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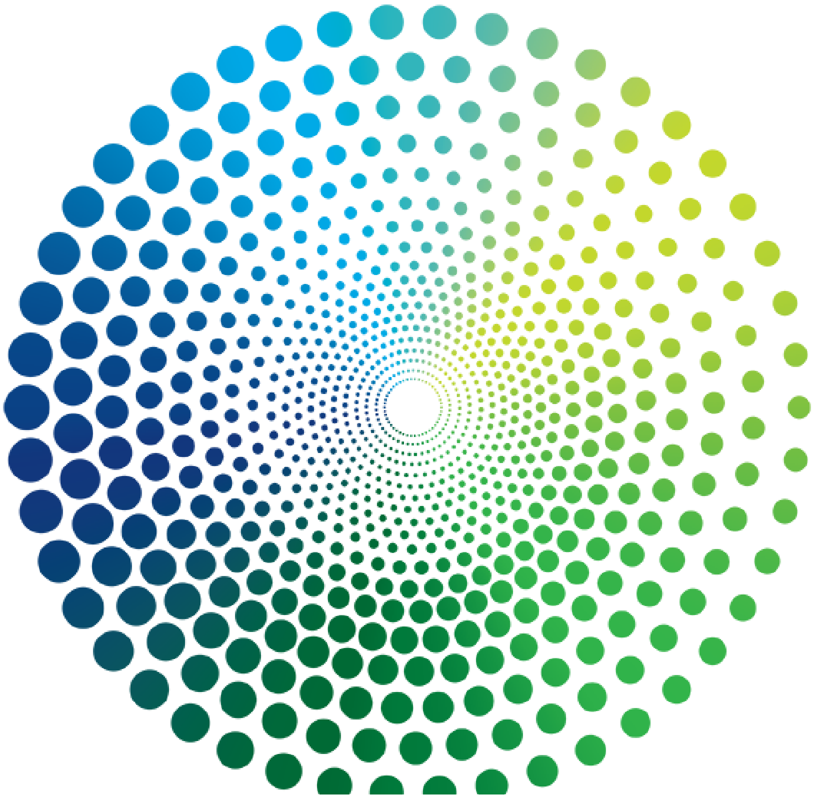

Tax Insights

COVID-19: Updated ATO and OECD guidance on international tax matters

Snapshot

On 3 February 2021, the Australian Taxation Office (ATO) updated its guidance on COVID-19 and Permanent Establishments (PE). This guidance addresses the increased risk of PE status for non-Australian resident companies as a result of the COVID-19 travel restrictions and is applicable until **30 June 2021**.

The ATO guidance follows the OECD's release of its *Updated guidance on tax treaties and the impact of the COVID-19 crisis* publication on 21 January 2021, which revisits the earlier guidance from April 2020. Other than PEs, the OECD publication considers the interpretation of tax treaty articles on the tax residence of companies and individuals and the taxation of employment income.

This Tax Insights provides an overview of the updated ATO and OECD guidance on these matters to-date.

Background

In March 2020, the ATO announced various administrative measures to assist taxpayers experiencing financial difficulty as a result of COVID-19, including the release of a series of Q&A dealing with emerging practical issues. The international tax matters covered in the Q&A series addressed the increased risk of Australian tax residency status and PE status.

In April 2020, the ATO issued further guidance on the risk of a change in tax residency status for individuals and on the source of employment income of non-residents working remotely from Australia as a result of COVID-19.

On the international front, the OECD issued guidance on 3 April 2020 as an urgent response to the effect of the COVID-19 pandemic on tax treaties and focused on the effects of temporary changes to the location of employees.

As the COVID-19 impacts stretch out over a year, restrictions and disruption remain and both the OECD and ATO guidance have been updated accordingly, as discussed below. Whilst the general direction of the various guidances is helpful and acknowledges the unusual challenges that COVID-19 is presenting, the OECD position is necessarily general and high level, whilst the ATO positions are quite restrictive as to the circumstances when those positions will be applied. Further, the longer that the travel and business impacts continue, the more likely it is that the administrative approaches cease to be available.

Updated guidance

The January 2021 OECD guidance focuses on "public health measures" which include, but are broader than, the "travel restrictions" discussed in the earlier guidance. It also refers to measures "imposed or recommended" by governments, which is more comprehensive than the earlier focus on "government directives."

The OECD January 2021 guidance reflects the general approach taken by tax authorities including the ATO, and recognises that each tax authority may adopt its own approach. The updated OECD guidance makes clear that its objective is to resolve instances of potential double taxation but that it cannot be relied on to create instances of double non-taxation.

Whilst the OECD guidance is directionally helpful and serves as a guiding light for tax administrations to respond to the temporary travel and business impacts of COVID-19, the positions of each country will depend upon the approach adopted by the relevant tax authority, and as always, those approaches will vary.

