

## **Mobility of Work**



# Mobility of Work

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## Preface

The COVID-19 pandemic has dramatically impacted the social dynamics of work and mobile employment. Due to multiple uncoordinated lockdowns, many employers – large and small – enabled their employees to leave the country in which they work to return to the employees’ country of origin. Furthermore, many started to shift their work location depending on the stringency of adopted local COVID-19 measures. Reacting to such a movement of workers and the disruption of normal day-to-day business activities, states have resorted to ad hoc agreements, unilateral measures or the interpretation of already existing laws and agreements to address the regulation of tax matters. Tax authorities often issued guidance to address the impact of the pandemic and the consequent behaviour of workers and businesses.

These pandemic-related initiatives, including uncoordinated lockdowns, led to the acceleration of a broader phenomenon that had already been slowly evolving behind the scenes due to the widening acceptance of remote work, i.e. digital nomadism. According to the Oxford English Dictionary, a digital nomad is “a person who uses digital technologies ... to work remotely while travelling and living in a variety of different places”. Countries with a low cost of living in particular are trying to attract digital nomads, which consequently leads to questions on the taxation of these individuals.

This book aims to address the latest developments and varying approaches to tax issues raised by the growing mobility of work. It provides tax authorities, policymakers, courts and practitioners with an overview of the characteristics of domestic tax law and mobility of work; the relationship between residence, tie breaker rules and work mobility; permanent establishments; the issue of physical presence and article 15 of the OECD Model; and frontier worker rules in bilateral tax treaties. Further, it also discusses the justification and legal basis of COVID-19-based rules, as well as the future of mobility of work in international taxation.

To enhance the quality of this publication, from 7-10 July 2022, the Institute for Austrian and International Tax Law hosted its annual Rust Conference. More than 100 experts from all over the world were brought together to discuss recent developments in the field. This book is also the product of the works of the conference. We are confident that the in-person format has further enhanced the scientific exchange and discussions leading to this publication.

This book brings together 33 national reports from experts in international tax law with strong knowledge in mobility of work and an in-depth understanding of the domestic and international tools adopted to tackle the issues addressed. We are very grateful to the general reporters, Pasquale Pistone and Mario Tenore, and all national reporters.

We would like to express our sincere thanks to IBFD for its cooperation and the realization of this publication project. Jenny Hill and Margaret McKinney contributed greatly to the completion of this book by editing and polishing the texts for the authors for whom English is – to a great extent – a foreign language.

Above all, we would like to especially thank research and teaching assistants of the Institute for Austrian and International Tax Law, Stefano Castagna and Vera Hellebrandt, as well as members of the secretariat, Nina Nimmerrichter and Caroline Ristic, who were responsible for the coordination of the activities that supplied the in-person conference and for the editing, organization and preparation of the publication of this book. Without their dedication and talent for organization, the success and the completion of this book would not have been possible.

Vienna, November 2022

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## General Report

Pasquale Pistone and Mario Tenore

The enhancement of advanced information technology solutions has prompted a Copernican revolution in models of working. The remote exercise of activity has gone from being highly exceptional to being a frequent modality of work. For many types of activities, whether the employee is at an employer's premises, at home, or in any other place has become immaterial – as long as there is a good connection to the Internet. These new working models have quickly created a competitive global market for labour supply with far-reaching repercussions for tax law that are yet to be fully identified.

International tax rules have not yet been adjusted to such changes, and the application of such rules raises numerous critical issues. The main structural issue is that they were developed in a context that presupposes the physical presence of workers. However, additional issues arise in connection with the traditional bilateral nature of most international tax agreements, along with the wording and structure of article 15 of the OECD Model and the treaties that follow its pattern.

Remote working may raise other specific issues such as, for instance, in the case of mobile workers who can exercise their activity in different places. Flexible agreements with the employer either make the place of exercise immaterial or create a discretionary framework for either party to determine where the activity might be exercised. This especially applies in the case of the so-called permanent remote workers, i.e. of workers that lack a fixed place of work and have a contractual vested right to exercise their employment from different places. Many states have approved or adapted their domestic labour law – and, to a lesser extent, domestic tax law – to address “teleworking”, “home working”, “remote work” and “distance work”. In such a context, it is not uncommon to set some geographical boundaries to the exercise of the activities, framing it on a contractual basis within the country of employment.<sup>1</sup>

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1. This solution prevents the exposure to legal uncertainty in tax matters and reduces possible conflicts in the applicable social security legislation.

The new models also encourage “digital nomadism”,<sup>2</sup> which gives individuals full independence from business organizations and often transforms them into suppliers of independent personal services outside the traditional employment framework. Digital nomads may work on several projects and may arrange their working schedule on the basis of personal preferences and not being bound to a particular location.

The digital or platform economy (also termed the “sharing economy” and the “peer-to-peer economy”) is also a rising phenomenon.<sup>3</sup> Freelancers use online working through digital platforms as a way to access international markets and compete with demand for the remote supply of services throughout the world. Digital work enabled by digital technologies attracts different types of workers and results in significantly different outcomes for workers. On the one hand, digital workers have better working conditions, flexible working hours and other environmental advantages. On the other hand, this context might generate an unregulated race to the bottom among gig workers, creating competitive conditions that might facilitate carrying out activities outside the framework of formal employment without the payment of social security contributions, health insurance and taxes. This trend is clearly confirmed in several national reports from the European region.<sup>4</sup>

The cases of permanent remote workers and digital nomads are the two extremes of the broader phenomenon of the global mobility of workers, which includes a wide range of situations such as frontier workers, regular commuters, directors with multiple board roles in group entities of multinational groups and C-level employees with a vertical role.

The international tax issues raised by these categories of workers will be analysed in a more granular way in the following sections, with a view to achieving a comprehensive assessment of the critical issues that arise in this context. References to countries included in the research project underlying this book are, in principle, to the national reports contained therein unless specified otherwise. The assessment coordinated by the authors of this

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2. S.V. Kostić, *In Search of the Digital Nomad – Rethinking the Taxation of Employment Income under Tax Treaties*, 11 World Tax J. 2 (2019), Journal Articles & Opinion Pieces IBFD.

3. See the North Macedonian report (ch. 22) in this book.

4. As indicated by the national reports, North Macedonia and Serbia are among the leading countries in Europe and the world by the percentage of digital workforce relative to the country’s total population and total workforce. In the case of North Macedonia, this is due to the high-quality education and skills of its young professionals, but also to the lower salaries expected by North Macedonians as compared to the ones of the nearby regions on the international labour market.

general report might be useful for determining what type of solutions may be found at the interpretative level and which ones require an amendment of the existing rules as well as suggesting a sound policy-based approach to them.

## **1. Mobility of work and domestic tax law**

### **1.1. Residence of individuals and domestic law**

Permanent remote workers who relocate to another (host) jurisdiction to carry out an employment activity therein on a permanent (and non-mobile) basis very often become a tax resident in the working jurisdiction. In remote working contexts, employees often choose to relocate to their state of birth or to a state where they maintain personal ties (non-working reasons). Digital nomads instead have a higher level of mobility and might less frequently take up residence in the working jurisdictions. In some cases, digital nomads may even not have a tax residence at all.

Residence remains the main criterion for establishing personal nexus of individuals in several countries.<sup>5</sup> Monitoring the stable personal presence presupposed by tax residence might be burdensome for tax authorities, especially within areas admitting free circulation of persons and lacking border controls. Digitalization helps tax authorities to track movements, but the factual assessment required by the domestic rules on tax residence is becoming a challenge. For this reason, the authors support the view that objective factors should have a leading role in establishing the concept of tax residence. Subjective elements should thus mostly remain in the background or be entirely irrelevant when not matched by the corresponding objective manifestation.

At present, most jurisdictions using residence as the main criterion for personal tax nexus consider individuals to be resident for tax purposes insofar as their physical presence on the national territory exceeds 183 (not necessarily consecutive) days in a year. The combination of the subjective (intention) and objective (physical presence) elements is normally required to establish tax residence. Domestic tax law sometimes uses proxies based

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5. National reports from Australia (ch. 1), Austria (ch. 2), China (ch. 6), Czech Republic (ch. 10), Norway (ch. 23), Slovenia (ch. 26), Spain (ch. 28), Moldova (ch. 20), Slovakia (ch. 25) and Ukraine (ch. 31) confirm that residence is the main criterion for determining the personal tax nexus required for unlimited liability to tax.

on factual elements<sup>6</sup> and sometimes allows taxpayers to prove the contrary.<sup>7</sup> In several countries, the 183 days threshold is calculated in any 12-month period beginning or ending in a given tax year.<sup>8</sup>

Some tax systems include an intermediate form of personal tax nexus for individuals who have a certain degree of non-occasional physical presence in the national territory but do not reach the 183-day threshold.<sup>9</sup> Such individuals are generally denominated as resident aliens. This intermediate category might play an important role in stretching the personal tax nexus in order to adjust it to the issues that arise in connection with remote workers and digital nomads. This prevents, on the one hand, possible attempts to circumvent the unlimited liability to tax and avoids, on the other hand, critical stretching of an objective tax nexus to situations of occasional presence on the territory of a country.<sup>10</sup>

Some countries also use additional criteria (sometimes as an alternative to physical presence) such as permanent place of abode,<sup>11</sup> habitual residence<sup>12</sup> or the centre of vital interests<sup>13</sup> to determine tax residence.

The comparative analysis conducted in the framework of this research project shows that the relevance of the individual's physical presence in a country is surpassed or supplemented by additional factors in special circumstances, such as acts of God or force majeure.

National reports from several countries recorded various measures that acknowledged the existence of such special circumstances during the COVID-19 period. Some countries have applied them at the level of administrative practice of tax authorities, ignoring the physical presence of individuals stranded in the national territory for unintended reasons.<sup>14</sup>

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6. See the case of Chile (ch. 5), Czech Republic (ch. 10) and Sweden (ch. 29).

7. In Israel, individuals staying in the national territory for more than 183 days in a year are regarded as residents for tax purposes subject to a rebuttable presumption.

8. See Chile (ch. 5), North Macedonia (ch. 22) and Sweden (ch. 29).

9. See Germany (ch. 12), the United Kingdom (ch. 32) and the United States (ch. 33).

10. Accordingly, individuals working remotely for 3 months from a state have a certain degree of physical connection that might trigger tax nexus in a different way from the ones who only stay for a week in the territory of that state.

11. See Australia (ch. 1).

12. See Austria (ch. 2).

13. Various countries use this criterion, which focuses on the place where the taxpayers build their personal and economic relations.

14. See, for instance, in Colombia (ch. 7), the tax ruling of DIAN (Dirección de Impuestos y Aduanas Nacionales) No. 100208221-687 of 11 June 2020 or the corresponding measures adopted in Croatia (ch. 8) and Cyprus (ch. 9).

Other countries took the opposite view and established that a personal tax nexus always referred to physical presence, without admitting exceptions.<sup>15</sup> In some cases, tax authorities even issued administrative guidance to reiterate this view.<sup>16</sup> Other countries have remained silent on the matter, possibly generating a situation that national reporters perceived as a source of legal uncertainty as to whether such situation could be tantamount to exceptional circumstances.<sup>17</sup>

The authors hold that physical presence should always remain the core factual element in the assessment of tax residence based on the counting of the number of days and including measures that deem tax residence in some circumstances and that prevent possible abusive practices. This view is reasonable, especially if considering that remote working makes the objective element (i.e. physical presence in a country) even more central by blurring the line between the personal and private spheres, as well as work and leisure activities, to the point that the authors suggest entirely abandoning the relevance of the intentional element.

The authors also find it important to focus the objective element solely on the factual situation of the individual, thus reducing the relevance of close persons and inner family. Insofar as the taxable person is the individual, the physical presence of such other persons should only matter for determining the individual's social relations. Exceptions should nevertheless be admitted when the close persons are directly relevant for taxing the individual such, as for instance, in the case of the splitting regime,<sup>18</sup> the quotient familial<sup>19</sup> and other equivalent regimes.

## 1.2. Residence of corporations and domestic law

The personal tax nexus of corporations and other legal entities raises issues that are not entirely identical to the ones addressed by section 1.1.1. The goals of this research project do not require a comprehensive analysis of such issues but focus on the impact that the mobility of individuals and their personal liability to tax in one country produces on the tax residence of corporations and other legal entities.

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15. See, for instance, Portugal and Spain.

16. This is, for instance, the case of Slovenia as to the determination of the residence status of individuals in the context of rules applicable to cross-border workers.

17. See Kenya (ch. 18), Indonesia (ch. 15), Norway (ch. 23) and Slovakia (ch. 25).

18. This regime exists in several countries such as, for instance, Austria and Germany.

19. This regime exists in France.

As is recognized by the OECD, the exceptional circumstances of pandemic-related restrictions were such that the place of effective management (PoEM) might change “as a result of a relocation, or inability to travel, of board members or other senior executives”. For this reason, the OECD guidance suggested that “a temporary change in location of board members or other senior executives is an extraordinary and temporary situation due to the COVID-19 pandemic and such change of location should not trigger a change in treaty residence”.<sup>20</sup>

The impact of cross-border mobility on the tax residence of corporate entities differs according to the domestic law criteria that determine their legal personality. The change is almost unavoidable for countries that use the place of incorporation theory.<sup>21</sup> Such an impact is more limited in countries that use the *siège réel* theory,<sup>22</sup> where the mobility of board members does not per se entail the loss of tax residence for a corporation, except when determining the transfer of its PoEM abroad. Special issues may nevertheless arise in some countries. For instance, a corporate employer with a registered seat in Slovakia might partly lose the substance of personal connecting factors when the employees work from home but still retain the corporate tax residence based on the registered seat criterion alone, which is used in addition to the PoEM.

Further specific issues arise in connection with exceptional circumstances, such as those that occurred during the COVID-19 crisis.

Some countries adopted specific guidance to address the challenges arising from COVID-19, sterilizing the impact of travel restrictions on the tax residence of corporations. For example, Cypriot tax authorities issued guidelines to clarify that – subject to a case-by-case assessment – the status of a legal entity is not affected by the inability of a director to travel to Cyprus for reasons exclusively related to COVID-19.<sup>23</sup> In addition, Chinese tax authorities held the view that, during the pandemic, the place where management decisions are taken shall not be taken into account when determining a corporation’s PoEM.

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20. OECD, *Updated guidance on tax treaties and the impact of the COVID-19 pandemic* (21 Jan. 2021).

21. See, for instance, the Netherlands (ch. 21) and the United Kingdom (ch. 32).

22. See, among others, Croatia (ch. 8), Germany (ch. 12), Italy (ch. 17), Portugal (ch. 24), Spain (ch. 28) and Ukraine (ch. 31).

23. See the Cyprian national report (ch. 9).



Other countries intervened with special legislation to protect their taxing rights. It is worth mentioning here the Czech tax measures that allow, on a case-by-case basis, for the levying of exit taxes on the assets of a corporation when the change of the PoEM is the outcome of an endured change of residence of its managers beyond the COVID-19-related travel restrictions.

More countries have also introduced exit taxes in connection with the transfer of the PoEM of corporations.<sup>24</sup> Moreover, in Liechtenstein, while the residence as such of the board members is not decisive for exit taxation purposes, the place where the strategic and operative decisions is, and the transfer of tax residence may cause the application of exit taxation.

### 1.3. Permanent establishment and domestic law

The mobility of individuals often has a specific impact on the existence of a fixed place of business for corporate entities. This is particularly the case for mobile workers and those workers who remotely exercise their activity, including from their own home. The circumstance that the premises should be available, also on a de facto basis, to business conducted by the employer shows, from a conceptual perspective, that the threshold for deeming the existence of a permanent establishment (PE) might be rather low.<sup>25</sup>

The so-called home office necessarily turned into the standard modality of work for many employees during the COVID-19 pandemic. The exceptional nature of this context generally suffices to exclude the existence of a home-office PE throughout the pandemic.

The circumstance that, after the end of the pandemic, employees kept exercising their activity on a remote basis – also just for some days of the week upon their own request or that of their employer – constitutes an important element for determining the impact of workers' mobility on the personal nexus of corporate entities and requires a more granular attention thereby.<sup>26</sup> This analysis will first look at the pre-COVID-19 interpretation, then focus on the interpretative guidance by the OECD and its concrete adoption by the various tax systems, and will conclude with an outlook that puts the

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24. See, for instance, the Netherlands (ch. 21), South Africa (ch. 27) and Sweden (ch. 29).

25. This might have some important repercussions for countries, such as India, that generally adopt very low thresholds for deeming the existence of a PE.

26. More limited issues only arise in those countries, such as Brazil, whose domestic law includes strong source rules based on the source-of-payment-as-nexus rule.

emphasis on the conceptual framework for a home-office PE in the post-COVID-19 context.

Some interpretative guidance on how to address these issues already exists from before the COVID-19 crisis. For example, the Dutch Supreme Court decided that a home office may constitute a PE if the office is at the disposal of the employer on a permanent basis and is furnished for the specific needs of the employer.<sup>27</sup> Similarly, in Norway, the Supreme Court issued a decision in 2009 which held that a home office equipped with facilities for meetings may create a PE under the tax treaty between Norway and Canada.<sup>28</sup> Interestingly, in South Africa (in a 2015 court judgment), a boardroom could also constitute a fixed place of business if it is considered to have a certain degree of permanence.<sup>29</sup>

The main argument against the existence of a PE is generally that the foreign company does not have any factual or legal right to carry on its activities in the private premises of an employee. This is particularly important when the agreement allows the employee to choose from where to work. Whether this is the case should be assessed, taking into account all of the facts and circumstances of the case at hand (especially the employment agreement). Interestingly, the German report (*see* chapter 12) pointed out a decision of the Federal Tax Court (*Bundesfinanzhof*) that took a strict approach and held that the working place must be legally at the disposal of the management. Consequently, prior to COVID-19, the court held that teleworking spaces do not constitute a PE<sup>30</sup> and, therefore, the home office may not trigger taxation for the corporation in general. Additionally, Switzerland applies a restrictive approach. The Swiss national report highlighted that the disposal condition would be satisfied only in very specific circumstances, i.e., when there is a contractual obligation upon the employee to use the home office as a working space and the employer reimburses the employee any additional cost.

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27. NL: HR (Supreme Court), 13 Mar. 1957, BNB 1957/144.

28. NO: HR (Supreme Court), Case no. HR-2009-2145-A (Rt. 2009-page 1400).

29. In the unreported case of ZA: TC, 15 May 2015, *AB LLC and BD Holdings LLC v the Commissioner of SARS*, the court had to determine whether an American company acting as an advisory group for the South African airline industry had created a PE in South Africa. The court held that the American company had created a PE because its employees had been in South Africa furnishing the consultancy services for more than 183 days and because it had a fixed base in the boardroom of its South African client (it had exclusive use of the boardroom for the entire duration of its contract). Based on this reasoning by the court, the American company was found to be liable for tax on the profits attributable to the services it rendered to its South African client. Penalties and interest were also charged.

30. See DE: BFH [Federal Tax Court], 16 May 1990, I R 113/87, BStBl. II 1990, 983).

The OECD Secretariat issued the *OECD Secretariat analysis of tax treaties and the impact of the COVID-19 crisis* on 3 April 2020 dealing with – among others – home office situations related to COVID-19 measures and whether they should give rise to a PE qualification.<sup>31</sup> The guidance points to, among other things, the lack of the permanency requirement, as well as the fact that a place should be at the disposal of the enterprise in order for that place to be considered a fixed place of business through which the business is wholly or partly conducted. These positions were then confirmed in the subsequent OECD paper of 21 January 2021.<sup>32</sup>

Several countries gave guidance relating to the PE risk exposure during the COVID-19 pandemic following the OECD recommendations.

The OECD view has been endorsed by the national tax authorities of various countries<sup>33</sup> to exclude the existence of a PE during the periods when restrictive measures due to the pandemic were in force, even though all situations are yet to be examined on a case-by-case basis and reviewed if remote working becomes more permanent.

Interestingly, when Swedish tax authorities assess the existence of a PE, they look at whether the employer has any advantages from the exercise of the working activity from Sweden. By contrast, no PE will arise if the employee is working from home on his or her own initiative, and the employer maintains an office at a different location. The same outcome is reached if the work from home is due to restrictions or recommendations from the government.

The Swiss Tax Conference (a body with representatives from all cantonal authorities, as well as the federal tax authorities) reports on the practice of Swiss tax authorities in respect of teleworking, according to which working from home usually does not create a PE, even in decentralized business models in which the employees are obligated to work from home.<sup>34</sup>

Many countries have not adopted the OECD Guidance. The Belgian report (chapter 3) refers to informal conversations with the staff of the Belgian

31. OECD, *OECD Secretariat analysis of tax treaties and the impact of the COVID-19 crisis* (3 Apr. 2020).

32. OECD, *Updated guidance on tax treaties and the impact of the COVID-19 pandemic* (21 Jan. 2021).

33. See, for instance, Australia (ch. 1) and Greece (ch. 13).

34. Schweizerische Steuerkonferenz, *Analyse zu den Auswirkungen von Telearbeit auf die interkantonale Steuerauscheidung von Unternehmen* sec. 3.1 (SSK 2022).

tax administration at the central administrative office, who indicated that they adhere to the OECD Guidance published on 3 April 2020 and 21 January 2021. Similarly, no guidance was issued in Liechtenstein on the circumstances under which a home office constitutes a PE within the meaning of the tax treaty, nor on whether changes in working practices due to the COVID-19 pandemic can lead to the establishment of a PE. Finally, Italian tax authorities also did not specify the conditions and circumstances under which a PE could be deemed to exist in a home office scenario. In the framework of the regime for inbound workers (so-called *regime degli impatriati*), Italian tax authorities stated that the presence in the Italian territory of a worker who relocated to Italy could create a PE of the foreign employer pursuant to article 162 of the ITC and the relevant tax treaty. The statement is rather vague.

The authors are receptive to the change in business models produced by remote working and find it important to nuance their view according to the relevant factual context. In principle, the possible existence of a PE cannot be *ex ante* excluded when the employees operate remotely from another country; it is irrelevant whether it is from their home or from other dedicated or shared spaces. However, the actual existence of the PE presupposes an actual exercise of business from such spaces. This means that the mere fact that an employee works remotely from a different country is not per se sufficient to give rise to the existence of the PE.

For instance, an employee exercising back-office activities that are either merely instrumental to further activities conducted by the employer or by its other employees, or have a merely secondary nature, will not give rise to a PE of the employer in the country where such activity is exercised. Certainly, this will not prevent such activity from being relevant for determining the entitlement to taxing rights to the latter country under article 15 of the OECD Model.

By contrast, the likelihood of the existence of a PE will grow in parallel with the exercise of relevant business functions. According to the authors, it makes no difference when the employees exercise the activity from different places in the same state, such as, for instance, partly from their home office and partly from (also flex) office spaces made available to them by the employer. From a conceptual perspective, what matters is that the business is partly conducted from the territory of that state. This view approximates the concept of PE to the predicaments of the significant economic presence that characterize the virtual PE and presuppose an active involvement of business on the territory of a country. The latter concept is more far-reaching

insofar as it does not presuppose a physical place for exercising business in the territory of a different country from that of residence of the enterprise.

Further issues may arise in connection with highly mobile workers who happen to exercise their activity remotely from different countries. Their mobility should not create a general exposure of the employer to a risk of having a PE in any country from which they operate. However, it should also not exclude this possibility. Balancing out all facts and circumstances might be a challenge in the absence of rules that establish some relevant time and size threshold for this activity to create a business nexus. Therefore, from a policy perspective, the authors recommend introducing *de minimis* rules that might achieve an agreed threshold and reduce the exposure to legal uncertainty for businesses. Such thresholds might operate in line with or separately from the ones that might determine the liability to tax of the employees.

Similar issues will now be addressed, on a more general basis, in the following section, which focuses on the substance requirements for establishing tax nexus of income from employment.

#### 1.4. Substance requirement

Many national reports indicate the lack of a clear definition of substance or even criteria that can delimitate substance requirements.<sup>35</sup> This situation creates legal uncertainty by leaving it up to interpretation by tax authorities and/or the judiciary and thus making tax compliance more difficult to implement on an *ex ante* basis.

The new business models show to an ever-greater extent the reduction of dedicated workspaces for all employees and the shift towards the concept of flex spaces for employment. The latter concept incorporates the core features of remote working based on policies that determine a percentage of on-site employment at the premises of the enterprises and nudge managers to develop flexible strategies for a more efficient use of workspaces. These policies also externalize some work-related costs such as energy, rent and others or reduce other costs such as, for instance, transportation. The authors hold that tax law cannot simply ignore these policies, which might also

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35. See, in particular, Germany (ch. 12), Greece (ch. 13), Italy (ch. 17), Norway (ch. 23) and Portugal (ch. 24).

produce direct repercussions on the tax treatment of income from employment in cross-border relations.

In a mobile context, it could be asked what the consequences will be in the case that a corporation no longer maintains sufficient workplaces for its employees. The question should be whether remote working may provide for sufficient substance and what requirements would then be appropriate to evidence that. The implications of these policies for businesses might, in extreme cases, deprive an entity of the substance required for the entitlement to treaty benefits. However, this would occur only to the extent that the employer required all workers to exercise their employment remotely, which seems a rather unrealistic scenario,<sup>36</sup> at least for the current standards of genuine business practices.<sup>37</sup> Therefore, remote working as such should not impact the “substance” that is understood as the company conducting real business activities.<sup>38</sup> In other words, the company cannot be considered to be a sham just because the work is mainly carried out remotely.<sup>39</sup>

More generally, the authors conclude that, except in special circumstances, the mobility of individuals should not have an impact on the substance of legal entities and their tax residence.

Such special circumstances may occur when domestic legislation includes a statutory set of conditions for accessing a specific type of legislation that might produce an impact on the substance requirements, such as, for instance, advance tax rulings and advance pricing agreements. This is, for instance, the case of the Netherlands, where access to such measures for a Dutch resident corporate taxpayer is subject to a stricter requirement of economic nexus when it exercises operational activities in the Netherlands and has sufficient relevant staff present in the Netherlands to fulfill operational activities at its risk and expense.

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36. This view is shared in the Liechtenstein national report (ch. 19).

37. The authors find it useful to recall the position held by the Court of Justice of the European Union in the *Cadbury Schweppes* judgment (UK, ECJ, 12 Sept. 2006, C-196/04, *Cadbury Schweppes and Cadbury Schweppes Overseas*, ECLI:EU:C:2006:544, Case Law IBFD), largely reflected in secondary EU law on tax matters, such as the ATAD (Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, Primary Sources IBFD) and the proposed unshell directive (Proposal for a Council Directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU, COM/2021/565 final).

38. In this sense, the Spanish national report (ch. 28) holds that remote working should not affect the residence of the company due to a lack of substance.

39. Interestingly, the Spanish national report (ch. 28) indicates that domestic legislation does not include any substance criterion connected to the residence of legal persons.

Special circumstances might impact the application of treaty rules from various perspectives. For example, as indicated in the Swiss report, the substance requirement might affect the entitlement to the reduced treaty rate applicable to the distribution of cross-border dividends made by Swiss-based companies to their shareholders. In such circumstances, taxpayers often ask for an up-front tax ruling to confirm that a foreign person is indeed the beneficial owner of dividends paid by a Swiss company and that such person shall be able to apply the double tax treaty in order to receive a full or partial refund of the Swiss dividend withholding tax. These tax rulings contain, in general, a rather detailed description of the substance in the state of the recipient company (e.g. information about office premises, personnel, etc.). Therefore, in the case that there is a change in the substance as outlined in the ruling, this would question the validity of the tax ruling. During the COVID-19 pandemic, the Swiss authorities were rather reluctant to seriously take into consideration changes in the fact pattern triggered by such exceptional context. Therefore, during that period, Swiss tax authorities also refrained from revoking their rulings, even when a taxpayer did not follow the fact pattern disclosed in a tax ruling.

The authors reach different conclusions when the absence of staff is coupled with that of premises and equipment, as all three elements are fundamental for determining whether a given entity has sufficient substance to conduct its business from a given tax jurisdiction. Denying treaty benefits in the absence of all such elements is a desirable result for the legal interpretation of the existing rules and should be possible in general also with most types of domestic legislation in the countries reported in this research project.

## 1.5. Social security system

Many social security systems in Europe rely on the so-called principle of “territoriality”, and social security contributions are due in the territory in which the working activity takes place. This applies irrespective of whether the activity is carried out remotely and/or for the benefit of foreign employers who do not have any presence in the territory.

Exceptions to this rule are based on the notion of “temporary secondment” or of the posting of foreign workers, which is regulated by either bilateral agreements and/or Regulation (EC) 883/2004.<sup>40</sup>

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40. Regulation (EC) No. 883/2004 of the European Parliament and of the Council of 29 April 2004 on the Coordination of Social Security Systems, OJ L166 (2004), Primary Sources IBFD.

Under article 12(1) of Regulation 883/2004, for example, an employee who pursues an activity as an employed person in a Member State on behalf of an employer that normally carries out its activities there and who is posted by that employer to another Member State to perform work on that employer's behalf shall continue to be subject to the legislation of the first Member State. This is provided that the anticipated duration of such work does not exceed 24 months and that they are not sent to replace another posted person.

In addition to the above, under article 13(1) of Regulation 883/2004, an employee who normally pursues an activity as an employed person in two or more Member States shall be subject to the legislation of the Member State of residence if they pursue a substantial part of their activity in that Member State.

Article 14 of implementing Regulation (EC) 987/2009<sup>41</sup> defines “substantial” as a share of the working time and/or wages of at least 25%. Where the substantial part of the activity is carried out is determined on the basis of a forecast for the next 12 months. Alternatively, if they do not pursue a substantial part of their activity in the Member State of residence, the employee can be subject to the legislation of the Member State in which the registered office or place of business of the undertaking or employer is situated.

Other than the exceptions mentioned previously that are limited to a “temporary secondment” or to cases when the employee normally pursues an activity as an employed person in two or more Member States, the territoriality principle applies with the consequence that the employee is subject to social security contributions in the host jurisdiction even if the activity is carried out remotely on a stable basis (regardless of the fact that the activity would be carried out for the benefit of a foreign employer).

Due to the COVID-19 pandemic measures, the Member States of the European Union agreed to apply a more flexible approach to the social security coordination rules for the duration of the pandemic. They adopted guidelines recommending that changes to working patterns caused by the COVID-19 restrictions on movement should not change the country responsible for the collection of social security.

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41. Regulation (EC) No 987/2009 of the European Parliament and of the Council of 16 September 2009 laying down the procedure for implementing Regulation (EC) No 883/2004 on the coordination of social security systems.



Later, they adopted a Framework Agreement, which entered into force on 1 July 2023. Countries invited to sign the Framework Agreement included the EU-27 Member States, Iceland, Liechtenstein, Norway and the United Kingdom. The Framework Agreement is based on article 16 (1) and derogates from the application of article 13(1) in Regulation 883/2004 in a situation of cross-border telework. Although the Framework Agreement is a multilateral agreement, it concerns telework in the country of residence and the country of the employer only.

The Framework Agreement provides an option in which an employee who works 25% to 49.9% in the country of residence and 50.1% to 75% in the country of the employer can be covered by social security in the country of the employer. If a country signs the Framework Agreement after 1 July 2023, the agreement will enter into force following the signature. It will not enter into force retroactively.

The Framework Agreement applies to employees who do cross-border telework. Cross-border telework refers to work done through a digital connection with the employer's digital environment. Manual-labour activities such as construction work are not subject to the Framework Agreement. At present, only 11 jurisdictions, including Switzerland, have signed the agreement.<sup>42</sup>

At the national level, a few reports indicated the issuance of local guidance in connection with COVID-19. The Portuguese social security authorities clarified that restrictions on free movement as well as telework situations temporarily imposed as a result of the COVID-19 pandemic should not entail changes to the legislation applicable to posted and cross-border workers. Furthermore, these guidelines determined that, in the case of workers who carry out activities in two or more Member States, if there are other circumstances that may entail a change in the applicable legislation, nothing prevents the employer or the self-employed worker from requesting an exception agreement under article 16 of Regulation 883/2004. Under it, in the worker's interest, they remain subject to the legislation that currently covers them.

Many non-EU reports<sup>43</sup> showed that the treatment of social security law is generally aligned with the fiscal residence nexus (with a few exceptions). For example, in Indonesia, the social security system in Indonesia is

42. <https://socialsecurity.belgium.be/fr/activites-internationales/teletravail-transfrontalier-dans-lue-lee-et-la-suisse>.

43. See, for instance, Chile (ch. 5), Colombia (ch. 7), and Indonesia (ch. 15).

quite aligned with the tax residence nexus according to the income tax law because the conditions to join the social security programme are not merely based on citizenship and job status but also on the time test that is also used in determining the tax residency status.

Interestingly, the Israel Social Security Law of 1995 classifies Israeli residents for social security purposes based on the centre-of-life criterion. However, since the income tax laws and social security laws have different ends, the ITA and social security authorities occasionally interpret it differently, and, similarly, the district courts (that rule tax cases) and the labour courts (that rule social security cases) occasionally interpret fiscal residency differently. According to section 76 of the Social Security Law of 1995, an Israeli insured (resident) may relocate abroad and can still be considered an Israeli resident for social security purposes during a five-year period. Another difference between the social security rules and the income tax rules is that the individual can actively reach out to the social security authorities and abandon their residency for social security purposes on the date they depart from Israel, whereas the ability to sever fiscal residency for tax purposes is much more complex and cannot be determined on the date of departure.

## **2. Residence, tiebreaker rules and mobility of work: Individuals and entities**

### **2.1. Residence of individuals and tax treaties**

#### **2.1.1. Mobility and impact on article 4.1. of the OECD Model**

The topic of global mobility can be addressed from the perspective of residence-based taxation, which is also influenced by the proliferation, on a global scale, of special tax regimes for personal income tax purposes.

The increase in the number of personal income tax schemes targeting foreign individuals is a current trend that had already started prior to the COVID-19 pandemic.<sup>44</sup> These regimes entail long periods of duration coupled with significant tax advantages targeting very high-income individuals without combining such advantages with the carrying out of any real economic activity.

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44. E. Flamant, S. Godar & G. Richard, *New Forms of Tax Competition in the European Union: An Empirical Investigation*, No. 3 (EU Tax Observatory 2021).

Interestingly, the EU Tax Observatory, in its report published about tax competition in the European Union, identified several tax regimes for individuals “facilitating real optimization strategies based on simple domicile changes”. They “do not have the same underlying characteristics, do not all target the same taxpayers and therefore do not all have the same effects in terms of harmful tax competition”. In this respect, the report classifies three different types of preferential tax regimes, namely:

- “foreign source or worldwide income regimes” that target the most affluent taxpayers by offering tax exemptions for various foreign income sources or worldwide income; these regimes can even be anti-progressive, e.g. lump-sum payments may be required instead of the progressive scale applied to domestic resident taxpayers;
- “schemes associated with income earned while performing a specific economic activity in the host country” that target highly skilled workers, applying exemptions or lower taxation for domestic earnings. In some cases, the regime targets special profiles (e.g. researchers or scientists, professional athletes or artists); and
- “schemes targeting pensioners”, granting the lower taxation of foreign-source pensions received by new residents.<sup>45</sup>

The authors wonder if the current version of article 4(1) of the OECD Model is adequate to address the issues raised by special tax regimes,<sup>46</sup> in particular treaty entitlement. Such issues go along with the analysis of whether individuals dismissed their ties with the jurisdiction of departure and thus whether the relocation to a foreign jurisdiction can be regarded as artificial or a sham.

Against this background, it should be analysed whether a taxpayer eligible for the application of a special tax regime is nonetheless subject to comprehensive taxation (full liability to tax)<sup>47</sup> even if (i) the residence state does

45. EU Tax Observatory, *New Forms of Tax Competition in the European Union: an Empirical Investigation*, No. 3, pp. 11-12 (2021).

46. M.T. Soler Roch, *Chapter 10: Individuals: The Forgotten Taxpayers in a BEPS Scenario in Building Global International Tax Law: Essays in Honour of Guglielmo Maisto* (P. Pistone ed., IBFD 2022), Books IBFD.

47. According to the *OECD Model Tax Convention on Income and on Capital: Commentary on Article 4* (21 Nov. 2017), Treaties & Models IBFD, in accordance with the provisions of the second sentence of paragraph 1, a person is not to be considered a “resident of a Contracting State” under art. 4 *OECD Model* if, “although not domiciled in that State, he is considered to be a resident according to the domestic laws but is subject only to a taxation limited to the income from sources in that State or to capital situated in that State. That situation exists in some States in relation to individuals, e.g., in the case of foreign diplomatic and consular staff serving in their territory” (§ 8.1). Moreover, according to the Commentary, “[t]he application of the second sentence, however, has inherent difficulties

not, in fact, impose tax on foreign-source income (such as in the case of regimes that are based on a remittance mechanism);<sup>48</sup> or (ii) it imposes a tax charge (such as a flat levy) in lieu of ordinary income tax.<sup>49</sup>

In some jurisdictions, the taxpayers enjoying a special tax regime are considered treaty residents and are able to obtain a tax resident certificate from the residence state under the assumption that such state considers the taxpayer to be resident for treaty purposes. This is, for example, the position of the Israeli tax authorities, according to which new and returning residents in Israel should qualify as Israeli residents for treaty purposes as they keep a single habitual abode in Israel. The same position is taken by the Italian tax authorities, which consider taxpayers who have opted for the new resident regime as residents for the purposes of the agreements. This is based on the indications provided in the Commentary on Article 4 of the OECD Model (2017) and in consideration of the fact that, on foreign source included in the optional regime, a tax is paid, albeit on a flat-rate basis.<sup>50</sup>

These types of regimes are different from the ones applicable to resident non-domiciled taxpayers that exist in some countries and are often accompanied by corresponding variations of the treaty rules.<sup>51</sup>

In the absence of rules that properly address such issues within double taxation conventions, these issues might give rise to an entitlement to treaty benefits that combines reduced taxation of foreign-sourced income, both in

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and limitations. It has to be interpreted in the light of its object and purpose, which is to exclude persons who are not subjected to comprehensive taxation (full liability to tax) in a State, because it might otherwise exclude from the scope of the Convention all residents of countries adopting a territorial principle in their taxation, a result which is clearly not intended" (§ 8.3).

48. The *OECD Model: Commentary* contains further guidance. In particular, with regard to remittance-based systems, the Commentary points out that taxpayers are "subject to potential double taxation to the extent that foreign income is not remitted to their State of residence, and it may be considered inappropriate to give them the benefit of the provisions of the Convention on such income. Contracting States which agree to restrict the application of the provisions of the Convention to income that is effectively taxed in the hands of these persons may do so by adding the following provision to the Convention". The notion of equivalent beneficiary for the purpose of art. 29 *OECD Model*, as suggested in the Commentary on the definition of "equivalent beneficiary" in the detailed version, also considers the position of individuals "who are liable to tax on a remittance basis or taxed on a fixed-fee / forfeit basis" and envisages the possibility for the contracting states "to prevent such individuals resident of third States from qualifying as an "equivalent beneficiary".

49. This is, for instance, the case of the Greek and Italian tax legislation.

50. IT: Circular No. 17 of 23 May 2017, para. 7.

51. See, for instance, the case of the United Kingdom (ch. 32).

the source state and in the residence state. However, the circumstance that those taxpayers might not have entirely cut off their tax nexus with another state of residence might generate triangular situations that are not easy to address on a general basis at the level of legal interpretation due to the bilateral fragmentation of tax treaty rules.

The fact that the taxpayer is regarded as entitled to treaty benefits from the perspective of the residence state is not per se sufficient, since treaty entitlement is a matter with a bilateral reach, and the position of the other contracting state cannot be ignored.

Interestingly, the issue of the treaty entitlement of taxpayers benefitting from a special tax regime should not ignore the manner in which the tax residence of individuals is constructed, in particular whether it is based on substantial criteria such as physical presence or on more formal criteria such as having a permanent residence address in the country. When the residence concept is not linked to physical presence or other substantial factors – particularly when based upon purely formal criteria or “residence by investment schemes” – it is not unusual that a taxpayer seeks to become a resident of the jurisdiction that – in addition to the tax advantages – offers the taxpayer a valid tax residence certificate in order to claim the treaty benefits.

Interestingly, the Israeli tax authorities took a substantive approach in an unpublished private ruling of 8 October 2017<sup>52</sup> entailing the minimum conditions that must be fulfilled for an individual to receive an Israeli tax residence certificate and be regarded as an Israeli resident for tax purposes (both for the purpose of Israeli local tax law as well as under Israel’s double taxation treaties). According to the ruling, the applicant did not spend many days in Israel in the years 2002-2016 (inclusive), and he was expected to spend more time in Israel as of 2017 onwards. The Israeli tax authorities agreed to provide a residency certificate, provided that all of the following conditions were met, namely:

- the taxpayer shall stay in Israel for more than 142 days in each tax year;
- there is no other country in which the taxpayer spent more days than in Israel in the relevant tax year;
- the taxpayer would have a permanent residence in Israel;
- the taxpayer did not elect to benefit from an “acclimatization year” (i.e. a year in which the individual chooses to be considered as a

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52. <https://www.step.org/industry-news/israeli-tax-ruling-restricts-residency-certificates-new-immigrants>.

- non-Israeli resident even though he should be considered as an Israeli resident under Israeli tax laws);
- the taxpayer does not have a non-Israeli resident spouse;
  - the taxpayer shall provide an opinion from a local expert in Country A confirming that he should not be regarded as a tax resident of Country A; and
  - the taxpayer shall declare that the above conditions were met with respect to tax years 2017-2019 and are also expected to be met in the next 2 tax years.

Moreover, in the same ruling, the Israeli tax authorities stated that they would consider notifying the foreign tax authorities if the taxpayer failed to meet the above conditions, and that the certificate should be annulled retroactively. The ruling clarifies that, even if the ITA refuses to issue a residency certificate, it can still argue that the taxpayer is indeed a resident of Israel for the relevant tax year, as the centre of his life was in Israel. In the ruling, it was also clarified that the issuance of a residency certificate does not obligate the Israeli tax authorities to protect the position that the taxpayer is indeed an Israeli resident in a competent authority's procedure with the foreign jurisdiction.

This unpublished ruling is a very good example of how to set the border between a genuine situation in which the treaty benefits should be preserved for the taxpayer that applies the special tax regime and situations where such a regime may be abusive as the taxpayer is not genuinely tied to the jurisdiction that offers the tax advantage. Further support can be found in § 8.2 of the Commentary on Article 4 of the OECD Model, which “also excludes from the definition of a resident of a Contracting State foreign held companies exempted from tax on their foreign income by privileges tailored to attract conduit companies”. Although the clarification is meant to apply to corporate entities, the reference made to “privileges tailored to attract” makes the principle relevant for cases of preferential tax regimes applicable to individuals. This stated, the example of the commentary points at conduit companies and, therefore, it could be argued that its relevance should be confined to cases of abuse of the tax treaty with the purpose of avoiding the achievement of undue tax benefits and the circumvention of the tax treaty.

According to the authors, treaty residence cannot be challenged on the sole assumption that the application of the special tax regime may lead to double non-taxation, as it is necessary to prove the existence of tax avoidance or evasion. In any event, the conclusion must consider the specific wording of the treaty, and the lack of specific clauses further supports the position that

a taxpayer benefiting from a special tax regime cannot per se be deprived of treaty residence status.

