters are often carefully managed by global businesses and closely scrutinised by tax authorities. Current Covid-19 measures implemented globally are having a dramatic and unforeseen impact on travel and individual movement, raising valid concerns about the knock-on tax implications in these areas.

Typical fact patterns

There are three typical fact patterns that Covid-19 measures have driven over the past few weeks and months.

- *Fact pattern one*. Individuals living in one country and typically resident in that country have voluntarily – albeit perhaps based on government recommendation – temporarily moved to another country, for example where their family resides, for the crisis period and are working remotely.
- *Fact pattern two*. Individuals who are not normally resident in a particular jurisdiction are forced to remain in and work remotely from that jurisdiction due to containment measures, for example because borders have been closed or air travel has been suspended.
- *Fact pattern three*. Individuals are restricted to their usual country of residence – due to lockdowns – and are unable to travel for work, for example to attend board meetings.

Key points

- Typical fact patterns that Covid-19 measures have driven.
- Implications of containment measures for corporate tax residence.
- Tax authorities' guidance on a company's central control and management.
- Existence of permanent establishments and allocation of profits.
- Individuals may become inadvertently resident in another country.
- Payroll matters should also be monitored.

Corporate residence implications

Companies should consider whether their corporate residence is affected as a consequence of any of the above fact patterns.

Many countries apply residency tests based on where a company is managed, in addition to and distinct from a residency test based on where a company is incorporated. Many global business will for various reasons have corporate entities that are incorporated in one jurisdiction but are managed – and therefore tax resident – in another jurisdiction. This issue is usually carefully managed.

Management and control

As an example, the UK operates a central management and control test for corporate residence. So, although a company may be incorporated outside the UK, it could still be considered UK tax resident, and therefore subject to UK tax on worldwide profits, if it is controlled and managed in the UK.

This is a factual test – but factors typically considered by HMRC in determining where central management and control is exercised are:

- who exercises management and control of the company; and
- where this is exercised.

Often, although not always, central management and control is exercised by the company's board of directors.

As noted, it is common for there to be non-UK incorporated companies that are UK tax resident by reason of being managed and controlled in the UK under the test above, usually through holding board meetings in the UK. It is equally common in these situations for some or most of the board members to be resident in jurisdictions other than the UK, but who travel to the UK for these board meetings to maintain UK-based management and control.

However, Covid-19 containment measures are likely to have an impact on such arrangements since non-UK based directors are unlikely to be able to travel to the UK for such board meetings. Depending on how long the situation continues and the management activities for affected companies over the relevant period, there is the potential for such companies to cease to be UK tax resident during the containment period. Much will depend on specific circumstances.

This issue can also play out in reverse. Taking the UK as an example again, it is equally common for foreign incorporated companies with UK board members to ensure that management and control of such companies do not take place in the UK, so the company cannot be treated as UK tax resident. This is often achieved by ensuring UK-based directors travel to the country of intended tax residence to hold board meetings. Such travel is not likely to be possible in the containment period, giving rise to an increased risk that such foreign companies could be treated as UK tax resident.

Different residence tests and dual residence

It is worth noting that countries operate different tests for residence. For example, some countries in continental Europe, such as France and Spain, operate a place of effective management test, which is slightly different from the UK's central management and control test. Companies should seek proper advice to ensure that such risks are limited and managed based on the specific local residency tests. It may also be possible to apply to revenue authorities for guidance or clearance.

Not only can a change in residence have an impact on the corporate and income taxation of the company but this could result in other unexpected tax consequences, for example taxing rights in relation to director's fees discussed subsequently. Changing residence of a company may also have specific domestic tax consequences, for example exit charges, which could be significant.

For the reasons above, it is possible that multiple jurisdictions may lay claim to the tax residence of the same company. In such cases, assuming the presence of a double tax treaty (DTT) between the countries, it should provide a tie-breaker clause. Under treaties that have not been modified by the Organisation for Economic Co-operation and Development (OECD) multilateral instrument (MLI) – for example, the current UK-Germany DTT – the tie-breaker may be based on the place of effective management. That is, the country in which the company's place of effective management is exercised will have taxing rights. However, for some treaties amended by the MLI, taxing rights will be determined by mutual agreement procedure (MAP). The movement in the modern international tax system through the MLI to determining these issues through MAP creates further uncertainty on the issue, as the outcome will depend upon the approach of the relevant tax authorities.