The ATO's February 2021 guidance for PEs now includes its approach towards applying compliance resources to determine whether a PE exists, however the guidance on the risk of tax residency status for foreign incorporated companies, change in tax residency status for individuals and the treatment of employment income earned by foreign residents remains largely unchanged.

Permanent establishments

Australian approach

The ATO's February 2021 guidance states that the ATO will **not** apply compliance resources to determine if there is a PE in Australia under the following circumstances:

- There was no PE in Australia before the effects of COVID-19;
- The temporary presence of employees in Australia continues to **solely** be as a result of COVID-19 related travel restrictions;
- Those employees temporarily in Australia will relocate overseas **as soon as practicable** following the relaxation of international travel restrictions;
- Those employees have not been recognised as creating a PE or generating Australian source income in Australia for the purpose of the tax laws of another jurisdiction.

The ATO's administrative approach is applicable until **30 June 2021**.

The ATO states that this approach will cease to apply from 1 July 2021 and taxpayers will be required to consider whether ongoing arrangements give rise to a PE in Australia. The ATO is encouraging taxpayers to contact the ATO to discuss the taxation consequences of ongoing arrangements after that date.

It is noted that the ATO guidance is limited to the "temporary presence of employees in Australia". This would be relevant to the general concepts or fixed place of business PE as contemplated under paragraph (1) of typical treaty definitions of PE. It would also be relevant to the PE as contemplated in the opening words of the definition in section 6(1), Income Tax Assessment Act, 1936.

However, other aspects of the definition of PE may be affected by matters other than the "temporary presence of employees in Australia". Under prevailing double tax treaties, the presence of substantial equipment in Australia or the activities of non-employee dependent agents for example may result in a PE in Australia. These arrangements may also have been affected by the public health and business impacts of the COVID-19 pandemic, and yet are not directly addressed by the ATO's administrative approach. By contrast, the OECD guidance outlined below adopts a wider view of the potential COVID-19 impacts on the PE issue.

OECD guidance

The OECD guidance considers that exceptional and temporary changes in the location where employees undertake their work because of the COVID-19 pandemic should **not**, in general, create a new PE.

The OECD's guidance recognizes that some businesses may be concerned that employees could create a PE if they are working from home in a country other than that in which they regularly work. The creation of a PE could create new tax and filing obligations for the business.

The guidance includes a sample of guidance issued by the ATO and the tax authorities in the following countries: Austria, Canada, Germany, Greece, Ireland, New Zealand, the UK and the US.

The OECD guidance also specifically addresses the PE risks associated with home offices, dependent agents and construction sites, as outlined below.

Home offices

The OECD considers the impact of public health measures that result in individuals working not at their usual office or place of work, and who instead stay at home to work remotely.

As set out in the OECD commentary on the PE article of the OECD Model Tax Convention (Article 5), the issue of whether a fixed place of business PE exists is based on facts and circumstances but the fixed place must have both a degree of permanence and be at the disposal of the business.

Even though part of a business may be carried on at a home office, that should not automatically lead to the conclusion that the home office is at the disposal of the business. The carrying on of intermittent business activities at a home office does not make the home office at the disposal of the business. A home office may however be a PE if it is used on a continuous basis for carrying out the business and the individual is required to use the home office to carry out the business.

Whether the employee is required by the business to work from home is an important factor. The guidance considers that individuals working from a home office as a result of a "public health measure" imposed or recommended by at least one of the relevant countries are not doing so because of any requirement from the business. In addition, an office is still provided by the business which, in the absence of public health measures, would be available to the employee.

The guidance therefore indicates that working from a home office as a result of public health measures would **not** create a fixed place of business PE, either because the arrangement lacks a sufficient degree of permanence or continuity, or the home office is not at the disposal of the business.

The home office may be considered to have a degree of permanence if an individual continues to work from home once public health measures imposed or recommended by a government have ceased. Following any permanent change to the individual's working arrangements, the facts and circumstances would determine whether the home office is at the disposal of the business such that a PE is created.

Agents

Under the current (2017) OECD Model Tax Convention, a dependent agent PE arises where a person habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts, on behalf of a non-resident business. The OECD commentary states that this presence should be more than "merely transitory."

The guidance considers that, if an employee or agent is only working from home because of public health measures imposed or recommended by the relevant government(s), their activity is unlikely to be regarded as habitual. A dependent agent PE should **not** therefore arise.

A different approach may be appropriate if the individual was habitually concluding contracts on behalf of the non-resident business in their home country before the COVID-19 pandemic. Likewise, if the employee continues to work from home after the pandemic it would be more likely that the employee would be considered to habitually conclude contracts on behalf of the non-resident business.