For these reasons, from a policy perspective, the authors suggest conceiving of an amendment to the existing treaty rules with direct action in models that may focus on article 4(1) and/or (2) of the OECD Model.

### 2.1.2. Mobility and impact on article 4(2) of the OECD Model

When a person maintains genuine ties with a plurality of jurisdictions, especially in the case of highly mobile individuals, it may become more and more difficult to ascertain a single country of residence for tax treaty purposes. In the case of digital nomads, it may well be that the residence will remain in the place of departure of the individual if the person neither stays for long enough in any country nor develops strong economic or personal links while working in transit.

Some of the factors contained in article 4(2) of OECD Model are easily disposable, e.g. those that are elective by nature, such as the permanent home. When the person maintains a permanent home in both states, the residence will be determined according to other criteria (centre of vital interests, habitual abode, nationality and a mutual agreement procedure (MAP)). Moreover, the short-duration presence of highly mobile workers and digital nomads can be perfectly combined with new types of accommodation that come reasonably close to a home-away-from-home concept.<sup>53</sup>

This circumstance leads the authors to wonder whether it might be appropriate to intervene with an amendment to article 4(2) of the OECD Model. The criterion of a permanent home is scarcely useful and very often subsidiary to physical presence and time spent in a given jurisdiction. In the Czech Republic, the Czech Supreme Administrative Court attributed a wide meaning to the term “permanent home”, including the official permanent residence registered at the parents’ home.<sup>54</sup> The Slovene tax authorities have held that a home is used permanently when the individual must have arranged and retained it for his permanent use, regardless of whether the taxpayer actually stayed at a particular place.<sup>55</sup>

53. This is, for instance, the case of [www.livezoku.com](http://www.livezoku.com), which provides self-catered hotel apartment accommodation that looks the same in different cities.

54. CZ: NSS [Supreme Administrative Court], 13 Nov. 2014, 7 Afs 120/2014 – 68.

55. *See* Slovenian national report (ch. 26).

Additionally, the criterion based on the centre of vital interest is often of an unclear application: on the one hand, it considers social and family ties and, on the other hand, the economic ties to a given jurisdiction. The question is therefore which ties prevail. In India, when the economic and personal relations are scattered across both contracting states, considerations based on “personal relations” should be preferred. By contrast, the Chilean report points out that the Chilean tax administration clarified that the economic element must be considered first (the place where the taxpayer carries out the activity that earns the most income and where the principal place of business is located). At the same time, the family factor may not be a necessary or essential element if it is not accompanied by the economic element.

Once it is decided that the centre of vital interest lies in a particular jurisdiction, the actual presence in the country is of secondary importance. Thus, for persons forced to stay in a state against their own will and with permanent residence in both contracting states, their centre of vital interest would be where they have deeper economic and personal ties.

In a mobile context, it could be wondered if social and especially family ties should still be considered relevant. Unlike in the past, some categories of workers (such as, for instance, highly mobile workers) may split their time along the concept of short-term (on a weekly basis or for a variable periods of days) commuting. Accordingly, they might spend a reasonable amount of time in a country other than the one where the family is established. In such circumstances, the personal ties of the taxpayer are more likely split between countries. The authors acknowledge the relevance of family ties, but the changed global habits for this category of taxpayers have weakened the conceptual validity of those ties, especially in countries where the single taxpayer is the taxable unit.

No lesser problems arise in connection with economic ties. Once again, for highly mobile workers (and for digital nomads), those ties are often split across several countries, and their assessment might require very burdensome fact finding for tax authorities, which makes this criterion impractical.

The criteria relying on the place of habitual abode is problematic too, especially for mobile workers who often have various places of habitual abode. This tie-breaker rule generated significant problems during the COVID-19 pandemic for a much broader group of workers, especially in the case of stranded workers who could not return to their country of residence due to travel restrictions.



These exceptional circumstances have put this tie-breaker rule to the test, especially for countries that did not issue specific guidance. According to the Austrian report (*see* chapter 2), the application of “tie-breaker rules” should be assessed in a “normal” situation. If one of the governments involved in the tax treaty prohibits a person from returning home because of public health measures, this should not affect a person’s residence status for purposes of the tax treaty. The Indonesian national report (*see* chapter 15) reached the opposite conclusion, arguing on factual grounds based on the physical presence and without any consideration for the exceptional nature of the effects determined by the pandemic.

In certain jurisdictions, such as Liechtenstein, there is no legal basis that makes a difference if an employee is forced to spend more time in their residence state or in another country (e.g. due to travel restrictions during a pandemic) or whether the stay is voluntary. Neither the domestic law nor the tax treaties of Liechtenstein contain a force majeure clause for this case (with the one exception of the mutual agreement reached with Switzerland).

On the other hand, some countries adopted a different approach and issued guidance to face the effects of the COVID-19 pandemic. Given the impossibility of leaving Croatia, the Croatian tax administration exceptionally disregarded the fact that the taxpayer stayed therein for more than 183 days in 1 or 2 calendar years. Similarly, the Greek tax authorities (Circulars E. 2113/2020 and 2130/2021) made a distinction between “coerced” and “voluntary” residence. Specifically, the periods during which restrictive measures and travel bans were in place are not taken into account for the determination of the 183-day rule or for determining whether the individual has their habitual abode in Greece.

For individuals teleworking in Greece for a foreign employer, the Greek tax administration stated that their tax residency shall be determined in principle after taking into account the domestic residency (article 4 of the ITC) that is in line with article 4 of the OECD Model and should be assessed on a case-by-case basis. The assessment should not consider exceptional circumstances that arose during the pandemic. The criteria followed by the Greek tax administration are: (i) whether the employee has a place of work available in the country of residence that cannot be used due to the circumstances; and (ii) whether the employment contract makes explicit reference to the employee providing his services from home compulsorily or that this can happen only exceptionally, in which case the employee is not obligated to work from home. It is obvious that the above criteria are set as indications

of what could be considered a temporary stay and whether it is justified under the circumstances of COVID-19.

Finally, the tie-breaker rule based on dual nationality is also losing its validity in several countries. The higher frequency of dual nationality might be based on the existence of personal- or family-related ties with more than one country. In areas of supranational integration, the entitlement to sojourn in a different country, even on a long-term basis, has become notably easier; moreover, individuals are nowadays more keen to have spouses/partners from different countries as compared to the past. Moreover, the release of the so-called golden visa or passport linked with substantial investment is depriving nationality of its intrinsic validity as a close personal nexus, an attribute it traditionally held in the past. Such validity now essentially remains in those countries that prohibit dual nationality.<sup>56</sup>

The difficulties in interpretation and fact-finding linked with the application of the tie-breaker rules enshrined in article 4(2) of the OECD Model lead the authors to suggest that the concept of residence for tax treaties might require reform that reflects the personal ties of the individual taking into account the effective presence on the territory of a country. A certain degree of approximation in the establishment of legal fictions, such as the one that characterizes deemed residence, might be accepted as a reasonable compromise provided that it reflects criteria that can be commonly established.

## 2.2. Residence of corporations and tax treaties

Even though the residence of corporations is only indirectly relevant for the mobility of workers, the reasons already indicated in this general report show that there might be important repercussions that require attention.

Article 4(3), prior to the 2017 OECD Model, resolved the conflict of residence by determining the place where the effective management is situated. In article 4(3) of the OECD Model (2017), the MAP pursuant to article 25 of the OECD Model is the standardized tie-breaker clause for corporations. Scholars have heavily criticized this development, which creates legal uncertainty and puts too much weight and burden on cross-border tax dispute settlement procedures. Neither set of rules, in fact, can operate without creating a significant degree of legal uncertainty.

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56. This is, for instance, the case of China.

As indicated in the OECD Commentary, competent authorities have to take into account factors such as the place of management, the place from which the directors typically carry out their activities, the place where the accounting records are kept and the legal system that governs the legal status of the company.<sup>57</sup>

Some reports<sup>58</sup> point out that the mobility of labour may influence the application of the PoEM criterion. After all, it should not be forgotten that, already before the change of models prompted by the COVID-19 pandemic, this criterion could be easily manipulated. This criterion relies on the assumption that decisions are taken at a given place. The PoEM alone is a criterion that may be easily disposed or circumvented.

This concept creates a close personal connection that lacks validity and has caused enormous leeway for arbitrage in the past. Moreover, the underlying assumption is nowadays out of date. Most meetings take place online and often involve people who are based in different countries. It appears to be scarcely effective in conditions of proliferating communication technologies, fly-in and fly-out management, COVID-19 travel restrictions and remote working as the new normal.

Cyprus has introduced a supplementary test for stateless companies registered or incorporated in Cyprus that are not tax residents in any other jurisdiction (commonly referred to as “stateless companies”), e.g. because their PoEM is in a jurisdiction that applies the legal seat test. According to this test, a company is considered a tax resident of Cyprus if its management and control is exercised in Cyprus. The existing corporate tax residence test will continue to apply so that a company that has its management and control in Cyprus will continue to be considered a tax resident of Cyprus (that is, its tax residency status will not be affected by new measures).

Under the new provision, the definition of a “resident” is enhanced so that Cyprus-incorporated or registered companies (i) with management and control exercised outside Cyprus and (ii) not tax resident in any other jurisdiction will now be considered tax residents of Cyprus and, as such, taxed in Cyprus on their worldwide income. The new suppletive rule is introduced as an anti-abuse provision following the OECD’s post-2017 amendment for dual companies pursuant to paragraph 3 of article 4 of the OECD Model (2017).

57. G. Maisto et al., *Dual Residence of Companies under Tax Treaties*, 1 International Tax Studies 1, pp. 3-84 (2018), Journal Articles & Opinion Pieces IBFD.

58. See the Ukrainian report (ch. 31).

Article 4(3) of the OECD Model (2017) provides for the possibility to broaden the range of factors, not only looking at the PoEM as indicated in the Commentary to the OECD Model, but substantially postponing the problems rather than addressing them with a reasonable degree of legal certainty. The Ukrainian report pointed out several factors to be considered when making the assessment of the tiebreaker rule for corporate entities. Such elements include the functions performed for the foreign entity in the Ukrainian territory (e.g. making management decisions; bank account management; conducting accounting and/or management accounting of a foreign company; and HR functions) and the presence of a CEO or someone else in Ukraine with power of attorney from a foreign company to sign contracts on its behalf.

The factors mentioned above are flexible. An entity may opt for the jurisdiction of residence, the place where the legal and audit records are kept, the place of its incorporation etc.. Certain factors, such as the place where the executives usually carry on their activities and where senior staff members perform day-to-day management, are somehow outdated and inoperative due to the digitalization of daily lower and middle management activities. Senior executives are not necessarily physically present at the premises to perform the day-to-day management and even less at the headquarters. The need to amend this tie-breaker rule is clear, but the possible content of such an amendment requires a deeper analysis, to minimize the leeway to possible arbitrage of such rules and their interpretation, which might generate forms of harmful tax competition and/or aggressive tax planning.

This analysis goes beyond the goals of this chapter, but the interaction with domestic measures often generates complexity that is hard to address at the level of administrative and judicial practice. A good example arises with regard to the relevance of the residence of senior executives in determining the residence of foreign incorporated entities. Some countries include it in the framework of measures intended to boost the attractiveness of the jurisdiction *vis-à-vis* senior executives and, more generally, high-net wealth individuals. This is, for instance, the case of the Israeli tax authorities, who disregard the managerial contribution of newcomers and 10-year veterans during their first 10 years following their transfer of residence to Israel.<sup>59</sup> Besides the different policy goals pursued, this practice generates unclear repercussions for the establishment of a personal tax nexus by the corporate entities in which they operate. In such a context, to the extent that Israeli

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59. IL: Income Tax Ordinance 5721-1961, amended 2023, sec. 1, Primary Sources IBFD.

residents or former Israeli residents (who abandoned their Israeli residency less than 10 years before) exercise managerial duties while staying in Israel (either on a voluntary basis or because they were forced to stay there due to COVID-19 travel restrictions), the corporation may be classified as resident in Israel. Upon their departure from Israel, an exit tax may be triggered. This diminishes the potential for multiple corporate residencies for reasons connected to the tax residence of their board members in Israel and also produced repercussions in cases of directors who were stranded in Israel during the COVID-19 pandemic. However, such a situation might not prevent the Israeli tax authorities from deeming that the company has a PE in Israel. A similar position has been taken by the Italian tax authorities.<sup>60</sup>

### 3. Permanent establishments and mobility of work

The question of whether the employee's home office constitutes a PE is frequently not new to international taxation but has become more recurrent in international tax practice since the COVID-19 pandemic. Such a question must be addressed in line with the overall requirements for the existence of a PE, but raises distinct critical issues in the specific context. The issues arise especially as to whether the place is at the disposal of the employer and whether the activity is habitually exercised from there.

Judicial and administrative practice had already addressed such issues before the COVID-19 pandemic and provided some useful elements that the authors incorporate in their own analysis of the issues, together with the findings of the national reports.

According to the Dutch Supreme Court (*Hoge Raad*, HR), the home office may constitute a PE if the office is at the disposal of the employer on a permanent basis and is furnished for the specific needs of the employer. This line of reasoning relies on the obligation incumbent on the employer under Dutch labour law as to the working environment for employees. The same view was held by the Norwegian Supreme Administrative Court in 2009 in a case of a home office including facilities for meetings which was regarded as a PE under the Canada-Norway Income and Capital Tax Treaty (2002).<sup>61</sup> From a scholarly perspective, the Spanish report holds that a PE could be deemed to exist when no such circumstance was found, the employer bears

60. IL: Circular no. 17 of 23 May 2017.

61. NL: HR [Supreme Court], 9 Oct. 2009, Case no. HR-2009-2145-A (Rt. 2009-page 1400).

the expenses of the home office and the work is carried out without any other facilities being available to the employee to exercise the employment at the business premises.

The Dutch judicial interpretation does not help to assess whether the habitual or recurrent exercise of the activity from the home office plays an equally relevant role. On the one hand, a floating tank storage facility in India did not constitute the fixed base of a self-employed diver resident in the Netherlands who worked on that floating tank for a one-off period of 89 days in the relevant tax year because of the fact that the activities had a one-off nature.<sup>62</sup> On the other hand, recurrency seems to have played a decisive role in assessing the existence of a PE in the case of a gynecologist who worked for one day per week in a clinic in Bremen (Germany) and the other days in the Netherlands.<sup>63</sup> The latter view shows a considerable development from the position held by the same court in the precedent of a German doctor implanting artificial eyes in the Netherlands,<sup>64</sup> where a 30-day rental of hotel rooms in the Netherlands did not constitute a PE.<sup>65</sup>

The authors hold that what matters is whether the place is used by the employee for the exercise of the employment rather than whether such a place is at the employer's disposal in strict terms. As long as the place can be effectively used for the exercise of the employment, its exclusive destination to such a function is of secondary relevance unless expressly required by the applicable administrative and legislative measures.

The habitual exercise of the activity requires its non-occasional nature. This element should not necessarily imply recurrency but often entail some level of stability, as indicated by the South African judiciary in 2015.<sup>66</sup> The authors do not exclude that a PE of the employer in the employee's residence state may also exist when the latter exercises the activity partly from home and partly from a dedicated office space made available by the employer.

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62. BNB 2016/114, NTFR 2016/671.

63. See NL: HR [Supreme Court], Decision 28 Feb. 1999, BNB 1990/107.

64. See NL: HR [Supreme Court], 15 June 1955, BNB 1955/277.

65. In the judgment, the HR indicated that the hotel rooms were not specifically furnished for the doctor, who could have exercised the activity also from the clients' homes.

66. In the unreported case of *AB LLC and BD Holdings LLC v. the Commissioner of SARS* (heard in Feb. 2015), the court had to determine whether an American company acting as an advisory group for the South African airline industry had created a PE in South Africa.

Different scenarios of remote working might have relevant implications for this requirement, which are worth being explored in more detail. Such scenarios might have remote working as the outcome of an agreement between the parties, be prompted by the employee and tolerated by the employer, or actively pursued by the employer. All scenarios share a common element to some extent, namely flexibility in conducting the activity from the home office, at the business premises or elsewhere.

Especially after the COVID-19 crisis, this kind of flexibility has turned into an element of negotiation between parties and also influences strategic business decisions that might pursue the reduction or externalization of costs that were traditionally directly borne by the enterprise. Flexibility often makes it more difficult to determine the place of exercise on an *ex ante* basis, especially when either party has some leeway to decide *à la carte* where the work will be conducted. This context generates a potential discrepancy between the agreed and actual place of exercise of the employment that international tax law should address with caution having regard to all relevant facts and circumstances. This dynamic developed spontaneously during the COVID-19 crisis – notably by the time that regulatory constraints imposed by public health were being gradually lifted – and kept operating after the end of the health emergency in the framework of the new flexible models of remote employment.

In principle, the allocation of taxing rights on income from employment should reflect the conditions agreed between the parties and having due consideration for how the activity is exercised in practice. This means that any deviation from such a pattern is of rather limited importance when it is caused by exceptional circumstances, such as during the COVID-19 crisis. Since the latter represented a real watershed for exercising employment, the authors recommend adopting very narrow boundaries for exceptional circumstances. They should be limited to situations in which force majeure and reasons of public health not depending on either party of the employment relationship prevented employees from exercising their activity at the employer's premises or in the place that had been agreed on a consensual basis.

Throughout the COVID-19 pandemic and at a later moment, several countries adopted solutions at the legislative and administrative levels aimed at promoting legal certainty and giving business a reasonable prospective outlook framework while also considering the need to levy taxes on a clear factual framework determined on an *ex ante* basis. These measures might include various forms of deemed place of exercise of employment that

address this issue but, due to their unilateral nature, may generate leeway for cross-border tax disparities. The authors recognize the importance of protecting the legitimate expectations of taxpayers in good faith arising from administrative practice and guidance. However, they stress the importance for international taxation, especially in the presence of tax treaties, of addressing the place of exercise of employment by looking primarily at the facts that concretely occurred and considering the conditions that such countries might have agreed bilaterally.

During the COVID-19 crisis, some countries issued administrative rulings following the OECD guidance to exclude the existence of a home office PE.<sup>67</sup> Spanish tax authorities held the view that the time lapse of measures that prevented employees from working at the business premises lacked the sufficient level of permanence required to give rise to a PE, giving rise to discontinuous and accidental work from the home office.<sup>68</sup>

Other countries such as Australia developed criteria for steering the administrative practices of tax authorities and auditing taxpayers with a more balanced approach to the exceptional circumstances occurring in the COVID-19 period. In particular, Australian tax authorities compared business conditions applicable during the COVID-19 crisis with the ones existing before, reaching the conclusion that no PE would be deemed to arise if (i) the company had no PE in Australia before the effects of COVID-19; (ii) the temporary presence of employees in Australia continued to be solely a result of COVID-19-related travel restrictions; (iii) those employees temporarily in Australia would relocate overseas as soon as practicable following the relaxation of international travel restrictions; and (iv) those employees had not been recognized as creating a PE or generating Australian-sourced income in Australia for the purpose of the tax laws of another jurisdiction.

In general, the authors hold the view that the international validity of the content of administrative measures cannot go beyond the framework of the exceptional circumstances that occurred during the pandemic. Therefore, any unilateral extension beyond such a framework might raise critical issues from the perspective of the correct interpretation and application of tax treaties and the related allocation of taxing powers. The authors hold that this should also affect the potential implications that might otherwise arise for legitimate expectation purposes.

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67. See Australia (ch. 1), Austria (ch. 2), Finland (ch. 11) and Slovenia (ch. 26).

68. See ES: Ruling of 18 January 2022 (ref. V0066-22) of the Spanish General Directorate for Taxation.



Some countries did not issue specific guidance during the COVID-19 crisis.<sup>69</sup> This might be the outcome of a specific policy decision<sup>70</sup> or of the conclusion that the analysis contained in the two documents of OECD guidance in fact reflected the existing boundaries for interpretation on the concept of PE.<sup>71</sup>

The three main scenarios outlined earlier in this section raise various critical issues of international taxation that will now be outlined more precisely, together with their implications for the existence of a PE.

When flexibility as to the place of exercise of employment is agreed, it is important to look at the contractual conditions that might achieve a reasonable degree of certainty as to where the employee will mostly work. If one main place of exercise of employment can be determined *ex ante* and that place is the employee's home, the point can be made that both parties have corresponding rights and obligations in such a context. In such circumstances, the so-called home office will have to be duly considered for both taxation of income from employment and business profits that are derived therefrom. This might mean concretely that nothing prevents this place from turning into a fixed place of business to the extent that the other requirements for deeming the existence of a PE are also met. Greek authorities indicated that this position also applies to cases of a dependent agency PE, for which the dependent agent habitually exercised such powers before the start of the COVID-19 crisis.<sup>72</sup>

This line of reasoning might create important repercussions for the interpretation and application of article 15(2), which includes a reference to a PE as an element of the triple condition that keeps exclusive allocation of taxing powers for activities exercised in a country other than that of residence of the employee. However, when looking at this context, the authors find that such repercussions are of rather limited importance in practice. The point is that the context of a home-office PE normally matches the situations in which employees work from their state of residence. Therefore, when that is the case, the case might in fact usually remain under article 15(1), first sentence. Article 15(2) might come into play only when the employment is also exercised in another state. However, when that is the case, the home-office

69. See Belgium (ch. 3), Kenya (ch. 18) and Liechtenstein (ch. 19).

70. For instance, considering that, in Brazil, the international tax nexus is based on the source of payment, the matter of whether a PE exists has very marginal relevance.

71. The latter view is apparently held by Belgian tax authorities, as indicated in the Belgian national report (ch. 3).

72. Circular GR: E. 2130/2021, para. 19 of the IAPR.

concept is unlikely to be relevant, except for cases in which the employee has two homes, i.e. a habitual abode in more than one country. In such a case, the relevant issues should be addressed in line with the solution of how the tie-breaker rule addresses the problems of dual residence.

In the scenario of an employee prompting remote working from home, the tacit endorsement by the employer should, in principle, be regarded as equivalent to an express consent to such an operational mode of exercise of the employment. The problem that arises in practice is that a fair assessment of such circumstances is hard to detect on an *ex ante* basis. The difficulties are even bigger when the employee intermittently decides from where to work. These situations create a strong exposure to risks of international double taxation in connection with different interpretations of the factual context by tax authorities of the states involved. Moreover, they also create complex issues of social security, especially when the employee in fact mostly works from a different country than that whose social security contributions are due. Besides recommending addressing these issues at the contractual level and with an *ex ante* basis, the authors find that tax authorities might find it meaningful to achieve commonly agreed interpretations by means of article 25(3) or issue guidelines that enhance the transparency of their actions at the level of tax audits. Such an agreed interpretative practice might also address the corresponding home office issues.

When the employer encourages remote working from home, it usually also reduces workspace at its premises, often turning individual workspaces into flex spaces. In such circumstances, this development clearly reflects a business strategy that raises the issue of whether the business premises of the employer might remain as the main place for exercising the employment. Since there must be a place of employment, the analysis of facts and circumstances will have to determine the extent to which remote exercise from home might give rise to a PE or be combined with additional places situated in that same state. Such an interpretation should avoid situations of a deemed working place that is manifestly unsuitable to host the employees, including where such a place was at the business premises. After all, this solution is in line with the overall criteria that are commonly used to assess the substance of legal entities.

In addition to the home office PE, remote working also creates exposure to the existence of a PE in connection with the place of exercise of activity by directors and persons with significant decision-making power. According to the Belgian report (*see* chapter 3), the Belgian tax authorities adopt a very low threshold to qualify a place of management as a PE. Indeed, in their

administrative commentary to double tax treaties, the Belgian tax authorities indicate that the mere performance of effective management in Belgium suffices to trigger the existence of a PE under a treaty.

Further critical issues expose a business to the existence of a PE in connection with digital nomadism. In practice, this type of issue mostly arises in connection with choices by the employee, who should nevertheless receive the endorsement of the employer. In essence, as it is entirely immaterial from where digital nomads work, any repeated mobility to a given state that meets the thresholds applicable in a given state can generate a PE for reasons that might be entirely unrelated from the employer's business decisions. This type of problem more frequently arises in the presence of unrestricted mobility of workers. Interestingly, some countries have introduced special regimes for digital nomads, offering visas with limited validity. This is the case in Croatia, Greece and North Macedonia, which grant visas to third-country nationals who intend to reside in the country as a digital nomad for a period of 1 year. The Greek and Macedonian regimes do not address the tax consequences, although it is unlikely that a presence of a digital nomad in the country triggers the existence of a PE. By contrast, the Croatian scheme provides that the holder of a digital nomad visa is not liable to pay tax from income generated by employment or activity for an employer not registered in Croatia. Accordingly, the question regarding the existence of a PE becomes irrelevant.

The North Macedonian report (chapter 22) pointed out that numerous freelancers and digital nomads are settled in North Macedonia while working for foreign companies and earning significant income that is neither declared nor taxed in North Macedonia. These workers have an independent self-employed status (freelancers) despite being *de facto* close to employees, as they are bound by the instructions of the foreign entity and are being remunerated on a monthly basis. This has prompted the Macedonian Public Revenue Office to propose to amend current legislation, broadening the PE definition to include these *de facto* dependent employees in the notion of a PE.

Once a PE is deemed to exist, profits should be attributed to the PE, according to the approved OECD approach (AOA). Therefore, the functions performed by the PE must be determined in order to allocate risks, assets and endowment capital to the PE and to subsequently determine the value of the contributions of the PE in the context of the distribution of tasks within the company as a whole. Consequently, the arm's length remuneration is

to be determined, taking into account the OECD Guidelines.<sup>73</sup> The authors wonder how such approach could concretely operate in a context of greater mobility. According to the Austrian report (chapter 2), in the case of a home office, the cost-plus method seems accepted, and the profits of the PE are determined by applying a profit markup of 3-10% (often 5%) for services with a routine character.

In the case of *DIT (International Taxation) v. Morgan Stanley & Co*, the Indian Supreme Court laid down the test for determining a PE in the case of deputed employees. The key principles of the test are the responsibility of the foreign company for the work performed by the employee, the presence of the employee on the payroll of the foreign company and the employees' control over their jobs with the foreign company. This decision may provide a criterion for determining a PE in the case of employees working from a home office in India and may lead to the creation of a PE for the financial year 2020-21.

#### **4. Physical presence according to articles 15(1) and 17 of the OECD Model**

This section explores the relevance of presence for the establishment of a source-based tax nexus on income from employment and activities exercised by entertainers and sportspersons.

The first sentence of article 15(1) of the OECD Model establishes a personal tax nexus with the employee's residence state, giving such a country exclusive tax jurisdiction on income from employment unless the employment is exercised in the other contracting state. In the latter circumstances, the shared allocation of taxing rights operates under the second sentence of article 15(1) of the OECD Model subject to the exception contained in article 15(2) of the OECD Model. The exception of article 15(2) of the OECD Model reflects the weakness of the link with the taxing jurisdiction of a country other than that of the employee's residence. The taxing jurisdiction of this country is excluded when the triple cumulative negative condition contained in article 15(2) of the OECD Model is met. This condition is formulated as follows:

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73. OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD 2022), Primary Sources IBFD.

- (a) the employee is present in the [work] other contracting state for a period or periods not exceeding 183 days in aggregate in any 12-month period commencing or ending in the fiscal year concerned; or
- (b) the remuneration is paid by or on behalf of an employer who is not resident of the [work] other contracting state; or
- (c) the remuneration is not borne by a PE that the employer has in the [work] other contracting state.

In such a context, physical presence is often the primary indicator of weakness in the tax nexus. If, on the one hand, article 15(1) contains no direct reference to physical presence, on the other hand, article 15(2)(a) carves out cases of short-duration presence of the employee from shared allocation of taxing rights on income from employment. Interestingly, this requirement does not focus on the place of exercise of the activity but rather on that of physical presence. This might be due to the circumstance that physical presence would be traditionally presupposed for the exercise of employment. However, the point can be made that it makes this clause vulnerable to possible distortive effects in respect of cases of remote working. Accordingly, the first condition would not be met by an employee who works remotely from his state of residence and only occasionally sojourns in the other country. Nevertheless, even if that was the case, there might still be chances for the second and third conditions to trigger the tax liability in that contracting state when, for instance, the employee works for an employer established in such a contracting state or has a PE there. Such reasoning leads the authors to conclude that physical presence contributes to establishing a source-based tax nexus but is not decisive for such a purpose. Moreover, in special clauses such as, for instance, that of article 15(3) of the OECD Model (after the 2017 update) or article 19, it is irrelevant.

From the survey conducted across the various national reports participating in this research project, few countries depart from the requirement of physical presence in the application of article 15 of the OECD Model; some are worth being mentioned hereby.<sup>74</sup>

Australia differentiates between short-term working arrangements and longer-term arrangements. A rough rule of thumb is used, and short-term working periods, described by the Australian Tax Office (ATO) as periods of 3 months or less, will not constitute carrying on employment in Australia and thus will not give rise to Australian-sourced income under the domestic law and the tax treaty. When a working arrangement is longer than

74. Others will follow in sec. 1.5. of this general report.

3 months, non-resident taxpayers are required to consider their individual circumstances to determine whether they carry out an employment activity connected to the Australian territory. The ATO lists nine factors that are not exclusively focused on physical presence. Moreover, the ATO issued guidance in which it emphasized that it must be determined whether a non-resident has chosen to stay in Australia despite being able to leave and whether the employee and employer have agreed that Australia can be the usual place of work until that person chooses to travel again. The ATO's approach seeks to distinguish ordinary cases in which Australia becomes a person's usual and longer-term place of employment from cases of similar duration when it is clear the extended stay was temporary and unexpected in terms of the location of performance of work.

As an exception to the criterion of physical presence, Austria also applies the criterion of exploitation of the employment, looking at whether the economic outcome directly relates to the Austrian economy, regardless of whether the employment is personally exercised in the Austrian territory. Such a presumption is particularly relevant for services that are rendered abroad that are utilized in the Austrian territory when the recipient of the services is an Austrian client.

Physical presence is decisive when it comes to article 17, which presupposes it as a single criterion to establish a source-based tax nexus. In such a context, the expression physical presence relates to the exercise of a public performance that contains an entertaining or sports element. As indicated by the Commentary on Article 17 of the OECD Model,<sup>75</sup> the absence of a performance might prevent such a clause from applying. Additionally, in this context, the remote exercise of activities might raise interesting elements. This type of situation is not new for films, considering the difference between the place of shooting the film and the ones where people see them, whether it is at cinemas, via television or by remote streaming. This specific context shows some of the shortcomings of linking a nexus with the physical presence from a policy perspective, especially if the global nature of revenue derived by this type of business is considered. Physical presence instead operates with a much stronger legitimacy when the place of performance in public matches the one where people watch the entertaining or sports event. The authors find that the state of residence and the one of source match in cases of remote performance from the state of residence of the entertainer or sportsperson because of the central relevance of physical

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75. Para. 9 *OECD Model: Commentary on Article 17*, according to which, for example, payments received in the event of the cancellation of a performance are also outside the scope of the provision.

presence and the absence of other source-based tax nexus, thus creating a situation where article 17 in fact ends up in a similar allocation of taxing powers to the one that applies under article 15(1), first sentence. The same holds true when comparing the application of article 17 to such a context with the allocation that would result under the ordinary criteria for taxing business income.

However, also in respect of article 17 of the OECD Model, some country practice shows relevant discrepancy from the criterion of physical presence.

Once again, Australia shows an interesting deviation from the place of physical performance; this time, it is developed at the level of judicial interpretation.<sup>76</sup> According to such interpretation, the place of contract or the place of payment are also relevant criteria for determining the source of the income. This judgment does not exactly clarify how these factors intertwine with the criterion of physical presence, hence leaving some uncertainty as to the source of income from entertainment. This uncertainty became relevant following the adoption of COVID-19 travel restrictions when entertainers and sportspersons were unable to perform due to travel restrictions and public health measures but still received remuneration under a relevant contract. In such a context, the ATO has offered no guidance on whether these payments are considered to be income sourced in Australia or attributed to the exercise of activities in Australia. However, due to the increased use of video conferencing tools and home offices, the exercise of the activity takes place in the residence state of the sportsperson/artist, and the income should be taxed exclusively in such state under articles 7 (business income) and 21 (other income) of the OECD Model. The authors consider that, due to the matching between the state of residence and performance, the solution would be no different in such a context had article 17 applied instead.

## **5. Article 15(2) and (3) of the OECD Model**

### **5.1. Brief introduction**

A closer scrutiny of the clauses of article 15(2) and (3) of the OECD Model is now appropriate in order to understand the critical issues raised by mobility of work for the application of the bilateral treaty clauses on income from employment that follow such a pattern.

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76. AU: HCA, 18 Nov. 1965, *Federal Commissioner of Taxation v Mitchum*, 113 CLR 401.

## 5.2. Article 15(2) of the OECD Model

Within the framework of the triple negative condition used by article 15(2) of the OECD Model for preserving the exclusive allocation of taxing powers in the employee's residence state, the object and purpose of subparagraphs (b) and (c) of paragraph 2 are to look at the potential implications of the link with the employer's activity.

The critical issues raised by these clauses will now be addressed in the context of mobility of workers together with the implications arising under article 15(2)(a) of the OECD Model including, in particular, the determination and enforcement of the time-threshold and the home office.

When looking at how states have regulated the short-duration presence of employees in the clauses of their bilateral treaties, reflecting the pattern of article 15(2)(a) of the OECD Model, some interesting issues arise showing that different tests may, in fact, apply in different bilateral treaties. This is the case, for instance, with Czech treaties. Moreover, the official Czech tax treaty policy is to limit the 183-day rule of article 15(2)(a) not just to pure presence in the territory of a state but the exercise of employment in such a period. This shows a different context that might have relevant implications for how the short-duration clause of article 15(2)(a) operates. Moreover, the Australian national report mentions that some bilateral tax treaties include a different time-threshold under article 15(2)(a).<sup>77</sup>

Interestingly, judicial interpretation in the Netherlands also includes the days of commuting in the computation of the time threshold and stresses that the computation does not require a physical presence for entire days.<sup>78</sup>

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77. For example, the Indonesia-Australia tax treaty only provides an exemption when the employee is in the country for a maximum of 120 days in any period of 12 months, and the Papua New Guinea-Australia tax treaty provides a non-resident employee with an exemption from source country taxation only if the non-resident employee is in the source country for a maximum of 90 days or less. One of the conditions for the short-term exemption condition in art. 15(2) is that the remuneration received by the non-resident person performing personal services in Australia is paid by or on behalf of a non-resident employer (*see further* sec. 1.5.3.).

78. *See* the Dutch report (sec. 21.5.2.). This position reflects the technical interpretation by the *OECD Model: Commentary* and is followed in many countries. However, its enforcement is easier in countries that apply strict border control and visa requirements to the mobility of workers as compared to the ones that admit free circulation across the national borders.



Chinese tax authorities instead apply a different counting for this clause as compared to the one that would apply to determine tax residence.<sup>79</sup>

In some jurisdictions, the requirement has been interpreted in a flexible manner due to the exceptionality of the COVID-19 situation. For example, in South Africa, a concession was made for the years 2020 and 2021, according to which the 183 days were reduced to 117 days. Nonetheless, a day in which an employee works out of his home (i.e. in the residence state) thus does not count as a day of physical presence in the working state. It goes without saying that COVID-19 restrictions may have resulted in unexpected or undesirable outcomes of the 183-day test. It is curious to notice that the Commentary on the OECD Model also restricts the application of article 15(2)(a) in the case that the taxpayer cannot leave the country. While including as a rule the days of sickness of the employee as days to be computed for the purposes of article 15(2)(a), the Commentary sets aside their computation when “they prevent the individual from leaving and he would have otherwise qualified for the exemption”.<sup>80</sup> The OECD suggests that a similar approach could be extended to exceptional circumstances caused by the COVID-19 pandemic.<sup>81</sup>

The impact of the home office on article 15(2)(a) is rather limited, at least insofar as the employee works from a home established in the residence country. The word “home” is often used in the English language as implying that each person usually only has one. In some countries, such as Brazil, physical presence for more than 183 days might trigger tax residence.<sup>82</sup>

79. In CN: STA, Circular 75 [2010], the STA interpreted that, when implementing the criterion provided in article 15(2) of the Chinese DTAs, the counting for the 183-day threshold is not as strict as the counting for the 183-day rule for determining a Chinese tax resident. Hence, in computing the number of days for implementing article 15(2) of the Chinese DTAs, if a person leaves China at the halfway mark, including leaving China and entering China within the validity period of the visa, the number of days of absence from China shall be deductible. However, all of the days of their stay in China shall be included, including the day of arrival or departure, regardless if it is less than 24 hours in a day. Additionally, even if the days of their staying in China are weekends, festivals or holidays, for his vacations spent in China before, during and after the exercise of employment, etc., those days should also be counted as days in China for the purpose of implementing article 15(2) of the Chinese DTAs.

80. Para. 5 *OECD Model: Commentary on Article 15*.

81. OECD, *Updated guidance on tax treaties and the impact of the COVID-19 pandemic*, p. 16 (Concerns related to income from employment) (21 Jan. 2021).

82. See sec. 4.1. of the Brazilian report.

Moreover, especially in the case of mobile workers and digital nomads, it may not be excluded, in principle, that a person has more than one “home”. When such a circumstance arises, it is important to adjust the concept of “home-office” with the conceptual framework of domicile, dwelling and habitual abode and correspondingly expand it to cover all of them. In such circumstances, the exercise of employment from a home office established in a country other than that of the employee’s residence might well trigger source-based taxation in such country.

Should that be the case, there might be links with the possible existence of a PE along the lines that have been described earlier in this general report.<sup>83</sup> The main difference is that article 15(2)(a) contains a 183-day requirement whereby no such minimum threshold is required for the existence of a PE. Therefore, a home office might well give rise to a PE with implications, among others, also for article 15(2)(c), even when it may not trigger the first condition of article 15(2).

Administrative interpretation by the Austrian Federal Ministry of Finance (*Bundesministerium für Finanzen*)<sup>84</sup> follows the OECD view and assumes the constitution of a PE through a home office if the employer de facto requires the employee to use it. Under certain circumstances, however, the Austrian tax authorities deny the constitution of a PE: namely, if either the home office does not become the norm or the employer does not have the power to dispose of the home office since they generally provide the employee with an office. If only preparatory or auxiliary activities are carried out in the home office, this does not constitute a PE within the meaning of article 5(4) of the OECD Model. In practice, the activities carried out by employees at home will often be subsumed under the catalogue of auxiliary PEs (article 5(4) of the OECD Model (2017)). In principle, the COVID-19 crisis should not lead to any changes in the assessment of PEs.

The wording of article 15(2)(b) of the OECD Model raises various critical issues for the mobility of workers. The broad definition of an employer was conveyed within such a clause in order to prevent possible distortions geared at artificially preventing the shared allocation of taxing powers and to secure a consistent application of this clause in cases of secondment. However, in practice, this broadening determines an exposure to mismatching in the characterization of the notion of an employer, which can result in problems of double taxation. The authors wonder whether remote working

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83. See sec. 1.3.

84. AT: BMF, 27 June 2019, EAS 3415; AT: BMF, 6 Nov. 2017, EAS 3392.

and the recruitment of a workforce on a global basis might further worsen this situation of legal uncertainty and therefore recommend the adoption of a globally integrated standard for determining the concept of employer for tax treaties or even including a definition in tax treaties.

At present, the so-called economic employer is often determined by reference to various indicators enshrined in the OECD Commentary<sup>85</sup> and rarely with express reference to it in bilateral treaties, such as the one between Norway and Spain.<sup>86</sup>

In some countries, domestic law has intervened with a corresponding amendment that broadened the conceptual category to the features of the economic employer. This is the case with Sweden, for instance. Since 1 January 2021, an economic employer concept has been adopted with the rule “hire of labour”. However, the rule supersedes the 183-day rule that becomes inapplicable since the economic employer is regarded to be the Swedish company (or similar), hence, the income is taxable in Sweden. The rule entails an exemption for a work-related visit to Sweden of no more than 15 workdays in a row or maximum of 45 workdays in a calendar year. Such situations are not considered as “hire of labour”, hence, the employee will not be taxed in Sweden.

85. See para. 8.14 *OECD Model: Commentary on Article 15*.

86. *Convention Between the Kingdom of Norway and the Kingdom of Spain for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income and on Capital*, Protocol: art. IV (6 Oct. 1999), Treaties & Models IBFD reads as follows: “In order to prevent tax avoidance and to clarify the application of paragraph 2 of Article 15, in particular in situations of hiring out of labour, the competent authorities shall, where necessary, determine by mutual agreement whether the conditions of said paragraph are met.

A situation of hiring out of labour shall be considered to exist where an employee is put at disposal by a person (hirer), to another person (user) to carry out work for the latter in the course of an activity the user carries on in the State where the work is performed, and where the hirer does not bear the responsibility and risk for the results produced by the employee’s work.

In determining whether an employee shall be considered hired-out, a general evaluation shall be made where particular weight shall be put on whether:

- a) the authority to instruct the worker is with the user;
- b) the work is performed at a place which is under the control and responsibility of the user;
- c) the remuneration to the hirer is calculated on the basis of the time utilised, or there is in other ways a connection between this remuneration and wages received by the employee;
- d) tools and materials are essentially put at the employee’s disposal by the user;
- e) the number and qualifications of the employees is not solely determined by the hirer.”

By contrast, the concept of an economic employer has been more frequently developed in the framework of interpretation by administrative and judicial practice, which the authors briefly summarize as follows.

As for administrative interpretation, the ATO holds that the meaning of an employer in tax treaties is aligned with the one applicable under Australian domestic law. Relevant factors for determining the employer include the content of the employment contract, the nature of the contractual relationship and other key indicators of the employment relationship.<sup>87</sup> Similarly in China, the STA interpreted the term “employer” as one who has the right to the work results of the employees and assumes the relevant responsibilities and risks thereof.<sup>88</sup>

The notion of an economic employer has also been clarified by tax courts. In Austria, the Austrian Administrative Court argued that the decisive factor in the assessment of the economic employer is understanding that the entity bears the remuneration.<sup>89</sup> According to Dutch case law, it is not decisive

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87. These key indicators include: (i) who exercises ultimate control over the worker – the right to control being considered in terms of the ability to withdraw a worker from an assignment and/or terminate the relationship with the worker; (ii) who exercises day-to-day control over the worker – that is, the degree of actual control exercised in terms of, for example, how, when and what is to be done; (iii) integration – the nature of the services rendered by the worker and whether they are an integral part of the business activities carried on by the enterprise to which the services are provided; (iv) the terms of engagement – for example, entitlements to leave and who has obligations to deduct withholding tax instalments, pay pension (superannuation) contributions and workers’ compensation insurance; (v) who is responsible for the payment of remuneration for the worker’s services; (vi) who bears the responsibility or risk for the results produced by the worker; (vii) whether the contract is for the achievement of a specified result; (viii) who provides or maintains the necessary equipment and resources to perform the work; and (ix) whether the work can be delegated by the worker.