The OECD secretariat recently released its analysis of DTTs and the impact of the Covid-19 crisis. On the residence tie-breaker test, its view was that it was unlikely that a company's residence status under a DTT would change due to Covid-19. The place of effective management is ordinarily where the most senior person or group of persons made the key management and commercial decisions necessary for the conduct of the company's business. Under MAP, it suggests that various factors ought to be considered including where board meetings are usually held and where chief executive officers usually carry on their activities. This is helpful guidance. However, it should be noted that this is the secretariat's interpretation of the application of DTTs – in practice the tax treatment will depend on the views that domestic tax authorities adopt and it is possible that these may be different.

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Tax authority guidance

Helpfully, tax authorities have started to recognise this problem. For example, the Australian Taxation Office (ATO) has issued guidance suggesting that it will not apply its compliance resources to determine whether a company's central control and management is in Australia 'if the only reason for holding board meetings in Australia or directors attending board meetings from Australia is because of Covid-19'.

The guidance further provides that companies would not be deemed to be Australian resident if they hold board meetings in Australia or the directors attend board meetings from Australia where there are:

- overseas travel bans or restrictions; or
- the board has made the decision to halt international travel because of the uncertainties around international travel due to COVID-19.

This is welcome but it still leaves some persons in fact pattern 1 potentially unclear on their position in the absence of any explicit company policy, since theirs would have been a conscious and voluntary decision to return to Australia.

Irish guidance provides that where a company's employee, director, service provider or agent is present in Ireland and the presence results from travel restrictions related to Covid-19, the Irish Revenue will disregard such presence for the company's corporation tax purposes.

The guidance adds that where, but for the Covid-19 travel restrictions, a company's employee, director, service provider or agent would have been present in Ireland, the Irish tax authorities would be prepared to disregard such presence outside Ireland for corporation tax purposes. This helpfully covers fact patterns 2 and 3. However, it does not cover fact pattern 1, therefore creating a similar lacuna to the ATO guidance, leaving persons under that fact pattern unclear about their tax consequences.

Similarly, Jersey has issued guidance which provides comfort that temporary changes to a Jersey resident company's control and management would not affect the company's corporate residence from a Jersey perspective. It further provides comfort in relation to the Jersey substance requirements. Guernsey has issued similar guidance.

> "It is important that individuals and businesses maintain a full record of relevant facts and circumstances."

HMRC has released some clarification on its approach to Covid-19. This does not provide any clear concessions, but instead refers taxpayers to HMRC's current guidance. Although the guidance does provide that a company will not necessarily become resident in the UK because a few board meetings are held there or because some decisions are taken in the UK over a short period, the guidance is caveated in that it provides that the actual determination of residence will be fact specific. It states that 'each case turns on its own facts and circumstances which makes it difficult for HMRC to provide definitive guidance as to where [central management and control] may abide in cases where businesses are forced to make changes in response to the Covid-19 pandemic'. This seems to bolster the argument that revenue authorities may distinguish between the fact patterns above.

It is likely that other tax authorities will issue guidance on this issue in due course. The detail of this guidance will be key since, as noted above, it may not cover all the different fact patterns arising from the Covid-19 measures.

Importance of contemporary evidence

It is important that individuals and businesses maintain a full record of relevant facts and circumstances to provide proper evidence and records to demonstrate that such changes were aberrations brought about due to Covid-19 and that, after resumption of business as normal, the original arrangements were also resumed. The evidence to be maintained in each jurisdiction may vary depending on domestic revenue authority guidance or practice.

In practice, it is unlikely that revenue authorities will target one-off transgressions. However, different jurisdictions may have different rules, practices and requirements, so these should be confirmed.

Permanent establishment implications

If a business is determined to have a permanent establishment in another country, then part of its profits would be attributable to that country and the business would be subject to tax in that country on such attributed profit.

In the context of Covid-19, a fixed place of business permanent establishment is the most relevant – where a non-resident enterprise carries on its business wholly or partly in a country through a fixed place of business in that country.

For employees who are working outside the country they usually would due to Covid-19, there is the possibility that an argument may be made by the tax authorities of the country where the employee works during Covid-19 that there is a fixed place of business in such country. However, for there to be a permanent establishment the business would need to have the relevant foreign premises at its disposal. Determining whether a business has a foreign premises at its disposal has long been a complicated issue and will be fact specific.

