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INSIGHT: OECD's Analysis of Lockdown-Related Tax Treaty Issues Raises Interesting Questions



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The drafters of the Organization for Economic Cooperation and Development's Model Tax Treaty (OECD Model) did not contemplate a global pandemic that would cause governments to place severe restrictions on international travel and to order non-essential businesses to close their doors for lengthy periods of time. Nor was the OECD Model written at a time when the internet made it easy for those with desk jobs to work at home. Now Covid-19 has arrived and changed how and where many of us work.

Many of those who are able to perform their duties from a home office have continued to work—sometimes in a different country from their prior work location—and it is as yet unknown how long these remote-working arrangements may last. Even after governments ease restrictions and allow non-essential businesses to reopen their premises, certain companies may decide to reduce their physical office space in order to save costs. At the same time, driven by health concerns or for other reasons, many workers in the post-crisis economy may prefer to work from home.

Against this backdrop, on April 3, 2020, the OECD issued tax treaty guidance focusing on issues raised by stay-at-home orders titled "OECD Secretariat Analysis of Tax Treaties and the Impact of the Covid-19 Crisis." Commendably, the OECD swiftly drafted the seven-page document to provide guidance on some difficult and pressing international tax questions facing businesses and individuals. The OECD's analysis raises interesting questions that may become important in the future.

Permanent Establishment (PE) Issue

Under Article 5(1) of the OECD Model, a PE is defined as a fixed place of business through which an enterprise wholly or partly carries on its business. There must be a physical location that has a sufficient degree of permanency to be considered "fixed," and the place must be at the disposal of the enterprise.

In considering the risk of establishing a PE in a foreign country by virtue of an employee working at home in that country, the OECD assumes in its analysis that any work dislocation brought about by Covid-19 is "exceptional and temporary." On that basis, the OECD concludes that the employee's home office is not a PE. The analysis refers to the OECD Commentary on Article 5, which assumes that working out of one's home office would generally be "intermittent or incidental." Under this assumption, the Commentary states that the worker's home office is not considered to be at the disposal of the enterprise.

This raises the question of what the position would be if working from home was not exceptional and temporary but rather became regular. The Commentary describes the following PE-creating scenario: "Where . . . a home office is used on a continuous basis for carrying on business activities for an enterprise and it is clear from the facts and circumstances that the enterprise has required the individual to use that location to carry on the enterprise's business (e.g. by not providing an office to an employee in circumstances where the nature of the employment clearly requires an office), the home office may be considered to be at the disposal of the enterprise."

If government lockdowns persist long enough, or businesses eliminate physical offices, or workers indefinitely delay their return to the business office, then workers' home offices would presumably, at some point, be considered as "used on a continuous basis." The remaining parts of the fixed-place PE definition would arguably be met if the employer required the employee to continue working, knowing that the employee would be working from home. Such a scenario is much easier to conceive post-crisis than before the Commentary was written. It may be necessary for the OECD to supplement its guidance on this issue in due course.

Cross-border Workers

In relation to cross-border workers, Article 15 of the OECD Model provides that an employee's "salaries, wages, and other similar remuneration" are taxable only in the person's state of residence unless the "employment is exercised" in the other state, where the employer is resident. The OECD Commentary clarifies that employment is exercised where the employee is "physically present when performing the activities for which the employment income is paid."

Stimulus legislation such as the CARES Act may provide for what are essentially grants to small businesses to allow them to retain and continue paying their workers. The OECD's analysis argues that such payments to employees "most closely resemble termination payments," which are treated for tax treaty purposes as "attributable to the place where the employee would otherwise have worked." The OECD again supports its conclusion by describing the Covid-19 impact as an "involuntary and temporary change of the place where employment is performed."

In reality, many employees who are being paid while staying home during the crisis are not on furlough but rather are working full-time from home. The longer the employee works from home (either by fear-driven choice or the physical impossibility of going to a locked or downsized business office), the more attenuated the arguments become that the worker's compensation is from an employment exercised in the employer's country. If the employment is exercised where the employee resides, then the employee's country of residence has the sole right to tax the compensation.

Here, it should be remembered that tax treaties (and the guidance related to those treaties) do not create taxing rights; they play the more limited role of allocating taxing rights between the contracting states and providing relief from double taxation. The OECD's analysis should not be seen as empowering a country to tax compensation paid to a nonresident merely because the person used to exercise his or her employment in that country but no longer does so due to having stayed home during the pandemic.

In responding to a world thrown into disarray by Covid-19, the OECD's analysis of treaty issues provides a useful initial discussion. However, further deliberation on these issues in light of the possibility of different fact patterns appears to be warranted.

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