88. CN: STA, Circular 75 [2010]. Accordingly, the following elements should be taken into account:

- the enterprise of China has command over the work exercised by the personnel mentioned previously;
- the workplace of the personnel in China is under the control or charge of the enterprise of China;
- the remunerations paid by the enterprise of China to the agency are computed on the basis of the working hours of the personnel or have a certain connection with the wages of the personnel. For example, the remunerations paid to the agency are determined according to a certain proportion of the total amount of the wages paid to the personnel;
- the tools and materials used by the personnel for work are mainly provided by the enterprise of China; and
- the quantity and standards of the personnel to be employed by the Chinese enterprise are determined by the Chinese enterprise rather than the agency.

89. AT: VwGH [Supreme Administrative Court], 22 May 2013, 2009/13/0031.

whether an employee has entered into an employment contract. Instead, for tax treaty purposes, it is required that the employee falls under a relationship of authority while these activities need to take place for the account and risk of that person. According to the court, the latter requires that the remuneration paid to the employee for the activities performed in the working state is borne by the person for whom these activities are performed.<sup>90</sup> Additionally, that person benefits from the advantages of these activities and bears any disadvantages and risks that may arise from them. Interestingly, the Netherlands introduced a safe harbour. The secretary of state for finance has indicated that no economic employer is found if a non-resident employee is posted with a Dutch group company (or companies) for a period not exceeding 60 days in a 12-month period, as they are not considered to fall under the authority of the Dutch group company (or companies) (the so-called 60-day test).

In Spain, the notion of an economic employer has been the subject of at least three judgments referring to the employees of a non-resident service provider that were relocated to Spain in order to provide the service to Spanish clients.<sup>91</sup> The cost of the seconded employees was recharged in whole or in part to the Spanish clients under the contract for service. In one decision issued on 19 April 2012 by the High Court of Madrid, the court denied that the Spanish subsidiary could be considered the employer of the seconded employee for the purposes of article 15(2)(b) of the Germany-Spain tax treaty (1968).<sup>92</sup>

Interestingly, the German report mentions a judgment of the German Bundesfinanzhof, according to which article 4, paragraphs 2 and 3 of the OECD Model or similar rules shall not apply for the qualification of the residence of the employer in the sense of article 15 of the OECD MC.<sup>93</sup>

90. See sec. 21.5.3. of the Dutch report.

91. See the following decisions: ES: TSJ (High Court of Madrid), 7 Mar. 2006, *recurso 396/2003*; ES: AN (National Court), 18 May 2006, *recurso 398/2003*; and ES: TSJ (High Court of Madrid), 19 Apr. 2012, *recurso 436/2010*.

92. The same conclusion was reached in the decision of 18 May 2006 issued by the National Court. In this case, the Spanish tax administration proved that the German parent company had invoiced the Spanish subsidiary for the seconded employee's salary costs. However, the Spanish subsidiary was not considered to be the employer because no evidence was provided on the work carried out by the seconded employees for the Spanish subsidiary. In both cases, the tax administration did not provide sufficient evidence regarding the existence of an economic employer.

93. DE: BFH [Federal Tax Court], 5 June 2007, I R 1/06, BStBl. II 810 (2007), IStR 2008, 29: *Convention between the Federal Republic of Germany and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital and to Certain Other Taxes* (29 Aug. 1989),

Article 4, paragraph 3 of the OECD Model should simply help to identify the work state and the residence state. As article 15 of the OECD Model would constitute the principle of taxation in the work state, the employee and not the employer would be the taxpayer under this provision. Thus, it would be solely necessary to define the employee's residence state under the law of the tax treaty. Other scholars have held that this would contradict the wording of the agreement itself, as it states in article 4, paragraph 1 of the OECD Model "residence" for "the purpose of the convention", and this would rather be a conflict of the state parties who claim to be the residence state. This argumentation seems to be in line with the OECD Commentary, which states that the object and purpose of article 15, paragraph 2, lit. (c) of the OECD Model is to avoid the source taxation of short-term employment to the extent that the employment income is not allowed as a deductible expense in the source state because the employer is not taxable in that state, as it is neither a resident nor has a PE. However, the employer is not a resident in the meaning of article 4, paragraph 1, sentence 2 of the OECD Model if it is just liable to limited taxation in the work state. Still, if the employer is liable to full taxation, the employment income is allowed as a deductible expense in this state and thereby does not contradict the object and purpose set out in the OECD Commentary. In these cases, article 4, paragraph 3 of the OECD Model shall not apply.

### 5.3. Article 15(3) of the OECD Model

Article 15(3) of the OECD Model refers to the taxation of income in respect of employment exercised aboard a ship or aircraft operating in international traffic and, in the version amended in 2017, attributes exclusive taxing rights to the employee's residence state in respect of income obtained as a member of the regular staff of a ship or aircraft.<sup>94</sup>

The purpose of this new rule is to provide a clearer and administratively simpler rule regarding the taxation of the remuneration earned by crews working aboard ships or aircraft operating in international traffic. The clear and unquestionable nexus with such a country gives this clause very solid validity. Moreover, it is a relatively simple and straightforward rule and easy

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Treaties & Models IBFD; the tie-breaker rule did not exist and sentence 2 art. 4 did not exist; same opinion L.E. Schoueri, 21 Intertax 1, p. 23 (1993); dissenting opinion: L. De Broe, *Article 15*, in *Klaus Vogel on Double Taxation Conventions* m. no. 250 (E. Reimer & A. Rust eds., 5th ed., Wolter Kluwer 2021).

94. The OECD Model prior to 2017 granted the exclusive taxing rights to the contract-ing state where a company's PoEM was situated.

for both the taxpayer and the tax authorities to apply. Hence, this concept keeps the compliance cost low. In principle, the authors consider this as a possible model also when exploring possible avenues for reforming the main clause of income from employment to address the critical issues raised by remote working.

However, a disadvantage with the concept of this allocation clause is that it is relatively easy to abuse. When there is a “solely” requirement, it is relatively easy to hinder taxation in the source state. If only a minor part of the work is performed in the resident state, the source state may not tax the remuneration at all (only the resident state may tax). With more use of home offices, the concept applied in article 15(3) of the OECD Model will, in fact, result in resident taxation of the remuneration in many cases.

Another problem is that the narrowing down of the scope of this clause to those remunerations and the exclusive allocation of taxing powers constitute elements that indicate the difficulties in geolocating the exercise of their employment.

The authors find it odd that the allocation of taxing powers under article 15(3) differs from that of article 16 for directors’ fees, which also raises difficult issues as to the determination of the place of exercise of their activity. The possible reasons for this discrepancy are unclear. However, the policy option enshrined in article 15(3) might in fact have a stronger validity, besides being easier to enforce. After all, the growing trend of directors exercising their activity on a remote basis (often making key decisions online), especially when operating at the global level, should not be forgotten. A possible future alignment between the two allocation clauses along the lines of article 15(3) might therefore be conceived.

While solving some issues, the narrower scope of article 15(3) opens a Pandora’s box on how to determine the place of exercise of employment for all other workers that used to fall within the scope of the wording of this clause in the version predating the 2017 update to the OECD Model. This is more problematic for ships than for aircrafts, where the staff usually operates as the crew.<sup>95</sup> In particular, cruise ships employ workers to a great extent who do not qualify as a regular complement of the crew and who exercise their activity in a way that raises exactly the same types of problems as all

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95. The authors consider this to also be the case of the so-called flying chefs who are available on board a very limited number of commercial flights and private jet flights. According to the authors, their presence on board is an extension of the crew, that exists to meet the quality standards required by some types of top-notch on-board services.

other employees on board the same ships. Therefore, the authors suggest that article 15(3) of the OECD Model should be amended in a way to also include such employees within the scope of such clause.

Besides the critical issues outlined above, this clause allocates taxing rights in a satisfactory way. The type of employment falling under the scope of article 15(3) requires on-site exercise of the activity. Therefore, even if these types of workers can be very mobile, the exclusive allocation of taxing rights to the residence state might prevent most problems from arising.

Critical issues may nevertheless arise in bilateral treaty practice. Some of them concern the interpretation of the conditions enshrined in this clause. For instance, article 15(3) of the OECD Model has been held to not apply to Portuguese employees of a Spanish company engaged in fishing in national and international waters. Therefore, under article 15 of the Portugal-Spain tax treaty (1993), the Portuguese employees could only be taxed in Spain on the part of the salary that corresponds to the time when the vessel was fishing in Spanish waters (including the time when the vessel was moored in Spanish ports).<sup>96</sup>

Other issues relate to the deviations that this clause presents in some bilateral treaties. For example, Brazilian treaties do not include the remuneration derived from employment exercised aboard boats engaged in inland waterways transport in article 15(3). Moreover, the Cyprus tax treaty model deviates from the OECD wording and, in most cases, Cyprus is awarded the right to tax the remuneration of the employees in the aircraft and shipping industry, since the right to tax is vested to the state of the company employing the crew. This allocation is constant and shows in the most recently concluded treaties.

## 6. Frontier workers

The OECD Model does not include specific clauses on frontier workers. This was an outcome of a clear policy decision that leaves this matter to bilateral negotiations.<sup>97</sup>

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96. See Spanish General Directorate of Taxation, Ruling of 14 October 2021 (ref. V2536-21).

97. See para. 10 *OECD Model: Commentary on Article 15*: “it should be noted that no special rules regarding the taxation of income of frontier workers [...] are included as it would be more suitable for the problems created by local conditions to be solved directly between States concerned.”



This category of workers shares the common distinctive element of a potential full exposure to double taxation in two countries considering their daily (or weekly) commuting between two states. Physical mobility of workers in the European region has prompted states to find ad hoc solutions in their bilateral treaties and to develop specific national tax policies on frontier workers.<sup>98</sup> More recently, the problems of highly mobile individuals, especially within the European Union, have shown that a growing number of persons belonging to this category of workers shares the same problems of frontier workers but cannot invoke the entitlement to ad hoc clauses. Therefore, they end up being treated less favourably, especially when it comes to the existence of cross-border disparities.<sup>99</sup> For this reason, the authors hold the issuing of supranational law of the European Union or similar measures of international tax coordination as highly desirable.

Most agreements regarding frontier workers entail an exclusive taxation right for the employee's residence state. In some cases, the working jurisdiction is entitled to receive certain compensation. For example, Switzerland and France have signed a specific agreement on frontier workers that forms an integral part of the tax treaty between Switzerland and France. According to such an agreement, the residence state is given the exclusive taxation rights. However, in return, the state of the activity shall receive 4.5% of the total amount of the annual gross remuneration as a compensation fee.<sup>100</sup>

In a few cases, the agreement allocates exclusive taxing rights to the working jurisdiction. For example, according to article 15(4) of the Italy-Switzerland tax treaty, the employment income earned by cross-border workers is subject to exclusive taxation in the state where the work is carried out by reference to the agreement of 3 October 1974.<sup>101</sup> The 1974 Swiss-Italian Agreement indeed grants exclusive taxing rights to Switzerland as

98. Switzerland is certainly the most prominent example of a structured policy on frontier workers. However, also other countries like Austria, Belgium, France, Germany, Italy, Liechtenstein and the Netherlands include clauses on frontier workers in their bilateral tax treaties.

99. For a comprehensive analysis of the issues of European Union law raised in this context, see EU Commission, *Ways to tackle cross-border tax obstacles facing individuals within the EU*, Report of Expert Group (2015).

100. See *Agreement between the Swiss Federal Council and the Government of the French Republic on the Taxation of the Employment Income of Frontier Workers*, SR 649.810, art. 2 (11 Apr. 1983).

101. Art. 15(4): "The taxation of employment income derived by frontier workers shall be determined in accordance with the Swiss-Italian Agreement of 3 October 1974, relating to the taxation of frontier workers and financial compensation for Italian frontier municipalities, of which Articles 1 to 5 shall be deemed to form an integral part of this Convention."

the source jurisdiction,<sup>102</sup> although it is provided that, at the end of each fiscal year, Canton Ticino (with Canton Graubünden and Canton Valais) must pay a compensation fee (38.8% of the gross amount of taxes collected) to the Italian municipalities located within 20 kilometres of the Swiss border.

On 23 December 2020, Switzerland and Italy signed a new treaty on cross-border workers as well as a protocol amending the existing double taxation treaty. The new agreement replaces the 1974 Swiss-Italian Agreement and entered into force on 17 July 2023.<sup>103</sup> The agreement applies to new frontier workers, i.e. those who will start working in Switzerland in the Cantons of Graubünden, Ticino and Valais after the agreement enters into force (“new cross-border workers”). The 2020 agreement entails a shared allocation of the taxing rights, whereas Switzerland (considered as the source state) may apply a withholding tax that cannot exceed 80% of the withholding tax that would otherwise normally be payable. Italy (considered the state of tax residence) taxes the worker’s income and eliminates double taxation.<sup>104</sup> The 2020 Swiss-Italian Agreement is not an isolated example of agreements that provide for a shared allocation of taxing rights (*see*, for example, Austria-Liechtenstein, Germany-Switzerland and Italy-San Marino).

The rules on frontier workers regularly require that the employee exercises the employment within a frontier region. The Austrian tax authorities are of the opinion that all places of work are still to be considered close to the border if, taking into account modern transport conditions, it is possible to travel to the place of work from the home on a daily basis based on a reasonable travel time. In other words, if no secondary residence is maintained in Liechtenstein (e.g. subletting a room or premises in a staff home) and if,

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102. Art. 1: “Salaries, wages and other elements of remuneration that a frontier worker receives in respect of an employment shall be taxable only in the State in which the employment is exercised”.

103. In order to avoid any abuse of the regime, there is now a clearer definition of a cross-border worker: “[a]n individual, tax resident in a municipality whose territory is located, totally or partially, in the area of 20 km from the border with the other contracting state who (i) carries out an employed activity in the border area of the other contracting state for a resident employer, PE, or fixed base of that other state and (ii) returns, in principle, on a daily basis to his principal place of residence in the municipality as stated in point (i). It has been established that the contracting state in which the employee’s activity is carried out will annually provide the state of residence in an electronic format (by 20 March of the year following the fiscal year of reference) the information relevant for the purposes of taxation of the cross-border worker (e.g., personal identification data, amount of gross remuneration received, mandatory social security contribution paid, the amount of tax withholdings applied, etc.).”

104. There are transitional rules for persons who work or have worked in the cantons of Graubünden, Ticino or Valais between 31 Dec. 2018 and the date of entry into force of the new agreement who will remain taxed exclusively in Switzerland.

therefore, a return to the Austrian residence on working days actually takes place, the frontier worker status is to be affirmed. According to the Austrian Ministry of Finance, the status as a frontier worker even exists if the distance between the Austrian residence in Tarrenz/Tyrol and the workplace at a company in Vaduz is 150 kilometres by rail or 125 kilometres by road for a shareholder-manager with residence in Götzis and place of work in Zurich. Even these longer distances leave no doubt that the primary frontier worker requirement of returning to the Austrian residence on each working day is actually fulfilled.

The rules on frontier workers also require that the employee returns daily to the residence state provided a certain number of “harmful” days (4 to 6 working weeks) is not exceeded.<sup>105</sup> In this regard, home office days are treated in various ways. While some agreements do not consider home office days as “harmful” days,<sup>106</sup> other frontier worker rules or a MAP regarding those rules expressly consider home office days as “harmful”.<sup>107</sup> The agreements between France and Switzerland grants frontier workers the maintenance of their status if they do not return home up to 45 days per year. However, such rules only apply to the Cantons of Basel-Land, Basel-Stadt, Bern, Jura, Neuchâtel, Solothurn, Valais and Vaud. In addition, for workers in the Canton of Geneva, a special agreement has been signed between the Canton of Geneva and France according to which the place-of-work principle pursuant to article 17 of the tax treaty between Switzerland and France applies.<sup>108</sup> In return, the Canton of Geneva pays an annual amount of 3.5%

105. OECD, *Updated guidance on tax treaties and the impact of the COVID-19 pandemic*, para. 58 (21 Jan. 2021); e.g. the frontier worker rule between Germany and Austria will not apply if the employee does not return to the state of residence or works outside of the border zone for more than 45 days (DE: BMF, 18 Apr. 2019 – IV B 3 – S 1301-AUT/07/10015-02; BStBl. I 2019, 456); Germany-France: 45 days (DE: BMF, 3 Apr. 2006 – IV B 6 – S1301-FRA-26/06; BStBl. I 2006, 304; DE: BFH [Federal Tax Court], 11 Nov. 2009, I R 84/08, BStBl. II 2010, 390); Germany-Switzerland: 60 days (*Convention between the German Federal Republic and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital*, art. 15a para. 2 sent. 2 (11 Aug. 1974), BStBl. II 2011, 1092).

106. S. Bruns, *Homeoffice und Kurzarbeit aufgrund der COVID-19-Pandemie – die steuerlichen Auswirkungen auf grenzüberschreitend tätige Arbeitnehmer und die Antwort der Finanzverwaltung*, Internationales Steuerrecht, p. 228 (230) (2020); *Convention between the Federal Republic of Germany and the French Republic for the Avoidance of Double Taxation and the Establishment of Rules for Reciprocal Administrative and Legal Assistance with Respect to Taxes on Income and on Capital, Business Tax and Land Tax* (BGBl. II 1961, 397) as long as the employee exercises the performance within the frontier region.

107. E.g. MAP Austria-Germany of 24 Aug. 2000 (DE: BMF, 18 Apr. 2019 – IV B 3 – S 1301-AUT/07/10015-02; BStBl. I 2019, 456); Bruns, *supra* n. 106, at p. 228 (231).

108. *Agreement between the Swiss Federal Council (acting on behalf of the Republic and Canton of Geneva) and the Government of the French Republic on financial compensation for frontier workers working in Geneva* (29 Jan. 1973).

of the gross wages paid to frontier workers residing in the district of Ain and Haute-Savoie. Interestingly, the condition is much more relaxed in article 1(f) of Regulation (EC) No 883/3004, which considers frontier workers those who return to the country of residence daily or at least once a week.

The 2020 Swiss-Italian Agreement contains an exemption threshold. In particular, Switzerland and Italy agreed on a 45-day period during which the cross-border worker may derogate to the daily return requirement, although for “work reasons only”. The carve-out is unclear, as it is difficult to draw the line between work reasons and other reasons. Moreover, the carve-out allows the worker to remain in the source state only (and eventually in a third country) but should not apply to the case when the employee works from their “home office” situated in the residence state.

In addition, the Annex to the agreement contains a clause stipulating that Switzerland and Italy would frequently monitor the remote working evolution and, if it was the case, an amendment to the agreement would be discussed. In June 2020, Italy and Switzerland signed an administrative agreement in line with the OECD recommendations published in April 2020.

In cases of remote work, problems could arise with regard to the requirements concerning the exercise of the employment in a frontier region and the daily return requirement. In some cases, the rules appear more flexible. The German reporter highlighted that the frontier rule between France and Germany does not qualify home office days as harmful days provided the employment is exercised within the frontier region.<sup>109</sup>

In the Nordic tax treaty, however, there are specific regulations for frontiers workers between Norway and Sweden, and Norway and Finland.<sup>110</sup> The specific regulation of frontier workers is included in section VI of the protocol to the treaty.<sup>111</sup>

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109. C. Bourseaux & D. Sendler, in *Schönfeld/Ditz Doppelbesteuerungsabkommen (DBA), Abschnitt III, Besteuerung des Einkommens* art. 15, para. 147 (2nd ed., Dr Otto Schmidt 2019 (2019)); D. Höppner & S. Melkonyan, *Grenzüberschreitend tätige Arbeitnehmer in Zeiten der COVID-19-Pandemie – Implikationen und Lösungsansätze*, IStR 735 (736) (2020); DE: BFH [Federal Tax Court], 9 Oct. 2014, BFH/NV 2015, 167.

110. The Nordic tax treaty is a multilateral tax treaty between the five Nordic countries: Iceland, Denmark, Finland, Norway and Sweden.

111. “With reference to Articles 15 and 19

Notwithstanding the provisions of paragraphs 1 and 2 of Article 15 and paragraph 1 of Article 19, income derived by a resident of a municipality in Finland or Norway which borders upon the land frontier between these States, in respect of work performed in such

The expression “is regularly present” means that the taxpayer is normally present at least once every week at his permanent address in the contracting state of which he is a resident. In order for the taxpayer to be deemed to be present at his permanent address, his presence in the state in which he is a resident must comprise at least two days. In this connection, as in any other place where the term “day” is used in this convention, “day” also means part of a day.<sup>112</sup>

The frontier workers rules in the Nordic tax treaty are relatively straightforward. It is the employee’s place of residency that may tax the employee’s income. The employer’s state may not tax. Hence, more use of, for example, a home office does not create any difficulties and/or changes to the current rules.

In the authors’ view, the frontier worker provisions should be revised to allow the employee’s status to be maintained without the daily commuting requirement. This could be done by establishing several working days per year when such commuting is not required: this could be, for example, 60 working days per year. This would facilitate the application of these provisions, as well as bringing it up to date with the new reality where it is now commonplace and possible for part of the work to be carried out remotely. This threshold of 60 working days would include both the days when the employee stays overnight in the state in which they work and the days when they stay in their home state.

Article 15a(2) of the tax treaty between Germany and Switzerland<sup>113</sup> defines a frontier worker as an employee who is resident in one contracting state and working in the other jurisdiction but regularly returns to his domicile. The requirement to return home may be waived without losing the

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a municipality situated in the other of these States, shall be taxable only in the State of which the person in question is a resident, provided that such person is regularly present at his permanent address in that State.

...

Notwithstanding the provisions of paragraphs 1 and 2 of Article 15 and paragraph 1 of Article 19, income derived by a resident of a municipality in Norway or Sweden which borders upon the land frontier between these States, in respect of work performed in such a municipality situated in the other of these States, shall be taxable only in the State of which the person in question is a resident, provided that such person is regularly present at his permanent address in that State.”

112. [https://www.regjeringen.no/contentassets/24bd8e3ac9b44651804beca5dcdbd4472/den\\_nordiske\\_skatteavtalen\\_innarbeidet\\_versjon.pdf](https://www.regjeringen.no/contentassets/24bd8e3ac9b44651804beca5dcdbd4472/den_nordiske_skatteavtalen_innarbeidet_versjon.pdf) (accessed 19 Dec. 2022).

113. *Convention between the Federal Republic of Germany and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital* (11 Aug. 1971), Treaties & Models IBFD.

frontier worker status if the worker does not return home for a maximum of 60 days per year “due to his working activity”. The competent authorities have agreed that working days on which a frontier worker spends the whole day at the place of residence are not considered non-return days within the meaning of article 15a(2) of the tax treaty.<sup>114</sup> According to article 15a(1), the state of residence has the main taxing right on income from employment of frontier workers. The source jurisdiction shall apply a withholding tax up to 4.5%.

Another type of derogation is the “24-day rule”, which is a tax tolerance applicable in the tax treaty between Belgium and Luxembourg concluded on 16 March 2015 that has a broader scope than the “frontier worker regime”. According to this agreement, a worker (who is a tax resident in Belgium and employed by a Luxembourg employer) may spend a maximum of 24 working days outside the territory of Luxembourg (for example, in his home office in Belgium or in a third country) while the earned income continues to be fully taxable in Luxembourg (thus meaning there is no shift of entitlement to levy tax on Belgium).<sup>115</sup> The same also applies the other way around (that is, a tax resident in Luxembourg who works in Belgium for a Belgian employer).<sup>116</sup> If the limit of 24 days is exceeded, then the tolerance is not applicable at all, and the worker would, in principle, be taxable in their state of residence for all of the days that they do not spend physically in their “normal” employment state.

After the COVID-19 pandemic, Belgian and Luxembourg authorities even adapted the limit of 24 days to a limit of 34 days. It is clear that remote working is taken into account in this tolerance that makes it more adapted to the new/hybrid ways of work.

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114. Consultation Agreement on the *Convention between the Federal Republic of Germany and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital* (11 Aug. 1971), Treaties & Models IBFD, concerning full-day working days spent at the place of residence by frontier workers on the application of the frontier worker rule in art. 15a (concluded 15/18 July 2022).

115. See S. Dumortier & O. Coulie, *Increased flexibility for Belgians working in Luxembourg*, Expat News 4, pp. 18-20 (2015); A. Elshout & Y. Bastiaens, *International employment – Belgium-Luxembourg Double Taxation Avoidance Agreement: the ‘24-day rule’ becomes the ‘34-day rule’*, Expat News 8, p. 9-11 (2021).

116. For the interpretation of this tolerance, see BE: Circular Letter AGFisc N° 22/2015 (n° Ci.700.520) of 1 Jun. 2015.

## **7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)**

Various sections of this general report have addressed the various cross-border tax issues raised by the mobility of workers throughout the COVID-19 crisis. This section focuses on the legal instruments used by tax authorities to introduce the temporary measures facing the emergency.

Besides the unilateral measures, most countries have concluded interpretative MAPs on issues of tax treaty interpretation arising in such a context.

A good example of the unilateral approach to cross-border tax issues raised by the COVID-19 pandemic is the guidance issued by the Canada Revenue Agency. It states that certain US residents who typically work in Canada but, at the same time, are usually not present in Canada for more than 183 days and that, for this reason alone, are not taxable in Canada on their employment-derived income, may stay and work in Canada for an extended period of time because of the travel restrictions. The Canada Revenue Agency's guidance confirms that, until the earliest of certain events occurs: for instance, when the employee returned or was able to return to their jurisdiction of residence before 31 December 2020, those days were not to be counted toward the 183-day test in the Canada-United States tax treaty.<sup>117</sup>

Interpretative MAPs are allowed under article 25(3) of the OECD Model and are generally included in bilateral treaties. The interpretative MAPs issued on the COVID-19 crisis were the main instrument recommended by the OECD in the two documents – respectively issued soon after the start of the emergency and, in an updated version, a year later – that proposed coordinating the reaction by the different states to a global problem and preserving the status quo of international tax law. In fact, the core guidance issued by the OECD was that the temporary nature of the force majeure situation should not change the allocation of taxing powers that governed the factual context before the start of the COVID-19 crisis.

The content of the OECD interpretative guidance also excluded the creation of a PE in connection with stranded workers or the unintended presence of employees in countries other than those in which they regularly work and keep an office space. Vice versa, a PE will not cease to exist due

117. <https://www.canada.ca/en/revenue-agency/campaigns/covid-19-update/guidance-international-income-tax-issues.html>.

to the temporary absence of workers. In line with this interpretation, the OECD recommended not to alter the framework concerning frontier workers, also considering the practical implications for tax and social security compliance.

Especially in the European region, states have extensively issued interpretative agreements usually reflecting the OECD guidance. Such agreements were generally issued with limited temporary validity and, in most cases, subject to tacit renewal.

Germany concluded several consultation agreements such as those with Austria, Belgium, France, Luxembourg, the Netherlands and Switzerland in order to avoid unforeseeable consequences because of special provisions concerning commuting in tax treaties with these states.<sup>118</sup>

Similarly, Belgium concluded agreements with France,<sup>119</sup> Germany,<sup>120</sup> Luxembourg<sup>121</sup> and the Netherlands,<sup>122</sup> implementing a mutual “force majeure tolerance” for cross-border workers and providing an exemption in relation to “home working days”. If certain conditions are met, these home working days are deemed to be spent by the employee in the state where the cross-border worker would have exercised the employment in the case that no such measures had been taken.

In addition, consultation agreements have also been concluded with regard to frontier workers. For example, pursuant to article 15(6) of the Austria-Germany tax treaty, “working days for which wages are received and on which frontier workers only carry out their activities in the home office due

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118. OECD, *Updated guidance on tax treaties and the impact of the COVID-19 pandemic* Box 4 (21 Jan. 2021).

119. *Agreement between Belgium and France*, 15 May 2020 (end 30 June 2022), available at <https://eservices.minfin.fgov.be/myminfin-web/pages/public/fisconet/document/7dfed6d4-eaa8-43a6-a3a1-59559f270ccd> (accessed 7 Oct. 2022).

120. *Agreement between Belgium and Germany*, 6 May 2020 (end 30 June 2022), available at <https://eservices.minfin.fgov.be/myminfin-web/pages/public/fisconet/document/17cc0520-2203-4b5e-a1d1-2e05e88bd5d4> (accessed 7 Oct. 2022).

121. *Agreement between Belgium and Luxembourg*, 15 May 2020 (end 30 June 2020), available at <https://eservices.minfin.fgov.be/myminfin-web/pages/public/fisconet/document/3fd5ea15-4c99-483b-90d6-532ea6456e1d> (accessed 7 Oct. 2022).

122. *Agreement between Belgium and the Netherlands*, 30 Mar. 2020 (end 30 June 2022), available at <https://eservices.minfin.fgov.be/myminfin-web/pages/public/fisconet/document/a0b7360a-d0d2-4064-bcd6-e42fc3c7f4b4> (accessed 7 Oct. 2022).



to the measures to combat the Covid-19 pandemic are not considered days of non-return".<sup>123</sup>

In some cases, the countries reached informal agreements despite not being mutual agreements. Liechtenstein tax authorities have agreed with Austrian tax authorities that persons who were previously classified as frontier workers because they commuted "as a rule every working day" but who now work in their home offices in order to contain the further spread of COVID-19 (among other things, on the basis of the recommendations issued by the respective governments) do not lose their frontier worker status as a result. This is because, "as a rule", the affected workers travel from their place of residence across the border to their place of work, and the special situation caused by the COVID-19 pandemic did not change this. However, a definite period of COVID-19 measures has not been defined.

Scholars acknowledge the value of interpretative MAPs as an expression of subsequent commonly agreed treaty practice and therefore treat them as relevant under article 31 of the VCLT.<sup>124</sup> The view has been held that interpretative MAPs are considered as public national law agreements that bind the negotiating authorities in the first place.<sup>125</sup>

The authors question the application of both lines of reasoning to the implications produced by the COVID-19 crisis on the models of exercise of the employment. In principle, using interpretative MAPs is a sound approach for addressing critical issues concerning the interpretation and application of tax treaties, even more so when they address exceptional situations with far-reaching implications for large groups of taxpayers. However, the validity of interpretative MAPs presupposing a crisis fades away when the latter comes to an end.<sup>126</sup> Moreover, states cannot use interpretative MAPs to change the conditions agreed in their treaties. For such purposes, they should instead use protocols and have them duly signed and ratified by the

123. DE: BMF, 29 Jan. 2021, *2nd maintenance of the info on the application and interpretation of double taxation agreements in connection with the COVID 19 pandemic*, 2021-0.065.761, sec. 3.

124. See B.J. Arnold, *An Introduction to Tax Treaties*, para. 56 (United Nations 2020), available at <https://www.un.org/development/desa/financing/document/introduction-tax-treaties-brian-arnold> (accessed 3 June 2022).

125. R. Ismer & S. Piotrowski, *Article 25*, in *Klaus Vogel on Double Taxation Conventions* m.no. 92 (E. Reimer & A. Rust eds., 5th ed., Wolters Kluwer 2021).

126. In this sense, see already P. Pistone, *Chapter 8: The Faltering Legitimacy of the Place of Physical Presence as a Tax Nexus for Active Income*, in *Building Global International Tax Law: Essays in Honour of Guglielmo Maisto* sec. 8.2. (P. Pistone ed., IBFD 2022), Books IBFD.

competent legislative bodies. In Germany, the dualistic tradition requires a sufficient statutory basis in domestic law for these agreements to bind the courts, while the implementation of article 25(3) of the OECD Model itself cannot serve as a sufficient basis.<sup>127</sup> However, Germany has enacted section 2, paragraph 2 of the General Tax Code (*Abgabenordnung*, AO) that qualifies closed mutual agreements as statutory orders according to domestic law.<sup>128</sup> Therefore, in principle, these mutual agreements would create a certain binding effect. However, according to German jurisprudence, the competent authorities may not simply unilaterally (from a domestic law perspective) differ from this former understanding and practice.<sup>129</sup> Second, German domestic law provides an authorization for the competent authorities to conclude MAPs.<sup>130</sup> Despite this, the German Federal Tax Court has held that such a provision contradicts the principle of legal certainty in light of German constitutional law.<sup>131</sup> In consequence, the German courts are still not bound by MAPs, especially if they do not simply clarify an agreement.<sup>132</sup> Therefore, in the context of the impact of COVID-19 on tax allocation, the combination of these two aspects creates severe uncertainty concerning the binding effect and legal validity of these agreements under German domestic law.

The critical issues outlined in this section lead the authors to conclude that interpretative MAPs may not deprive states of the right to enforce their laws in conformity with the facts that concretely occur. This is particularly true also insofar as it is considered that the impact of COVID-19 on employment models has produced a structural change that generally reduces on-site work and replaces it with remote and agile work.<sup>133</sup>

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127. R. Ismer & S. Piotrowski, *Article 25*, in *OECD MA 2017* para. 155 et seq. (Vogel/Lehner, Beck 2021).

128. Cf. Para. 53 *OECD Model: Commentary on Article 25* (2017).

129. J. Schönfeld & N. Häck, in *Systematik* para. 110 (Schönfeld/Ditz, Otto Schmidt 2019); DE: BFH [Federal Tax Court], 25 Oct. 2006, I R 81/04, BStBl. II 2010, 778.

130. In DE: *Abgabenordnung* (General Tax Act, AO), 16 Mar. 1973, para. 2, sec. 2; Ismer & Piotrowski, *supra* n. 127, at m. no. 92; DE: BFH [Federal Tax Court], 11 Nov. 2009, I R 15/09, BStBl. II 2010, 602; AT: VwGH [Supreme Administrative Court], 27 Aug. 1991, 4 K 3363/07, EFG 2008, 593.

131. DE: BFH [Federal Tax Court], 10 June 2015, I R 79/13, BStBl. II 2016, 326; cf. Y. Hohler, C. Laschewski & K. Laschewski, *Die Besteuerung von Abfindungen in Wegzugsfällen*, Deutsches Steuerrecht, p. 2333 f. (2016).

132. DE: BFH [Federal Tax Court], 10 June 2015, I R 79/13, BStBl. II 2016, 326; para. 53 *OECD Model: Commentary on Article 25* (2017); Ismer & Piotrowski, *supra* n. 127, at m.no. 92.

133. It is, in fact, a new normal as indicated by Pistone, *supra* n. 128, at para. 8.2.

Some specific issues of the content of the interpretative mutual agreements issued during the COVID-19 crisis require further attention hereby. Consultation agreements contain MAPs that consider days spent in the home office due to the COVID-19 crisis as days spent in the state where the employee would have usually exercised the employment.<sup>134</sup> The object and purpose of these rulings is comparable to the “replacement approach” applied in accordance to article 15(2) of the OECD Model.<sup>135</sup> However, it is not usual practice in some jurisdictions such as Germany, where the *Bundesfinanzhof* strictly adheres to the physical presence principle.<sup>136</sup> Evidently, allowing for this approach to apply also after the end of the COVID-19 crisis creates some major disturbance to the allocation of taxing powers that states had agreed when signing the treaty.

Moreover, according to several interpretative MAPs, working days spent in the residence state shall only be deemed as working days spent in the contracting state in which the place of work (place of integration into the enterprise of the employer) would have been located if the measures had not been taken (source state). As a consequence of the fiction, the salary attributable to the days worked in the residence country because of the pandemic may be taxable in the source state.

Evidently, the new normal for remote and agile working suggests the need for a possible intervention on the drafting of the treaty clauses to re-establish a reasonable balance in the allocation of taxing powers. The need for a change mainly concerns the wording of article 15 of the OECD Model but also other types of active income, such as business profits – with implications also for the validity of the concept of PE – and income derived by entertainers and sportspersons.

134. OECD, *Updated guidance on tax treaties and the impact of the COVID-19 pandemic* Box 4 (21 Jan. 2021).

135. Compare L. De Broe, *Article 15*, in *Klaus Vogel on Double Taxation Conventions* m. no. 53 et seq. (E. Reimer & A. Rust eds., 5th ed., 2021). See also P. Pistone, *Article 15: Income from Employment/Dependent Personal Services - Global Tax Treaty Commentaries* paras 2.2.1.1. and 3.2.1., *Global Topics IBFD* (accessed 24 July 2023).

136. DE: BFH [Federal Tax Court], 17 Oct. 2003, I B 98/03, I S 9/03, NV 161 (2004).

## 8. The future of the mobility of work: A need for adjusting the existing treaty rules?

### 8.1. Article 5 (permanent establishment)

The existing discussions regarding the question of whether employees in a home office constitute a PE for the foreign employer show the need for a change to the existing system in order to adapt to the increasing mobility. Additionally, with regard to the issues raised by the digital economy, the question arises as to whether a physical presence for a state's right to tax is still necessary to take account of current business models. The international debate on Pillar One has proven the validity of claims to tax income by the so-called market state, and the authors consider that the place of business should, in fact, be adjusted to the specific business models. Accordingly, a virtual PE is not contrary to the wording of article 5 and adjusting the allocation of taxing rights to cases of significant economic presence in such country can occur even when the enterprise does not have a physical place of business there.

The authors reiterate the validity of the virtual PE concept as a qualitatively suitable solution to keep the role of PE in tax treaties. Adjusting the commentary to the virtual business models would be required anyhow to meet the new challenges of remotely exercised activities.

Interesting proposals relevant for the amendment of the PE definition in view of “digital nomads” have also been put forward by De Wilde<sup>137</sup> and Kostić.<sup>138</sup> De Wilde has proposed that the taxable presence of multinationals could be assessed by means of some quantitative “labour factor presence test” which refers to, for example, the operations undertaken by the multinational workforce within a country (workforce presence test or PE-when-functions-performed rule). Kostić proposes that the PE definition should encompass situations where a non-resident enterprise engages dependent service providers (employees and/or independent workers) who perform activities that enable business activity of the enterprise other than local marketing and distribution activities (workforce presence PEs). All in all, there are good reasons for additional specific rules, but the authors warn that this may result in another layer of complexity.

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137. M.F. de Wilde, *Sharing the Pie: Taxing Multinationals in a Global Market* sec. 6.3.3.4. (IBFD 2017), Books IBFD.

138. S.V. Kostić, *A Plea for a Workforce Presence PE Concept in a Post-Covid Digitalized World*, 49 Intertax 10 (2021).

The commentary should be amended to provide clearer guidance regarding what constitutes a home office PE. To that effect, a counting-day test could be included to clarify the degree of permanence needed to constitute a PE. In addition, a more fundamental problem seems to arise in relation to the notion of a PE – that is, the possibility of creating and providing products and services without a permanent place of business in the jurisdictions where those products and services are created. Thus, the problem is no longer restricted to not having a physical presence in market jurisdictions but to not having a physical presence (understood as a permanent place of business) anywhere.

Kostić has proposed including a new workforce presence PE in which “the existence of certain personnel of the foreign enterprise in the source state, personnel without the existence of a fixed place of business of the enterprise for which they are working, may be deemed to constitute the PE of that enterprise”.

Second, it seems that the profit allocation methodologies should be updated to consider the new virtual reality that enables new players and new functions taking part in the profit-generating process. Due to technological breakthroughs, more players manage to participate in the profit generation activities of an enterprise than in the past, and it is easier and less costly to allocate revenues between the relevant states based on the different players that contribute.

## 8.2. Article 15 (Employment income)

International remote working has called into question the adequacy of physical presence and whether a revision of article 15 of the OECD Model is required to address the new challenges. The authors suggest changing the allocation of taxing rights applicable under this treaty clause.

Article 15(1) of the OECD Model assigns the right of taxation to the state in which the work is performed. With the increasing mobility, this nexus could be considered no longer appropriate for the proper allocation of taxation rights between contracting states. For example, the income of digital nomads who are very mobile and do not have a sufficient nexus to the state where they currently exercise work is unlikely to be captured by article 15(2) of the OECD Model. Their income shall remain taxable only in the state of residence (assuming they have one). The outcome is therefore similar to workers who fall under article 15(3) of the OECD Model

regarding employees that work on a ship or aircraft that operates in international traffic who are exclusively taxable in the residence state except when the ship or aircraft is operated solely in the other contracting state. Accordingly, exclusive taxation in the residence country should remain as the basic rule for article 15.

Given the development of modern technologies, it becomes increasingly difficult to determine the exact location of the physical performance (place of activity). The same difficulty is also enshrined in the Commentary on Article 16 of the OECD Model, and that provision also assigns the right of taxation to the residence state of the company in which the directorship role is maintained. This clause could also shift to exclusive taxation in the country of residence of the manager or, alternatively, be shared with the country of the day-to-day management of the company.

Similarly, for income derived in the exercise of a public function, article 19 of the OECD Model assigns the right of taxation to the state that makes the payment (only exceptionally to the state where the activity is performed).

Therefore, the question arises as to whether a similar system could be applied in article 15 of the OECD Model, departing from the location of physical exercise of the employment and taking into account that article 15(2)b) of the OECD Model already allows taxation in the state in which the company bearing the employee's costs is resident. Various solutions have been advocated.

According to a first solution, the place of exercise of the employment should be determined by reference to the employee's ordinary place of work. It has been submitted that this goal could best be achieved with an amendment to the Commentary on Article 15 of the OECD Model that could expressly mention the ordinary place of work as a relevant criterion for the identification of the place of exercise of the employment. An option could also be to limit the scope of this clarification only to mobile workers by using the following formulation:

For employees entitled to work remotely in part or full, the place of exercise of the employment will be deemed to be the one where they ordinarily conduct their activity. If such activity is conducted in the State of residence of the employee, Article 15 (1) will be interpreted as attributing exclusive taxing jurisdiction to such country.

Under a second solution, the criterion of physical presence could be maintained (hence preserving the current setting of article 15 of the OECD

Model), but the threshold of the 183 days contained in article 15(2)a) of the OECD Model could be lowered. However, according to this solution, the state of the activity would still not be allowed to tax the income in the case that the employee works remotely from the residence state on a full-time basis.

Under a third solution, the tax could be levied only in the state where the employer is resident for tax purposes. The taxing rights would be allocated to the employer's residence state similar to article 16 or article 19(1a) of the OECD Model, although with a maximum threshold. Under a variant of the third solution, the employer's state could then remit a portion of the revenue to the employee's residence state, as is the case in many frontier worker agreements. Such a sharing mechanism could therefore apply also if the employment activity is carried out remotely and, therefore, the employee is not physically resident in the other contracting state where the employer is tax resident, and the activity would have been exercised if not carried out remotely.

Under a fourth solution, the employee's residence state could be given exclusive taxing rights similar to article 15(3) of the OECD Model. Such a solution could be achieved by deleting article 15(2)(b) and 15(2)(c) of the OECD/UN Model, as also advocated by some authors.<sup>139</sup> According to this line of reasoning, article 15(2)(b) should be deleted because it does not meet an adequate – substantial – nexus for source taxation of mobile service providers; similar considerations could also be made in respect to article 15(2)(c) of the OECD/UN Model. In this respect, deleting article 15(2)(b) and (c) might also be a sensible option considering the rise of the notion of the economic employer, which calls upon the need for further work on the notion of the economic employer. The concept of economic employer gained new momentum also due to remote working and/or teleworking. However, this may affect cases where employees “formally” working from a country on the payroll of a local subsidiary or a branch, “in substance” work exclusively for an overseas company of the same MNE group. The domestic legislations of some countries contain the concept of economic employer of seconded employees. For example, the German Ministry of Finance defines seconded employees as employees of non-German entities,

139. S. Kostikidis, *Nexus for Source Taxation of Mobile Individual Service Providers in Tax Treaties*, British Tax Review 2 (2023), available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=4444617](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4444617).

whereas the entity to which the worker is seconded can be regarded as their economic employer.<sup>140</sup>

The concept of economic employer may have a twofold impact, with regard to the application of article 15 of the OECD Model and the fulfilment of withholding tax obligations and (less frequently) social security obligations, respectively. Until 2010, the Commentary on Article 15 of the OECD Model defined the term “employer” in the strict legal sense – *de jure* employer. The 2010 and later versions of the commentary suggested that the substance should prevail over the form of employment relations and that the term “employer” should be understood in a broader economic sense, where the domestic legislation of the relevant contracting state allows disregarding the formal employment relationship for tax purposes. The notion of an economic employer is flourishing in domestic legislations.