Working from home should not *per se* put this premises at an enterprise's disposal, and the commentary on the OECD model tax convention notes that in most situations working from home is likely to be ancillary and unlikely to create a permanent establishment. However, the current situation is distinguishable from the example the OECD is considering, in particular in countries such as the UK, India and Italy, on the following basis:

- employees of entire businesses have been instructed to work from home;
- enterprises are not, and cannot, provide their employees with an office to work at; and
- it is unclear for how long this *status quo* will last.

These points, in particular the uncertainty in relation to the time frame, throw some doubt on whether working from home arrangements can be viewed as purely incidental or ancillary. As the OECD commentary notes, this will depend on the facts, and different countries may adopt different approaches. Further, there may be a different analysis depending on the phase of containment.

The OECD secretariat opines that in the current climate, individuals who stay at home to work remotely are typically doing so as a result of government directives, citing it as a force majeure and not an enterprise's requirement. It considers that generally these arrangements would lack the permanence and would not be at the disposal of the business, further noting that under normal circumstances such businesses would typically provide their employees an office to work from. But they do caveat that this is assuming it does not 'become the new norm over time' – which creates an element of subjectivity to this opinion. Again, this opinion is helpful, but domestic approaches will be important.

Dependent agent permanent establishments may also be a point that businesses need to consider further. However, this will depend on the business structure and the exact circumstances. Analysis of dependent agent permanent establishments is beyond the scope of this article.

Businesses should take these points into consideration, especially if it becomes clearer over the next few weeks that social distancing and working from home will not be a short-term measure.

Tax authority guidance

Again, the ATO has taken the initiative on this issue. It has released guidance stating that when a company did not

have an Australian permanent establishment before the impact of Covid-19, there are no changes in the company's circumstances and the unplanned presence of employees in Australia is a 'short-term' result of being temporarily relocated or restricted in their travel, it will not itself result in the company having a permanent establishment. However, emphasis should be laid on 'short-term', and there is no guidance on how this is to be interpreted.

The HMRC clarification also leaves uncertainty since it refers taxpayers to existing guidance and cites that there will be no fixed place of business 'after a short period of time' – the ambiguity surrounding this is similar to the ATO guidance.

Individual residence implications

Individuals, particularly those in fact pattern 1 and fact pattern 2, may find their individual tax residence affected as well. If they inadvertently become tax resident in another country, this could subject them individually to tax in these countries.

Individual residence tests often use a threshold number of days that an individual needs to spend in a country to become tax resident or a threshold number of days that an individual can spend in a country without becoming tax resident – subject to other conditions which will be jurisdiction-specific. Individuals under fact pattern 1 and fact pattern 2 may find themselves unavoidably breaching such thresholds. For globally mobile persons, individual residence is often carefully managed to prevent the risk of double taxation and tax complexity. However, the restrictions on mobility due to Covid-19 are likely to affect this.

Tax authority guidance

The UK has been one of the first tax authorities to issue guidance in this area. By way of background, the UK operates a statutory residence test (SRT). The detailed provisions of the test is beyond the scope of this article, but it is important to note that various tests employ threshold days as previously noted. In determining these days, HMRC states that an individual's UK day count may be reduced to take into account days spent in the UK due to exceptional circumstances.

It has released specific Covid-19 guidance providing that it would consider the circumstances exceptional if an individual is:

- quarantined or advised by a health professional or public health guidance to self-isolate in the UK as a result of Covid-19;
- advised by official government advice not to travel from the UK as a result of Covid-19;
- unable to leave the UK as a result of the closure of international borders; or
- asked by an employer to return to the UK temporarily as a result of Covid-19.

This guidance, however, does not entirely provide clarity to non-resident individuals in fact pattern 1 who voluntarily return to the UK – at different stages of the Covid-19 period – to work from home and spend this period with family. It also leaves unclear the position of persons restricted from travelling to the UK and therefore who may not satisfy the test in the SRT despite intentions.

A similar conclusion can be drawn in relation to the Irish guidance published. Broadly, the rule in relation to Irish individual residence is that when an individual is prevented from leaving Ireland on an intended day of departure either due to extraordinary natural occurrences or an exceptional third party failure of action which could not have been foreseen or avoided, the individual is not regarded as being present in Ireland for tax purposes for the day after the intended day of departure, as long as the individual is unavoidably present in Ireland on that day due only to a force majeure.

The Irish guidance provides that when an individual's departure from Ireland is prevented due to Covid-19, the Irish tax authorities will consider this 'force majeure' for the purpose of establishing an individual's residence position. Subject to individual circumstances, this is likely to cover some individuals in fact pattern 2. However it does not provide comfort to those in fact pattern 1 who voluntarily return to work from home in Ireland, and it is possible that this may not be considered force majeure.