Construction sites

Under the OECD Model Tax Convention, a construction site will constitute a PE where the site lasts more than twelve months. The OECD commentary states that a site should not be regarded as ceasing to exist when work is temporarily discontinued (e.g., due to weather) and that any such periods of temporary interruption should be included in the calculation of the duration of the construction site.

There is no bright line test in the OECD commentary as to whether an interruption is "temporary" and the guidance notes that countries may have different views. Some countries may consider that periods of interruption as a result of public health measures imposed or recommended by the government where the site is located should be **excluded** from the calculation of time thresholds.

Tax residency status for corporates

Australian approach

Generally, a foreign incorporated company will be an Australian resident if it carries on business in Australia, and it has Central Management and Control (CMAC) in Australia. The current ATO position on this can be found in Taxation Ruling TR 2018/5 and Practical Compliance Guideline PCG 2018/9. As a general matter, the holding of board meetings in Australia may result in the company being an Australian resident for Australian tax purposes.

The ATO's administrative guidance indicates that where a foreign incorporated company holds board meetings in Australia, or directors attend board meetings from Australia, and the **only** reason for this is because of the effects of COVID-19, the ATO will **not** apply compliance resources to determine if CMAC is in Australia.

The ATO expects to issue further updates on this guidance in the coming months.

This matter is further complicated by the fact that the ATO revised its position on CMAC when it withdrew TR 2004/15 and issued TR 2018/5. Based on that view and the associated PCG, the presence of CMAC in Australia of itself can result in Australian tax residency.

However, the Government announced in the October 2020 Budget that it will make technical amendments to the CMAC test to clarify that a foreign incorporated company will be treated as an Australian tax resident only if it has a 'sufficient economic connection to Australia'. The measure will have effect from the date of Royal Assent of the amending legislation, however taxpayers will have the option of applying the new law from 15 March 2017, being the date on which the ATO withdrew TR 2004/15.

In the interim period between 15 March 2017 and the commencement of the new law following Royal Assent, taxpayers are faced with the situation that the existing law remains in force and the ATO's current technical and compliance positions are in effect. However post Royal Assent, the new law can be elected to apply to that interim period. Based on our expectations of that new law, it is likely that the presence of CMAC in Australia of itself will not result in Australian tax residency, if there is not otherwise a 'sufficient economic connection to Australia'.

These issues can play out in various fact patterns including foreign incorporated subsidiaries of an Australian headquartered group.

At this stage, there is no indication of when the new law will be further developed, and it is likely that there will be a period of consultation prior to the matter being put to the Parliament. This, combined with the relatively narrow approach adopted by the ATO in its administrative approach and the ongoing impacts of COVID on travel and business practices, leaves taxpayers at risk of inadvertently triggering Australian tax residency as prudent governance procedures are applied to foreign incorporated companies.

OECD guidance

The OECD guidance considers it **unlikely** that the potential changes in the place of effective management of a company due to the relocation, or inability to travel, of board members or senior executives will create any changes to an entity's residence status under a tax treaty.

If a company is considered a resident of two countries simultaneously under their domestic laws, the tie-breaker rules within the relevant tax treaty would need to be considered to determine the country of residence for tax treaty purposes:

- Where the treaty contains a provision like the 2017 OECD model tie-breaker, the competent authorities are required to deal with dual residence on a case-by-case basis by mutual agreement. Such a determination will take into consideration all of the facts and circumstances over the determination period, and a range of factors are taken into account.

- Where the treaty contains the pre-2017 OECD model tie-breaker rule, the place of effective management will be the only criterion used.

Based on the OECD Model Tax Convention and its commentary, the guidance considers that all relevant facts and circumstances should be examined to determine the "usual" and "ordinary" place of effective management, and not only those that pertain to an exceptional period such as the COVID-19 pandemic. It concludes that the treaty tie-breaker outcome is unlikely to be affected by the fact that the individuals participating in the management and decision-making of an entity cannot travel as a result of a public health measure imposed or recommended by at least one of the governments of the countries involved.

The guidance includes a sample of guidance issued by the ATO and the tax authorities in the following countries: Canada, Greece, Ireland, New Zealand, the UK and the US.

As is evident from the above, the OECD has focussed on the treaty tie-breaker rules in cases of dual residence: but that of itself has no bearing on whether tax authorities in particular countries will assert increased scope of residency under local law.

Tax residency status for individuals

Australian approach

Generally, an individual would be tax resident in Australia if the person:

- Resides in Australia;

- Is domiciled in Australia unless the Commissioner is satisfied that the person's 'permanent place of abode' is outside Australia; or

- Spends over half the year in Australia, unless the Commissioner is satisfied that their ‘usual place of abode’ is outside Australia and the person does not intend to take up residence in Australia.