This could have an impact in the context of remote working. For example, the Swedish government introduced the concept into the domestic legislation, which entered into force as of 1 January 2021. In Sweden, income from employment can be taxed if an employee works from Sweden for more than 15 days in a row or 45 days in total during a calendar year (while the employees carry out the working activities remotely for the rest of the time). In the United States, the threshold is longer, that is, more than 90 days in the calendar year. Not all domestic notions of economic employers rely on physical presence. Salaries that are paid by a foreign employer (who does not have a PE in Germany) but are recharged to the German company are also subject to wage tax withholding. The same applies as of 2020 for a salary that is not actually recharged but should have been recharged under an arm’s-length perspective. The German company is deemed to be the economic employer and is thus required to calculate and transfer the appropriate wage tax return to the tax office on day one.

The changes considered in the paragraph should also consider in depth the consequences of possible misalignment with social security contributions and also with administrative burdens for the taxpayers. Remote workers can cause wage tax withholding obligations in more than two countries. One of the potential solutions for this problem could be implementing a “one-stop shop” approach that would require the country where the employer is resident to withhold tax on the whole amount and distribute it to the tax

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140. The concept of economic employer can be also found in the domestic legislation of several countries, including Australia, Canada, China, Finland, Germany, India, the Netherlands, South Korea, Sweden and the United Kingdom.



administrations of other states entitled to the tax of the business income of the employee.

### **8.3. Article 17 (Entertainers and sportspersons)**

Article 17 of the OECD Model relies on the requirement of physical presence, and it captures activities of very short duration. Some authors have advocated for the removal of article 17 of the OECD Model as the main justification for keeping the article – that is, the lack of information regarding the residence taxation of artists and sportspersons is outdated in the current legal framework. Similarly, technological advances, in general, might ease a transition into a new set of rules that better factor in the new ways of work. Although passport stamps remain important in countries with border controls, GPS technology might also be important in the case of countries without border controls. This technology is already incorporated into the devices that are used daily, and it might prove helpful in tracking the place of work of individuals to apportion the income according to the effective presence within a jurisdiction. In this regard, a “redistribution mechanism” in which the residence state transfers the portion of tax revenue to the source states should be devised.

It could be wondered, therefore, whether the provision should be amended by inserting a minimum duration requirement or a requirement that only performances that exceed certain monetary thresholds are taxed in the source state, as is also envisaged in the OECD Commentary.

First, the traditional thought of services was that they are performed in physical proximity to the recipient and, as such, the source rules adopted for such services prioritized the place where such services were rendered. Nowadays, thanks to technological change, it is relatively easy to perform services remotely, and the time has come to revisit the existing “binary” source rule and possibly adopt rules that would allocate the profit between the relevant states of the service providers and recipients. It also seems that special source rules may be adopted to live-stream activities.

Similarly, similar issues arise under article 17 of the OECD Model in respect of digital entertainment such as e-sports and e-gaming. Assuming that participants to competition connect from home, where are the activities performed for such a tournament? Is it the place from which the players take part in the event? Is it the country in which the e-sports players/teams are tax resident? Is it the country in which servers of the e-sports game platform

are located? Is it the country where the tournament organizer/publisher is tax resident?

The US report pointed out that US international tax source rules seem to be outdated in situations such as a performance by Zoom to US viewers by an individual who is present in another country. The current rule of personal services will allow the performer to avoid US tax even though the performance is only for American viewers. For example, the reporter mentioned that, in the United States, certain hospitals provide medical advice during the night-time while using doctors who are situated in Australia.

This is a difficult question to answer. In movie production, many taxing jurisdictions may be involved as far as the remuneration of the actor is concerned: the actor's residence state, the state where the actor is physically present during the movie production and, lastly, the state where the movie is displayed in cinema halls (if different from the other two). Putting aside the actor's residence state, which is not prevented from applying its tax on the actor's remuneration, under article 17, such income could be taxable as well in the state where the performance related to the movie production takes place but not in the state where the movie is displayed in cinema hall. The reason is that no performance is exercised on the territory of such state. In other words, for the purposes of article 17, the source state is only that in which the entertainer or sportsperson is physically present and personally performing an activity as such. In digital entertainment, this means that the income of e-gamers is taxable exclusively in the residence state.

As a derogation to the criterion of physical presence, it could be wondered if it could make sense that the income is taxable in the residence state of the tournament organizer/promoter considering that it pays the prize money. Alternatively, the residence state of the video game publisher could also be allowed to tax the income. A video game publisher is a company that publishes and owns video games that have been developed either internally by the publisher or externally by a video game developer. This stated, it could therefore be argued that, since the e-sports player performs the entertaining activity through the video game (which is owned by the publisher), the place where the video game platform is operated, which may coincide with the state where the publisher is tax resident, could be regarded as the place of the performance for purposes of article 17. In other words, the video game could be assimilated to a "virtual space" where e-sports players exercise the relevant performance with the publisher's permission to access the video game and therefore become visible to the "virtual spectators".

In the authors' view, the solutions that depart from the place of the physical exercise are intriguing from a scientific point of view but require substantial amendments to the current legal framework.

After all, it should be considered that the principle of physical presence appears the most suitable in consideration of the fact that the wording of article 17 refers to "personal activities as such exercised in the other Contracting State". The provision therefore presupposes that the entertainer enters the territory of the other contracting state, although it must not do so necessarily to entertain the public of such state. The movie example is illustrative in this respect. The actor is taxable in the other contracting state even though the activity exercised therein will entertain the audience of cinema halls located in other jurisdictions (where the actor is not taxable under article 17).

Second, the solution appears in line with logic that has driven the drafting of the provision that has been thought to address entertaining activities in a non-digitalized world that did not contemplate forms of online entertainment.

Accordingly, based on the place of physical exercise, in the case of e-sports players playing online and connecting from their homes, it can be concluded that prize money is taxable exclusively in the state of the physical presence, which generally coincides with the residence state. By contrast, in the case of offline playing, the income is taxable in the state where the activity is physically exercised – that is, in the place where the tournament takes place.



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## Chapter 1

# The Impact of Tax Treaties on International Mobility of Work in Australia

Kerrie Sadiq and Richard Krever

### 1.1. Mobility of work and domestic tax law

#### 1.1.1. Background

Australia comprises over 7.5 million square kilometres, which makes it the sixth largest country by land mass and the largest completely surrounded by water. Its land mass is 50% greater than Europe, but with a population of approximately 25 million, mainly located on the eastern seaboard, it is sparsely populated and only accessible by air or sea. These unique features made it possible for the government to impose both stringent and long-term domestic and international travel restrictions at the onset of the COVID-19 pandemic, restrictions that affected many hundreds of thousands of Australian residents and citizens. The top five nations of travellers who were the most affected but were able to enter Australia during restrictions by meeting certain strict requirements including quarantine periods were New Zealand, the United Kingdom, China, India and the United States.<sup>1</sup>

The first reported case of COVID-19 in Australia was on 25 January 2020, with the first recorded death on 1 March 2020.<sup>2</sup> On 21 January 2020, enhanced screening measures for travellers from Wuhan to Sydney commenced.<sup>3</sup> This was followed by foreign nationals, excluding permanent residents, who had been in mainland China from 1 February 2020 being banned from entering Australia for 14 days from the time they had left or transited through mainland China, although Australian citizens and permanent residents were still able to enter Australia subject to self-isolation. This was

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1. Australian Bureau of Statistics, *Overseas Travel Statistics, Provisional*, June 2021 (14 July 2021), available at <https://www.abs.gov.au/statistics/industry/tourism-and-transport/overseas-travel-statistics-provisional/latest-release> (accessed 15 Sept. 2022).

2. K. Campbell & E. Vines, *COVID-19: A Chronology of Australian Government Announcements (Up Until 30 June 2020)*, Parliamentary Library Research Paper Series 2020-21 p. 2 (23 June 2021) (citing WA Health, *WA Confirms First Novel Coronavirus Death*, Media Release (1 Mar. 2020)), available at [https://parlinfo.aph.gov.au/parlInfo/download/library/prspub/8027137/upload\\_binary/8027137.pdf](https://parlinfo.aph.gov.au/parlInfo/download/library/prspub/8027137/upload_binary/8027137.pdf) (accessed 15 Sept. 2022).

3. Campbell & Vines, *supra* n. 2, at p. 3.

closely followed by various federal government announcements in respect of Iran, Italy and Korea (Rep.).

On 15 March, a universal self-isolation requirement of 14 days was put in place for all international arrivals, followed four days later by the closure of international borders to all non-citizens and non-residents. Outbound travel for Australians was subsequently banned from 25 March 2020. From 27 March 2020, travellers arriving in Australia were subject to mandatory quarantine at designated facilities. Throughout 2020 and 2021, many Australians were stranded overseas with limited ability to return due to lack of flights, caps on passenger arrivals, and/or exorbitant airfares. Restrictions began to ease in late 2021, but some restrictions remain in place.

Throughout this period, many Australians were forced to remain outside the country and either extend employment in their host destinations or work for Australian employers from abroad. In theory, Australia's domestic tax rules and treaty provisions applied to these situations in a manner consistent with previous interpretation. However, Australia's revenue authority, the Australian Taxation Office (ATO), chose to apply a liberal interpretation of the rules during the early period of COVID-19 and the associated travel restrictions. A stricter approach is currently being applied with a reversion to the traditional interpretation of the rules on residency and source.

The OECD's Updated Guidance on Tax Treaties and the Impact of the COVID-19 Crisis invited jurisdictions to consider adopting an approach of providing certainty to taxpayers through guidance documents and highlighted Australia as a jurisdiction that had adopted this approach.<sup>4</sup> The high level of guidance by the ATO explains how Australia's international tax rules would apply in a COVID-19 environment.

In March 2020, the ATO announced a broad range of administrative measures to assist taxpayers affected by COVID-19. As part of the announcement, a series of questions and answers were also released and dealt with emerging practical issues such as residency and permanent establishment status. Further guidance was issued in April 2020, specifically dealing with the risk of a change in residency status for individuals and the source of employment income of non-residents working remotely from Australia due to COVID-19. Subsequent updates were made as needed. The ATO's views expressed in the released guidance are discussed below.

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4. OECD, *Updated Guidance on Tax Treaties and the Impact of the COVID-19 Pandemic* pp. 3-4 (21 Jan. 2021).

### 1.1.2. Effects on individuals

Australia's domestic tax regime provides that an Australian resident is taxed on income from all sources (worldwide income) while a non-resident is taxed on income sourced in Australia only. The broad residence and source principles are contained in Division 6 of the Income Tax Assessment Act 1997. In addition to the domestic rules determining what sources of income are to be taxed in Australia, residency also affects the income tax rate and the application of what is known as a Medicare levy, which is administered through the income tax system. Non-residents also do not have access to many personal tax credits, known as "offsets" in Australian tax terminology.

#### 1.1.2.1. Residence

The current definition of individual residence is found in sec. 6(1) of the Income Tax Assessment Act 1936 and contains four separate and exhaustive tests with only one of the tests needing to be satisfied for an individual to be considered a resident of Australia. Residence is determined on a year-by-year basis, and events may be examined after the year end in order to determine residency status. The four tests are: (i) the person resides in Australia; (ii) the person's domicile is in Australia unless the Commissioner of Taxation is satisfied that the person's permanent place of abode is outside Australia; (iii) the person has actually been in Australia continuously or intermittently during more than one half of the year of income unless the Commissioner is satisfied that the person's usual place of abode is outside Australia and they do not intend to take up residence in Australia; or (iv) the person is a member of a specified retirement savings scheme operated for Australian diplomats and other government officers. The first test, known as the ordinary concepts test, is based on common law principles that consider the facts and circumstances of the taxpayer, particularly practical ties with the jurisdiction such as home or vehicle ownership, health and other insurance policies, membership in local organizations, and so forth. There are numerous court cases that have been decided in relation to this test. The remaining three tests are considered statutory tests but have also been the subject of a substantial amount of litigation.

Over the years, the court cases to determine whether worldwide taxation is triggered have broadly fallen into two categories, with the first concerning individuals who have left Australia to live abroad for a period and the second concerning individuals who have entered Australia for a period. Heuristics, while not contained in the legislation, have tended to indicate

that a person needs to leave Australia for approximately two years to be considered a non-resident, and a person needs to be present in Australia for a period of six months to be considered an Australian resident. COVID-19 travel restrictions proved challenging to the tests, which rely on facts and circumstances as well as these two heuristics. However, the ATO made it clear that the residency rules did not change because of COVID-19 and the same tests would apply, meaning that a person's residency may change due to the addition of COVID-19-specific facts.

Actions by and opinions of the ATO are referred to in Australia as actions by or opinions of “the Commissioner”, a reference to the statutory head of the agency. The ATO provides in Taxation Ruling TR 98/17 the Commissioner's interpretation of the ordinary meaning of the word “resides”, with the Ruling applying to broad categories of individuals entering Australia including migrants, academics, students studying in Australia, visitors on holiday and workers with pre-arranged employment contracts.<sup>5</sup> This Ruling was released in 1998 and continued to apply during the travel restriction period during the COVID-19 pandemic.

Non-residents who were living in Australia for weeks or months due to COVID-19 would not be considered Australian residents provided they usually lived overseas permanently and intended to return to their country of origin as soon as able. However, their residency status could change where they ended up staying in Australia for a lengthy period of time and did not intend on returning to their country of residency when they would be able to do so. Consistent with the tests that the courts have applied, the facts and circumstances considered during the period of COVID-19 travel restrictions included a person's intention and purpose of coming to and remaining in Australia, their living arrangements while in Australia, and their family and business or employment ties to Australia.<sup>6</sup> The ATO specifically states that choosing to remain in Australia when a person is able to leave is a factor that points towards residency status.<sup>7</sup> A lack of commercial flights as well as government restrictions both in Australia and a person's home country are taken into account.

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5. ATO, *Income Tax: Residency Status of Individuals Entering Australia*, Taxation Ruling TR 98/17, para. 2 (25 Nov. 1998).

6. ATO, COVID-19, *Support for Individuals and Employees, Residency and Source of Income* (last modified 10 Aug. 2021), available at <https://www.ato.gov.au/General/COVID-19/Support-for-individuals-and-employees/Residency-and-source-of-income/> (accessed 15 Sept. 2022).

7. ATO, *supra* n. 6.



Australian residents who were overseas or who remain temporarily overseas and have been affected by COVID-19 are also subject to the ordinary rules that applied pre-COVID-19. Individuals particularly impacted by the COVID-19 restrictions and changes are those who were meant to be out of Australia for a short period but remained for a significant period of time or who had a more permanent overseas arrangement and had to return to Australia earlier than expected. Individuals who normally live and work in Australia, but were temporarily overseas for longer than anticipated, were treated by the Commissioner as maintaining their Australian residency.

Difficulties have arisen, however, for a particular group of residents potentially eligible for an exemption from Australian taxation for foreign-source employment income. The exemption in question applies to employment income for foreign service related to the delivery of Australian official development assistance, and the overseas work of certain charities, as well as to members of the armed forces or police serving abroad for security or peace-keeping purposes. The ATO did not provide any COVID-19 concessions in its interpretation of this provision and continued to apply strictly the 91-day rule. As a result, if a resident entitled to the employee income exemption was scheduled to remain overseas for more than 91 days but returned before the period was complete as a result of the COVID-19 situation, income related to the overseas service would no longer qualify for the exemption even if work on the assignment continued for longer than 91 days in total, with part completed in Australia. Similarly, if the individual spent 91 days or more abroad on a qualifying assignment and continued work related to the assignment after returning to Australia, only income relating to the period of service abroad would be exempt from taxation.<sup>8</sup>

#### 1.1.2.2. Source

While the source of income is crucial to the determination of the tax liability of non-residents and to determine tax issues for residents such as the ability to use foreign tax credits, Australia's income tax legislation is surprisingly almost devoid of source rules. The law contains only three source rules: for interest related to mortgages over immovable property located in Australia; for royalties derived by non-residents; and for capital gains realized on the disposal of Australian immovable property. The source of all other types

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8. ATO, *Early Return from Foreign Service Due to COVID 19 – Foreign Employment Income*, Fact Sheet for Foreign Service Employees (20 May 2020), available at <https://www.ato.gov.au/law/view/document?DocID=AFS/23AG-COVID-19/00001> (accessed 15 Sept. 2022).

of income, including business profits, employment income and investment income, is determined using common law doctrines that look at the facts peculiar to each amount.

Restrictions on international travel resulted in a number of non-residents staying in Australia and carrying on work remotely for foreign employers. The ATO did recognize that COVID-19 created a special set of circumstances for persons who had no choice but to work in Australia for a period and adopted a pragmatic interpretation to provide these persons with some relief from Australian taxation through generous interpretations of source principles.<sup>9</sup> Generally, if the work by a non-resident person for a foreign employer was remotely performed in Australia for less than three months, the ATO would consider the income to have a foreign source.<sup>10</sup> If, however, working arrangements lasted longer than three months, the ordinary common law source principles would apply, and it would become a question of fact and circumstance as to whether the employment is connected with Australia.

The ATO has provided a list of factors that are considered when applying the common law tests. These include whether: (i) the terms and conditions of the employment contract change during the period the person works from Australia; (ii) the nature of the job changes; (iii) the individual starts performing work for an Australian entity affiliated with the employer; (iv) the economic impact or result of the work shifts to Australia; (v) the economic employer – the entity for which the person provides services – is in Australia; (vi) work is performed with Australian clients; (vii) the performance of the work is wholly or to a significant degree dependent on the individual being physically present in Australia to complete it; (viii) Australia becomes the permanent place of work, and (ix) the individual's intention towards Australia changes.<sup>11</sup> Ultimately, the ATO states that employment income is likely to have an Australian source if the individual has chosen to stay in Australia despite being able to leave, and they agree with their employer that Australia can be their usual place of work until they choose to travel again.<sup>12</sup>

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9. ATO, *supra* n. 6.

10. *Id.*

11. *Id.*

12. *Id.*

### 1.1.3. Effects on corporations

#### 1.1.3.1. Residence

The definition of corporate residence is also contained in sec. 6(1) of the Income Tax Assessment Act 1936. The definition provides three alternative tests for residency: (i) the company is incorporated in Australia; (ii) the company is incorporated elsewhere but carries on business in Australia and has its central management and control in Australia; or (iii) the company is incorporated elsewhere but carries on business in Australia and has its voting power controlled by shareholders who are residents of Australia. In 2020, the former government announced that it intended to revise the definition of corporate residency to treat a company incorporated elsewhere as a resident of Australia if the company has a “significant economic connection” to Australia. A company would be treated as enjoying a significant economic connection with Australia if it had both its core commercial activities undertaken in Australia and its central management and control are in Australia. To date, the proposed amendments have not been legislated.

The test used to identify resident companies most likely to be affected by COVID-19 is that applying to companies incorporated outside of Australia that carry on business in Australia and have their central management and control in Australia. In contrast to the relatively straightforward place of incorporation and Australian shareholder ownership tests, which have attracted little litigation, the “carrying on of business in Australia and central management and control in Australia” test is inherently uncertain and has been the focus of considerable litigation. Uncertainty extends to both limbs of the test: when is central management and control in Australia and when is the company carrying on business in Australia.

The common law courts have developed a long line of precedents interpreting the place of central management and control phrase, but their application in any particular set of circumstances remains uncertain. The place of central management and control is understood to mean the place where high-level decisions are made. This will depend on where those who control the company perform the activities to control and direct the company. The starting point for this test is the place where board meetings take place since legally it is the company directors who are responsible for its control and direction. However, if it can be shown that the board of directors merely “rubber stamp” decisions made by an external party, that party will be considered the person exercising central management and control, and the place

of central management and control will be the place at which that person makes the decisions, not the place the board meets.<sup>13</sup>

It is possible that travel restrictions and limitations resulting from COVID-19 could have resulted in the board of directors of a foreign company or the de facto decision maker of the company being in Australia exercising central management and control even though this would not happen in Australia under normal circumstances. The ATO has indicated that it will not take steps to assess a foreign-incorporated company as an Australian resident company on the basis of central management and control being exercised in Australia if the only reason board meetings are held in the country is because of COVID-19 travel restrictions.<sup>14</sup>

The question of when a company is carrying on business in Australia is also decided by reference to common law precedents. Traditionally, passive businesses were considered by the ATO to be carrying on a business in Australia if their central management and control was in Australia, while active businesses were considered to be carrying on business in Australia only if some of the activities were carried out in Australia. The interpretation of this limb of the definition is evolving, however, and the ATO has interpreted a 2016 decision of the High Court of Australia, Australia's final court of appeal,<sup>15</sup> as suggesting that if a company's central management and control were exercised in Australia, the company could be considered to be carrying on its business in Australia even if its investment or trading activities took place abroad.<sup>16</sup>

### 1.1.3.2. Permanent establishment

Foreign companies may also face challenges relating to Australia's permanent establishment rules because of COVID-19. Non-resident companies based in non-treaty countries will be assessable on income from an Australian source including business operations in Australia, Australian

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13. AU: *Bywater Investments Limited & Ors v. Commissioner of Taxation; Hua Wang Bank Berhad v. Commissioner of Taxation* [2016] HCA 45; 2016 ATC 20-589.

14. ATO, *Working Out Your Residency, Companies* (last modified 24 June 2022), available at <https://www.ato.gov.au/Business/International-tax-for-business/Working-out-your-residency/#Companies> (accessed 15 Sept. 2022).

15. *Bywater Investments*, *supra* n. 13.

16. ATO, *Income Tax: Central Management and Control Test of Residency*, Taxation Ruling TR 2018/5 (21 June 2018).

contracts, and services performed in Australia.<sup>17</sup> Foreign companies resident in a treaty partner are only liable to Australian tax on business profits derived through a permanent establishment in Australia (and withholding tax on their passive income derived from Australia).

The travel restrictions imposed as a consequence of the COVID-19 pandemic led to a concern that foreign companies could be treated as having a permanent establishment in Australia only because they had employees who had no option but to remain in Australia for lengthy periods. In response to these concerns, the ATO adopted a pragmatic approach and advised foreign businesses that a permanent establishment would not come into existence where a foreign-incorporated company did not otherwise have a permanent establishment in Australia before the effects of COVID-19, there were no other changes in the company's circumstances, and the unplanned presence of employees in Australia was the short-term result of them being temporarily relocated or restricted in their travel because of COVID-19.<sup>18</sup> The ATO decision expired on 31 December 2021, and as from 1 January 2022, foreign companies must use the ordinary rules to determine if they have a permanent establishment in Australia.

Australian domestic law does not rely on the presence of a “permanent establishment” to define the tax liability of non-resident companies. Rather, under domestic law, non-resident companies are liable to tax on all Australian-source income whether or not they have a permanent establishment in Australia. The limitation of foreign company liability to Australian tax to companies with permanent establishments in Australia only applies where a treaty is in place. In other cases, the broader domestic law applies and non-resident businesses are liable to Australian tax on all Australian-source income, whether or not they have a permanent establishment in Australia. There is, however, a definition of “permanent establishment” in the Australian domestic law that is used for other purposes, particularly in respect of the withholding tax provisions.

Like treaties, the domestic legislation incorporates a notion of carrying on a business in the jurisdiction. While the OECD Model speaks of “a fixed place of business through which the business of an enterprise is wholly or partly

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17. ATO, *Foreign Residents Doing Business in Australia – Tax on Income and Capital Gains – If You Are From a Non-Treaty Country* (last modified 28 Aug. 2020), available at <https://www.ato.gov.au/Business/International-tax-for-business/Foreign-residents-doing-business-in-Australia/Tax-on-income-and-capital-gains/#fromnontaxtreatycountry> (accessed 15 Sept. 2022).

18. ATO, *supra* n. 14.

carried on”,<sup>19</sup> the Australian domestic law merely refers to “a place at or through which” a person carries on any business,<sup>20</sup> without the incorporation of the qualifying “fixed” adjective.

The definition contained in domestic law is based on the meaning of permanent establishment in the Australia-United Kingdom Income Tax Treaty (1946) and the Australia-United States Income Tax Treaty (1953) with the predominant idea being that a *fixed* place of business was required. Despite the absence of the qualifying “fixed” adjective, the ATO adopts the view that the concept of permanence is central to the question of whether a permanent establishment exists.<sup>21</sup> The concept of permanence has then been interpreted to have both the elements of geographic permanence and temporal permanence. COVID-19 raised issues of temporal permanence as the ATO adopts the view that, while the question is ultimately one of fact and degree, as a guide, a period of six months or more of a business operating at or through a place continuously will establish a permanent establishment. To address the problem of companies satisfying this interpretation of permanent establishment only because of stays in Australia caused by COVID-19-related travel restrictions, the ATO supplemented its interpretation ruling on permanent establishments with an addendum that states:

It is also conceivable that in some limited circumstances, a period of six months or more might not constitute temporal permanence, however the Commissioner considers this would be likely to occur in only the most extraordinary of circumstances. For example, the international travel restrictions and government-mandated lockdowns globally during the COVID-19 pandemic resulted in many businesses having employees present in Australia when they would ordinarily have been located outside of Australia, and many employees were typically required to continue their employment under “working from home” arrangements. While temporal permanence remained a question of fact and degree in each case, the extraordinary circumstances of the COVID-19 pandemic presented some situations in which a forced presence in Australia for more than six months was considered temporary.<sup>22</sup>

Details specifically relating to Australia’s double tax agreements (tax treaties) are discussed in section 1.3.

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19. OECD *Model Tax Convention on Income and on Capital* art. 5(1) (21 Nov. 2017), Treaties & Models IBFD.

20. AU: Income Tax Assessment Act, 1936 (Cth.), sec. 6(1).

21. ATO, *Income Tax: Permanent Establishment – What Is “A Place At or Through Which [a] Person Carries On Any Business” in the Definition of Permanent Establishment in subsection 6(1) of the Income Tax Assessment Act 1936?*, Taxation Ruling TR 2002/5 (13 Mar. 2002).

22. ATO, *supra* n. 21, at para. 35.

## 1.2. Residence, tiebreaker rules and mobility of work: Individuals and entities

### 1.2.1. Definition of resident in tax treaties

Australia's most recent tax treaties generally contain an equivalent article to article 4(1), of the OECD Model definition of "resident of a Contracting State". That is, a person will be considered a resident under the tax treaties where they are liable to tax by reason of domicile, place of management, place of incorporation or any other criterion of a similar nature. However, most of Australia's older tax treaties, such as the Australia-Italy Income Tax Treaty (1982), simply refer back to the domestic tax laws of the relevant state. For example, the Australia-New Zealand Income Tax Treaty (2009) states in article 4(1), that "for the purposes of this Convention, the term 'resident of a Contracting State' means any person who, under the laws of that State, is liable to tax as a resident of that State, and also includes that State and any political subdivision or local authority of that State".<sup>23</sup> It should be noted, however, that the differences in wording have no practical effect on the location of residence of individuals or other entities. As such, from the perspective of Australia's tax treaties, the initial step in determining residence is the requirement to consider the domestic law as outlined in section 1.1. of this chapter.

### 1.2.2. Tiebreaker rules for individuals

The ATO has not provided any guidance on the effects of COVID-19 on the tiebreaker rules for individuals contained in its tax treaties. Australia's tax treaties generally adopt the wording of article 4(2) of the OECD Model where an individual is a resident of both contracting states. The ATO, in Taxation Ruling TR 2001/13, provides guidance on how it interprets Australia's tax treaties. In ATO Interpretive Decision 2004/777, the ATO refers to TR 2001/13 where it provides that the OECD Model and Commentary will often need to be considered in interpreting tax treaties. It then refers to specific statements in the OECD Commentary in relation to what is meant by a "permanent home". Despite the challenges of COVID-19, it is expected that the ATO will refer to the OECD Commentary

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23. *Convention between Australia and New Zealand for the Avoidance of Double Taxation with Respect to Taxes on Income and Fringe Benefits and the Prevention of Fiscal Evasion* art. 4(1) (26 June 2009), Treaties & Models IBFD.

on the operation of the tiebreaker rules. Whether other OECD materials might be used is discussed in section 1.7.

### 1.2.3. Tiebreaker rules for corporate entities

The tiebreaker rule in Australia's tax treaties for taxpayers other than individuals (generally meaning corporate entities) is generally consistent with article 4(3) of the OECD Model. That is, as per the changes adopted through the MLI<sup>24</sup> that is now being incorporated into Australia's treaty network, residency of a corporation is determined by mutual agreement, taking into consideration the place of effective management, the place where the company is incorporated or constituted and any other relevant factors. As a result, Australia's treaty provisions may prescribe a different test from that set out in the domestic law which looks at the place of *central management and control* rather than *place of effective management*. Prior to the change in the OECD Commentary in 2017, Australia used the test set out in the former paragraph 24(4) of the Commentary to Article 4 to interpret "place of effective management", namely where "key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made". Australia will continue to apply this test and apply the factors set out in paragraph 24(1) of the Commentary to Article 4 when interpreting the treaty definition of company residence.<sup>25</sup>

While Australia's more modern tax treaties will provide a tiebreaker rule for corporations based on mutual agreement and place of effective management, older treaties may have differing tiebreaker rules. For example, the Australia-Indonesia Income Tax Treaty (1992) provides that residency is based on the place of incorporation, creation or organization. The Australia-Papua New Guinea Income Tax Treaty (1989) provides that the tiebreaker rule is the place of central management and control or, failing that, the place of incorporation. Other treaties, such as Australia-New Zealand Income Tax Treaty, specifically deal with dual-listed companies, providing that the company is a resident in the place of incorporation and has its primary stock exchange listing in that state.

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24. *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* art. 3 (7 June 2017), Treaties & Models IBFD [hereinafter MLI].

25. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 4* para. 24 (2017), Treaties & Models IBFD.



#### 1.2.4. Article 8: Ships and aircraft

Australia's tax treaties generally contain an equivalent to article 8 of the OECD Model dealing with ships and aircraft. The ATO has not directly addressed the impact of COVID-19 on the application of article 8. It is, therefore, expected that its normal application will apply even where travel has been interrupted by COVID-19.

#### 1.2.5. Article 16: Directors' fees

Australia's tax treaties generally contain an equivalent to article 16 of the Model dealing with directors' fees. While the ATO has not directly addressed the impact of COVID-19 on the distributive rule in relation to directors' fees, it has been made clear that a company's central management and control will not change simply because board meetings are held in Australia because of the effects of COVID-19. That is, corporate residency status will not be altered because directors are attending board meetings in or from Australia as a consequence of COVID-19-related travel restrictions.

#### 1.2.6. Tracking residence

Australia's income tax system has had a long history of both individual and corporate residency disputes. The income tax regime is now based on a self-assessment model and generally, individuals and corporations self-assess their residency status based on ATO guidance provided in fact sheets and Taxation Rulings. Separately, the ATO itself has a data-matching program that allows it to receive data from a range of sources including banks, financial institutions and government agencies, and this information may trigger a review of a taxpayer's claimed resident or non-resident status.

Particularly important is the ATO's data-matching program with the Department of Home Affairs that records passenger movements in and out of the country. This program has been developed to address identity and residency compliance risks.<sup>26</sup> The objectives of the program are broadly to promote voluntary compliance and increase community confidence in the integrity of the tax and superannuation systems, and to improve knowledge

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26. ATO, *Department of Home Affairs Passenger Movement Records – 2016-17 to 2022-23* (last modified 13 Apr. 2021), available at <https://www.ato.gov.au/General/Gen/Department-of-Home-Affairs-Passenger-Movement-Records---2016-17-to-2022-23-financial-years/> (accessed 15 Sept. 2022).

of the overall level of identity and residency compliance risks including registration, lodgement, reporting and payment obligations.<sup>27</sup> As such, the program is not used to directly initiate compliance activity but rather to verify the identity and residency status of individuals for registration purposes and aid the ATO in profiling, determining and assessing individuals for residency status for tax purposes.<sup>28</sup>

In addition to the Department of Home Affairs passenger movement records data-matching program, the ATO also conducts a visa-matching program which has operated since 2009. This program is specifically used to determine the appropriate tax treatment of individuals and identify taxpayers who incorrectly claim residency status.<sup>29</sup>

### **1.3. Permanent establishments and mobility of work**

In March 2020, initial guidance was issued by the ATO on the increased risk of permanent establishment status due to COVID-19. This was prior to the OECD's analysis of the impact of the COVID-19 crisis on the application of tax treaties, released a month later on 3 April 2020.<sup>30</sup> In contrast to the OECD document, which takes the form of a high-level general guidance statement, the ATO guidance offers clarity on administrative approaches to the characterization of foreign company presence in Australia when a foreign company has employees in Australia for a period that is longer than anticipated as a result of COVID-19 factors.

The guidance indicates that the ATO will not consider a foreign-incorporated company to have a permanent establishment if it meets three criteria: (i) the foreign-incorporated company did not have a permanent establishment in Australia before the effects of COVID-19; (ii) there are no other changes in the company's circumstances; and (iii) the unplanned presence of employees in Australia is the short-term result of them being temporarily relocated or restricted in their travel because of COVID-19.<sup>31</sup>

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27. ATO, *supra* n. 26.

28. *Id.*

29. ATO, *Department of Home Affairs Visa – October 2015 to 2022-23 Financial Years* (last modified 15 Feb. 2021), available at <https://www.ato.gov.au/General/Gen/Department-of-Home-Affairs-visa---October-2015-to-2022-23-financial-years/> (accessed 15 Sept. 2022).

30. *OECD Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis* (3 Apr. 2020).

31. ATO, *supra* n. 14.

This guidance is arguably of limited use as it only applies to situations where there is a temporary presence of employees in Australia. While applicable to what is normally article 5(1) of Australia's tax treaties, where a permanent establishment is a fixed place of business through which the business of an enterprise is wholly or partly carried on, it is of limited use for other situations. It is silent, for example, as to whether a period of disruption due to COVID-19 should be included in the calculation of the duration of building, construction or assembly sites (the last of these being an addition to some Australian treaties not found in the OECD Model). Also not covered are permanent establishments created by a supervisory role over a building, construction or assembly site, another deemed permanent establishment test found in some Australian treaties and not the OECD Model.

At the same time, in contrast to the OECD Model, which stipulates a minimum 12-month period for a site to be considered a permanent establishment, most Australian tax treaties only require a six-month period for a site to constitute a permanent establishment. There is, consequently, a greater likelihood that a COVID-19-related disruption and project extension could push an enterprise over the deemed permanent establishment threshold for building and construction sites. While no advice has been provided by the ATO in respect of these issues, Australia generally follows OECD guidance and it is likely that the ATO would view these issues in a way that is sympathetic to the unanticipated circumstances of taxpayers, in the spirit of the OECD guidance.

In February 2021, the ATO modified its position through an informal mechanism without making any changes to official binding rulings. In updated guidance, the tax authority indicated it would not take action to assess a foreign company on the basis that it had a permanent establishment in Australia if: (i) the company had no permanent establishment in Australia before the effects of COVID-19; (ii) the temporary presence of employees in Australia continued to be solely a result of COVID-19-related travel restrictions; (iii) those employees temporarily in Australia would relocate overseas as soon as practicable following the relaxation of international travel restrictions; and (iv) those employees had not been recognized as creating a permanent establishment or generating Australian-source income in Australia for the purpose of the tax laws of another jurisdiction.<sup>32</sup>

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32. ATO, *COVID-19 and Permanent Establishments* 1 (last modified 25 May 2021), available at <https://www.ato.gov.au/misc/downloads/pdf/qc64197.pdf> (accessed 15 Sept. 2022).

Initially, the concessional administrative approach was due to apply until 30 June 2021, but it was later extended to 31 December 2021. Since 1 January 2022, taxpayers have been required to consider whether ongoing arrangements give rise to a permanent establishment in Australia without regard to the temporary concessional approach.<sup>33</sup>

## **1.4. Physical presence according to articles 15(1) and 17 of the OECD Model**

### **1.4.1. Article 15(1)**

Australia's tax treaties broadly adopt the wording of article 15 of the OECD Model in relation to income from employment. Newly negotiated treaties all follow the updated OECD approach of labelling article 15 as the "Income from Employment" article. Where a DTA is in force, the Australian revenue authority will exercise its right to assess non-resident individuals on their income from employment only to the extent the employment was "carried on" in Australia. Where no DTA is in force, the domestic law imposes a liability on non-resident individuals deriving income from employment to the extent the income has a "source" in Australia. The common law test used by the ATO to identify the source of employment income is similar to that found in the treaties, looking at where the employee carries on their employment duties. In this respect, the ATO places an emphasis on the geographical location rather than a business office compared to a home office when looking at where employment duties are carried out. However, the question is always one of fact and degree, and other factors may on occasion be considered more significant. The ATO is of the view that COVID-19 has created a special set of circumstances that must be taken into account when determining the source of income of a non-resident who usually works overseas but instead performs the same employment in Australia.<sup>34</sup>

In the course of administering the income tax law, the ATO distinguishes between short-term working arrangements and longer-term arrangements, using a rough rule of thumb that short-term periods of working in Australia, described by the ATO as periods of three months or less, will not constitute carrying on employment in Australia and thus will not give rise to Australian-source income under the domestic law.

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33. ATO, *supra* n. 32.

34. ATO, *supra* n. 6.

Where a working arrangement is longer than three months, non-residents are required to consider their individual circumstances to determine whether their employment is connected to Australia. The ATO lists nine factors that need to be considered, as noted in section 1.1.2.2., most of which relate to a change in circumstances. These factors are: (i) the terms and conditions of an employment contract change; (ii) the nature of the job changes; (iii) an individual starts performing work for an Australian entity affiliated with their employer; (iv) the economic impact or result of the work undertaken shifts to Australia; (v) the economic employer – the entity for which the individual is providing services – is in Australia; (vi) the work is performed with Australian clients; (vii) the performance of work is wholly or to a significant degree dependent on the individual being physically present in Australia to complete it; (viii) Australia becomes the individual’s permanent place of work; and (ix) the individual’s intention towards staying in Australia changes.<sup>35</sup>

The ATO has indicated that when it applies its usual nine-factor test to persons in Australia for longer periods as a result of COVID-19 travel restrictions, it will place greater emphasis on whether a non-resident has chosen to stay in Australia despite being able to leave, and whether the employee and employer have agreed that Australia can be the usual place of work until that person chooses to travel again.<sup>36</sup> The ATO’s approach seeks to distinguish ordinary cases in which Australia becomes a person’s usual and longer-term place of employment from cases of similar duration where it is clear the extended stay was temporary and unexpected in terms of the location of performance of work.<sup>37</sup>

#### 1.4.2. Article 17

Australia’s tax treaties also generally contain the equivalent of article 17 of the OECD Model on entertainers and sportspersons, allowing Australia to retain its taxing rights over Australian-source income where remuneration is for an entertainer’s or sportsperson’s activities “exercised” in Australia. Australia’s domestic income tax law imposes a tax liability on non-resident entertainers and sportspersons whose remuneration is sourced in Australia. Income from activities of this type is generally thought to be sourced in Australia if the activities are exercised in Australia, an approach identical with that in Australia’s tax treaties. There is, however, a judicial precedent

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35. Id.

36. Id.

37. Id.

that says in the case of income from entertainment, regard may be had to the place of contract or the place of payment.<sup>38</sup> The decision did not indicate how these factors may affect the general rule, but simply asserted they might, leaving some uncertainty as to the source of income from entertainment.

This uncertainty became relevant following the adoption of COVID-19 travel restrictions, when entertainers and sportspersons were unable to perform due to travel restrictions and public health measures but still received remuneration under a relevant contract. The ATO has offered no guidance on whether these payments are considered to be income sourced in Australia or attributed to the exercise of activities in Australia. The treatment may depend on how the payments are characterized, in particular whether they might be characterized as compensation for the income that would have been paid had the person performed in Australia. Australian common law doctrines treat amounts received as compensation for lost income as a type of income different from the remuneration for which it substitutes, and there are no clear source rules for this separate category of income.

## **1.5. Article 15(2) and (3) of the OECD Model**

### **1.5.1. Article 15(2)**

Article 15(2) removes a source country's right to tax employment income derived by a non-resident who has carried out their employee activities in the source country for a period of 183 days or less in any 12-month period commencing or ending in the fiscal year. Some of Australia's tax treaties vary the maximum days in the source country allowed for the non-resident employee to be exempt from source country taxation. For example, the Australia-Indonesia Income Tax Treaty only provides an exemption where the employee is in the country for a maximum of 120 days in any period of 12 months, and the Australia-Papua New Guinea Income Tax Treaty provides a non-resident employee with an exemption from source country taxation only if the non-resident employee is in the source country for a maximum of 90 days or less.

One of the conditions for the short-term exemption condition in article 15(2) is that the remuneration received by the non-resident person performing personal services in Australia is paid by, or on behalf of, a non-resident *employer*. The ATO has offered guidance on when the relationship between

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38. AU: *Federal Commissioner of Taxation v. Mitchum* (1965) 113 CLR 401.

the entity paying for personal services and the individual performing them is an employment relationship and when it is a principal and contractor relationship in the context of article 15(2).<sup>39</sup>

The ATO has stated that the meaning of employer in article 15(2) of Australia's tax treaties is the same as its meaning in Australian domestic law. Factors considered by the ATO when characterizing the relationship between the payer and the person performing services include the existence of a contract, the nature of the contractual relationship and key indicators of the employment relationship. These key indicators include: (i) who exercises ultimate control over the worker – the right to control being considered in terms of the ability to withdraw a worker from an assignment and/or terminate the relationship with the worker; (ii) who exercises day-to-day control over the worker – that is, the degree of actual control exercised in terms of, for example, how, when and what is to be done; (iii) integration – the nature of the services rendered by the worker and whether they are an integral part of the business activities carried on by the enterprise to which the services are provided; (iv) the terms of engagement – for example, entitlements to leave and who has obligations to deduct withholding tax instalments, pay pension (superannuation) contributions and workers' compensation insurance; (v) who is responsible for payment of remuneration for the worker's services; (vi) who bears the responsibility or risk for the results produced by the worker; (vii) whether or not the contract is for the achievement of a specified result; (viii) who provides or maintains the necessary equipment and resources to perform the work; and (ix) whether or not the work can be delegated by the worker.<sup>40</sup>

### 1.5.2. Article 15(3)

Article 15(3) of Australia's tax treaties removes Australia's right to tax remuneration derived by non-resident crew members employed aboard a ship or aircraft operated in international traffic, even if the income were to be considered Australian-source income under Australia's domestic law. In theory, if a crew member's stay in Australia were extended because of COVID-19 travel restrictions, the person might satisfy the domestic definition of a resident of Australia, in which case the prohibition on Australian taxation in article 15(3) would not apply. The ATO has provided no guidance

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39. ATO, *Income Tax: The Identification of "Employer" for the Purposes of the Short-Term Visit Exception under the Income from Employment Article, or Its Equivalent, of Australia's Tax Treaties*, Taxation Ruling TR 2013/1 (30 Jan. 2013).