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In general, it is unclear how other countries will respond to this and whether they will take a lenient approach. However as HMRC cautions, this will depend on the facts and circumstances.

Other non-tax impacts

It is also worth noting that individual residence – whether or not explicitly referred to – can have a wider impact. For example, Indian corporate legislation provides that every company needs at least one director who has stayed in India for a period of not less than 182 days in the previous calendar year – in effect a residence test. Recent announcements by the Indian finance minister have relaxed this requirement post-Covid-19, providing that where the director of a company is unable to comply with this residency requirement this will not be treated as a violation.

The main takeaway from this is that there are likely to be non-tax requirements in relation to, for example, companies and funds, that have certain similar residence requirements. Businesses should review these to ensure they are still compliant.

Importantly, preserving evidence will be imperative.

Payroll taxes and social security contributions

Employees should also be careful to monitor that they are not subject to tax on their employment income due to the terms of DTTs. This is more easily explained with an example. A typical non-mobile UK employee who exercises their employment entirely in the UK will be subject to income tax only in relation to their employment income, for example salary, in the UK, that is the employee's country of residence.

Even if the employee exercises some of their employment in another country – assuming the DTT between the UK and this other country is based on the OECD's model tax convention – the UK-resident should only be subject to tax in the UK if:

- the employee is present in the other country for an aggregate of less than 183 days in any 12-month period beginning or ending in the fiscal period concerned;
- the remuneration is paid by, or on behalf of an employer who is not a resident of this other country; and
- the remuneration is not borne by a permanent establishment which the employer has in the other country.

In other circumstances, the employee could be subject to tax in this other country.

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In most situations in fact patterns 1,2 and 3 an employee should be taxed only in their country of residence – the UK in the above example. However, a complication could arise, especially in fact pattern 1 and 2, if an employee has already spent a significant amount of time in this other country before Covid-19 since the 183 period is an aggregate of days spent over a 12-month period. It is important to note that this does not need to be consecutive days. Employees and business payroll functions should be careful to monitor this risk.

For clarity, even in this scenario the change in individual residence is a risk because if the individual employee's residence changes as a consequence of this period, the above analysis would be reversed.

With regard to directors' fees, the provisions are more straightforward. The provision in the OECD model tax convention says that a director of a foreign-resident company may be taxed in that country on fees received in their capacity as a member of the board, even if the director is not tax resident there.

Although there is no time threshold, changes in individual residence – due to a change in the applicable DTT – and corporate residence (as discussed above) could have a potential impact so should be monitored. It should also be noted that sometimes payments to persons may be part employment income and part in lieu of director's fees, so both the above rules could be in issue.

In relation to payroll taxes it is important to note that different DTTs may have different provisions and these will need to be specifically considered. It is also possible that countries will publish clarifying guidance over time.

Planning point

Keeping accurate records will be key in deciding the residence of a company and its employees.

Further, countries may have special domestic rules for taxing employment income which may also need to be considered. For example, Ireland has special rules in relation to e-working and it has provided guidance on this post-Covid-19.

Businesses should also check whether there is an impact on social security payments or contributions.

Tax authority guidance

Payroll is an area where tax authority guidance is also expected. For example, Ireland has released guidance providing that in 'genuine cases' where an employee was working abroad for a foreign entity before Covid-19 but relocates 'temporarily' to Ireland during the 'Covid-19 period' and performs duties for their foreign employer within the state, Ireland will not seek to enforce payroll obligations for foreign employers. This guidance is helpful and is likely to provide comfort to employers and employees in an array of circumstances. However, it is not without its ambiguity in that key phrases such as 'genuine cases', 'temporarily' and 'Covid-19 period' are undefined. These terms are likely to require defining at some later stage and it will be interesting to see the line drawn by Ireland in this regard.

Conclusion

Given the unprecedented circumstances that we are faced with, it is hoped that governments and revenue authorities will release more guidance on residence issues to provide taxpayers with more clarity and adopt a sympathetic approach. And given the global nature of Covid-19, this would be an area where it would be beneficial for the OECD to co-ordinate a global response, since it has already made other tax recommendations in light of the virus.

However, with the permutations of factual circumstances that exist, revenue authorities may seek to distinguish between taxpayers' facts and circumstances.

So where do I lay my hat? Anywhere safe and indoors for the moment. Ultimately the tax can be worked out later, but keeping good evidence will help. ●

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