The current ATO position on this can be found in TR 98/17.

The ATO’s administrative guidance indicates that where a foreign resident individual is present in Australia temporarily **for some weeks or months** due to COVID-19, they will **not** become an Australian resident for tax purposes if the person:

- Usually lives overseas permanently;
- Intends to return there as soon as they are able.

However, the residency status of such individuals may need to be reviewed if the person:

- Ends up staying in Australia for a lengthy period;
- Does not plan to return to their country of residence when they are able to do so.

Whilst of some assistance, this administrative guidance is quite narrow in its scope especially as the travel and business impacts of COVID-19 continue for extended periods.

OECD guidance

The OECD guidance indicates that an individual’s treaty residence would **not** normally be affected by a temporary dislocation of employees from their normal place of work because of COVID-19.

However, it goes on to consider two distinct situations, where an individual who is temporarily away from home, perhaps on holiday, is stranded in a host location, and where a person who has become tax resident in a country where they are working, returns to their previous home location as a result of COVID-19. In the first case, the guidance suggests the individual would be unlikely to become resident in the host country, but goes on to say that if they did, they normally would remain treaty resident in the home country under the tie-breaker in the relevant treaty. In the second case, however, there is a recognition that while a return “home” might not change anything if it was exceptional and temporary, the position could be more complex e.g., if their connections to their previous home remain stronger than those to their working and residence location immediately before the pandemic.

In practice, determining the treaty residence of individuals in this second group is likely to be more complex, especially where a temporary dislocation continues beyond the point at which government-imposed public health restrictions are lifted. The guidance recognizes that returning to the previous home location might be regarded as tipping the balance of social and economic ties to that country, rather than to the pre-pandemic home. In this situation the habitual abode test usually would be considered, and the guidance stresses the need to consider a sufficient length of time to ascertain the frequency, duration, and regularity of visits to both countries, that form part of an individual’s settled routine, disregarding the impact of time spent in a particular location, because of government-imposed COVID-related travel restrictions.

The guidance includes a sample of guidance issued by the ATO and the tax authorities in the following countries: Canada, Finland, France, Greece, India, Ireland, New Zealand, the UK and the US.

Source of employment income

Australian approach

Generally, foreign residents would be subject to Australian tax on their Australian-sourced income only, subject to the application of a tax treaty.

The ATO's administrative guidance indicates that in some circumstances, employment income earned working remotely from Australia may **not** have an Australian source.

The ATO accepts that where the remote working arrangement is **three months or less**, the income from that employment will **not** have an Australian source.

However, for working arrangements **longer than three months**, all circumstances need to be examined to determine if their employment is connected to Australia, including whether:

- The terms and conditions of the employment contract changes;
- The nature of the job changes;
- The employee starts performing work for an Australian entity affiliated with the employer;
- The economic impact or result of the work shifts to Australia;
- The economic employer (the entity for which services are provided) is in Australia;
- The employee performs work with Australian clients;
- The performance of the work is wholly or to a significant degree dependent on the individual being physically present in Australia to complete it;
- Australia becomes the permanent place of work;
- The employee's intention towards Australia changes.

Notwithstanding the above, the employment income may **not** be regarded as having an Australian source where all the following conditions apply:

- The **only** thing that has changed about the employment is that the employee is now doing it from Australia as a result of COVID-19;
- There are **no other connections** to Australia;
- The employee intends to leave Australia **as soon as** they are able to do so; and
- A double tax agreement does **not** apply to deem the employment income to have an Australian source.

OECD guidance

The OECD guidance considers the 183-day exemption in the income from employment article (Article 15) of the OECD Model Tax Convention, and the extent to which COVID-related days of presence may be ignored in considering the 183-day limit. The OECD commentary permits the exclusion of days attributable to sickness in cases where the employee would otherwise have qualified for exemption from tax in the host location.

The guidance confirms that where an employee is prevented from traveling because of public health measures it would be reasonable to ignore any such days, but recognises that some countries will take a different view. Businesses are encouraged to liaise with the tax authorities concerned.

In cases where cross-border workers receive income (such as a wage subsidy) from the government of the country in which they normally work, the payment would be attributable to the work country under the employment income article of the OECD Model Tax Convention.

Some countries have agreed special treaty provisions with neighbouring countries to which employees frequently commute for work and these provisions may allocate taxing rights in a different way to the OECD Model Tax Convention. The guidance notes that some countries have agreed that time spent by an employee working from their home country will be considered as force majeure or an exceptional circumstance and will not be included in calculations of work days for the purposes of the treaty.

The guidance includes a sample of guidance issued by the ATO and the tax authorities in the following countries: Austria, Canada, Finland, Germany, Greece, Ireland, New Zealand, the UK and the US.

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