40. ATO, *supra* n. 39, at para. 13.

as to whether COVID-19 has altered its interpretation of this article to persons who are treated as residents but would otherwise be afforded protection from Australian taxation by article 15(3). The discussion of how the ATO applies the domestic law definition of a resident to persons staying in Australia longer than intended as a result of COVID-19 rules will be relevant to these persons (see section 1.2.1.).

## **1.6. Frontier workers**

As noted earlier, Australia comprises over 7.5 million square kilometres and is completely surrounded by water. It is sparsely populated and only accessible by air or sea. Consequently, none of Australia's 47 signed tax treaties contain specific rules for the taxation of frontier workers as such provisions are unnecessary. While Australia does not have a frontier worker cohort, prior to COVID-19 it relied heavily on migrant workers with an estimated 2 million temporary migrants in Australia.<sup>41</sup> Since 1 July 2006, Australian income tax law has recognized a special category of taxpayers known as "temporary residents".<sup>42</sup> Taxpayers are temporary residents if they hold a temporary visa granted under the Migration Act 1958, are not Australian residents within the meaning of the Social Security Act 1991 and their spouse (if applicable) is not an Australian resident within the meaning of the Social Security Act 1991. A temporary visa is one that allows a person to travel to and remain in Australia during a specified period, until a specified event happens and while the holder still has specified status. Temporary residents pay tax using the rate scale for ordinary residents, but their foreign-source income and foreign capital gains are exempt from taxation.

No special rules were adopted for temporary residents whose stays in Australia were extended because of COVID-19 travel restrictions. Individuals treated as temporary residents who stayed longer than anticipated or whose circumstances changed so they no longer qualified for temporary resident visas (for example, married an Australian resident) could be taxed as an ordinary resident if they otherwise satisfied the definition of a resident person.

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41. University of Sydney, *The Future of Enforcement for Migrant Workers in Australia: Lessons from Overseas* 7 (Mar. 2021), available at <https://www.sydney.edu.au/sydney-policy-lab/news-and-analysis/news-commentary/the-future-of-enforcement-for-migrant-workers-in-australia.html> (accessed 15 Sept. 2022).

42. AU: Income Tax Assessment Act, 1997 (Cth.), Div. 768-R.



### **1.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)**

As noted earlier in this chapter (*see* sections 1.1., 1.3. and 1.4.), the ATO took a number of steps to modify its practices in respect of the application of Australia's tax treaties to the country's domestic income tax law where involuntary COVID-19-driven changes in circumstances would have affected the tax status of non-residents. It did not, for example, seek to treat foreign companies as having a permanent establishment in Australia where employees of those companies were effectively stranded in Australia with the closure of international borders. Similarly, it adopted generous, and arguably temporarily modified, interpretations of domestic law source and residence tests to accommodate persons who remained in Australia for longer than anticipated as a result of COVID-19 travel restrictions.

The ATO has not attempted to justify its approach by reference to any legal authority, recognizing that its interpretations have all been generous to taxpayers, and it is virtually certain that none would seek to challenge the interpretations in a court and argue they should be required to pay much more tax than is required under the interpretations. If the approaches were challenged, the ATO would have no difficulty arguing that its interpretations and policies are not inconsistent with its treaty obligations. It is true that there are court decisions and rulings that on their face are difficult to reconcile with the generous positions taken by the ATO. However, these positions are not at odds with the treaties or the OECD Commentary.

If the OECD Commentary were to be modified in such a way as to provide, in particular, an interpretation of the permanent establishment definition that was inconsistent with the approach taken by the ATO in its COVID-19-related interpretations, the question would arise whether the Commentary could be considered in any dispute in respect of the concessional ATO interpretations. There is substantial support for the view that the Commentary could be used in this way. Tax treaties in Australia are given effect through incorporation into domestic laws passed by the parliament, and the explanatory memoranda that accompany laws submitted to the parliament to enact many of Australia's double tax agreements make express reference to the OECD Model and its Commentary for the purposes of interpretation.<sup>43</sup>

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43. J. Davies, *Tax Stability*, 44 Melb. Univ. L. Rev. 1, pp. 424, 437 (2020).

Australian courts have willingly applied the Commentary to assist in the interpretation of a DTA.<sup>44</sup>

Less certain is whether a taxpayer could rely on materials published by the OECD, apart from the OECD Model and Commentary, to support an argument disputing the ATO's interpretations, though there is much to support that view. In some cases, the answer is clear because enabling legislation or accompanying documents specifically allow this. Thus, for example, Australia's domestic transfer pricing provisions authorize the use of the OECD Model, Commentaries and Transfer Pricing Guidelines when interpreting the domestic law. Similarly, the explanatory statement provided to the parliament to accompany legislation enacting the MLI states that it largely reflects the final BEPS reports, implying these can be used to interpret the treaty. The question as to whether the use of extraneous material allows for an ambulatory approach is also yet to be settled,<sup>45</sup> but such use would appear overall to be accepted.<sup>46</sup>

## **1.8. The future of the mobility of work: A need for adjusting the existing treaty rules?**

While there has been much attention paid to the impact of tax treaties on mobile workers in terms of issues such as when a mobile person is a resident and tiebreaker rules where the worker is resident in two jurisdictions or when a mobile worker can constitute a permanent establishment of their employer, two of the most important issues facing mobile workers – the high likelihood of double taxation of fringe benefits or retirement savings or both – have yet to be addressed effectively in tax treaties.

The first of these issues arises where the mobile worker's country of work and country of residence have inconsistent rules for amounts contributed to retirement savings funds such as pension funds or superannuation funds. This has proven to be a particularly serious problem in the case of mobile workers who have been employed in Australia. Australia uses the

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44. AU: *Thiel v. Federal Commissioner of Taxation* [1990] HCA 37; (1990) 171 CLR 338.

45. Davies, *supra* n. 43, at p. 437.

46. For an analysis of the case for using an ambulatory approach, see R. Vann, *Interpretation of Tax Treaties in New Holland*, Legal Studies Research Paper No. 10/121, (Sydney Law School Nov. 2010). An "ambulatory" approach to interpretation of a tax treaty provision was also recently endorsed by the Federal Court in *Federal Commissioner of Taxation v. Seven Network Ltd* [2016] FCAFC 70 at [83].

“taxed-taxed-exempt” model of retirement savings, with employers’ and employees’ pre-tax contributions to retirement savings funds subject to tax when received by the funds, and earnings from investments by the funds also subject tax when received. Benefits in the form of pensions or lump sum withdrawals are then exempt from taxation when paid from the fund to a retired person. The tax rate imposed on amounts contributed to qualified retirement savings funds is much lower than the highest and middle individual marginal tax rates as a subsidy for retirement savings. Importantly, the tax is paid by the retirement savings fund, not the employer or the employee.

As employer contributions to retirement savings plans of employees are effectively compulsory in Australia (a very high rate penal tax applies to any employer that fails to contribute to employees’ retirement savings plans), mobile workers who spend time in Australia working for an Australian employer will likely leave the country with an interest in an Australian retirement fund. When the benefits are paid from the fund to an employee who is resident in a country that uses the “exempt-exempt-taxed” model for taxing retirement savings, the pension or lump sum benefits will most likely be taxed again in the employee’s home country even though they are paid from contributions or fund earnings that have been fully taxed in Australia when derived by the fund. The employee’s home country will not provide any foreign tax credits because the tax was paid by another person, namely the retirement income fund.

This is an issue that can be easily resolved by an appropriate double tax treaty, and while Australia would be amenable to a treaty that relieved employees from double taxation of amounts received from Australian pension funds, its treaty partners have been surprisingly complacent on the issue.

The second issue arises when a mobile worker who is an employee in Australia receives remuneration in the form of a fringe benefit such as housing, a motor vehicle, or any other benefit apart from salary. Australia has a comprehensive system of taxation for non-cash benefits and cash benefits that are not considered salary, subjecting fringe benefits to tax at the highest individual marginal tax rate. However, applying the model used by some neighbouring countries, the tax is paid by the employer providing fringe benefits, not the employee receiving them. This leads to the likelihood of double taxation where a mobile employee is taxed on global income, including fringe benefits, in the employee’s country of residence as the employee cannot claim credits for the tax paid by the employer on the fringe benefits

enjoyed by the employee. Again, this is an issue that can easily be addressed in a double tax treaty and, again, Australia would be amenable to a treaty that relieved employees from double taxation of fringe benefits but to date, treaty partners have shown no interest in addressing the issue.

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## Chapter 2

### The Impact of Tax Treaties on International Mobility of Work in Austria

Jürgen Romstorfer and Stefanie Stöcklinger

#### 2.1. Mobility of work and domestic tax law

The COVID-19 pandemic not only raised challenges in the health sector but also caused several changes in tax law. Once again, it became evident that the digital economy is far advanced and requires an adaptation of existing systems in both international and national tax law. This report will take a closer look at the impact of increasing mobility of work on tax law from an Austrian perspective at the time of the Rust Conference in July 2022.

##### 2.1.1. Natural persons

Austria has a social security system. The Austrian General Social Insurance Act (*Allgemeines Sozialversicherungsgesetz*, ASVG)<sup>1</sup> follows the principle of territoriality, according to which the domestic place of employment is the connecting factor for the applicability of the ASVG.<sup>2</sup> Neither the domicile of the insured person nor the registered office of the company nor the nationality of the employee have any bearing on the assessment of the social insurance obligation.<sup>3</sup>

Natural persons who have their domicile or habitual residence in Austria are subject to unlimited tax liability in Austria. They are subject to tax in Austria on their world income, according to section 1(2) of the Austrian Income Tax Act (ITA).<sup>4</sup> According to section 26(1) of the Federal Tax Code

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1. AT: *Bundesgesetz vom 9. September 1955 über die Allgemeine Sozialversicherung (Allgemeines Sozialversicherungsgesetz – ASVG 1955) zuletzt geändert durch BGBl. I Nr. 236/2022* [Austrian General Social Insurance Act (ASVG 1955)] (amended 2022).

2. See sec. 3(1) iVm (4) ASVG 1955 (amended 2022).

3. I. Gruber, *Section 3*, in *ASVG Praxiskommentar* m. no. 2 (R. Poperl et al. eds., 72nd edn., LexisNexis ARD ORAC 2021).

4. AT: *Bundesgesetz vom 7. Juli 1988 über die Besteuerung des Einkommens natürlicher Personen (Einkommensteuergesetz 1988 – EStG 1988), zuletzt geändert durch Bundesgesetzblatt BGBl. I Nr. 153/2023*, [Federal Act of 7 July 1988 on the Taxation of Personal Income (ITA 1988)] (amended 2022).

(*Bundesabgabenordnung*, BAO),<sup>5</sup> a person is resident “where he occupies a flat<sup>6</sup> under circumstances which indicate that he will maintain and use it.” A hotel room rented on a permanent basis may also constitute a dwelling within the meaning of section 26(1) of the BAO.<sup>7</sup> A sleeping place at the workplace shared with other employees, on the other hand, does not constitute a flat.<sup>8</sup> It is necessary that the individual has exclusive power of disposal.<sup>9</sup>

On the other hand, an individual establishes a habitual abode pursuant to section 26(2) of the BAO “where he is staying under circumstances which indicate that he is staying at that place or in that country on more than a temporary basis” [translation by the authors]. The actual length or voluntariness of the stay is not important, the stay only having to be permanent.<sup>10</sup> However, habitual abode is generally assumed if it lasts longer than 6 months.<sup>11</sup> A stay of 5 months is not permanent if there is a clear intention to return.<sup>12</sup> From the above, it can be concluded that unlimited tax liability in Austria linked to habitual abode can be affirmed much more easily due to increased mobility of work. The COVID-19 situation and a possible establishment of habitual abode in Austria can – also in the sense of the OECD Guidance<sup>13</sup> – be negated, since the individual’s will to return is very much in the foreground.

If an individual works abroad for a longer period of time, this can lead to a loss of residence in Austria and trigger exit taxation. In cases of leaving Austria, investments and derivatives are only taxed pursuant to section 27(6),

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5. AT: *Bundesgesetz vom 28. Juni 1961, betreffend allgemeine Bestimmungen und das Verfahren für die von den Abgabenbehörden des Bundes verwalteten Abgaben (Bundesabgabenordnung — BAO). Bundesabgabenordnung (BAO) (1961) zuletzt geändert durch das allgemeine Bundesgesetz BGBl. I Nr. 108/2022 vom 20.07.2022* [Federal Law of 28 June 1961 on General Provisions and the Procedure for Taxes Administered by the Federal Tax Authorities (Federal Tax Code – BAO)] (amended 2022).

6. Translation by the authors. Although the wording of the provision is very narrow, other permanent residences are also subsumed under “flat”.

7. AT: VwGH [Supreme Administrative Court], 23 May 1990, 89/13/0015.

8. AT: VwGH, 22 Sept. 1981, 2287/80.

9. E. Marschner, § 1, in *Jakom EstG Einkommensteuergesetzkommentar* m. no. 30 (S. Kanduth-Kristen et al. eds., 15th edn., Linde Verlag 2022).

10. AT: VwGH, 31 Mar. 1992, 87/14/0096; see Marschner, *supra* n. 9, at m. no. 47 f.; AT: BMF [Austrian Federal Ministry of Finance], Income Tax Directive of the Austrian Tax Authority [*Einkommensteuerreichlinie, EstR*], para. 24 (2000).

11. See Marschner, *supra* n. 9, at m. no. 48.

12. AT: VwGH, 24 June 2010, 2009/16/0133.

13. Secretary-General of the OECD, *Updated guidance on tax treaties and the impact of the COVID-19 pandemic* (OECD 2021), Primary Sources IBFD [hereinafter *OECD Guidance*].

no. 1(b) of the ITA if there is a de facto departure in the sense of a change of residence under treaty law (i.e. abandonment of the domestic residence or transfer of the centre of vital interests). The same applies for a gratuitous transfer to another individual (in particular a gift, inheritance or bequest).<sup>14</sup> Since the definitive abandonment of the Austrian domicile and the relocation of the centre of vital interests is required for exit taxation, the COVID-19-related restrictions do not trigger it.

### 2.1.2. Legal persons

Pursuant to section 1(1) of the Austrian Corporate Income Tax Act (CITA),<sup>15</sup> companies are subject to unlimited tax liability in Austria if their registered seat or place of management in the sense of section 27 of the BAO is in Austria. According to section 27(2) of the BAO, the registered office in terms of the centre of business management of a corporation is where the decisive will for the management of the business is formed or where the measures necessary and important for the business are taken.<sup>16</sup> The focus is on the important decisions for ordinary day-to-day business operations.<sup>17</sup> The place of management will usually be in the offices of the managing director or in their home.<sup>18</sup> If the directors of the company live abroad, the place of management may shift abroad, and unlimited tax liability in Austria only exists if the registered office, within the meaning of section 27(1) of the BAO, is in Austria. If a company has its registered office abroad, but the place of management shifts to Austria due to a change of residence of the board members, the company is subject to unlimited tax liability in Austria if the foreign company is comparable with a domestic company.<sup>19</sup> If, conversely, the place of management is shifted from Austria to a foreign

14. G. Mayr, *Entstrickungsbesteuerung NEU im EStG und bei Umgründungen*, in *Aktuelle Fragen der Konzernbesteuerung* p. 52 (H. Zöchling, E. Lackmayer et al. eds., Linde Verlag 2016); see also S. Kirchmayr, § 27, in *Einkommensteuergesetz Kommentar* m. no. 429 ff. (W. Doralt et al. eds., 21st edn., Facultas Verlag 2020).

15. AT: *Bundesgesetz vom 7. Juli 1988 über die Besteuerung des Einkommens natürlicher* (*Einkommensteuergesetz 1988 – EStG 1988 zuletzt geändert durch BGBl I Nr. 200/2023* [Austrian Income Tax Act, 1988 (ITA)] (amended 2023).

16. AT: VwGH, 24 May 2012, 2008/15/0211; 16 Sept. 2003, 97/14/0169; 6 Apr. 1995, 94/15/0206; see C. Ritz & B. Koran, § 27, in *BAO Bundesabgabenordnungskommentar* m. no. 2 (C. Ritz & B. Koran eds., 7th edn., Linde Verlag 2021).

17. M. Achatz & T. Bieber, § 1, in *Körperschaftsteuergesetz Kommentar* m. no. 41 (M. Achatz et al. eds., 7th edn., Facultas Verlag 2011).

18. AT: VwGH, 19 June 2003, 97/14/0169; see Ritz & Koran, *supra* n. 16, at m. no. 3.

19. Achatz & Bieber, *supra* n. 17, at m. no. 38.

country, the company may be taxed in accordance with section 6, no. 6 of the ITA.<sup>20</sup>

However, due to the constitution of a permanent establishment (PE) in Austria, a corporation may still be subject to limited tax liability in Austria.<sup>21</sup> The criteria for constituting a PE are set out in section 29(1) of the BAO, which stipulates that “any fixed local plant or facility serving the exercise of a business or economic activity” [authors’ translation] is considered to be a PE. In accordance with the opinion of the Federal Ministry of Finance (*Bundesministerium für Finanzen*, BMF), work utensils used by the employee in their home, and which are provided by the employer, can already lead to the existence of a fixed local installation or facility.<sup>22</sup> Premises rented by the employee can thus constitute a PE for the employer if the premises are used for the purposes of the enterprise.<sup>23</sup> According to the BMF, the necessary power of disposal, which is another criterion for constituting a PE, is provided to the employer by the employee’s use of the home office for business purposes.<sup>24</sup> The minimum period for the creation of a PE is disputed, the majority of opinion presuming a minimum period of 6 months.<sup>25</sup>

## **2.2. Residence, tiebreaker rules and mobility of work: Individuals and entities**

### **2.2.1. Defining the residence state according to article 4(1) of the OECD Model**

According to the OECD Model Tax Convention on Income and on Capital, the residence state of persons is generally determined on the basis of the place of actual management, residence, domicile or similar criteria. Due to

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20. G. Ehgartnerin, § 6, in *Jakom EstG Einkommensteuergesetzkommentar* m. no. 147 ff. (S. Kanduth-Kristen et al. eds., 15th edn., Linde Verlag 2022); see M. Schilcher, *Neuregelung der „Wegzugsbesteuerung“ im EStG*, 26 *Steuer und Wirtschaft International* 3, p. 162 (2016).

21. See sec. 1(3) no. 3 in conjunction with sec. 21(1) no. 1 CITA in conjunction with sec. 9(1) no. 3 TS 1 ITA.

22. AT: BMF, EAS [Express Reply Service of the Austrian Federal Ministry of Finance], 27 June 2019, 3415.

23. Ritz & Koran, *supra* n. 16, at § 29, m. no. 8.

24. S. Haas, *Auswirkungen der COVID-19-Pandemie auf das grenzüberschreitende Steuerrecht*, *Österreichischer Steuerzeitung* (ÖStZ) 11, p. 317 (2020); see also A. Ullmann, *Steuer und Wirtschaft International – Jahrestagung: Begründet ein Homeoffice eine Betriebsstätte?*, 30 *Steuer und Wirtschaft International* 3, p. 119 (2020).

25. AT: VwGH, 21 May 1997, 96/14/0084; see Ritz & Koran, *supra* n. 16, at m. no. 3.



increased mobility, it can naturally be easier to shift the place of residence. For example, if the domicile, residence or place of actual management is moved to another state, a change in tax residency occurs. However, a general increase in mobility should not fundamentally affect the system of residence in a contracting state, because the rules in the OECD Model do not distinguish between high or low mobility.

The domicile of a company is determined by the place of management. This is the place where the decisive will of the management of the company is formed.<sup>26</sup> However, it is assumed that ultimately the place where the management has issued its declaration of intent or where the company's executive bodies take their management actions must be taken into account.<sup>27</sup> If all employees work from home, but the management takes its management actions at the registered office of the company, there is no shift in residency, because the place of activity of the employees is not taken into account. If, however, the managing director also only works from home and the main decisions are made there, there may be a shift in residency to the managing director's place of residence.<sup>28</sup>

The OECD addressed this issue at the outset of the COVID-19 pandemic and issued guidance on 4 March 2020 on how to address the residency question in such an extraordinary situation.<sup>29</sup> An update to this guidance was published on 21 January 2021.<sup>30</sup> Accordingly, involuntary relocations of managing directors or senior executives are to be considered as an extraordinary and temporary situation that does not lead to a shift in residency.<sup>31</sup> The OECD expressly cites two scenarios that do not lead to a change of residence (under treaty law) due to a merely temporary transfer of residence.<sup>32</sup> The first situation is if a "person is temporarily away from their home (perhaps on holiday, perhaps to work for a few weeks) and gets

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26. AT: VwGH, 6 Apr. 1995, 94/15/0206; 16 Sept. 2003, 97/14/0169; 24 May 2012, 2008/15/0211.

27. E. Lechner, *Ort der Geschäftsleitung von inländisch beherrschten ausländischen Gesellschaften*, in *Steuern im Rechtsstaat: FS (Festschrift für Gerold Stoll zum 65. Geburtstag* p. 403 (W. Doralt et al. eds., Orac 1990); S. Kanduth-Kristen & G. Kofler, *Teil 2: Abgrenzung zwischen unbeschränkter und beschränkter Steuerpflicht - Anknüpfungsmerkmale*, in *Internationales Steuerrecht*, m. no. 44 (S. Bendlinger et al. eds., 2nd edn., LexisNexis ARD ORAC Verlag 2018); M. Tumpel & M. Luketina, *Article 4*, in *Doppelbesteuerung (DBA)-Kommentar 2018* m. no. 15 (D. Aigner et al. eds., 2nd edn., Linde Verlag 2019).

28. AT: UFS [Independent Finance Senate], 23 Aug. 2011, RV/0820-L/11.

29. OECD, *OECD Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis* (3 Apr. 2020).

30. *OECD Guidance*, *supra* n. 13.

31. *Id.*, at para. 29.

32. *Id.*, at para. 39 ff.

stranded in the host jurisdiction by reason of the COVID-19 pandemic and attains domestic law residence there”.<sup>33</sup> The second situation is if a “person is working in a jurisdiction (the “current home jurisdiction”) and has acquired residence status there, but they temporarily return to their “previous home jurisdiction” because of the COVID-19 situation. They may either never have lost their status as resident of their previous home jurisdiction under its domestic legislation, or they may regain residence status on their return.<sup>34</sup> However, the Austrian tax authorities did not express any explicit opinion as to whether the COVID-19 pandemic should lead to deviations from the texts of tax treaties. At any rate, since the opinion of the OECD does not have any legal effect,<sup>35</sup> no distinction should be made between voluntary and involuntary stays, nor should special rules on residence be applied that are not covered by the wording of the treaty.

### 2.2.2. Tiebreaker clause according to article 4(2) and (3) of the OECD Model

In Austria, as far as can be seen, there has been no discussion of a change in the understanding of the tiebreaker clause due to increasing mobility. Rather, reference continues to be made to the sequence for resolving a residency conflict as set out in article 4(2) of the OECD Model.<sup>36</sup> According to this, double residence is to be treated according to the following criteria and in the following order:

- permanent home (in the case of two permanent homes, the centre of vital interests is to be taken into account);
- habitual abode;
- nationality; or
- mutual agreement procedure (MAP).

In the authors’ opinion, the criteria set out in article 4(2) of the OECD Model should not be influenced by increased mobility. A permanent home is assumed, for example, if it is intended for permanent use. However, it is not necessary that the home actually be used continuously.<sup>37</sup> If an allocation cannot be made in this way, an assessment is made on the basis of

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33. Id., at para. 39.

34. Id.

35. S. Bendlinger, *Die rechtliche Relevanz des BEPS-Aktionsplans*, in *Steuer und Wirtschaft International-Spezial – Die österreichischen DBA nach BEPS* p. 7 (G. Kofler et al. eds., Linde Verlag 2018).

36. See Tumpel & Luketina, *supra* n. 27, at m. no. 27.

37. AT: VwGH, 16 Sept. 1992, 90/13/0299.

habitual abode, nationality or ultimately a MAP. Through these regulations, any situation can be solved, regardless of increased mobility. If a change in the tiebreaker clause is actually to be brought about, a change in the OECD Model and the tax treaties must be made, and not merely a change in interpretation.

In article 4(3) of the OECD Model, as amended by the OECD Model (2017), the MAP pursuant to article 25 of the OECD Model was standardized as a tiebreaker clause for companies. According to this clause, a MAP must be initiated between the competent authorities in the case of dual-resident legal entities.<sup>38</sup> In such a procedure, the competent authorities have to take into account factors such as the place of management meetings, the place from which the directors typically carry out their activities, or the place where the accounting records or the legal system that governs the legal status of the company are kept.<sup>39</sup> Since the authorities thus have a wide scope for interpretation, it would be quite conceivable for there to be, in the case of activities carried out by a managing director in another state, a shift in the company's domicile. The same result is likely to be reached by the version as amended prior to the OECD Model (2017), whereby a conflict of residence is resolved by determining the place where the effective management is situated. However, such a shift (if regularly occurring) will only be possible if there is only one managing director. If there is more than one managing director and only one of them moves the place from which they exercise management, there will be no shift of residency.

If a transfer of residence occurs as a result of article 4(3) of the OECD Model, this regularly leads to a transfer of taxation rights. Closed distributive rules such as those of article 8 of the OECD Model lead to exclusive rights of taxation on the part of the new country of residence, and open distributive rules such as those of article 16 of the OECD Model lead to a shared right of taxation on the part of the residence state and the source state. However, this really requires a change of residence. If, for example, management activities are only partially carried out in another state, but this does not result in a shift of the company's residence, the performance of the activity in a state other than the residence state of the company has no consequences. Unlike article 15 of the OECD Model, article 16 does not implement the place of work principle, but rather the residence state principle with respect to the company. Taxation is therefore completely independent of where the activity is carried out.

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38. See Tumpel & Luketina, *supra* n. 27, at m. no. 27.

39. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 4* para. 24.1 (21 Nov. 2017), Treaties & Models IBFD.

If an activity is generally carried out in different places, and a distributive rule such as article 15 of the OECD Model is applicable, reliable documentation of the activity must be made in order to benefit from tax advantages under a tax treaty.<sup>40</sup> However, there are no concrete national regulations on how documentation of the place of work must be carried out in Austria. According to section 26 of the Working Time Act (*Arbeitszeitgesetz*, AZG), employers must keep records of the hours worked at the place of work.<sup>41</sup> There is no provision for the documentation of the place of work. It will, therefore, hardly be possible for the state to verify where the place of work is located. Nonetheless, it is advisable to keep precise records in order to be able to provide the authorities with proof of the place of work.

## **2.3. Permanent establishments and mobility of work**

### **2.3.1. Home office as permanent establishment**

A PE, according to article 5(1) of the OECD Model, is a fixed place of business through which the business activities of an enterprise are wholly or partly carried on. In order to meet the definition of a PE as defined in article 5 of the OECD Model, four requirements must be fulfilled cumulatively: business facility, permanence, power of disposal and the exercise of an entrepreneurial activity. These general requirements must be fulfilled in any case, therefore also if a PE is to be constituted by a home office activity.

A fixed place of business can be established by any physical object.<sup>42</sup> This must have a permanent connection, i.e. a connection to a specific point on the earth's surface that is not merely temporary.<sup>43</sup> As a rule, a connection existing for more than 6 months is assumed to be permanent.<sup>44</sup> However, a mechanical connection is not required.<sup>45</sup> Control over such a business

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40. K. Waser, *Art. 15*, in *Doppelbesteuerungsabkommen (DBA)-Kommentar 2018* m. no. 176 (D. Aigner et al. eds. 2nd edn., Linde Verlag 2019), who states that for relief from Austrian wage tax, there must be reliable documentation on the determination of the part of the income to be tax-exempt in Austria.

41. AT: *Bundesgesetz vom 11. Dezember 1969 über die Regelung der Arbeitszeit (Arbeitszeitgesetz – AZG 1969)* BGBl. Nr. 461/1969 [Austrian Federal Act on the Regulation of Working Hours (1969)].

42. S. Bendlinger, *Art. 5*, in *DBA-Kommentar 2018* m. no. 15 (D. Aigner et al. eds., 2nd edn., Linde Verlag 2019).

43. AT: VwGH, 28 Apr. 2003, 2001/14/0226; see Bendlinger, *supra* n. 35, at p. 20.

44. Para. 29 *OECD Model: Commentary on Article 5* (2017).

45. DE: BFH [German Federal Tax Court], 30 Oct. 1996, II R 12/96 BStBl II 1997, p. 12.

facility exists if a company can dispose of this business facility and use it for business activities.<sup>46</sup> Furthermore, for the constitution of a PE, it is assumed that the exclusive right of use exists.<sup>47</sup> A business facility is considered to be a functional instrument of carrying on business activities.<sup>48</sup> While the other requirements may well be met in the case of a home office, it is, above all, the permanence and the power of disposal that are problematic. A home office can be permanent if it is carried out over a long period of time without interruptions. The OECD assumes that a home office PE should only be constituted if the company requires a home office, for example because it does not provide a workplace.<sup>49</sup> In the opinion of the Austrian tax authorities, the entrepreneur can also be provided with the power of disposal over the facility by way of business use through the employee.<sup>50</sup> According to the Austrian tax authorities, the establishment of a home office would also be supported by the fact that expenses are claimed in connection with the use of the Austrian residence.<sup>51</sup> Thus, it is generally possible to constitute a PE through a permanent home office that is not merely used occasionally.<sup>52</sup>

### 2.3.2. Dependent agent permanent establishment

An individual who is classified as a dependent agent may also constitute a so-called dependent agent PE if they act for an enterprise in the source state and:

- have power of attorney to conclude contracts on behalf of the enterprise;
- habitually exercise this power of attorney there;
- are not an independent agent within the meaning of article 5(6) of the OECD Model; and
- do not exclusively perform preparatory and auxiliary activities.<sup>53</sup>

46. Para. 10 *OECD Model: Commentary on Article 5* (2017).

47. AT: BMF, 4 May 1994, EAS 437.

48. See Bendlinger, *supra* n. 35, at p. 14.

49. Para. 18 *OECD Model: Commentary on Article 5* (2017).

50. AT: BMF, 27 June 2019, EAS 3415.

51. AT: BMF, 6 Nov. 2017, EAS 3392.

52. AT: BMF, 3 Dec. 1993, EAS 350; the Austrian tax authorities are of the opinion that even 50% use of home office constitutes permanent use within the meaning of art. 5 *OECD Model*; see also AT: BMF, 26 May 2008, EAS 2966; critically S. Bendlinger, *Steuerlicher Nexus durch „digitale Nomaden“ und der Unsinn der Homeoffice Betriebsstätte*, 31 *Steuer und Wirtschaft International* 9, p. 461 (2021), appealing that a fiscal nexus should not be hastily established; critically also N. Zorn, quoted by Ullmann, *supra* n. 24, at p. 120; see also P. Stanek, *Zur Verfügungsmacht im Betriebsstättenbegriff des § 29 Abs 1 BAO*, ÖStZ 18, p. 462 (2019); B. Häusler, *Homeoffice als Wunsch des Mitarbeiters – DBA-rechtliche Erwägungen bei grenzüberschreitenden Sachverhalten*, 31 *Steuer und Wirtschaft International* 2, p. 64 (2021).

53. Art. 5(5) *OECD Model* (2017); see in detail, Bendlinger, *supra* n. 35, at p. 400.

According to Austrian case law, the self-employed representative must be bound by instructions vis-à-vis the represented party.<sup>54</sup> In order to be sustainable, a dependent agent must also be active for more than 6 months.<sup>55</sup> The Austrian tax authorities are further of the opinion that a self-employed person can constitute an agent PE if there is a dependency that meets the requirements.<sup>56</sup>

### 2.3.3. Digital nomads

By restricting freedom of movement and travel, the pandemic significantly increased the trend towards telecommuting and triggered a change in the world of work.<sup>57</sup> Restrictions on freedom of travel were frequently imposed, leaving people stranded, mostly only for short periods of time, but nevertheless in locations where they usually only performed their work.<sup>58</sup> Digital nomads do not need a particular workplace, but are characterized by flexible workplaces, often several, and in different countries. In most cases, such workplaces probably do not meet the criterion of a permanent connection in terms of time. A fixed business establishment requires a permanent connection in terms of location to a specific point on the earth's surface. This connection must not be temporary.<sup>59</sup> If digital nomads typically work from different locations, a business establishment does not exist permanently and no PE occurs.

### 2.3.4. Service permanent establishment

A service PE within the meaning of article 5(3) of the UN Model may apply if no fixed place of business within the meaning of article 5(1) of the OECD Model is maintained in the source state.<sup>60</sup> This means that a right of taxation on the part of the source state can be triggered if services are performed outside the state of residence of the employer for a period of more than 183 days.<sup>61</sup> Thus, neither the criterion of a fixed place of busi-

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54. AT: VwGH, 17 Dec. 1993, 93/15/0094.

55. C. Ludwig, § 98, in *Einkommensteuergesetz (EStG) Kommentar* m. no. 49 (W. Doralt et al. eds., 22nd edn., Facultas Verlag 2020) with reference to DE: BFH, 3 Aug. 2005, I R 87/04, BStBl 2006 II, p. 220.

56. AT: BMF, 21 Oct. 1996, EAS 958; *see also* S. Bendlinger, *supra* n. 35, at p. 405.

57. Bendlinger, *supra* n. 35, at p. 450.

58. *Id.*, at p. 461.

59. *Id.*, at p. 460.

60. *Id.*, at p. 459.

61. *Id.*

ness nor a power of disposal over a place of business is required.<sup>62</sup> So far, service PEs are rarely found in Austrian tax treaties.<sup>63</sup> The calculation of the period of over 183 days is based on a 183-day period within 12 months. The calculation is thus independent of the calendar year and is based on a period within 12 months, which begins to run when the first activity takes place in the source state. According to Austrian literature, the calculation of the 183-day rule is based on the principles of the period calculation in article 15 of the OECD Model.<sup>64</sup>

### 2.3.5. The opinion of the Austrian tax authorities on permanent establishments

In the opinion of the Austrian tax authorities, there is a distinction between a home office agreed with the employer and a home office made necessary by force majeure as a result of the COVID-19 pandemic. While, as already described earlier in this chapter, it is generally possible to constitute a home office PE, a home office triggered by the COVID-19 crisis but which does not become the norm does not lead to a PE for the foreign company within the meaning of article 5 of the OECD Model.<sup>65</sup> This is justified by the fact that the home office “lacks permanence or continuity or a sufficient power of disposal of the enterprise”.<sup>66</sup> This view was also included in a consultation agreement between Germany and Austria.<sup>67</sup>

62. F. Rosenberger, *Betriebsstättenbegriff und Dienstleistungsbetriebsstätte*, 82 Steuer- und Wirtschaftskartei 27, p. 751 f. (2007).

63. Id., at p. 752.

64. Para. 5 *OECD Model: Commentary on Article 15* (2017), see also Bendlinger, *supra* n. 35, at p. 459; Rosenberger, *supra* n. 62, at p. 752; S. Bendlinger, *Die Dienstleistungsbetriebsstätte im DBA-Recht*, 17 Steuer und Wirtschaft International 4, p. 155 (2007); Bendlinger, *supra* n. 35, at p. 185.

65. AT: BMF, 2. Wartung der Info zur Anwendung und Auslegung von Doppelbesteuerungsabkommen im Zusammenhang mit der COVID-19 Pandemie, sec. 3. 2021-0.065.76129 [2nd maintenance of the info on the application and interpretation of double taxation agreements in connection with the COVID 19 pandemic (Jan. 2012)].

66. Rosenberger, *supra* n. 62, at sec. 3.

67. AT: BMF, *Konsultationsvereinbarung zum DBA-Deutschland betreffend Arbeitnehmer und im öffentlichen Dienst Beschäftigte im Homeoffice sowie Kurzarbeitergeld und Kurzarbeitsunterstützung iZm der COVID-19-Pandemie*, 2020-0.239.636; AT: BMF-AV 2020/55, 15 Apr. 2020 [Consultation Agreement on the Agreement of 24 August 2000 between the Federal Republic of Germany and the Republic of Austria for the Avoidance of Double Taxation in the Field of Taxes on Income and on Capital Concerning the Tax Treatment of the Wages of Employees in Home Offices as well as Short-Time Workers' Allowances and Short-Time Workers' Benefits (2020)].

Since the Austrian tax authorities have not departed from this view, it will probably not change. As described above, it was argued that force majeure lacks permanence, continuity or sufficient control. Since the COVID-19 pandemic continues to constitute force majeure, it is conceivable that this view will be maintained.

According to article 5(3) of the OECD Model, construction or installation projects constitute a PE if they exist for more than 12 months. If the construction or installation project is not completed within 12 months, a PE is created. Interruptions in the execution of construction or installation projects are generally to be included in the calculation of the period.<sup>68</sup> According to the Austrian tax authorities, even a temporary interruption caused by COVID-19 does not lead to a suspension of the period.<sup>69</sup> However, only those services that are actually performed in the respective PE state can be attributed to the construction or installation PE. Supervision activities performed outside the PE state cannot be attributed to the PE.<sup>70</sup>

If a PE is constituted by means of a home office, which, as described above, is possible in principle, profits must be apportioned between the parent company and the PE according to the approved OECD approach (AOA).<sup>71</sup> In a first step, the functions performed by the PE must be determined in order to allocate risks, assets and endowment capital to the PE and subsequently to determine the value of the contributions of the PE in the context of the distribution of tasks within the company as a whole.<sup>72</sup> Consequently, the arm's length remuneration is to be determined, taking into account the OECD Guidelines.<sup>73</sup> If the Austrian literature is followed, the cost-plus method should be used, which provides for a profit markup of 3% to 10% (often 5%) for services with a routine character.<sup>74</sup>

The classical PE definition is no longer really practicable in many situations. As noted by M. Lang, the classical PE definition is in many cases no longer suitable "for allocating taxing rights between the resident state and the other

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68. Para. 55 *OECD Model*; AT: BMF, 27 May 2002, EAS 2059; 5 Sept. 2017, EAS 3391.

69. BMF, *supra* n. 65, at sec. 4.

70. AT: BMF, 24 July 2017, EAS 3384.

71. Bendlinger, *supra* n. 35, at p. 462.

72. Bendlinger, *supra* n. 35, at p. 462; S. Bendlinger, *Betriebsstätten-Ergebnisabgrenzung nach den neuen Verrechnungspreisrichtlinien*, 5 *Transfer Pricing International (TPI)* 3, p. 177 ff. (2021); W. Blumers, *DBA-Betriebsstätte und Personalfunktionen*, 74 *Der Betrieb* 22, p. 1162 (2021).

73. *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (24 Jan. 2022), Primary Sources IBFD.

74. *BMF Transfer Pricing Guidelines 2021* para. 90 (2021).



contracting state in a manner perceived as appropriate by both sides”.<sup>75</sup> This is due to greater mobility, which is likely to continue into the future. Many companies partly switched to home office as a result of the pandemic and will continue to do so.<sup>76</sup> It would, therefore, be desirable for mechanisms to be developed that bring about a fair distribution of taxation rights in the long term.<sup>77</sup> Since there is still no Austrian Supreme Court ruling, such a ruling would also be desirable for the sake of legal certainty.<sup>78</sup> A rethinking on the current PE concept will nevertheless be necessary, due to a further increase in mobility.

## 2.4. Physical presence according to articles 15(1) and 17 of the OECD Model

### 2.4.1. Physical presence according to article 15(1) of the OECD Model

The domestic connection for the taxation of income from employment is subdivided according to section 98(1), no. 4 of the ITA into two facts, namely the exercise or utilization of employment in Austria or on Austrian ships and the granting of domestic public funds with regard to a current or former employment relationship.<sup>79</sup> An employee is considered to be engaged in gainful employment if they are actually physically present at the place of work. The exercise may be of an active or passive nature.<sup>80</sup> A short-term or temporary activity is already sufficient.<sup>81</sup> The decisive factor is whether the activity is carried out mainly in Austria. According to the Austrian doctrine, the exercise of a mere secondary activity should not be taxed in Austria.<sup>82</sup> In addition to the exercise of the activity, Austrian tax law is also linked to the

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75. M. Lang, *Homeoffice nach der Konsultationsvereinbarung zum DBA Deutschland – Österreich*, 30 *Steuer und Wirtschaft International* 7, p. 343 (2020).

76. Id., at p. 344.

77. Id.

78. Häusler, *supra* n. 52, at p. 65.

79. AT: VwGH, 19 Mar. 1997, 94/13/0220.

80. Marschner, *supra* n. 9, at m. no. 29; E. Lechner & G. Stangl, *Die “Ausübung” und “Verwertung” bei den Einkünften aus nichtselbständiger und aus selbständiger Arbeit*, in *Die beschränkte Steuerpflicht im Einkommen- und Körperschaftsteuerrecht Beschränkte Steuerpflicht* p. 64 f. (W. Gassner et al. eds., Linde Verlag 2004).

81. AT: BMF, 1 Dec. 2006, *Ausländische Sportmannschaften - Protokoll Außensteuerrecht*, 010221/0626-IV/4/2006, in *Zweifelsfragen zum Außensteuerrecht und Internationalen Steuerrecht* [Foreign sports teams – Doubts about foreign tax law and international tax law]; Marschner, *supra* n. 9, at m. nos 28, 77.

82. Marschner, *supra* n. 9, at m. no. 4; Lechner & Stangl, *supra* n. 80, at p. 66; if necessary, a division of the remuneration may be necessary.

utilization of the employment. Accordingly, dependent work is considered to be exploited in Austria if its economic success is directly intended to serve the Austrian economy; personal exercise in Austria is not required for this.<sup>83</sup> The assumption applies to exploitation in Austria if a service is rendered abroad for a domestic client.<sup>84</sup> The tax administration usually interprets the definition of exploitation relatively broadly.<sup>85</sup> For example, the activities of the foreign trade offices of the Austrian Economic Chambers are considered to be utilized domestically.<sup>86</sup> The connecting factor under Austrian tax law is thus broader than the one in article 15 of the OECD Model, which only covers the performance of work and not also exploitation.<sup>87</sup> According to the first sentence of article 15(1) of the OECD Model, the right of taxation primarily belongs to the state in which the work is carried out. The place where the work is performed is the place where the employee is personally present or physically present at the time the work is performed.<sup>88</sup> If the employee works in their home office in the state of residence, then, according to the Austrian view, this state is to qualify as the source state in which the work is carried out, and the remuneration components attributable to the home office days are to be taxed in the state of residence of the employee.<sup>89</sup>

According to the Austrian view, severance payments for the early termination of an employment relationship are assigned to the former activity pursuant to article 15(1) of the OECD Model and left to the source state for taxation.<sup>90</sup> If the previous activity was carried out exclusively from the home office, the right to tax the severance payments is to be allocated to the state where the employee's home office is located, in accordance with article 15(1) of the OECD Model. In cases of only partial home office work, the right of taxation is to be divided accordingly between the states.<sup>91</sup>

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83. Marschner, *supra* n. 9, at m. nos. 30, 77.

84. AT: VwGH, 20 Oct. 1982, 81/13/0083; BMF, 24 Nov. 2008, EAS 3021.

85. AT: BMF, 16 Mar. 1998, EAS 1237; 25 Aug. 2008, EAS 2997; 19 June 2012, EAS 3287; 22 Feb. 2008, EAS 2943.

86. AT: VwGH, 27 Nov. 1968, 0889/67.

87. See Waser, *supra* n. 40, at para. 1.

88. See Waser, *supra* n. 40, at para. 1.

89. M. Mitterlehner, *OECD zu abkommensrechtlichen Fragen in Zusammenhang mit COVID*, 30 *Steuer und Wirtschaft International* 5, p. 216 (2020).

90. AT: VwGH, 26 Feb. 2015, 2012/15/0128; AT: BMF, 11 Feb. 2009, EAS 3037; 19 July 1994, EAS 480; 27 Sept. 1999, EAS 1531; H. Loukota, *Österreichisch-deutsche Verständigung vom 3. 3. 2000 über DBA-Anwendungsfragen*, 10 *Steuer und Wirtschaft International* 4, p. 155 (2000); V. Drummer, T. Fink & A. Miladinovic, *DBA-Auslegungsfragen bei der Vergütung von Arbeitnehmern und ähnlichen Einkünften in Deutschland, Liechtenstein, Österreich und der Schweiz*, 27 *Steuer und Wirtschaft International* 5, p. 232 f. (2017).

91. AT: BMF, 10 Aug. 2010, EAS 3172; see D. Höppner & E. Steinhäuser, *Homeoffice-Tätigkeiten im grenzüberschreitenden Kontext zwischen Österreich und Deutschland*, 30 *Steuer und Wirtschaft International* 4, p. 160 f. (2020).

If home office working is obligatory due to a government order, e.g. during COVID-19, Austria applies the basic rule of article 15(1) in conjunction with (2) of the OECD Model. Therefore, the state in which the employee performs their home office activity has the right to tax the portion of the remuneration attributable to the home office days.<sup>92</sup> However, any bilateral consultation agreements concluded during the COVID-19 pandemic – as is the case with Germany – take precedence over the basic rule and can lead to the assumption that home office days due to the COVID-19 pandemic can be considered as working days spent in the contracting state in which the employees would have carried out their activities normally.<sup>93</sup>

In relation to countries with whom no consultation agreement has been concluded, this means that the basic rule, according to article 15(1) in conjunction with (2) of the OECD Model, also applies to “stranded workers” who temporarily exercise their activity in Austria due to COVID-19 travel restrictions, and Austria could have a right of taxation in this respect. According to article 15(2)(a) of the OECD Model, when calculating the time limit, not counted are those non-working days that an employee stays in Austria past the end of their contract, but is not allowed to leave due to COVID-19, when they would otherwise have done so.<sup>94</sup>

For workers who were (partially) at home during COVID-19 but could not actually work from home and yet still received payment, Austria introduced COVID-19 short-time work, among other measures, to preserve jobs during COVID-19. According to this measure, a short-time work allowance is paid out by the state to the employer as a partial compensation for their loss of earnings but for still employing the employee even if they are not

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92. EAS 3172; AT: BMF, 21 July 2020, *Info zur Anwendung und Auslegung von Doppelbesteuerungsabkommen im Zusammenhang mit der COVID-19 Pandemie* [Information on the application and interpretation of double taxation agreements in connection with the COVID-19 pandemic], replaced by the information dated 29 Jan. 2021, 2020-0.459.612, p. 2.

93. BMF, *supra* n. 65, at para. 1; the relevant consultation agreement was amended on 30 Mar. 2022 and was applicable to situations up to 30 June 2022 (AT: BMF-AV No. 41/200, 30 June 22); however, it should be noted that COVID-19-related home office days are not counted as days of stay within the meaning of art. 15(2)(a) *Austria-Ger. Income and Capital Tax Treaty* (2000), *Treaties & Models IBFD*, on the basis of this agreement; see I. Kerschner & S. Schmidjell-Dommes, *BMF-Info: Doppelbesteuerungsabkommen und die COVID-19-Pandemie*, 30 *Steuer und Wirtschaft International* 7, p. 347 (2020).

94. AT: BMF, 20 July 2020, 2. *Wartung Info zur Anwendung und Auslegung von Doppelbesteuerungsabkommen im Zusammenhang mit der COVID-19 Pandemie* [2nd maintenance of the info on the application and interpretation of double taxation agreements in the context of the COVID-19 pandemic], p. 2; with this, Austria follows the proposal of the *OECD Guidance*, *supra* n. 13, at para. 56.

needed at that time.<sup>95</sup> In accordance with the OECD Guidance, the Austrian tax authorities assume subsumption under article 15 of the OECD Model.<sup>96</sup> According to the principle of causality, the short-time working allowance is taxable in the country in which the activity to which the short-time working allowance relates would have been carried out.<sup>97</sup> This is usually the state that was also entitled to tax the income before the COVID-19 crisis.<sup>98</sup> However, the right of taxation only remains with this state if the compensation is actually taxed there.<sup>99</sup> Some tax treaties contain special provisions for a different allocation of the right of taxation to income from statutory social insurance, and assign the right of taxation to the fund state.<sup>100</sup>

#### 2.4.2. Physical presence according to article 17 of the OECD Model

With regard to the taxation of training or rehearsal fees of athletes and artists, the Austrian tax authorities are of the opinion that a purely training camp, even if open to the public to spectate, is not to be regarded as a sporting event with entertainment characteristics, and that the money paid for it does not fall under article 17 of the OECD Model.<sup>101</sup> Training and rehearsal fees should only fall under the latter to the extent that they are closely related to a performance in the source state.<sup>102</sup> However, this close relationship may also exist if the training or rehearsal still takes place abroad but is closely related to an appearance in the home country.<sup>103</sup> If there is a close connection to performances in several states, attribution of fees shall be divided accordingly.<sup>104</sup>

Furthermore, regarding the implications of live-streaming performances of athletes or artists, Austrian treaty practice leans heavily on the OECD Model.<sup>105</sup> Accordingly, such payments fall under article 17 of the OECD

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95. AT: *Bundesgesetz über das Arbeitsmarktservice (Arbeitsmarktservicegesetz – AMSG 2020)*, BGBl I 12/2020 (Austrian Labour Market Service Act) (2020), sec. 37b and 37c; see Kerschner & Schmidjell-Dommes, *supra* n. 93, at p. 349.

96. AT: BMF, 21 Dec. 2007, EAS 2922.

97. BMF, *supra* n. 91, at p. 6; VwGH, 26 Feb. 2015, 2012/15/0128.

98. See Kerschner & Schmidjell-Dommes, *supra* n. 93, at p. 349.

99. VwGH, 26 Feb. 2015, 2012/15/0128, p. 6. BMF, *supra* n. 90.

100. See for example art. 18(2) *Austria-Ger. Income and Capital Tax Treaty* (2000).

101. C. Toifl, para. 47, art. 17, *DBA-Kommentar 2018* (D. Aigner et al. eds., 2nd edn., Linde Verlag 2019).

102. H. Treer & G. Mayr, 1 *ÖStZ Spezial - Der Salzburger Steueralog* 1 (2006).

103. BMF; 22 Feb. 2008, EAS 2943.

104. See Toifl, *supra* n. 101, at para. 47.

105. See Toifl, *supra* n. 101, at para. 80.

Model if the broadcast is live. In the case of a live broadcast, only the place of the artist's or sportsperson's actual activity is to be taken into account, not the place where it is actually broadcast.<sup>106</sup>

According to a past decision, well before the COVID-19 pandemic, the BMF took the view that payments from a singer's fee cancellation insurance are not paid for artistic work performed, but rather because the artistic work did not take place and may therefore only be taxed in the country of residence.<sup>107</sup> This view could also be applied to such payments to artists and athletes made due to COVID-19; however, there are no current statements in Austrian administrative practice confirming that this view remains valid. In accordance with the OECD Model, doctrine assumes that such payments are not to be subsumed under article 17 of the latter, but rather under article 7 of the OECD Model for self-employed persons and under article 15 of the same for employed persons.<sup>108</sup>

If the COVID-19 situation had lasted longer, it can be assumed that the exercise principle provided for in article 17 of the OECD Model would have continued to apply.<sup>109</sup> With the increased use of video conferencing tools and home office, the exercise of the activity takes place in the residence state of the sportsperson/artist, and the state of activity is, therefore, also the residence state within the meaning of article 17(1) of the OECD Model. Furthermore, COVID-19-related changes in residence not only of a temporary nature can lead to residence or unlimited tax liability in Austria, according to national regulations.<sup>110</sup>

Depending on the sector they operate within, influencers can also be varying affected by the COVID-19 pandemic. In the context of the digital economy, beauty influencers, for example, can still carry out their activities unhindered and work from home. In this case, the COVID-19 pandemic was viewed as having no impact on taxation under article 17 of the OECD Model, as communication via social media allows images and sound to reach the public.<sup>111</sup> However, influencers also regularly participate in different events across borders. Due to the ban on events in the context of the COVID-19 crisis, the question arose as to where any cancellation payments

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106. AT: BMF, 15 Jan. 2010, EAS 3111.

107. BMF, 21 Dec 2004, EAS 2538.

108. See Mitterlehner, *supra* n. 89, at p. 218.

109. Lang, *supra* n. 75, at p. 341.

110. M. Mitterlehner, *Internationales Steuerrecht in Zeiten der COVID-19-Krise*, Der Wirtschaftstreuer (VWT) 3, p. 182 (2020).

111. Lang, *supra* n. 75, at p. 341.

could be taxed. Currently, neither the Austrian tax administration nor the OECD Secretariat have made any statements in this regard.<sup>112</sup> According to the OECD Model, such payments are not to be subsumed under article 17 of the OECD Model, but under article 7 for self-employed persons and under article 15 for employed persons.<sup>113</sup>

## **2.5. Article 15(2) and (3) of the OECD Model**

The actual stay at the place of employment, including the day of arrival and departure, is decisive for the calculation of the 183-day period in article 15(2) lit. a of the OECD Model.<sup>114</sup> Activities performed in the home office in the state of residence are carried out there and not in the other contracting state. These home office days are therefore not taken into account as days stayed in the state in which the work is carried out.<sup>115</sup>

If an employer loses its substance (premises) due to all its employees working from home, the fact of the employees in the other contracting state also working from home does not result in the establishment of the employer's registered office in the state in which the activities are carried out, within the meaning of article 15(2) lit. b of the OECD Model. In this respect, the Austrian literature follows the view of the German Federal Tax Court (*Bundesfinanzhof*, BFH), and therefore a PE constituted by the employees' home office cannot be an employer under civil law.<sup>116</sup> According to the case law of the Austrian Administrative Court, the decisive factor is who is to be regarded as the employer "economically", i.e. who bears the remuneration.<sup>117</sup> The employees in the home office do not fulfil either the economic or the civil law definition of employer as defined in article 15(2) lit. b of the OECD Model.<sup>118</sup>

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112. See Mitterlehner, *supra* n. 89, at p. 218.

113. Para. 9 *OECD Model: Commentary on Article 17* (2017).

114. AT: BMF, *Lohnsteuerrichtlinien* (LStR) 2002 [Payroll Tax Directive (2002)], para. 721.

115. BMF, *supra* n. 90, at p. 2 f.; see M. Kunesch, *COVID-19 und die Konsequenzen für grenzüberschreitend tätige Arbeitnehmer*, 15 PV-Info, die Fachzeitschrift für Personalverrechnung 6, p. 13 (2020); Lang, *supra* n. 75, at p. 332.

116. DE: BFH, 29 Jan. 1986, IR 296/82, BStBl II, p. 442, 513; see S. Bendlinger & G. Kofler, *Teil 3: Die Verteilungsnormen im OECD-MA (Art 6 bis 22 OECD-MA)*, in *Internationales Steuerrecht*, para. 515 (S. Bendlinger et al. eds., 2nd edn., LexisNexis ARD ORAC Verlag 2018); AT: BMF, 22 Feb. 1996, EAS 817.

117. AT: VwGH, 22 May 2013, 2009/13/0031.

118. Implicit also S. Rasch & F. Rosenberger et al., *Auswirkungen dezentraler Home-Office Tätigkeiten auf Betriebsstättenbegründung, Gewinnzuordnung und die Besteuerung der Arbeitnehmer – Praxis in Deutschland, Österreich und in der Schweiz*, StAW – Spektrum der Steuerwissenschaften und des Aussenwirtschaftsrechts 1, p. 28 (2021).

However, the increased use of videoconferencing technologies, amongst others, by managing directors in their home offices, can lead to a shift of the place of actual management and consequently the company's residence, within the meaning of article 4(3) of the OECD Model.<sup>119</sup> If, as a result, the employer's country of residence shifts to the source country, the right to tax the employee's remuneration reverts to the employee's country of residence, pursuant to article 15(2) lit. b of the OECD Model.

Furthermore, the employee's home office could also constitute a PE, according to article 15(2) lit. c of the OECD Model. The BMF follows the OECD view and assumes the constitution of a PE through a home office if the employer de facto requires the employee to use it.<sup>120</sup> Under certain circumstances, however, the Austrian tax authorities deny the constitution of a PE, namely, if either the home office does not become the norm<sup>121</sup> or the employer does not have the power to dispose of the home office since they generally provide the employee with an office. If only preparatory or auxiliary activities are carried out in the home office, this does not constitute a PE within the meaning of article 5(4) of the OECD Model.<sup>122</sup> In practice, the activities carried out by employees at home will often be subsumed under the catalogue of auxiliary PEs (article 5(4) of the OECD Model (2017)).<sup>123</sup> In principle, the COVID-19 crisis did not lead to any changes in the assessment of PEs.<sup>124</sup>

The vast majority of Austrian tax treaties still follow the wording of the OECD Model as amended in 2014.<sup>125</sup> About one third of the tax treaties concluded by Austria also refer to inland navigation, while the majority of the Austrian tax treaties limit the distribution standard to activities on board a sea-going vessel or aircraft operated in international traffic.<sup>126</sup> According to the Austrian tax authorities, article 15(3) of the OECD Model should apply not only to employees of the operating company but also to subcontractors, for example employees of a catering company.<sup>127</sup> With respect to

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119. M. Mitterlehner, *Langfristige Veränderungen*, Ögswissen 2-3, p. 16 (2020).

120. BMF, 27 June 2019, EAS 3415; 6 Nov. 2017, EAS 3392.

121. AT: VwGH, 12 June 1985, 83/13/0158; 25 Feb. 1987, 84/13/0053; 24 Oct. 1990, 86/31/0032; 1 Oct. 1991, 90/14/0257; 12 Dec. 1995, 94/14/0060; AT: BMF, 8 Apr. 2013, EAS 3323; 27 June 2019, EAS 3415.

122. BMF, 27 June 2019, EAS 3415; 24 Aug. 2006, EAS 2754; 28 Mar. 1996, EAS 849.

123. See Bendlinger & Kofler, *supra* n. 116, at para. 65.

124. BMF, *supra* n. 90, at p. 9.

125. See Waser, *supra* n. 40, at para. 100.

126. *Id.*, at para. 151.

127. *Id.*, at para. 105.



the question of whether the special rule of article 15(3) of the OECD Model could require an alternative interpretation due to the challenges of increasing mobility, the authors would argue that a place of effective management (PoEM)-based sourcing rule is no worse than a place of activity-based allocation rule.

From the above, it is obvious that an improvement of article 15 of the OECD Model would be necessary in order to determine the undefined terms of employer or employment in an autonomous way. Since states rely heavily on an understanding of national law when interpreting undefined tax treaty terms, and that these interpretations vary greatly from state to state, such an improvement would lead to more legal certainty. Furthermore, the question arises whether the nexus for taxation of employment income is still appropriate or may need to be reviewed, also taking into account the related administrative difficulties for source states in implementing taxation in cases where there is a lack of physical presence of non-residents.

## **2.6. Frontier workers**

The reason for frontier worker regulations is, amongst others, to be seen in the fact that no taxation differences arise for workers living in border areas simply because they do not have their place of work in Austria but in a neighbouring country.<sup>128</sup> The relevance of these rules is not diminished, even with increasing labour mobility, when certain jobs still require the activity to be performed locally on the employer's premises. The application of the frontier worker rule mostly requires that the employer is resident in the other contracting state. Problems relating to a change of residence of the employer or board members due to increased mobility (and related problems in the application of the frontier worker rule) have so far not arisen in Austrian practice.

In principle, any reasons for which the daily border crossing does not take place are irrelevant.<sup>129</sup> If the frontier worker pursues their activity from their home office, these days count as non-return days in the scope of application

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128. H. Loukota et al., *Internationales Steuerrecht I/1* Z 15 para. 173 (MANZ Verlag Wien 2022).

129. S. Bendlinger, *Auslandsentsendungen in der Praxis des internationalen Steuer- und Sozialversicherungsrechts* p. 265 (S. Bendlinger ed., 3rd edn., LexisNexis ARD ORAC 2017).



of the tax treaty between Austria and Germany, for example.<sup>130</sup> The tax treaties with Italy and Liechtenstein (article 15(4) of the OECD Model in each case) also contain a frontier worker rule that requires daily commuting between the place of work and the place of residence; if the activity is carried out in the home office, this criterion is not fulfilled.<sup>131</sup> However, within the framework of consultation agreements, Austria agreed with Germany, Italy and Liechtenstein that taxpayers who had to perform their work in a home office due to the COVID-19 pandemic did not lose their frontier worker status.<sup>132</sup>

## **2.7. Mobility of work and the justification and legal basis of COVID-19 based rules**

### **2.7.1. Legal basis for interpretations by contracting states that contradict the wording of the respective agreement**

During the pandemic, for tax treaty purposes, some governments deemed employees, although working from home in the state of residence, to still be exercising their activities in their previous state of activity. In the authors' opinion, there is no legal basis for such a view, because it is not covered by the wording of the treaty. This view is also generally held in Austrian literature.<sup>133</sup> According to article 15(1) of the OECD Model, income from

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130. AT: BMF: 30 Apr. 2019, *Konsultationsvereinbarung zu Zweifelsfragen hinsichtlich der Auslegung der Grenzgängerregelung nach Art. 15 Abs. 6 des österreichischen-deutschen Doppelbesteuerungsabkommens vom 24. August 2000*, 010221/0113-IV/8/2019 [Consultation agreement on questions of doubt regarding the interpretation of the cross-border commuter regulation pursuant to Art. 15 (6) of the Austrian-German double taxation agreement of 24 August 2000]; AT: BMF, 12 Jan. 2007, EAS 2803.

131. Critically E. Steinhauser, *Steuerliche Aspekte in grenzüberschreitenden Fällen des mobilen Arbeitens*, in *Die Arbeit ist immer und überall*, p. 133 f. (A. Reichel, W. Pfeil et al. eds., MANZ Verlag Wien 2020).

132. AT: BMF, *Konsultationsvereinbarung zum DBA-Deutschland iZm der COVID-19 Pandemie*, 2021-0.877.188, 21 Dec. 2021 [Consultation Agreement on the Austria-Ger. Income and Capital Tax Treaty (2000) in the Context of the COVID-19 Pandemic (2021)]; AT: BMF, *Konsultationsvereinbarung zu den Auswirkungen der COVID-19-Pandemie auf die Grenzgängerregelung iSd Art. 15 Abs. 4 DBA-Italien*, 2020-0.394.761, 27 June 2020 [Consultation Agreement on the Effects of the COVID-19 Pandemic on the Cross-Border Commuter Regulation within the Meaning of Para. 4 Art. 15 Austria-Italy Income and Capital Tax Treaty (1981) (2020)]; AT: BMF, Consultation agreement regarding Art 15 (4) Austria-Liech. Income and Capital Tax Treaty (1969), 2021-0.065.761, 29 Jan. 2021 [*Wartung der Info zur Anwendung und Auslegung von Doppelbesteuerungsabkommen im Zusammenhang mit der COVID-19-pandemie*].

133. Lang, *supra* n. 75, at p. 332; Höppner & Steinhauser, *supra* n. 90, at p. 160; S. Raab, *Homeoffice im Lichte aktueller Entwicklungen*, 13 BFGjournal 5, p. 201 (2020).

employment is taxable in the residence state of the employee, unless the work is performed in the other contracting state. The place where the work is performed is the place where the employee is personally present during the performance of their work and is thus physically present.<sup>134</sup> Therefore, if an employee works in a home office, they perform their work in their residence state and not in the other contracting state.<sup>135</sup>

Some governments also assumed that no PE was constituted by the home office, except for during the time period of the pandemic. However, there is no legal basis for this, for such an interpretation contradicts the wording of the PE rule according to article 5 of the OECD Model. If the requirements for the constitution of a PE are met, this cannot be deviated from by means of administrative action. The Austrian tax authorities are of the opinion that a home office activity triggered by force majeure does not constitute a PE.<sup>136</sup> With regard to the state in which the activity takes place, no generally applicable rules have been issued, rather only individual consultation agreements concluded. However, there was also an amendment to the frontier worker regulation of the tax treaty between Austria and Liechtenstein. Accordingly, persons who were previously classified as frontier workers because they usually commuted every working day are still considered frontier workers within the meaning of article 15(4) of the tax treaty between Austria and Liechtenstein if they work in their home office in order to prevent the further spread of COVID-19.<sup>137</sup>

### 2.7.2. Voluntary or involuntary home office

It is questionable whether a distinction can be made between voluntary and involuntary home office working, as is partly done by the Austrian tax authorities. In their opinion, a distinction must generally be made between voluntary home office activities and home office activities that are triggered by force majeure.<sup>138</sup> In the authors' opinion, however, no distinction can be made, since the wording of the OECD Model and the tax treaties based on it do not provide for any distinction. Even the conclusion of individual consultation agreements that make a distinction between voluntary and involuntary home offices does not lead to a permissibility of distinctions, because consultation agreements pursuant to article 25(3) of the OECD

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134. Waser, *supra* n. 40, at para. 1.

135. Lang, *supra* n. 75, at p. 332; Ullmann, *supra* n. 24, at p. 119.

136. BMF, *supra* n. 65, at sec. 3, question 6.

137. BMF, *supra* n. 65, at sec. 1.3.

138. *Id.*, at sec. 3, question 6.

Model can neither change the content of a tax treaty nor distribute taxing rights differently.<sup>139</sup>

Nevertheless, consultation agreements with such content have been concluded by the Austrian tax administration, for example a consultation agreement with the German tax administration, according to which, working days spent in the home office due to the COVID-19 pandemic are considered working days spent in the other contracting state, insofar as the reason for the home office was actually a measure to limit the spread of the COVID-19 pandemic.<sup>140</sup> However, this does not apply to working days that would have been spent in the home office regardless of the measures. The basis for the consultation agreement is article 25(3) of the tax treaty between Austria and Germany. In addition, within the framework of this consultation agreement, a consultation agreement with Germany from 2019 was extended with regard to the frontier worker regulation pursuant to article 15(6) of the tax treaty between Austria and Germany. Accordingly, working days for which wages are received and upon which frontier workers only carry out their activities in the home office due to the measures to combat the COVID-19 pandemic are not considered days of non-return.<sup>141</sup>

A consultation agreement was also concluded in the tax treaty between Austria and Italy, which deals with the frontier worker regulation analogously with the decree in the treaty between Austria and Liechtenstein. Accordingly, employees who usually commute to their place of work, but who work in their home office in order to limit the spread of COVID-19, continue to be regarded as frontier workers within the meaning of article 15(4) of the tax treaty between Austria and Italy.

## **2.8. The future of the mobility of work: A need for adjusting the existing treaty rules?**

A need to amend the rules in double taxation treaties in view of increasing mobility cannot be answered in a generic way, but has to be assessed

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139. Lang, *supra* n. 75, at p. 332; M. Lang, *Auslegung und Anwendung von Doppelbesteuerungsabkommen*, in *100 Jahre Steuerrechtsprechung in Deutschland 1918 – 2018, Festschrift für den Bundesfinanzhof* p. 1001 ff. (K. Drüen et al. eds., edn. Band I, Dr. Otto Schmidt KG 2018); J. Romstorfer, *Besteuerung Schweizer AHV-Renten aus einer früheren öffentlich-rechtlichen Beschäftigung nach dem DBA Schweiz*, 33 *Steuer und Wirtschaft International* 11, p. 566 et. seq. (2023).

140. BMF, *supra* n. 65.

141. *Id.*

separately for each distributive rule. In most cases, the existing tax treaty rules still prove suitable for changing working patterns. As previously illustrated, there is no need for change in connection with article 4 of the OECD Model, as it covers almost all configurations, thanks to its various connecting factors.

The situation is different with regard to article 5 of the OECD Model regarding permanent PEs. Reference should be made here to the comments in section 5 on the home office PE.<sup>142</sup> The existing discussions regarding the question of whether employees in a home office constitute a PE for the foreign employer show the need for a change to the existing system in order to adapt to increasing mobility.<sup>143</sup> Also with regard to the issues raised by the digital economy arises the question as to whether a physical connection with regard to a state's right to tax is still appropriate in relation to current business models.<sup>144</sup> This problem further extends to the application of article 15(1) of the OECD Model, which assigns the right of taxation to the state in which the work is performed. With increasing mobility, this nexus also no longer seems appropriate for the proper allocation of taxation rights between contracting states. Thus, it becomes increasingly difficult to determine the exact place of activity. Against the background of the rule in article 16 of the OECD Model, which assigns the right of taxation to the company's state of residence, or article 19 of the OECD Model, which assigns the right of taxation to the state that also has to bear the costs, the question arises as to whether a similar system could be applied in article 15 of the OECD Model. According to the latter article, the resident state of the company bearing the employee's costs has the right of taxation.

A standardization of the terms "employment" and "employer" used in the United Nations OECD Model is desirable in view of the fact that contracting states often refer to the definitions in national law when interpreting undefined treaty terms. Harmonization is preferable, as national definitions differ greatly, and this can result in double taxation. Such a harmonization is also recommended with regard to the criteria mentioned in lit a to lit c of article 15(2) of the OECD Model. The calculation of days of presence or absence in a contracting state has significant effects, especially for the frontier worker regulations that are often included in Austrian tax treaties. Consequently, states must define coherent and clear requirements for the application of these rules, especially with regard to home working days, as

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142. See sec. 3.1.

143. See Bendlinger, *supra* n. 35, at p. 463.

144. See, for example, the OECD's work on Pillar One and Pillar Two.

was done, for example, in the consultation agreements with regard to the COVID-19 situation.

The phenomenon of mobile work has not yet engaged the tax authorities from the point of view of the value-added process and the impact on current tax instruments.



## Chapter 3

### The Impact of Tax Treaties on International Mobility of Work in Belgium

Pieter Deré, Stefaan De Baets, Bart Van den Bussche and  
Jean-Philippe Van West

#### 3.1. Mobility of work and domestic tax law

##### 3.1.1. A high number of frontier workers

Belgium is one of the smaller countries in the European Union. It shares borders with four other EU Member States: France, Germany, Luxembourg and the Netherlands. Every day, thousands of employees cross the Belgian border to come to work in Belgium (inbound) or to go to work in one of these neighbouring countries (outbound). The RIZIV/INAMI,<sup>1</sup> the national institution responsible for social security matters, publishes annual data on the number of frontier workers. On 30 June 2021, 52,085 non-residents were registered as frontier workers for social security purposes in Belgium, the majority of them from France (37,983) and the Netherlands (12,414). At the same time, 87,973 residents of Belgium were registered as outgoing frontier workers, the majority them working in Luxembourg (46,211) and the Netherlands (26,595).

Table 3.1. Incoming and outgoing frontier workers – 2021

| Provincie        | Inkomende grensarbeiders |           |           |           |        | Provincie | Uitgaande grensarbeiders |           |           |           |        |
|------------------|--------------------------|-----------|-----------|-----------|--------|-----------|--------------------------|-----------|-----------|-----------|--------|
|                  | Luxemburg                | Frankrijk | Duitsland | Nederland | Totaal |           | Luxemburg                | Frankrijk | Duitsland | Nederland | Totaal |
| Antwerpen        | 31                       | 159       | 137       | 4.828     | 5.155  |           | 285                      | 39        | 122       | 8.229     | 8.675  |
| Brussel          | 90                       | 637       | 87        | 368       | 1.202  |           | 218                      | 206       | 81        | 175       | 680    |
| Vlaams Brabant   | 5                        | 40        | 44        | 130       | 219    |           | 236                      | 62        | 83        | 345       | 726    |
| Waals Brabant    | 5                        | 121       | 3         | 6         | 135    |           | 326                      | 69        | 13        | 17        | 425    |
| Weest-Vlaanderen | 13                       | 5.761     | 25        | 751       | 6.550  |           | 106                      | 831       | 35        | 357       | 1.329  |
| Oost-Vlaanderen  | 10                       | 186       | 39        | 4.003     | 4.238  |           | 135                      | 105       | 52        | 1.307     | 1.599  |
| Henegouwen       | 62                       | 22.570    | 10        | 35        | 22.677 |           | 332                      | 6.563     | 22        | 14        | 6.931  |
| Lijk             | 66                       | 428       | 590       | 106       | 1.190  |           | 8.287                    | 103       | 6.098     | 988       | 15.476 |
| Limburg          | 7                        | 259       | 145       | 2.162     | 2.573  |           | 147                      | 7         | 226       | 15.129    | 15.509 |
| Luxemburg        | 285                      | 6.243     | 5         | 4         | 6.537  |           | 35.113                   | 220       | 8         | 21        | 35.362 |
| Namen            | 23                       | 1.579     | 6         | 1         | 1.609  |           | 1.026                    | 215       | 7         | 13        | 1.261  |
| Totaal           | 597                      | 37.983    | 1.091     | 12.414    | 52.085 |           | 46.211                   | 8.420     | 6.747     | 26.595    | 87.973 |

A few conclusions can be drawn from this data.

1. Rijksinstituut voor ziekte- en invaliditeitsverzekering / Institut national d'assurance maladie-invalidité, *Incoming and outgoing frontier workers – 2021* (30 June 2021), available at [https://www.inami.fgov.be/SiteCollectionDocuments/statistieken\\_grensarbeiders\\_2021.pdf](https://www.inami.fgov.be/SiteCollectionDocuments/statistieken_grensarbeiders_2021.pdf) (accessed 7 Oct. 2022).

First, the data confirms that Belgium has a substantial number of cross-border workers, both incoming and outgoing. This is all the more so because the data includes only those workers registered as frontier workers for social security purposes, and not non-residents coming from other countries or residents working in other countries. Brussels, as the capital of Europe and the location of many NGOs, hosts thousands of government representatives, lobbyists and EU officials. Many of these workers fly in and out on a regular basis. Second, there is a significant difference between the number of incoming frontier workers and the number of outgoing workers, both in terms of the total amount and in terms of the countries from which they are coming or going. There are about 35,000 more outgoing frontier workers than incoming frontier workers. From a country perspective, the biggest difference exists with respect to Luxembourg, from which Belgium received only 597 incoming frontier workers but to which more than 46,000 Belgium residents were outgoing frontier workers. Third, if comparing the data of 30 June 2021 with the latest data available before the outbreak of the COVID-19 pandemic, there is only a limited difference.<sup>2</sup>

Table 3.2. Incoming and outgoing frontier workers – 2019

| Inkomende grensarbeiders |           |           |           |           |        | Uitgaande grensarbeiders |           |           |           |        |  |
|--------------------------|-----------|-----------|-----------|-----------|--------|--------------------------|-----------|-----------|-----------|--------|--|
| Provincie                | Luxemburg | Frankrijk | Duitsland | Nederland | Totaal | Luxemburg                | Frankrijk | Duitsland | Nederland | Totaal |  |
| Antwerpen                | 23        | 128       | 124       | 5.038     | 5.281  | 297                      | 37        | 124       | 10.050    | 10.448 |  |
| Brussel                  | 77        | 1.418     | 88        | 406       | 1.969  | 226                      | 193       | 72        | 192       | 583    |  |
| Vlaams Brabant           | 8         | 256       | 37        | 110       | 411    | 262                      | 59        | 90        | 450       | 861    |  |
| Waals Brabant            | 6         | 119       | 2         | 5         | 132    | 363                      | 70        | 13        | 22        | 468    |  |
| West-Vlaanderen          | 12        | 5.805     | 22        | 804       | 6.644  | 99                       | 825       | 31        | 412       | 1.367  |  |
| Oost-Vlaanderen          | 8         | 172       | 28        | 3.890     | 4.098  | 131                      | 112       | 56        | 1.683     | 1.982  |  |
| Hennegouwen              | 64        | 21.579    | 15        | 40        | 21.498 | 362                      | 6.479     | 23        | 21        | 6.885  |  |
| Luk                      | 79        | 572       | 698       | 109       | 1.458  | 8.002                    | 90        | 5.931     | 1.111     | 15.134 |  |
| Limburg                  | 8         | 31        | 177       | 2.035     | 2.251  | 152                      | 7         | 256       | 17.558    | 17.973 |  |
| Luxemburg                | 264       | 6.320     | 7         | 4         | 6.595  | 33.895                   | 208       | 11        | 22        | 34.136 |  |
| Namen                    | 22        | 1.527     | 8         | 0         | 1.557  | 1.021                    | 213       | 7         | 18        | 1.259  |  |
| Totaal                   | 571       | 37.728    | 1.188     | 12.411    | 51.894 | 44.810                   | 8.293     | 6.614     | 31.578    | 91.296 |  |

The number of registered incoming frontier workers increased from 51,894 to 52,085 between 30 June 2019 and 30 June 2021, whereas the number of registered outgoing frontier workers decreased from 91,296 to 87,973 over the same period. It is fair to say that the impact of the COVID-19 pandemic on the number of registered frontier workers was, unexpectedly, fairly limited.

2. Rijksinstituut voor ziekte- en invaliditeitsverzekering / Institut national d'assurance maladie-invalidité, *Incoming and outgoing frontier workers – 2019* (30 June 2019), available at [https://www.inami.fgov.be/SiteCollectionDocuments/statistieken\\_grensarbeiders\\_2019.pdf](https://www.inami.fgov.be/SiteCollectionDocuments/statistieken_grensarbeiders_2019.pdf) (accessed 7 Oct. 2022).



### 3.1.2. Residence of individuals

According to the Belgian Income Tax Code (BITC), residents are taxed on their worldwide income whereas non-residents are taxed only on certain categories of income that have their source in Belgium. According to the BITC, individuals are resident in Belgium if they have their residence (*domicile/ woonplaats*) in Belgium or, alternatively, if they have their residence outside Belgium but their centre of economic interests (*siège de leur fortune/ zetel van fortuin*) in Belgium. Nationality is not regarded as a determining criterion.

Residence under the BITC is something to be determined based on facts and circumstances, and does not necessarily correspond with residence for civil law purposes. It is the place where a person actually lives, where their family is, where their social life happens, etc. The determination of the residence of a person regularly leads to disputes with the tax authorities, resulting in multiple court decisions. A person working abroad does not automatically mean that they will be considered a non-resident under the BITC, in particular if they still have ties with Belgium. In such a situation, more importance will be given to where the person has their centre of family life and social contacts rather than to where they actually stay or work.<sup>3</sup> Although the courts often take into account the duration of the period abroad when assessing the facts and circumstances, the law does not provide any time threshold.

Similarly to the determination of the residence of a person, the determination of the centre of economic interests is something that requires a case-by-case analysis based on all facts and circumstances. It is the place from which a person administers their property rather than the place where that property is located.

The tax authorities bear the burden of proof if they want to tax an individual as a resident of Belgium. However, the BITC contains two presumptions that help the tax authorities in this regard and that shift the burden of proof to the taxpayer. First, there is a rebuttable presumption that a person registered in the civil register of a Belgian municipality is deemed to be a resident until proven otherwise.<sup>4</sup> Second, there is an irrebuttable presumption that a married person is deemed to have their residence at the place

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3. BE: Circular no. Ci.RH.241/585.607 (AOIF 19/2007) of 12 July 2007.

4. BE: Belgian Income Tax Code, art. 2(1)(1°)(2) (1992) (hereinafter BITC).

where their family is established.<sup>5</sup> This presumption, for example, applies if one parent works and lives abroad while the other parent lives in Belgium together with their children. The same presumption applies to couples that have signed a declaration of statutory cohabitation.

### **3.1.3. Residence of legal persons**

Entities that are resident in Belgium are taxed on their worldwide income. Article 2(5)(b) of the BITC determines that a company is a Belgian resident if it has its principal establishment or seat of management or administration in Belgium. Again, there is a presumption that helps the tax authorities in determining that an entity is resident in Belgium, i.e. an entity that has its registered office in Belgium is deemed to have its principal establishment in Belgium until proven otherwise.

The determination of the principal establishment will be based on facts and circumstances. It is most often the place where key management decisions are taken. The criteria generally used to determine the principal establishment include where the meetings of the board of directors are held, where the accounting records are kept and where the general shareholders' meetings are held. In light of the increased mobility of legal persons, the residence of a company might be challenged if it is proven that key management decisions are actually taken from abroad. The factual analysis shows that the location of employees is of lesser relevance compared to the location of the board activities and that of where the day-to-day management decisions are taken.

## **3.2. Residence, tiebreaker rules and mobility of work: Individuals and entities**

The increasing mobility of work leads to the increased risk of dual residence for both individuals and for legal entities. For example, a married person who spends more than 183 days in another country that applies a time threshold to determine the residence of individuals while their spouse remains in Belgium with any small children and/or children who attend school in Belgium is likely to be a dual resident. Similarly, legal entities with board members and senior management that are located in different countries are more likely to be regarded as resident in more than one

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5. Art. 2(1)(1°)(3) BITC.

country. Consequently, it is more likely that taxpayers will fall within the scope of the tiebreaker rules contained in article 4(2) and (3) of the OECD Model Tax Convention on Income and on Capital (OECD Model).

Belgium has concluded about 100 double tax treaties. Most of these double tax treaties follow the OECD Model. The Belgian Model Tax Convention is also generally in line with the wording of the OECD Model. The Commentary on the OECD Model can therefore be regarded as a useful source when applying the tiebreaker rules based on article 4 of the OECD Model. Belgium made use of the possibility to make a reservation under article 4(3)a of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI), indicating that it does not wish to include the revised wording of article 4(3) of the OECD Model in its tax treaties. Interestingly, however, Belgium did not make a reservation to article 4(3) of the OECD Model in the 2017 version.

### 3.3. Permanent establishments and mobility of work

#### 3.3.1. General

A distinction should be made between a Belgian establishment (BE) under the BITC and a permanent establishment (PE) as defined under the OECD Model (2017).<sup>6</sup> Although the definition of a BE is aligned, to a certain extent, with the definition of a PE under the OECD Model, there are also some key differences. In short, the definition of a BE under article 229 of the BITC is broader than the definition of a PE under the double tax treaties that Belgium has concluded. The table below lists the commonalities and differences between a BE (under the BITC) and a PE (under the OECD Model) (differences are indicated in ***bold italics***).

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6. The OECD Model (2017) is used in this contribution as a benchmark only. The reader should bear in mind that the text of each tax treaty may deviate from the OECD Model, including with regard to the options chosen under the MLI.

**Table 3.3. Commonalities and differences between a BE (under the BITC) and a PE (under the OECD Model)**

| Belgian establishment (article 229 of the BITC)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | Permanent establishment (OECD Model)                                                                                                                                                                                                                                                                                                                                                                                    |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Fixed place of business through which the business of an enterprise is wholly or partly carried on                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                | Fixed place of business through which the business of an enterprise is wholly or partly carried on                                                                                                                                                                                                                                                                                                                      |
| <p>A BE specifically includes:</p> <ul style="list-style-type: none"> <li>– a place of management;</li> <li>– a branch;</li> <li>– an office;</li> <li>– a factory;</li> <li>– a workshop;</li> <li>– <b>an agency</b>;</li> <li>– a mine, and oil or gas well, a quarry or any other place of extraction of natural resources;</li> <li>– <b>a building site or construction or installation project if it lasts longer than 30 days</b>;</li> <li>– <b>facilities for the purpose of storage of goods or merchandise</b>; and</li> <li>– <b>a stock of goods or merchandise</b></li> </ul> <p>(this list is non-exhaustive)</p> | <p>A PE specifically includes:</p> <ul style="list-style-type: none"> <li>– a place of management;</li> <li>– a branch;</li> <li>– an office;</li> <li>– a factory;</li> <li>– a workshop;</li> <li>– a mine, and oil or gas well, a quarry or any other place of extraction of natural resources; and</li> <li>– a building site or construction or installation project if it lasts longer than 12 months.</li> </ul> |
| A dependent agent does not constitute a BE, unless a person acts exclusively or almost exclusively on behalf of (a) closely related enterprise(s) <sup>7</sup>                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | A dependent agent does not constitute a PE, unless a person acts exclusively or almost exclusively on behalf of (a) closely related enterprise(s)                                                                                                                                                                                                                                                                       |
| <i>The furnishing of services by a foreign enterprise for the same or connected projects through individuals present in Belgium but only if activities of that nature continue for a period or periods aggregating more than 30 days in any 12-month period<sup>8</sup></i>                                                                                                                                                                                                                                                                                                                                                       |                                                                                                                                                                                                                                                                                                                                                                                                                         |
| Provision with regard to fragmentation (the split-up) of contracts <sup>9</sup>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | Fragmentation of contracts under article 4(1) of the OECD Model                                                                                                                                                                                                                                                                                                                                                         |
| <i>No exemptions identical or similar to those under article 5(4) of the OECD Model</i>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           | Exemptions under article 5(4) of the OECD Model <sup>10</sup>                                                                                                                                                                                                                                                                                                                                                           |

7. The definition of a closely related enterprise conforms to the definition of a closely related enterprise under the OECD Model.

8. See also *United Nations Model Double Taxation Convention between Developed and Developing Countries*, art. 5(3)(b) (2021), *Treaties & Models IBFD*. In this respect, note that there are some differences.

9. The provision on the fragmentation of contracts was introduced by the law of 12 Dec. 2012. See the explanatory memorandum available at <https://www.dekamer.be/FLWB/pdf/53/2458/53K2458001.pdf> (accessed 7 Oct. 2022).

10. These exemptions are: the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise; the maintenance of a stock

The BITC contains a set of provisions for recognizing a BE and taxing the income related to it. In light of the broader nature of these provisions as compared to the definition under the tax treaties concluded by Belgium, the latter take precedence (domestic legislation yields to international law). The broad definition of a BE allows that a home office – or working from anywhere, in this case Belgium – may constitute a BE. In this section, the term “home office” is used as a synonym for working from anywhere.

The following analysis discusses whether the presence of a home office may lead to a PE or BE. Mobility of work and the possible creation of a PE (or BE, in the absence of a treaty) relates to whether the home office is *at the disposal* of the enterprise. To a very large extent, Belgium follows the OECD rules.

Although there may not be a PE under the relevant tax treaty, there can still be a BE under the BITC. In that case, the income allocated to the PE is exempted under the relevant tax treaty, but some administrative obligations may still apply. These administrative measures may consist of the filing of a (nihil) tax return and the filing of returns with regard to social security. The existence of a PE under a tax treaty will automatically lead to the existence of a BE, due to the broader nature of a BE. The opposite is not true, however. The existence of a BE under the BITC does not automatically lead to the creation of a PE under the tax treaties.

Two kinds of PE or BE are typically recognized, i.e. the fixed place of business (FPOB) PE or BE and the dependent agent PE (DAPE) or dependent agent BE (DABE). A more detailed discussion can be found in the following sections. Certain tax treaties concluded by Belgium, in particular those with developing economies, also contain a “service PE”. A service PE is generally defined as the furnishing of services in a contracting state. These services include consultancy services by an enterprise through employees or other personnel engaged by the enterprise for such purpose but only when these employees or personnel are present in that contracting state (for the same or a connected project) within a certain period. The period may differ in the individual tax treaties.

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of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery; the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise; the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information for the enterprise; and the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity, provided that such activity is of a preparatory or auxiliary character. The actual text of the tax treaty may vary.

### **3.3.2. A fixed place of business permanent establishment or Belgian establishment**

In general, in order for an FPOB PE or BE to exist, the following conditions should be met simultaneously:<sup>11</sup>

- there should be a place of business, i.e. a facility such as a premises or, in certain instances, an office, machinery or equipment at the disposal of the enterprise;
- the place of business should be at the disposal of the enterprise; it is irrelevant whether the enterprise owns or rents these premises, facilities or installations;
- the place of business must be fixed, i.e. must be established at a distinct place with a certain degree of permanency; and
- the business of the foreign enterprise should be carried on through this fixed place of business. This usually means that persons who, in one way or another, are dependent on the enterprise conduct the (core) business of the enterprise in the country in which the fixed place is situated.

The term “place of business” covers any premises, facilities, or installations used for carrying on the business of the enterprise, whether or not they are used exclusively for that purpose. Furthermore, it is immaterial whether the premises, facilities or installations are owned by, rented by or otherwise at the disposal of the enterprise. Whether a location is considered “at the disposal” of an enterprise depends on that enterprise having (i) the effective power to use that location; and (ii) the extent of the presence of the enterprise at that location and the activities that it performs there.<sup>12</sup>

Regarding the permanency criteria, the Commentary on the OECD Model refers in general to a 6-month period for the constitution of a PE. However, in light of the text under the BITC, a period of 30 days is sufficient to create a BE. A place of business may constitute a PE or BE even if it exists in practice for only a short period of time because the nature of the business is such that it will only be carried on for that short period of time. A temporary interruption of activities does not cause a PE to cease to exist.

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11. BE: Commentaar op het Wetboek van de Inkomstenbelastingen / Commentaires sur le Code des Impôts sur les revenus – 229/2 [Commentary on the Belgian Income Tax Code – 229/2].

12. BE: Commentaar op het Wetboek van de Inkomstenbelastingen – Commentaires sur le Code des Impôts sur les revenus – 229/3 [Commentary on the Belgian Income Tax Code – 229/3].

### 3.3.2.1. Home office

A home office can only be considered to constitute an FPOB PE or BE if it is “at the disposal of” a foreign enterprise which is, in principle, only the case in exceptional circumstances. Such circumstances could arise, for example, when a company clearly requires – contractually or de facto – a person to work from home. As Belgium follows the Commentary on the OECD Model, an enterprise is deemed, in principle, to have a fixed place of business “at its disposal” when it has the effective power to use that location to carry on its business activities. The extent of the presence of the enterprise at that location and the nature of the activities performed there are crucial in this respect. The Commentary on the OECD Model clarifies that a fixed place of business is deemed to be at the disposal of an enterprise if

- the enterprise has an exclusive legal right to use a particular location that is used for carrying on the enterprise’s business activity, or
- the enterprise is allowed to use a specific location and performs its business activities during an extended period of time.

When the carrying on of business activities at the home of an individual is intermittent or incidental, the home will not be considered to be at the disposal of the enterprise. However, when a home office is used on a continuous basis for carrying on the business activities of the enterprise, and it is clear from the facts and circumstances that the enterprise has required the individual to use that home location to carry on the enterprise’s business (by not providing an office to the employee in circumstances in which the nature of the function clearly requires such an office to perform the employment activities), the home office may be considered to be at the disposal of the enterprise. The respective employment contract between the employee and the company will be the starting point for the Belgian tax authorities (BTA) in the case of a potential tax audit. It will therefore be key that the different contractual conditions that relate to the home office are well-determined, sufficiently detailed, and in line with the actual conduct of the employee.

Notwithstanding the above, counter arguments should, in principle, be available to defend the position that a home office cannot be deemed to be “at the disposal of” if it can be substantiated that the foreign company does not have any factual or legal right to carry on its activities on the private premises of an employee. Whether this is the case should be assessed taking into account all the facts and circumstances of the case at hand (especially the employment agreement). Such potential counterarguments could also be drawn from decisions taken by the Belgian ruling authority. From a practical point of view, working from home is often formalized in an annex to an

employment contract containing the (maximum) number of home working days. Often, this is 2 days a week, but it can be as much as 100% of the time.

During the COVID-19 pandemic, lots of employees were confined to home office working due to physical distancing rules and travel bans. For some time, there was no clarity from the BTA regarding whether employees working from home in a country other than the state of residence of their employer could give rise to a PE or a BE. The OECD Secretariat provided some additional guidance on this situation in the Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis, issued on 3 April 2020.<sup>13</sup> In this communication, the OECD Secretariat highlights how home office situations related to COVID-19 measures should not give rise to a PE qualification. The text refers, among other things, to the absence of the required degree of permanency, as well as the fact that a place should be at the disposal of the enterprise in order for that place to be considered a fixed place of business through which the business is wholly or partly carried on. These positions were confirmed in the OECD Secretariat Paper of 21 January 2021.<sup>14</sup>

In informal conversations, the staff of the BTA at the central administrative office indicated that they adhere to the OECD guidance published on 3 April 2020 and 21 January 2021. The BTA also indicated that the OECD Secretariat's analysis does not go further than the application of the existing guidance on a PE in the Commentary on the OECD Model. As such, the BTA has not published any further guidance or a position on COVID-19-related matters.

### 3.3.2.2. Place of management of a permanent establishment or Belgian establishment

As indicated in table 3.3., both the BITC and the tax treaties concluded by Belgium contain a list, which is by no means exhaustive, of examples of what can be regarded, *prima facie*, as constituting an FPOB PE (one of the examples relates to management PEs) or an FPOB BE. As these examples

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13. OECD, *OECD Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis* (3 Apr. 2020), available at <https://www.oecd.org/coronavirus/policy-responses/oecd-secretariat-analysis-of-tax-treaties-and-the-impact-of-the-covid-19-crisis-947dcb01/> (accessed 10 May 2022).

14. OECD, *Updated Guidance on Tax Treaties and the Impact of the COVID-19 Pandemic* (21 Jan. 2021), available at <https://www.oecd.org/coronavirus/policy-responses/updated-guidance-on-tax-treaties-and-the-impact-of-the-covid-19-pandemic-df42be07/> (accessed 10 May 2022).



are to be seen in the context of the general definition of a PE/BE, it is assumed that the terms listed are interpreted in such a way that such places of business constitute PEs only if they meet the requirements of continuity and permanency. Moreover, the managers concerned should habitually (i.e. regularly) exercise their decision-taking power. Hence, occasional management decisions do not seem sufficient to create a management PE or BE.

It is important to note that the BTA adopts a very low threshold to qualify a place of management as a PE. Indeed, in their administrative commentary on tax treaties, the BTA indicates that the mere performance of effective management in Belgium suffices to trigger the existence of a PE under a treaty.<sup>15</sup> The BTA does not, in other words, require the existence of a place of business. It could be questioned whether this interpretation is in line with treaty law, taking into account the key condition that the examples of what constitutes a PE or BE need to meet the basic conditions (i.e. a fixed place of business through which the business of an enterprise is wholly or partly carried on).

However, experience with the BTA regarding personal PEs or BEs reveals that tax auditors take a broad view. Hence, the risk of recognition of a PE or BE through working from home is always present. The issue is on the BTA's radar, but no concrete actions have yet been taken to address the issue of working from home and the creation of a PE.

### 3.3.2.3. Absence of exception for preparatory or auxiliary activities in the Belgian Income Tax Code

Notwithstanding the discussion in sections 3.3.2.1. and 3.3.2.2., tax treaties concluded by Belgium mention certain exclusion grounds to the existence of a PE. Under these tax treaties, the maintenance of a fixed place of business solely for the purpose of carrying on activities for the enterprise that are of a preparatory or auxiliary character (including the maintenance of a stock of goods or merchandise) does not constitute a PE. This means that, even when an activity meets the conditions for an FPOB PE to be triggered, the activity will not be considered a PE if it falls within the scope of a tax treaty. According to the Commentary on the OECD Model, the decisive criterion when determining the preparatory or auxiliary character of such an activity is whether or not the activity in itself forms an essential and significant part

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15. BE: Algemeen commentaar van de overeenkomsten tot het vermijden van dubbele belasting / Commentaire général des conventions préventives de la double imposition – 5/325 [General commentary on tax treaties – 5/325].

of the activity of the enterprise as a whole (“core business of the entity”). If the purpose of an activity is identical to the general business purpose of the whole enterprise, a PE will nevertheless be constituted.

In addition to the clarifying elements listed in the preceding two paragraphs, the Belgian Office for Advance Tax Rulings has taken some elements into account upon deciding whether an activity carried out through a fixed establishment in Belgium has a preparatory or auxiliary character. The following elements have been put forward to positively decide on the preparatory or auxiliary character:

- the activities performed in Belgium are very remote from the actual realization of profits, in the sense that the activities do not generate profits due to their nature;
- the activities performed in Belgium do not correspond to the substantial activities of the foreign company as they are only complementary;
- the activities performed in Belgium will be significantly less important (quantitatively) compared to the activities performed by the enterprise to which the place of business belongs; and
- the activities performed in Belgium are in themselves not essential for the process and could be subcontracted to a third party (e.g. quality control of assembly activities performed by a third party).

As indicated in table 3.3., the BITC does not contain any exceptions that are similar to those covered by the article 5(4) of the OECD Model.

### 3.3.3. A dependent agent permanent establishment

A PE under a tax treaty can also be triggered through the mere presence in Belgium of employees/management of the foreign enterprise without a fixed place of business (such as an office). This means that persons who are both economically and legally dependent on an enterprise for which they are performing activities can create a dependent agent PE (DAPE).

Currently, tax treaties that follow the OECD Model (including the changes introduced under BEPS through the MLI if the relevant tax treaty is a covered tax agreement) apply a broader PE definition of a dependent agent. In order to trigger a DAPE under this modified definition, the following conditions must be fulfilled:

- a person (who is not an independent agent) acts in a contracting state on behalf of an enterprise;

- in doing so, that person habitually concludes contracts or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise;
- these contracts are: in the name of the enterprise; for the transfer of ownership of that enterprise; for the granting of the right to use property owned by that enterprise or that the enterprise has the right to use; or for the provision of services by that enterprise; and
- the activities of the person go beyond activities that are of a mere auxiliary or preparatory nature.

Hence, the key criteria is no longer whether the employee/agent would have the authority to conclude contracts but instead whether the employee would habitually play the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the foreign head office. This determination is aimed at situations in which the conclusion of a contract directly results from the actions that the person performs in Belgium on behalf of the enterprise (e.g. when that person acts as the sales force of the enterprise) even though, under the relevant law, the contract is not concluded by that person in Belgium. The principal role leading to the conclusion of the contract will therefore typically be associated with the actions of the person who convinced the third party to enter into a contract with the company.

According to the Commentary on the OECD Model, the words “contracts that are routinely concluded without material modification by the enterprise” clarify that, when such a principal role is performed in that state, the actions of that person will fall within the scope of article 5(6) of the OECD Model. This is the case even if the contracts are not formally concluded in the state, for example, if the contracts are routinely subject to review and approval outside the state without such review resulting in a modification of any key aspects.<sup>16</sup>

Under the BITC, a DABE will already exist based on the presence of a representative or other intermediary acting in Belgium for a foreign company, even if that person is not authorized to conclude contracts on behalf of that company, except in the event that such a person carries on a business in Belgium as an independent broker and acts for the company in the normal course of that business. A person who acts exclusively or almost exclusively

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16. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 5(6)*, paras. 88 and 89 (23 Nov. 2017), Treaties & Models IBFD.

for one or more companies with which they are closely related is not considered to be independent.

#### 3.3.4. Absence of a tax treaty

As indicated, the BITC allows the BTA to recognize a BE. The definition of a BE is broader than the definition of a PE under the OECD Model (and, as a result, the definition as included in the tax treaties concluded by Belgium based on the OECD Model). The definition distinguishes, among other things:

- a material establishment, defined broadly in the same way as under the tax treaty;
- a personal establishment or agency BE. An agency BE is present when an agent/representative other than an agent of an independent status acting in the ordinary course of its business acts in Belgium on behalf of a non-resident, even if that agent/representative does not have the authority to conclude contracts in the name of the non-resident enterprise; and
- a services establishment. This is when an individual of a foreign enterprise performs services in Belgium for more than 30 days in a year within the framework of one or more related projects and will thus be considered to have a BE.

It is possible to have a BE without having a taxable PE based on the tax treaty, due to the broad definition of a BE. Again, it should be noted that the Belgian definition does not contain any exemptions similar to the exemptions listed under article 5(4) of the OECD Model.

#### 3.3.5. Example: Is the home office a permanent establishment, a Belgian establishment or nothing of the kind?

By way of illustration, take the following example of a home office. Imagine that the employees of a foreign enterprise work partly from their home office in Belgium (for example, 3 days a week) and have no direct physical contact with clients at their home office nor any authority to conclude contracts (or material elements of contracts) for their employer. An office is put at their disposal by their employer in the residence country of the employer. Furthermore, the home office shows no signs of any connections to the employer (or any affiliate thereof) (i.e. there is no sign on the door or

a name on the doorbell) nor does the employer make any reference to the home office on, for example, the corporate website, in a broader business context or on business cards. The employer does not pay employees a specific allowance for the use of their home office but does pay representation costs to the employees that they can use to cover electricity, internet, etc. Furthermore, the employees receive a smartphone and a laptop from their employer, and their employer can contact them in Belgium directly via this smartphone. Furthermore, imagine that, for one of the employees, the use of their home office to carry out part of their activities is an essential condition of the employment contract. The activities that the employee carries out in their home office are administrative tasks such as answering emails and phone calls, as well as preparing for customer visits (these are activities that would be considered of a preparatory/auxiliary nature).

Taking the facts into account, it would be possible to defend the case that employee home offices do not constitute an FPOB PE or BE as they cannot be considered at the disposal of the foreign enterprise. Indeed, given the availability of an office abroad in which employees are able to perform their activities if preferred, it is possible to argue that there is no legal nor de facto obligation to work from home. Nonetheless, the fact that home working is a separate condition of the employment contract for one of the employees will trigger scrutiny from the BTA. This is because the employment contract is the starting point for the BTA when assessing whether a home office could be deemed to trigger an FPOB PE. Hence, it is crucial for an employer to substantiate by other means (e.g. absence of client contact in the home office, references in a business context, etc.) that home offices are not at their disposal.

### 3.3.6. The allocation of profits to a permanent establishment/ Belgian establishment

According to the administrative guidance published on 25 February 2020, it can be assumed that the BTA will apply the authorized OECD approach (AOA).<sup>17,18</sup>

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17. BE: Circular no. 2020/C/35 of 25 February 2020, chap. XI, available at [https://news.pwc.be/wp-content/uploads/2020/02/2020-02-25\\_NL\\_Circular-2020\\_C\\_35-on-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-authorities.pdf](https://news.pwc.be/wp-content/uploads/2020/02/2020-02-25_NL_Circular-2020_C_35-on-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-authorities.pdf) (Dutch) and [https://news.pwc.be/wp-content/uploads/2020/02/2020-02-25\\_FR\\_Circular-2020\\_C\\_35-on-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-authorities.pdf](https://news.pwc.be/wp-content/uploads/2020/02/2020-02-25_FR_Circular-2020_C_35-on-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-authorities.pdf) (French) (accessed 11 May 2022).

18. OECD Committee on Fiscal Affairs, *2008 Report on the Attribution of Profits to Permanent Establishments* (OECD 2008), Primary Sources IBFD; and OECD Committee

According to article 7(1) of the tax treaties concluded by Belgium, profits of an enterprise are taxable only in the residence state of said enterprise, unless the enterprise carries on business in the other contracting state (i.e. the source state; in this case, Belgium) through a PE situated therein. If an enterprise carries on business in such a way, profits that are attributable to the PE may be taxed in Belgium (the source state). As indicated in section 3.3.1., the definition of a BE under Belgian domestic law is broader than the definition of a PE under the OECD Model. Hence, when a PE is recognized under a Belgian tax treaty with another contracting state, there will automatically be a BE, allowing for the taxation of the BE in Belgium under domestic law.

There may be some variance in the text of the tax treaties concluded by Belgium. Most tax treaties contain the text of article 7 of the OECD Model as it read before the 2010 version. However, some tax treaties (for example, the Belgium's tax treaty with Switzerland) contain text that is aligned with the text of article 7 of the OECD Model as it reads as from 2010.

In order to allocate profits to a PE according to the authorized OECD approach, a two-step approach must be followed:

- first, the PE should be hypothesized as a separate and independent enterprise based on a factual and functional analysis; and
- second, profits should be allocated to the PE (based in part on step one).

Under the BITC, income to be allocated to a BE is, of course, taxable in Belgium. Such income comprises, in particular, profits and capital gains derived through the BE.

### **3.4. Physical presence according to articles 15(1) and 17 of the OECD Model**

The subject matter concerning the taxing authorities for income related to professional activities that are not from self-employment can be found in article 14 of the Belgian Model Tax Convention and article 15 of the OECD Model. Article 14 of the Belgian Model Convention is, in essence, identical

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on Fiscal Affairs, *2010 Report on the Attribution of Profits to Permanent Establishments* (OECD 2010), Primary Sources IBFD.

to article 15 of the 2010 OECD Model; the only difference is that the numbering has shifted.<sup>19</sup>

More concretely, article 15 of the OECD Model deals with the allocation of taxing rights on salaries, wages and other similar remuneration derived by employees from cross-border activities in a professional relationship. Article 15 states as a main rule that the tax jurisdiction is allocated to the state of residence unless the employment is exercised in the other state. In the case of employment exercised in the other state, the state of employment may exercise the taxing rights (this is known as the work state principle).

It is hardly surprising that article 15 of the OECD Model has caused and still causes a lot of interpretation problems in practice (especially in times of a health crisis, given the travel restrictions, and also considering the Commentary on the OECD Model versus the national tax authorities' position).<sup>20</sup> However, in 2017, the OECD published new commentaries on the OECD Model.<sup>21</sup> These commentaries attempt to address certain difficulties in interpreting article 15, such as the fact that the source state is the taxing state for salaries, wages or other similar remuneration derived from the exercise of an employment activity. This applies irrespective of when such income may be paid to the employee. In this respect, there are also comments on the taxation of stock options.

These extensive commentaries have been updated in view of the recent COVID-19 pandemic. A first offer of guidance was published on 3 April 2020. The note of 21 January 2021 revisits the initial guidance of April 2020 and tries to offer the taxpayer more (legal) certainty on the tax measures taken in these unprecedented times.<sup>22</sup> The updated guidance represents the OECD Secretariat's views on the interpretation of the provisions of the tax treaties. At the same time, it acknowledges that each jurisdiction may adopt its own guidance to provide tax certainty to taxpayers.

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19. C. Lebegue, *Artikel 14. Inkomsten uit een dienstbetrekking, in Het Belgisch standaard-model van dubbelbelastingverdrag* pp. 367-472 (P. Bielen & S. Janssens eds., Intersentia 2018).

20. A. Cools, *Verdragsinterpretatie als OESO-modelverdrag en VN-verdrag gezamenlijk model hebben gestaan*, Internationale Fiscale Actualiteit 16/05 (2016); P.J. Wattel & O. Marres, *The legal status of the OECD Commentary and Static or Ambulatory Interpretation of Tax Treaties*, 43 Eur. Taxn. 7, p. 224 (2003), Journal Articles & Opinion Pieces IBFD; E.F. Faase, *Omtrent het OESO-commentaar*, NTFR, p. 1165 (2001); R.W. Tieskens, *De betekenis van het OESO-modelverdrag voor de interpretatie van belastingverdragen*, WFR, p. 1757 (1999); and Lebegue, *supra* n. 19.

21. *OECD Model Tax Convention on Income and on Capital* (21 Nov. 2017), Treaties & Models IBFD.

22. OECD, *supra* n. 13.

In times of a health crisis, various questions may be raised, i.e. what happens to a country's taxing rights if employment income is received by cross-border workers who are unable to work due to the restrictions, what happens if a worker is stranded in a jurisdiction in which they are not a resident but are working and what happens if a worker who works remotely from one jurisdiction also works for another employer in another jurisdiction?<sup>23</sup> Can article 15 of the OECD Model provide an answer to these questions and, furthermore, is there a specific paragraph that could offer more certainty?

In the case of cross-border workers who are unable to work due to health restrictions, governments could subsidize employers to keep employees on the payroll. In this case, the employment income would be attributed to the place where the employment used to be exercised. There are scenarios in which these payments may be similar to severance payments (i.e. final payment of compensation in exchange for services).<sup>24</sup> When this is the case, the Commentary on Article 15 of the OECD Model indicates that this income should be attributed to the place where the employee would otherwise have worked.<sup>25</sup>

However, when employees live in a certain jurisdiction and are stranded in the jurisdiction in which they perform their employment, the 183-day limit may be exceeded, and the state of employment becomes the tax jurisdiction. After all, all the days of presence in the state of employment count, including non-working days. However, exceptions exist, such as the frontier workers' regulation with Belgium that is elaborated in section 3.6. Moreover, it was possible to consider the COVID-19 crisis as a force majeure. In concrete terms, this means that the number of days worked in the state of residence is not included in the calculation of the maximum number of working days allowed in the state of employment.

A third scenario that has emerged during the health crisis, and which will continue to apply, is that of employees teleworking from another jurisdiction. This can have implications for the country that has the tax jurisdiction

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23. J. Mattelaer & F. Van Praet, *Updated OECD Guidance on Tax Treaties and COVID-19*, 6 Expat News, pp. 14-17 (2021).

24. F. Dierckx, *Opzeggingsvergoedingen onder het OESO-model en de Belgische dubbelbelastingverdragen*, *Fiscoloog* (I.) 62, p. 4 (1989); L. De Broe, *Article 15: Income from Employment*, in *Klaus Vogel on Double Taxation Conventions* p. 1130, sec. 48 (E. Reimer & A. Rust eds., Kluwer Law International 2015) ; and R. De Baere, *Belgium Interprets Employment Article of OECD Model Tax Treaty*, 39 *Tax Notes International* 11, p. 1013 (12 Sept. 2005).

25. F. Van Praet & N. Driesen, *Niet-concurrentievergoedingen: Taxation at home or away?*, 3 Expat News, pp. 6-10 (2018).



and may lose it as a result. Moreover, when employees work from home offices, the liability in the state of residence is higher.

During the COVID-19 pandemic, different jurisdictions have issued various forms of relief.<sup>26</sup> For example, Belgium has entered into mutual agreements to consider the health crisis a force majeure. A temporary fiction was created for the taxpayer to invoke, with the result that income taxed during home working days would be taxed in the country in which said taxpayer would normally have worked.<sup>27</sup>

There is one category, however, that should be less concerned about the 183-day rule of article 15 of the OECD Model, and that is the category of sportspersons and entertainers. After all, they fall, in principle, under article 17 of the OECD Model, which states that income from sports activities can be taxed in the country where the activity takes place. The fact that the taxation is carried out in the country where the services are rendered is an attempt to avoid a number of practical problems and also to limit fraud.<sup>28</sup>

It is clear that the COVID-19 pandemic has exposed several issues. The question arises of whether the current legislative framework can provide an answer to these issues or if the measures taken during the crisis need to be examined. One of these measures was to treat the crisis as a force majeure situation and thus qualify home working days (i.e. working from home because of restrictions) as days “where the employee would normally have worked”.<sup>29</sup> If this rule were to be established as a principle, questions of interpretation and definition may once again arise. Another possibility could be that the current articles 15(3) and 17 of the OECD Model are implemented as *lex generalis*. It remains to be seen whether article 15(1) and (2) is obsolete, especially the criterion of the economic employer. After all, at a time when working from home is increasingly common, the concept of “under direct authority” is difficult to interpret.

Can Article 17 of the OECD Model offer any further certainty? The state in which an activity is exercised is the taxing state. In the case of working from home, it will always be the state of residence that has the right to levy tax. The question remains whether it is administratively feasible to establish this

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26. F. Van Praet, *Update COVID-19: Extension of agreements until 31 December 2021*, 10 Expat News (2021).

27. Mattelaer & Van Praet, *supra* n. 23.

28. J. Kerremans & B. Ameye, *Sociaal en fiscaal statuut van de sportbeoefenaar* pp. 125-132 (Wolters Kluwer 2015).

29. Mattelaer & Van Praet, *supra* n. 23.

as a principle. An alternative proposal could be to update article 15 of the OECD Model so that the article aligns more with the practices of the “new normal” (i.e. employees who are working remotely for a (virtual) organization rather than limited to one or more entities (e.g. European organizations, Benelux structures, etc.)).

However, it will not be easy to update this article 17 of the OECD Model to reflect reality or to write it in a future-proof manner to avoid extensive discussions regarding interpretations. In this case, it may be better to continue using the current legislative framework and interpretations. There could then be a reliance on national law, potentially complemented by an additional required threshold. In other words, there could be a threshold for the number of days of physical presence in the state in which the (economic) employer is located. This might help to strike a balance between the administrative consequences for the employee and the organization, and the allocation of taxation rights between the employee’s state of residence and the source state in which their employer is located. It is clear that there is no one-size-fits-all answer for the future and that any reforms must be carefully considered.

### **3.5. Article 15(2) and (3) of the OECD Model**

The starting point for the rule in article 15 of the OECD Model is that “salaries, wages and other similar remuneration” are taxable only in a person’s jurisdiction of residence, unless the “employment is exercised” in the other jurisdiction. The Commentary on Article 15 of the OECD Model explains that this means the place where the employee is “physically present when performing the activities for which the employment income is paid”. However, article 15(2) of the OECD Model provides an exemption. If following criteria are all met, the source jurisdiction may exercise a taxing right:

- the employee is in the source jurisdiction for more than 183 days;
- the employer is a resident of the source jurisdiction; and
- the employer has a PE (in the source jurisdiction) that bears the remuneration of the employee.

From these conditions, it is clear that the term “employer” is important in order to allocate the taxing rights as referred to in article 15 of the OECD Model. The method of interpretation of article 3(2) of the OECD Model states that, in the absence of a clear definition, reference should be made to the meaning of the term under the law of the state to which the tax

treaty applies, unless the context otherwise requires.<sup>30</sup> This article would therefore represent a kind of bridge between a formal and material method of interpretation. As such, the concept of employer can be interpreted substantively. This means that the employee is in a relationship of authority with the employer for the activities concerned in the state of employment.<sup>31</sup> The legal contract is not important in this sense. However, a relationship of authority alone is not sufficient. A company is also required to bear the costs and benefits of the work and the resulting disadvantages and risks. Until the Circular Letter of 25 May 2005, Belgium used a formal interpretation of the term “employer”.<sup>32</sup> With the 2010 update of the Commentary on the OECD Model, the OECD adopted the material interpretation of the term “employer”. However, the question may still be raised as to whether this concept and the different interpretations are outdated.<sup>33</sup>

Last but not least, in article 15(3) of the OECD Model, a special rule provides that, for remuneration of personnel on board ships and aircraft in international traffic, remuneration is taxable only in the state of residence of the personnel member.<sup>34</sup> Prior to 2017, this was not the case, and article 15(3) stated that such remuneration was taxable in the state in which the actual management of the enterprise was located (bear in mind the interpretation of economic employership of article 15(2)). In addition to the fact that the taxing jurisdiction is now attributed to the state of residence, the article also specifies that it must be remuneration obtained “as a member of the regular staff of a ship or aircraft”. This wording is broad enough to cover any form of employment in the regular operation of a ship or aircraft. The last two clarifications since 2017 focus on transport operated by a company of a third state, to the effect that the remuneration received by a resident of a contracting state for work performed on board a ship or aircraft operated by a company of a third state is taxable in the state of residence. Finally, article 15(3) does not apply to remuneration with reference to any form of employment on board a vessel or aircraft operated exclusively in the

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30. L. De Broe et al., Interpretation of Article 15(2)(b) of the OECD Model Convention: “Remuneration Paid By, or on Behalf of, an Employer Who is not a Resident of the Other State”, 54 Bull. Intl. Taxn. 10, p. 505 (2000), Journal Articles & Opinion Pieces IBFD; and De Broe, *supra* n. 24, at pp. 1162, in particular sec. 148.

31. A. Cools, *Rulingcommissie geeft visie over werkgeversbegrip in artikel 15 OESO-modelverdrag, maar er blijven onduidelijkheden*, Internationale Fiscale Actualiteit 11 (2014).

32. BE: Circular no. AFZ 2005/0652 of 25 May 2005.

33. E. Burgstaller, “Employer” Issues in Article 15(2) of the OECD Model Convention – Proposals to Amend the OECD Commentary, 33 Intertax, p. 127 (2005).

34. OECD, *Taxation issues relating to International Hiring-Out of Labour* p. 31 (OECD 1984); and J. Bourguignon, *International Hiring-Out of Labour: A comprehensive Overview*, 53 Jura Falconis 1 (2016-2017).

contracting state other than the state of residence of the employee. The Commentary on Article 15 of the OECD Model states that, in such a case, it would not be appropriate to attribute the exclusive taxing rights to the employee's state of residence. Therefore, the general rules of article 15(1) and (2) continue to apply in that situation.<sup>35</sup>

### **3.6. Frontier workers**

Contrary to the OECD Model, Belgium has, in the past, included some specific rules for the taxation of frontier workers. Reference is made to the data presented in section 3.1., which indicates that, every day, thousands of employees cross the Belgian border to come to work in Belgium (inbound) or to go to work in a neighbouring state (outbound). Therefore, it is not surprising that specific rules have been included in the tax treaties concluded between Belgium and France, Germany and the Netherlands. No specific rules regarding frontier workers were included in the tax treaty concluded between Belgium and Luxembourg. However, a general “24-day rule” (that recently became the “34-day rule”) has been applicable between Belgium and Luxembourg since 1 January 2015.

The tax treaty of 11 April 1967 concluded between Belgium and Germany and that of 19 October 1970 concluded between Belgium and the Netherlands introduced specific rules for the taxation of frontier workers. These specific rules entailed a derogation of the principle according to which the tax jurisdiction is allocated to the state in which employment is exercised (i.e. the work state principle). Indeed, despite the fact that employment is physically exercised in a different state from the taxpayer's state of residence, the right to tax was allocated to the state of residence (which is contrary to the OECD guidance).

In order to fall into the scope of the frontier rules, the taxpayer has to exercise their professional activity in the defined frontier territory of the contracting state and to maintain their permanent residence in the defined frontier territory of the other contracting state. The specific rules for the taxation of frontier workers moving between Belgium and the Netherlands or Germany have been completely abolished (in 2003 and 2004, respectively). In both situations, the justification given by the BTA to abolish these regimes was mainly the lack of exact correspondence between the payment

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35. N. Bammens et al., *Internationaal Fiscaal Recht* pp. 268 et seq. (Wolters Kluwer 2023).

of taxes (in the state of residence under the application of the frontier worker regime) and social security contributions (in the employment state). The regime applicable between Belgium and France is still applicable (although only for the workers who were already validly benefiting from this regime before 1 January 2012). This too will be abolished from 2033.

In order to benefit from the Belgian-French frontier worker regime, workers must meet three conditions:<sup>36</sup>

- they must maintain their permanent residence in the French frontier area;
- they must continue to exercise their professional activity in the Belgian frontier area; and
- they must not leave the Belgian frontier area (where their employment is exercised) for more than 30 days per calendar year while exercising their activity.

In order for a worker to be considered as exercising their professional activity in the Belgian frontier area, the worker must be physically present in this area to perform the activity. Moreover, the 30 days condition must be fulfilled each year.

According to Circular Letter No AAF/2008-0408 (AAF 17/2009) of the BTA, every outing from the Belgian frontier area must be taken into consideration for the application of the 30-day rule. The circular letter raises nine exceptions that allow certain days not to be taken into consideration.<sup>37</sup> No exception is made for home working days. Nevertheless, Belgium and France have concluded a COVID-19 agreement, according to which home working days (due to the pandemic situation) are not taken into account in the quantum of the 30-day rule. This means that, as long as this COVID-19 agreement is applicable, the application of the frontier regime can coexist with the idea of home working. However, as soon as the COVID-19 agreement disappears,<sup>38</sup> every home working day will count towards the 30-day rule, and thus the limit will easily be reached. This point can be problematic in a “post-covid” world in which home working has become the new norm.

In conclusion, the authors expect that the last frontier worker taxation regime that exists in Belgium (i.e. the regime with France) will also disappear in

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36. See *avenant* of 12 Dec. 2008 to the tax treaty concluded between Belgium and France.

37. See BE: Circular no. AAF/2008-0408 (AAF 17/2009), point 88.

38. The application of the COVID-19 agreement has been extended several times and was applicable until 30 June 2022 (with a possibility of extension).

principle after 2033. In practice, it may disappear well before then, as this regime is, in principle, not made to coexist with remote working.

Another type of derogation of the OECD Model is the 24-day rule, which is a tax tolerance applicable between Belgium and Luxembourg. According to the data presented in section 3.1., more than 46,000 Belgian residents cross the border with Luxembourg to exercise their professional duties in Luxembourg, which may explain the need for a specific tolerance. The original agreement was concluded on 16 March 2015 between both countries. According to this agreement, a worker who is a tax resident in Belgium and employed by a Luxembourg employer may spend a maximum of 24 working days outside the territory of Luxembourg (for example, in a home office in Belgium or in a third country) while their earned income continues to be fully taxable in Luxembourg (thus meaning there is no shift of entitlement to levy tax in Belgium).<sup>39</sup> The same applies the other way around (i.e. a tax resident in Luxembourg who works in Belgium for a Belgian employer).<sup>40</sup> If the limit of 24 days is exceeded, then the tolerance is not applicable and the worker would, in principle, be taxable in their state of residence for all the days that they do not spend physically in their “normal” employment state.

Even if this tolerance has a broader scope than the frontier worker regime that was applicable in the past between Belgium and Germany and the Netherlands, and which is still applicable for a few more years with France, it is a good comparison to make because this system would seem to be more adapted to the current tendencies of remote working. Indeed, even post COVID-19, many workers will no longer work entirely from their company’s premises but also from their home offices. This new way of working requires some change, which is the main reason why the Belgian and Luxembourg authorities have extended the 24-day limit to 34 days. It is clear that remote working has been taken into account in this tolerance, which makes it more adapted to new/hybrid ways of work.

With the application of this tax tolerance with Luxembourg, the issue of the lack of an exact correspondence between the payment of taxes and social security contributions is, in principle, avoided (contrary to the frontier worker rules analysed previously in this section). This is because the

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39. See S. Dumortier & O. Coulie, *Increased flexibility for Belgians working in Luxembourg*, Expat News 4, pp. 18-20 (2015); and A. Elshout & Y. Bastiaens, *International employment – Belgium-Luxembourg Double Taxation Avoidance Agreement: The “24-day rule” becomes the “34-day rule”*, Expat News 8, pp. 9-11 (2021).

40. For the interpretation of this tolerance, see BE: Circular AGFisc no. 22/2015 (Ci.700.520) of 1 June 2015.

entitlement to levy tax is given to the state of employment and not to the state of residence, which coincides with the applicable social security scheme of the state of employment (unless the employee works more than 25% of the business time in the state of residence, in which case they would be subject to social security in the state of residence but would also exceed the 34-day limit for tax purposes).

Recently, the Belgian Chamber discussed whether to extend this tolerance further, to a limit of 48 days, not only with Luxembourg but also with France, Germany, and the Netherlands (i.e. all of Belgium's neighbouring countries). This limit corresponds more or less with one home working day per week. This extension is not yet applicable, but it clearly shows an intention to adapt to the new way of working and to take into account new tendencies. It is, according to the authors, an interesting solution, but it is important to keep in mind that, depending on the exact facts and circumstances, there is potentially a PE risk for the employer if the worker works too often in a country that is not their usual work state. In order to avoid discussions about a potential PE risk, one idea might be for contracting states to insert a specific clause in their tax treaty stating that such situations do not trigger a PE as long as a certain number of days is not exceeded. It could easily be envisaged that this might even be a higher number of days, in order to reflect the remote working reality.

### **3.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)**

Unlike some countries, Belgium has not held consultations on the introduction of COVID-19-based rules. This does not mean that no COVID-19-related measures were taken with regard to the mobility of work. For example, agreements were concluded with France,<sup>41</sup> Germany,<sup>42</sup> Luxembourg<sup>43</sup>

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41. Agreement between Belgium and France (15 May 2020-30 June 2022), available at <https://eservices.minfin.fgov.be/myminfin-web/pages/public/fisconet/document/7dfed6d4-eea8-43a6-a3a1-59559f270ccd> (accessed 7 Oct. 2022).

42. Agreement between Belgium and Germany (6 May 2020-30 June 2022), available at <https://eservices.minfin.fgov.be/myminfin-web/pages/public/fisconet/document/17cc0520-2203-4b5e-a1d1-2e05e88bd5d4> (accessed 7 Oct. 2022).

43. Agreement between Belgium and Luxembourg (15 May 2020-30 June 2020), available at <https://eservices.minfin.fgov.be/myminfin-web/pages/public/fisconet/document/3fd5ea15-4c99-483b-90d6-532ea6456e1d> (accessed 7 Oct. 2022).

and the Netherlands<sup>44</sup> to implement a mutual “force majeure tolerance” for cross-border employees in relation to COVID-19 (travel) restrictions. The agreements provide that an exemption is created in relation to employment income linked to “home working days” solely due to the measures taken by the governments of the respective states to combat the COVID-19 pandemic. If certain conditions are met, these home working days are deemed to be spent by the employee in the state in which the cross-border worker would have exercised the employment had no such measures been taken. The agreements were originally concluded for a short period of time but were extended several times. In principle, all agreements implementing the force majeure tolerance expired on 30 June 2022.

As indicated in section 3.3.2.1. of this contribution, the OECD has provided additional guidance on this situation in the Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis. The BTA indicated that it adheres to OECD guidance on COVID-19 but that the OECD Secretariat’s analysis does not go further than the application of the existing guidance on PEs in the Commentary on the OECD Model. The BTA did not publish any further guidance or position on COVID-19-related matters. In light of the BTA’s position, it is the authors’ experience that the likelihood of recognizing a PE in Belgium (or the existence of a BE with a nihil tax return but with effects on social security measures) has increased because of COVID-19 and home-working. This is particularly the case with regard to the United Kingdom, due to the absence of an agreement concluded with said country.

### **3.8. The future of the mobility of work: A need for adjusting the existing treaty rules?**

The COVID-19 crisis has been a catalyst for the mobility of work. Employees are rethinking where they want to live and work. Employers – often in search of talent – are increasing flexibility and provide opportunities to facilitate work mobility.

Post COVID-19, many workers will no longer work entirely from the offices of their employer but, instead, will work (partly) from their home office, which may be located in a state other than the state in which their employer is located. Taking into account the example of the tolerance of 34 days

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44. Agreement between Belgium and the Netherlands (30 March 2020-30 June 2022), available at <https://eservices.minfin.fgov.be/myminfweb/pages/public/fisconet/document/a0b7360a-d0d2-4064-bcd6-e42fc3c7f4b4> (accessed 7 Oct. 2022).



concluded between Belgium and Luxembourg, a more general tolerance being introduced at the level of the OECD Model can be imagined. In this scenario, a certain level of home working in the residence state would be de facto tolerated (e.g. one home working day per week) without having an impact on an individual's income tax in their state of residence (i.e. taxation rights remain fully in the state in which the employer is located, assuming there are no business trips to third countries).

A similar tolerance could be provided for employees working for regional organizations, who would become taxable based on the economic employer concept despite initially having a formal employer in their state of residence. Under the current rules, interacting on a limited physical basis with the international team in the state in which the economic employer is located may lead to individual income tax consequences in that state. Also, in this situation, a general tolerance would help to keep taxation rights in the state in which the employment is usually physically exercised.

Indeed, in both examples, employment is usually exercised either in the state of residence of the employee or in the other state, in which the employer is located. In both cases, a tolerance could limit the tax consequences in the state in which, for a limited period of time, professional duties are physically exercised. This may decrease the administrative consequences in terms of compliance formalities. In these types of situations, it might be a good idea to define what activities are considered marginal in terms of physical presence when performed outside the state (or states) in which employment is usually and mainly exercised. Such tolerance may fit the rationale of article 15(2) of the OECD Model, which provides an exemption to the general rule that “salaries, wages and other similar remuneration” are taxable only in a person's jurisdiction of residence unless the “employment is exercised” in the other jurisdiction.

The Commentary on the OECD Model (2017) provides only limited guidance on home offices and the mobility of employees.<sup>45</sup> In addition, this guidance is more focused on ad hoc situations in which work is being carried out from a home office. In order to increase the legal certainty of taxpayers, further guidance is needed so that taxpayers can assess whether their structural global mobility and flexible labour agreements may trigger additional administrative and financial consequences. Guidance is also needed in cases in which a PE is triggered, and the taxpayer needs to allocate an arm's

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45. Paras. 18 and 19 *OECD Model: Commentary on Article 5* discuss the qualification of a home office.

length level profit to the PE. In those situations, certain simplification rules or internationally accepted safe harbour rules could make a difference by reducing the administrative burden for taxpayers, increasing legal certainty and reducing the burden for tax authorities to perform a tax audit. Though guidance is useful, it has no legal binding value. This begs the question: can an update of the wording of the relevant provisions in the tax treaties and the OECD Model be envisaged?

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## Chapter 4

### The Impact of Tax Treaties on International Mobility of Work in Brazil

Luís Eduardo Schoueri and Renan Baleeiro Costa

#### 4.1. Mobility of work and domestic tax law

Tax residence in Brazil is regulated by article 2 of Normative Ruling (NR) no. 208/2002. It sets a different treatment for nationals and foreigners for the determination of tax residence.<sup>1</sup> While nationals are to be regarded as tax residents as long as they intend to reside in Brazil on a permanent basis, foreigners trigger tax residence once they meet either of the objective tests provided by NR no. 208/2002. Brazil thus adopts a subjective approach to a national's tax residence and an objective approach to a foreigner's tax residence.

A foreigner becomes resident in Brazil in the following situations: (i) when they enter Brazil with a permanent visa (or later obtain it); (ii) when they enter Brazil with a temporary visa but then stay in Brazil for at least 184 days; and (iii) when they enter Brazil with a temporary visa but hold (or later come to hold) a position as an employee. Therefore, residence can be triggered either at the moment of entrance of the foreigner or later depending on the specific situation.

Since all tax residence tests, to an extent, require physical presence in the country, a higher degree of mobility of work is clearly able to affect the tax residence situation of individuals (either nationals or foreigners) in Brazil. For example, consider a foreigner resident abroad who becomes an employee of a Brazilian company, but their work can be done from anywhere. If they never enter Brazil, they would not become a Brazilian resident even though they hold a position as an employee of a Brazilian company. This is because some sort of physical presence in Brazil is a general requirement of any of the applicable tax residence tests. In the case of foreigners, physical presence is required by the need that they "enter" Brazilian territory, as NR no. 208/2002 states. In the case of nationals, presence in the Brazilian

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1. L.E. Schoueri, *Residência Fiscal da Pessoa Física*, 28 Revista Direito Tributário Atual, p. 163 (2012).

territory is required by the need that they reside in Brazil with a definitive intention of so doing.

Since the Brazilian law approach towards nationals is subjective, time spent in Brazil or any other objective criterion is not relevant for nationals' residence as the sole requirement is the "definitive animus" (will) to reside in Brazil.<sup>2</sup> The definitive animus is not defined by Brazilian legislation nor by Brazilian courts. In any case, the fundamental idea underlying a tax residence rule based on the definitive animus is to make tax residence independent of formal tests. This can be seen as a more appropriate approach for nationals since they are expected to have a natural connection with their home country, thereby allowing a more comprehensive analysis of the facts and circumstances by tax authorities.

The investigation for tax purposes of the intention to permanently reside originates from Brazilian private law. Brazilian tax law uses the private law approach to non-tax residence in order to determine tax residence as well. Just as it occurs with the rules applicable to foreigners, the tax residence rule for nationals aims to assess economic allegiance. In this sense, a Brazilian citizen with a definitive intention to reside in Brazil is seen as having a sufficient personal connection to Brazil and to be fully liable to Brazilian taxation.

That said, it should be questioned how Brazilian tax residence rules should apply to an individual who is physically present in Brazil due to force majeure reasons, i.e. not due to their will. Particularly, one should question whether the answer would be different for nationals and foreigners.

Ricardo Mariz de Oliveira clarifies that, although taxes originate from the law (*ex lege*) and not from people's self-determination (*ex voluntate*), the free will of a person is a necessary requirement for the rise of any taxes. Taxes are due by virtue of law, this is true; but no one is legally obligated to behave in a way that would give rise to taxes. If such an obligation existed, taxes would be confiscatory.<sup>3</sup>

There must be clarification on this issue. It is true that the law (and not people's self-determination) provides for the activities that shall give rise

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2. Id.

3. R.M. de Oliveira, *Tributação em Tempos de COVID-19: Fixação de Residência Fiscal. Dedutibilidade de Doações*, in *VIII Congresso Brasileiro de Direito Tributário Internacional: Novos Paradigmas da Tributação Internacional e a COVID-19*, p. 87 (L.E. Schoueri, L.F. Neto & R.M. da Silveira eds. IBDT 2020).

to taxation. It is also true that, once such activities occur in reality, they give rise to taxation by command of law (and not by command of people's self-determination). This does not mean, however, that the rise of taxes is possible without people's self-determination. For taxes to arise, people must have the free will to practise the activities that give rise to taxation. In other words, if a taxpayer does not have the freedom *to not practise* the activities that give rise to taxation, taxes shall be considered confiscatory. Since, for the rise of any taxes, it is required that the taxpayer acts freely, tax residence rules should be approached accordingly. As tax residence implies full tax liability in a given jurisdiction, it is essential to look at how people's intentions (or absence thereof) to move from one country to another affects the application of tax residence rules.

That said, in the authors' view, an individual (either a national or a foreigner) cannot be forced to become a Brazilian tax resident because of circumstances beyond their control. Otherwise, taxation would be confiscatory. Consider the case of a Brazilian who has definitively moved abroad but happens to visit their parents in Brazil for a week. Obviously, no one would dare to claim that there was the definitive animus of residing in Brazil. Should a return become impossible (for instance, due to administrative measures that would unexpectedly interrupt flights), then it can convincingly be argued that they would not become a Brazilian resident. Of course, this would not be the case if such measures could have been expected, and the taxpayer accepted such risk. In addition, some administrative measures could consist of mere recommendations that would not effectively prevent the taxpayer from returning abroad. This might also be of relevance for asserting the taxpayer's residence in Brazil.

This is true also for foreigners. The fact that tax residence rules for foreigners are based on objective tests cannot be interpreted as allowing the emergence of tax residence for foreigners regardless of a taxpayer's free will; otherwise, taxation could be confiscatory. Therefore, a foreigner who, for example, comes to Brazil for vacation and finds themselves forced to stay in Brazil for a longer period due to the emergence or aggravation of a global pandemic, they should not be regarded as a Brazilian resident (even if they meet the 184-day threshold).

It could be argued that, besides the prohibition of confiscatory taxation, the very interpretation of Brazilian tax residence rules would lead to a denial of tax residence for someone who is in Brazil for force majeure reasons. According to this view, the very concept of residence would include a

consideration of the intention to stay in Brazil regardless of whether the taxpayer is a national or a foreigner.<sup>4</sup>

Yet, the authors are not convinced of such a view. Tax residence rules for foreigners base their search for economic allegiance on objective elements. Of course, it could be questioned whether such objective elements indicate sufficient economic allegiance for a foreigner to become fully liable to taxes in Brazil. However, since lawmakers did not consider any subjective aspect, the intention to stay in Brazil should not be investigated for applying tax residence rules.

Not only Brazilian rules on the acquisition of tax residence but also those regulating the loss of tax residence are worth some consideration.

As a rule, a tax resident in Brazil may become a non-resident in two main situations. Accordingly, a tax resident may leave Brazilian territory on a definitive basis and report it to Brazilian tax authorities (first situation); or a tax resident may leave Brazilian territory (whether with a definitive animus or not) and stay abroad for more than a year without reporting it to Brazilian tax authorities (second situation). In the first situation, Brazilian law regards the individual as a non-resident the moment they leave Brazilian territory. In the second situation, Brazilian law still regards the individual as a resident during the first 12 months from their departure even if, within that period, the individual has become a tax resident of another jurisdiction as well. Accordingly, Brazilian law will only regard the individual as a non-resident after the expiration of 12 months from the individual's departure from Brazil. This means that, at least for a 12-month period, it is possible that an individual will be a double tax resident (in Brazil and abroad).

Yet, Brazilian legislation provides particular rules to those Brazilian residents moving to low-tax jurisdictions. In this case, Brazilian law still regards the individual as a Brazilian resident until they prove that they have effectively become a resident of that low-tax jurisdiction. They can prove it by demonstrating that they have either spent more than 183 days in that jurisdiction or that the habitual abode of their family as well as the major part of their wealth are located there. Alternatively, the individual may opt to demonstrate that they are subject to income and capital taxation and that they pay their tax liabilities in that low-tax jurisdiction. In any case, Brazilian law will still regard the individual as a Brazilian resident until

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4. V.L.G. Luz, *Ainda sobre Reflexos Tributários Decorrentes do Covid-19: Determinação da Residência Fiscal de Indivíduos em Home Office no Brasil*, 9 Revista Direito Tributário Internacional, p. 282 (2021).

they manage to furnish the corresponding evidence required by law. This situation is called “Brazilian extended tax residence”.

## 4.2. Residence, tiebreaker rules and mobility of work: Individuals and entities

At the very beginning of the COVID-19 pandemic, the OECD issued a document discussing a range of effects that the pandemic could have on international taxation.<sup>5</sup> As for the residence of individuals, the OECD says that “[d]espite the complexity of the rules” and, in spite of “their application to a wide range of potentially affected individuals”, it would be “unlikely” that the COVID-19 pandemic affects the treaty residence status of taxpayers.<sup>6</sup>

Firstly, treaty residence would not be impacted by the COVID-19 crisis due to the countries’ unilateral measures that were taken to rule on residence status during the COVID-19 crisis. It is true that many countries issued guidelines on tax residence during the COVID-19 pandemic with most of them setting aside the residence status caused by exceptional circumstances. For instance, this is the case in Australia,<sup>7</sup> Ireland<sup>8</sup> and the United Kingdom.<sup>9</sup> However, this was not the case in Brazil. Brazilian tax authorities expressed their intention to relax the application of tax residence rules for exceptional situations caused by the pandemic,<sup>10</sup> but they never released any official statement on how to apply those rules in a COVID-19 context.

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5. OECD, *Secretariat analysis of tax treaties and the impact of the COVID-19 crisis* (2020).

6. Id., at p. 6.

7. Australian Taxation Office, *COVID-19 frequently asked questions* (2020), available at <https://www.ato.gov.au/individuals-and-families/financial-difficulties-and-disasters/covid-19/covid-19-frequently-asked-questions> (accessed 14 March 2024).

8. Irish Tax and Customs, (2022), available at <https://www.revenue.ie/en/covid-19-information/temporary-concessions-reliefs-and-exemptions/transborder-workers-relief.aspx> (accessed 14 March 2024).

9. HM Revenue & Customs, *RDRM13200 - Residence: The SRT: Annex B: Contents* (2023), available at <https://www.gov.uk/hmrc-internal-manuals/residence-domicile-and-remittance-basis/rdrm13200> (accessed 6 June 2022).

10. A. Aguiar, *Receita deve flexibilizar norma sobre residência fiscal devido à pandemia*, Valor Econômico (18 June 2020), available at <https://valor.globo.com/legislacao/noticia/2020/06/18/receita-deve-flexibilizar-norma-sobre-residencia-fiscal-devido-a-pandemia.ghml> (accessed 6 June 2022).

Secondly, even if tax residence arises in a given jurisdiction due to exceptional circumstances, tiebreaker rules of tax treaties would come in to correct it in favour of the country of “ordinary” residence.

The OECD drafts two scenarios that could result from the pandemic:

- (1) a person is temporarily away from their home (perhaps on holiday, perhaps to work for a few weeks) and gets stranded in the host country by reason of the COVID-19 crisis and attains domestic law residence there; and
- (2) a person is working in a country (the current home country) and has acquired residence status there, but they temporarily return to their previous home country because of the COVID-19 situation. They may have either never lost their status as resident of their previous home country under its domestic legislation, or they may regain residence status upon their return.<sup>11</sup>

In the first scenario, the taxpayer would probably not have a “permanent home” (article 4(2)(a) of the OECD Model) available for them in the host country. In the case that they have a permanent home in both countries, it is much more likely that the centre of vital interests (article 4(2)(a)), the place of habitual abode (article 4(2)(b)) or nationality (article 4(2)(c)) would solve the double residence situation in favour of the home country.<sup>12</sup>

The second scenario could be more difficult because the person would have a strong attachment to the previous home country. In the case that a permanent home is available in both countries and none of them can be said to be the centre of vital interests, it is much likely that the place of habitual abode (understood as the place where the individual lives “habitually” where they are “customarily or usually present”)<sup>13</sup> would be the taxpayer’s current home country.<sup>14</sup> In addition, it could be argued that, for someone to “habitually” live somewhere, they must have the will to do so. Accordingly, in the case that the taxpayer finds themselves stranded in their previous home country, it would somehow be contradictory to say that they “habitually” live there while they are simply unable to return home.

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11. OECD, *Secretariat analysis of tax treaties and the impact of the COVID-19 crisis*, p. 6 (2020).

12. *Id.*, at p. 7.

13. OECD *Model Tax Convention on Income and on Capital: Commentary on Article 4*, para. 19 (2017), *Treaties & Models IBFD*.

14. OECD, *Secretariat analysis of tax treaties and the impact of the COVID-19 crisis*, pp. 6-7 (2020).



As for the residence status of legal entities, the main concern relates to the place of effective management either as a domestic or treaty tiebreaker rule for the determination of residence of legal entities. Since the place of effective management is understood as where “the key management and commercial decisions” necessary to conduct the business are made,<sup>15</sup> a temporary change in the location, for example, of a senior executive officer, could potentially affect the company’s residence.<sup>16</sup>

Even if possibly relevant to Brazilian treaties relying on the place of effective management as the tiebreaker for legal entities, this debate is of minor importance under Brazilian domestic law. In spite of the existence of controversies around the concept of domicile for legal entities, it is reasonable to argue that legal entities are domiciled in Brazil once their head office is in Brazil. As a result, formal aspects of the management (i.e. what the company declares to be its head office) are more important than substantial aspects such as where management decisions are in fact taken. Brazilian law is not concerned with whether the legal entity is effectively managed from within the Brazilian territory. Once the headquarters are situated in Brazil, the entity will be regarded as resident in Brazil.<sup>17</sup>

Therefore, corporate tax residence in Brazil is based on a rather formal threshold (head office). For a legal entity to be resident in Brazil, it does not matter whether the business directors ordinarily meet in Brazil or abroad. A head office would not be changed by the displacement of high executive officers because it does not necessarily follow the place where management is undertaken in practice. As a result, mobility of work and displacement restrictions caused by the pandemic have a minor impact on the residence of legal entities in Brazil. The absence of legal disputes decided in Brazil regarding the impact on tax residence caused by the place of effective decision-making seems to reinforce this conclusion.

### 4.3. Permanent establishments and mobility of work

The permanent establishment threshold may suffer effects from the mobility of work as the concept of a permanent establishment requires physical presence. Accordingly, Philip Baker states that, for recognizing a permanent

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15. Para. 24 *OECD Model: Commentary on Article 4* (2017).

16. OECD, *Secretariat analysis of tax treaties and the impact of the COVID-19 crisis*, p. 4 (2020).

17. G. Galdino, *A Residência das Pessoas Jurídicas nos Acordos para evitar a Dupla Tributação*, pp. 135-137 (Dissertation, University of São Paulo 2022).

establishment, one “must be able to point to a physical location at the disposal of the enterprise” through which the business is conducted.<sup>18</sup>

The permanent establishment issue in Brazil, however, has almost no practical relevance. Brazilian income taxation of non-residents is based on the source of payment as the nexus rule and not on any physical presence requirement. Therefore, the permanent establishment clause has not received much consideration from Brazilian tax authorities and courts.

Since non-resident taxpayers are not subject to taxation by virtue of a personal connection with the country, the taxation of non-residents may occur either via a withholding tax regime or by treating them as if they were entities domiciled in the country. The permanent establishment regime is an example of the latter approach by which the conduct of the business in the country takes place through an organization of people and assets to which income is attributed and then taxed just as with any resident enterprise.<sup>19</sup>

Brazilian taxation of non-residents is far more based on withholding taxes than on treating them as if they were entities in Brazil. However, Brazil provides two situations of non-residents’ taxation that somehow resemble a permanent establishment approach. The first is the taxation of branches and offices located in Brazil held by non-resident enterprises. The second is the taxation of income earned in Brazil by a non-resident enterprise concluding sales through an agent in Brazil (regardless of whether such an agent acts in the name or merely in the interest of the non-resident enterprise). In both cases, the revenues obtained and the expenses incurred by the non-resident in the course of the operations are considered such as to reach a net taxable profit. In the case of the agent, they are liable to pay both the taxes due by the non-resident enterprise and the taxes due by themselves in relation to their own profits.

The situation of the branches held by non-resident enterprises in Brazil does not seem to be affected by the mobility of work and displacement restrictions. However, mobility of work and displacement restrictions do affect the taxation of non-residents operating through agents in Brazil.

The justification for Brazil to tax income from non-residents operating through agents in Brazil is the participation of a person (the agent) other

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18. P. Baker, *Double Taxation Conventions, Article 5 – Permanent Establishment*, para. 5B.06, p. 5-2/2 (Sweet & Maxwell 2002).

19. A. Xavier, *Direito Tributário Internacional do Brasil*, p. 590 (R.D. Estrada & R. Emery eds., Forense 2015).

than the non-resident in the Brazilian market. Accordingly, Brazil does not tax income from sales concluded between Brazilian residents (purchasers) and non-residents (sellers) without an intermediate agent. One may thus infer that the participation of an intermediate agent in Brazil is considered by law as a reason to justify a different tax treatment for “direct” sales on the one side, and “indirect” sales on the other.<sup>20</sup>

This leads to the conclusion that the agent must be resident in Brazil to allow taxation of the non-resident on behalf of whom (or in the interest of whom) the agent acts.<sup>21</sup> In the case that the agent is a non-resident, the situation is nearly the same of that of a contract directly concluded between a purchaser resident in Brazil and a non-resident seller (which does not trigger Brazilian taxation). The very wording of the Brazilian legislation favours the conclusion regarding the need that the agent be a resident in Brazil for taxation to occur. The legislation explicitly states that the non-residents’ income to be taxed is the income obtained “from the operations carried out by *agents in Brazil*” [emphasis added] (article 76 of Law no. 3,470/1958).

That said, situations could be imagined where mobility of work and displacement restrictions could affect the taxation of non-residents in Brazil. For instance, a situation could be imagined in which an agent is resident in Brazil and acts in the interest of non-resident enterprises. In this situation, non-resident enterprises would be subject to Brazilian taxation regarding the income obtained through the agent in Brazil. If such an agent loses Brazilian tax residence after moving to another country but continues to exercise their activities of intermediating sales between Brazilian residents and non-residents, the taxation of non-residents would cease to occur.

#### 4.4. Physical presence according to articles 15(1) and 17 of the OECD Model

According to article 15(1) of the OECD Model, income from employment is taxable only in the residence state unless the activities of the worker are exercised in the other state. In this case, the place-of-work principle prevails as income from employment would also be taxable in the source state (i.e. the state where the work is performed).<sup>22</sup> As a rule, the place where the

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20. Id.

21. Id., at pp. 610-611 and 617.

22. A.P. Saunders & D.V.B. Cordeiro, *O Artigo 15º da Convenção Modelo da OCDE e os Tratados Internacionais em Matéria Tributária no Brasil*, in *Estudos de Tributação Internacional*, p. 99 (A.P. Saunders et al. eds., Editora Lumen Juris 2017).

employment is exercised is the place where the employee is physically present to exercise their employment.<sup>23</sup> Brazil generally follows article 15(1) of the OECD Model.

As anticipated, Brazil has an income tax system largely based on withholding taxes. Additionally, Brazil adopts source of payment as the general nexus rule for the taxation of non-residents. As a result, non-residents are generally subject to taxation in Brazil on the basis of withholding taxes charged according to a source of payment principle. This is also the case for services income and employment income. Non-resident workers and service providers who derive income from Brazil (i.e. income whose source of payment is in Brazil) are subject to withholding tax in Brazil regardless of where they perform their activities.

Since the taxation of non-resident workers is not based on physical presence but rather on the source of payment, Brazil has not issued any guidance regarding the treatment of non-resident workers that got stranded in Brazilian territory due to the COVID-19 pandemic. Similarly, the fact that a worker otherwise working abroad could opt to perform their activities remotely in Brazil raises no special concern since the place where they work from is of no tax relevance. Of course, they could trigger tax residence in Brazil pursuant to Brazilian domestic residence rules, but the place of work itself does not affect Brazilian income taxation of non-resident workers.

Since the source of payment does not necessarily match the place of work, there must be a reconciliation between Brazilian domestic rules and article 15(1) when a treaty is applicable. Non-resident employees receiving income from Brazilian sources would be taxable in Brazil under tax treaties only if they exercise their activities in Brazil as required by article 15(1). It is true, however, that a worker performing activities in Brazil is likely to be regarded as a resident in Brazil (not as a non-resident) pursuant to Brazilian domestic rules. This will be discussed in section 4.5.

#### **4.5. Article 15(2) and (3) of the OECD Model**

The wording of article 15(2) is structured with a double negative: the state where the activity is developed would not be able to tax the income from

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23. K. Vogel et al, *Klaus Vogel on double taxation conventions: commentary to the OECD-, UN- and US model conventions for the avoidance of double taxation on income and capital with particular reference to German treaty practice*, p. 892 (Kluwer Law International 1997).

employment if none of the three connection criteria (article 15(2)(a), 15(2)(b) and 15(2)(c)) are present. Putting it clearer, for the state where the activities are performed to have the right to tax the income from employment, it is enough that one of the three situations be present.<sup>24</sup> Brazil generally follows article 15(2) of the OECD Model.

Articles 15(2)(a) and 15(2)(b) deserve special consideration.

Article 15(2)(a) entails that, if an employee spends more than 183 days in the state where they perform their work, then taxation by that state is allowed. However, if a foreign employee stays in Brazil for 184 days within a 12-month period, they will trigger tax residence in Brazil due to the Brazilian domestic 184-day rule. A foreign employee spending more than 183 days in Brazil would thus be taxed not as a non-resident but as a Brazilian resident (notwithstanding the fact that the Brazilian domestic 184-day rule and the corresponding treaty rule of article 15 are not identical, so they may occasionally lead to different results in practice).

A similar result occurs under article 15(2)(b). As per this provision, if the employer is a resident of the state where the work is exercised, then taxation of employment income by that state is allowed. However, the existence of an employment relationship in Brazil is a trigger of tax residence for foreigners that enter Brazilian territory with a temporary visa (it is worth mentioning that Brazilian legislation does not seem to require that the employer be a Brazilian resident for the employee's tax residence to arise). If an employee were in this situation, they would be taxed not as a non-resident but as a Brazilian resident.

Even though Brazilian treaty rules and Brazilian residence rules for foreigners clearly have different origins, important outcomes arise from this partial overlapping between tax residence events under domestic law and article 15(2)(a)(b) of tax treaties. In most situations where a foreigner would be regarded as a Brazilian resident under domestic law (due either to number of days spent in Brazil or to the existence of an employment relationship), conditions under article 15(2) for taxation by the state where the work is performed would be met. Of course, this overlapping does not apply to nationals, since for them, a subjective approach applies, i.e. legislation requires the intention to permanently reside in Brazil for them to be regarded as tax residents. This overlapping issue between Brazilian

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24. A.P. Saunders & D.V.B. Cordeiro, *O Artigo 15º da Convenção Modelo da OCDE e os Tratados Internacionais em Matéria Tributária no Brasil* In *Estudos de Tributação Internacional*, p. 101 (A.P. Saunders, et al. eds., Editora Lumen Juris 2017).

residence rules for foreigners and article 15(2)(a)(b) of tax treaties will be further discussed in this section.

The OECD highlights three possible situations of an exceptional nature that could arise due to the COVID-19 pandemic: (i) wage subsidy and similar income received by cross-border workers who cannot perform their work due to restrictions; (ii) a worker who is stranded in a jurisdiction where they are not a resident but previously exercised employment; and (iii) a worker who works remotely from a jurisdiction for an employer who is resident in another jurisdiction.<sup>25</sup>

As to the first situation, the OECD suggests that “the income that the employee receives from the employer should be attributable to the place where the employment used to be exercised”.<sup>26</sup> This is important since Brazil would certainly intend to tax such an income if its source of payment was in Brazil. Therefore, the OECD ends up endorsing Brazilian source of payment taxation in this case.

The second situation deserves a more in-depth analysis. As said in section 4.1., the rationale underlying the 184-day rule under Brazilian domestic law is the search for economic allegiance based on objective elements. Instead of inquiring over the taxpayer’s intention to reside in Brazil, the law disregards such an intention and assigns tax residence once the taxpayer spends 184 days in Brazilian territory. Although inserted in a different context, the treaty rule of article 15(2)(a) should be interpreted in a similar way. The purpose of this treaty rule is to ensure a “straight connection” between the worker activities and the state where they are performed. Provided that such a straight connection exists, then the state where working activities are performed is to be granted the ability to tax the corresponding income.

The reasons why a taxpayer spends more than 183 days in a state do not seem to have much relevance for assessing economic allegiance. Provided that the employee is physically present in a state for more than 183 days and exercises their activities there, article 15(2)(a) sees a sufficient economic connection of the employee to that state so as to be taxable therein. The approach is clearly intended to be objective, so it prevents subjective analyses.<sup>27</sup> Therefore, if an employee spends more than 183 days in a country due

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25. OECD, *Updated guidance on tax treaties and the impact of the COVID-19 pandemic*, p. 15 (2021).

26. Id.

27. L.E. Schoueri, *The Residence of the Employer in the “183-Day Clause” Article 15 of the OECD’s Model Double Taxation Convention*, pp. 20-21 (Intertax 1993).

to, for example, travel restrictions imposed by the COVID-19 pandemic, the rationale of article 15(2)(a) does not suggest such an employee should escape taxation at source.

In the case of a pandemic-related restriction, the obstacle to taxation would not be article 15(2)(a) itself but the prohibition of confiscatory taxation.

As was discussed in section 4.1., a taxpayer cannot be required to pay taxes if they do not freely give rise to the tax event. This would certainly be the case when an employee finds themselves stranded in a country due to travel restrictions. It is curious to notice that the Commentary on Article 15 of the OECD Model also restricts the application of article 15(2)(a) in the case that the taxpayer cannot leave the country, even though the commentary does not mention the anti-confiscatory argument. While including as a rule the days of sickness of the employee as days to be computed for the purposes of article 15(2)(a), the commentary sets aside their computation when “they prevent the individual from leaving and he would have otherwise qualified for the exemption”.<sup>28</sup> The OECD suggests that a similar approach could be extended to exceptional circumstances raised by the COVID-19 pandemic.<sup>29</sup>

In the third place, there is the situation of an employee working remotely in a jurisdiction for an employer of another jurisdiction. Consider the case of an employee resident in Brazil working for a Brazilian company who leaves Brazilian territory on a temporary basis to work abroad for the same employer (as it could be the case, e.g. of a COVID-19-related absence). In this case, provided that the employee leaves Brazilian territory without reporting it to Brazilian tax authorities, Brazilian law would require that employee to still be regarded as a Brazilian resident until they complete 12 consecutive months of absence. From that day on, they would become a non-resident. The answer would be the same regardless of whether the employee is a Brazilian national or a foreigner. Once characterized as a non-resident, such an employee would be subject to Brazilian taxation rules on employment income from non-residents, i.e. withholding taxes at source. Concerns regarding the compatibility of that taxation with article 15(1) could then arise since the place of performance of work would not be in Brazil anymore.

Consider also the case of an employee resident abroad who works for a foreign company but is exceptionally present in Brazilian territory (as it

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28. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 15*, para. 5 (2017), Treaties & Models IBFD.

29. OECD, *Updated guidance on tax treaties and the impact of the COVID-19 pandemic*, p. 16 (2021).

could be the case, e.g. of a COVID-related presence). This situation could produce different results in Brazil depending on the nationality of the employee involved. If the employee were a foreigner, the 184-day domestic rule would apply. If they passed the 184-day test, then they would be treated as a Brazilian resident and taxed accordingly. In this case, double residence could potentially arise and Brazil could be considered not to be the state of residence for treaty purposes as a result of the application of tiebreaker rules under article 4 (e.g. if the place of habitual abode of the taxpayer or their centre of vital interests is in the other state). Assuming the employee would meet the 183-day treaty threshold (article 15(2)(a)), Brazilian taxation would not be a problem since the employee would have exercised their activities in Brazilian territory as required by article 15(1). Besides, even though source-based for treaty purposes, Brazilian taxation would be residence-based under domestic law. This represents one of the most relevant consequences of the overlapping between Brazilian residence rules for foreigners and the conditions imposed by article 15(2)(a)(b) for taxation by the state where the work is performed. The tax laws that would apply to the taxpayer would be those applicable to residents as the employee would still be a Brazilian resident for domestic law purposes even in the case that Brazil is not regarded as the state of residence for treaty purposes.<sup>30</sup> This is of utmost importance since residents and non-residents are subject to very different income tax regimes under domestic law. For instance, Brazilian residents are allowed to include personal deductions in the calculation of their taxable income, while non-residents are taxed on a gross basis.

Now consider that the employee would be a Brazilian national. Then they would be a non-resident Brazilian national that comes to Brazil to perform their work for a foreign company. Regarding nationals, Brazil is not concerned, for example, with how many days a national taxpayer spends in Brazil for recognizing them as a tax resident. Objective tests are irrelevant. It is enough that tax authorities can assess the national taxpayer's intent to be in Brazil on a permanent basis. Therefore, if a Brazilian national residing abroad comes to Brazil to perform their work and gives some indication of the intention to definitely reside there (e.g. if they register their children in school), they are likely to trigger tax residence in Brazil even if they stay less than 184 days in Brazilian territory. A double residence situation would probably arise also in this case and Brazil could be considered not to be the state of residence for treaty purposes due to the application of tiebreaker rules. As a result, and assuming the taxpayer would not have met

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30. K. van Raad, *Five Fundamental Rules in Applying Tax Treaties in Liber Amicorum Luc Hinnekens*, p. 590 (Bruylant 2002).



the 183-day treaty threshold in Brazil (article 15(2)(a)), Brazilian taxation would not be allowed. Of course, a different answer would be reached if the company the employee works at were resident in Brazil (and not abroad). In this case, the situation of article 15(2)(b) would be met and taxation in Brazil would be allowed.

It is worth noting that article 15(2) of Brazilian treaties has a small deviation from the OECD Model. In some treaties, article 15(2)(a) uses the term “calendar/civil year” instead of “fiscal year”. This terminological difference has no relevance in Brazil as both the calendar year and the fiscal year refer to the same period. For the other contracting state, however, this difference may be of some significance.

Article 15(3) of Brazilian treaties also presents a deviation as Brazilian treaties do not include the remuneration derived from employment exercised aboard boats engaged in inland waterways transport in article 15(3).

## 4.6. Frontier workers

Some jurisdictions provide a special treaty provision with their neighbouring jurisdictions targeted at cross-border workers.<sup>31</sup> Some of these countries agreed that the employees commuting to a neighbouring jurisdiction are taxable on their employment income only in the home jurisdiction provided any employment activity carried on elsewhere is limited to a maximum stated period (typically ranging from 4 to 6 working weeks).<sup>32</sup>

Brazil has no specific rules for frontier workers in its tax treaties, however.

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31. F. Pierini, *Frontier Workers in the European Union: Directorate General for Research*, Working Paper, Social Affairs Series, available at [https://www.europarl.europa.eu/work-ingpapers/soci/w16/summary\\_en.htm](https://www.europarl.europa.eu/work-ingpapers/soci/w16/summary_en.htm) (accessed 8 June 2022).

32. OECD, *Updated guidance on tax treaties and the impact of the COVID-19 pandemic*, p. 17 (2021).

#### **4.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)**

Brazil has no tradition of concluding mutual agreement procedures or consultations with its treaty partners. Particularly, Brazil has not concluded a mutual agreement procedure to rule on pandemic-related tax issues.

In addition, Brazil has not issued any particular guidance on how to apply Brazilian (either domestic or treaty-based) tax rules during the COVID-19 pandemic.

#### **4.8. The future of the mobility of work: A need for adjusting the existing treaty rules?**

The mobility of work raises the question of whether the place-of-work principle, as relied upon by article 15 of the OECD Model to allocate tax rights to source states, is still a useful approach. The authors believe it still represents, as a general rule, a reasonable way to assess the economic allegiance of an employee in the source state.

It could be argued that home office situations should escape the place-of-work principle since a home office is an “anywhere office”; as work could be exercised from anywhere in the world, taxation in the state of the home office on the grounds of the place-of-work principle would lack justification. However, as currently framed, the search for economic allegiance under article 15 does not seem to be concerned with the utility produced by the employee, i.e. whether such utility is consumed in the source state. The place where “the employment is exercised” should not be read as the place where the work becomes “effective” or where it is “exploited”<sup>33</sup> even if, in some cases, the search for the effects of the employee’s activities could seem a more reasonable approach in terms of legal policy.<sup>34</sup>

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33. K. Vogel et al, *Klaus Vogel on double taxation conventions: commentary to the OECD-, UN- and US model conventions for the avoidance of double taxation on income and capital with particular reference to German treaty practice*, pp. 892-893 (Kluwer Law International 1997).

34. K. Vogel & M. Lehner, *Doppelbesteuerungsabkommen der Bundesrepublik Deutschland auf dem Gebiet der Steuern vom Einkommen und Vermögen – Kommentar auf der Grundlage der Musterabkommen*, art. 15, para. 64, p. 1677 (Beck 2021).

The current underlying assumption of article 15 is rather that an employee who is present in the source state for a significant length of time demonstrates sufficient attachment to that state so as to be taxable therein. If an employee works in a country for a significant length of time and earns their income there, it is assumed from article 15 that such an employee is sufficiently connected to the economic life of the source state so as to pay taxes to that state.

Therefore, a change of the sourcing rule in article 15 (either generally or to a specific category of workers) would imply also changing, to an extent, the underlying rationale of that article. In addition, the adoption of a more utility-based approach for certain kinds of workers (e.g. work at distance, home office, etc.) could present difficulties in practice and lead to uncertainty in the determination of the source of income. In any case, adjustments in tax treaties would be welcome to deal with particular contemporary work modalities, such as highly mobile workers. As currently framed, article 15 would require those workers to apportion income to the different places where they perform their work, which would subject them to multiple compliance duties. A more simplified treatment of these situations would be very welcome.<sup>35</sup>

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35. P. Pistone, *Article 15: Income from Employment - Global Tax Treaty Commentaries*, sec. 3.3.2.4. (IBFD 2019).



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## Chapter 5

### The Impact of Tax Treaties on International Mobility of Work in Chile

Sergio Ayala and Felipe Yañez

#### 5.1. Mobility of work and domestic tax law

Chile is a peripheral country literally located at the end of the world. For this reason, it has not regularly been the protagonist of large population movements to or from abroad. For the same reason, until a few years ago, it has not been not a country that has focused much attention on the migration issue. On the contrary, the only relevant regulation affecting labour mobility dates back to 1964 and consisted of a kind of tax holiday that allows foreigners coming to reside in Chile to be subject to taxation only on their income from national sources (i.e. those coming from assets located in the country or activities carried out in a national territory) during the first 3 years of residence.<sup>1</sup> This implies that foreign-source income obtained during such a period will not be subject in any way to taxation in Chile, nor will it be considered for determining the progressive income tax levied on individuals (known in Chile as global complementary tax).<sup>2</sup>

Therefore, in order to trigger taxation on worldwide-source income with respect to a foreigner who acquires residence in Chile, it is not enough with the mere configuration of the quality of resident but also a minimum of 3 years of residence must be reached in order to meet such condition.<sup>3</sup>

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1. CL: *Decreto Ley 824 Ley sobre Impuesto a la Renta* [Decree Law 824 Law on Income Tax], 1974, art. 3(2), available at <https://www.bcn.cl/leychile/navegar?idNorma=6368> (accessed 18 Mar. 2024). The origin of this paragraph is found in Law No. 15.564 of 1964, as referred to in A. Rencoret, *El Impuesto sobre la Renta* pp. 15 and 29 (Editorial Jurídica de Chile 1975).

2. There are several pronouncements from the Chilean tax authority on this provision. The latest of them is CL: *Ordinario Nr. 2670* [Ruling Nr. 2670] 2019, Chilean tax administration database, available at [https://www.sii.cl/normativa\\_legislacion/jurisprudencia\\_administrativa/ley\\_impuesto\\_renta/2019/ley\\_impuesto\\_renta\\_jadm2019.htm](https://www.sii.cl/normativa_legislacion/jurisprudencia_administrativa/ley_impuesto_renta/2019/ley_impuesto_renta_jadm2019.htm) (accessed 18 Mar. 2024).

3. This has been affirmed on several occasions by the Chilean tax authority, the latest of which can be found in CL: *Ordinario No. 275* [Private Ruling Nr. 275] 2022, which states: “The foreign natural person who moves from Spain to Chile in order to constitute a domicile or residence (...) will only be subject in Chile to the taxes levied on income obtained from Chilean sources during the first three years from the date of entry into Chile. After these three years, the person will be taxed in our country for all his income,

Until now, neither the tax administration nor the courts have had the opportunity to distinguish the situations of prolonged residence, which are generated as a result of a voluntary stay, from others in which the stay in Chile is due to external factors that prevent the individual from moving to another jurisdiction. In light of this situation, it can be stated that this distinction is currently irrelevant for the purposes of determining when and how the person concerned will be subject to worldwide-source taxation.

Regarding the reasonableness of the tax holiday rule, the authors' opinion is that this rule had its origin in the Chilean government's interest in attracting technicians and professionals who were domiciled in the country to participate in medium or long-term investment projects. Indeed, the 3 years in which such technicians and professionals were exempt from taxation in Chile for income unrelated to their professional activity was a special attraction for this type of talent. However, at present and after the large migratory movements from neighbouring countries, such as Colombia, Ecuador, Peru and Venezuela (especially from the latter due to the humanitarian crisis in that country), it is worth asking whether this rule should also apply to this new type of immigrant. In fact, a significant number of these migrants do not meet the characteristics of the profile that was kept in mind at the time of establishing this tax vacancy.<sup>4</sup>

Chilean law does not contemplate the imposition of exit taxes for loss of tax residency. The tax reform bill sent by the Chilean government to the national congress on 7 July 2022 originally proposed the establishment of a wealth tax that would affect individual personal wealth that is over approximately USD 6 million. It included an exit tax for those individuals who lose their tax residency in Chile after the entry into force of the law. However, this initiative was deleted in the new version of the bill dated 4 October 2022.<sup>5</sup>

Therefore, under the current regulatory framework, the only effect that such loss entails is the limitation of their tax obligations to those arising from the holding of assets located in Chile or activities carried out in a Chilean

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whether from Chilean or foreign sources." Chilean tax administration database, available at [https://www.sii.cl/normativa\\_legislacion/jurisprudencia\\_administrativa/otras\\_normas/2022/otras\\_normas\\_jadm2022.htm](https://www.sii.cl/normativa_legislacion/jurisprudencia_administrativa/otras_normas/2022/otras_normas_jadm2022.htm) (accessed 18 Mar. 2024).

4. This was expressly pointed out in the parliamentary discussion of Law 15.564 of 1964, cited by Rencoret, *supra* n. 1, at p. 29.

5. The discussion of this bill can be followed on the Chilean Chamber of Deputies website, available at <https://www.camara.cl/legislacion/ProyectosDeLey/tramitacion.aspx?prmID=15680&prmBOLETIN=15170-05> (accessed 18 Mar. 2024).

territory (Oficio N°1058 of 2021).<sup>6</sup> However, the mere physical absence from the country is not a sufficient reason to conclude the loss of tax residency (called “tax domicile” in Chile) if the taxpayer directly or indirectly retains their family or the main seat of their business in Chile (article 4 of the Income Tax Law and article 65 of the Civil Code). In this respect, the Chilean tax authority has understood that the fact that a person keeps or has lost the tax residency in Chile must be assessed on a case-by-case basis in the respective tax audit instance that affects them. It must take into consideration elements such as their and their family’s residence, where the taxpayer’s children study and the location of their job or the one that gives them the greatest income (Oficio No. 1383 of 2015, No. 1058 of 2021).<sup>7</sup> Therefore, in order to lose tax residency due to working abroad for a long time, it is also required that such absence involves a transfer abroad of the main source of their income.

In principle, if the members of the board of directors of a company incorporated in Chile live and work in different countries, this fact does not generate consequences for the tax or commercial residence of the respective company in Chile. This is because, according to the local law, the place of incorporation of the company is the main criterion to qualify a company as resident in Chile for tax purposes (*a contrario*, article 58 N°1 and article 60 of the Chilean Law on Income Tax). In fact, the concept of “place of effective management” has not been formally taken up by Chilean law, nor is it known whether such criterion has been taken up by the tax administration in its pronouncements or by the courts of justice in their decisions. Consequently, if the members of the board of directors of a company incorporated in Chile were to change their residence from Chile to one or more other countries, such circumstance would not alter the Chilean resident status of that company. This is notwithstanding that, in any of those states, it could be argued that the Chilean company has transferred its place of effective administration to that country. Certainly, this circumstance could give rise to a conflict between the law of both countries that could be resolved in accordance with the tiebreaker rules of the conventions. This would avoid double international taxation (article 4 of the OECD Model) in the event that the country claiming to have become the effective place of administration of a company incorporated in Chile has an agreement in force with Chile.

6. CL: *Oficio Ordinario Nr. 1058* [Ruling Nr. 1058] 2021, Chilean tax administration database, available at [https://www.sii.cl/normativa\\_legislacion/jurisprudencia\\_administrativa/ley\\_impuesto\\_renta/2021/ley\\_impuesto\\_renta\\_jadm2021.htm](https://www.sii.cl/normativa_legislacion/jurisprudencia_administrativa/ley_impuesto_renta/2021/ley_impuesto_renta_jadm2021.htm) (accessed 18 Mar. 2024).

7. CL: *Oficio Ordinario Nr. 1383* [Ruling Nr. 1383] 2015, Chilean tax administration database, available at [https://www.sii.cl/normativa\\_legislacion/jurisprudencia\\_administrativa/otras\\_normas/2015/otras\\_normas\\_jadm2015.htm](https://www.sii.cl/normativa_legislacion/jurisprudencia_administrativa/otras_normas/2015/otras_normas_jadm2015.htm) (accessed 18 Mar. 2024).

In this case, an exit tax that is levied on the Chilean company could not be activated since domestic regulations do not contemplate this possibility.

In the reverse case, if the members of the board of directors of a company that was originally incorporated and managed abroad moved their place of domicile to Chile, said circumstance could not be invoked by the Chilean administration to maintain that such company has become tax resident of Chile. This is because the concept of an effective place of administration has not been included in domestic legal regulations. The authors are not aware that such a criterion has been included by the tax administration in its pronouncements or by the courts of justice in their decisions.

However, such a circumstance could give rise to – in the authors’ opinion – the Chilean tax administration sustaining that the foreign company has constituted a form of permanent establishment (PE) in Chile. This would be on the assumption that it is proven that the members of the board of directors now resident in Chile have the quality of habitual agents of the foreign company. This will be the case if, in the exercise of their representation, they normally conclude contracts typical of the ordinary business of the foreign company or they play a main role that leads to the conclusion of said types of contracts or they negotiate essential elements of these (article 2 No.12 of the Law on Income Tax).<sup>8</sup> Under such circumstances, the Chilean tax administration could require that the foreign company comply with formal and material obligations similar to those of a company incorporated in Chile. This could include – for example – its registration in the taxpayers’ registry, the presentation of monthly and annual tax returns and the obligation to keep accounting books and pay taxes on the activities that are developed from the acts of said agents.

The tax residency of a company in Chile does not depend on the permanence in the country of bodies that assume the management functions of the company nor on the fact that there is a minimum number of workers occupying the premises of the company. Therefore, the authors opine that, if all employees worked from their homes and the company no longer had a work space available to such workers, such company would still maintain the quality of tax resident in Chile to the extent that it had been incorporated in the country or then had formally installed a PE in Chile. From a formal point of view, the tax administration will always require the company to maintain a domicile where it can be notified of the administration’s actions,

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8. However, there are still no pronouncements from the Chilean tax authority on a possible application of this concept to management bodies of legal entities, although the rule was incorporated into the law by the reform of 2020.



but this function can be fulfilled by the domicile of the company's tax, legal or accounting advisers.

In the authors' opinion, the rules of Chilean domestic law that regulate the concept of a PE allow the argumentation that a foreign company that was not incorporated under Chilean law and has not formally installed a branch in the country could, in practice, constitute a PE in Chile. This will be the case if one or more individuals resident in the country work regularly for such company, even if they do so from their own homes and not from an office or premises owned by the company. In fact, such a figure would not meet the requirements of a PE as a fixed place of business since they would not qualify as "offices, agencies, facilities, construction projects, and branches".

However, the work of such persons could imply the performance of "activities in the country represented by an agent".<sup>9</sup> Then, if, in the exercise of such activities, such agent "habitually concludes contracts that are proper to the ordinary business of the company or plays a main role that leads to their conclusion or negotiates essential elements of them",<sup>10</sup> this would be a case of a PE insofar as the workers have the quality of agents of the foreign company. Nothing is said in the law or in the administrative regulations about the term that such representation should last, so any term would be sufficient. This possible case of setting up a PE is relevant without considering, of course, the particular effects that can be derived from a situation triggered involuntarily by the COVID-19 crisis.

As explained, given that local law does not apply substantive requirements to determine whether a company maintains its tax residency in the country, there is no need to make it more flexible to deal with the new mobile work flows.

In general, the treatment of social security law in Chile is aligned with the fiscal residence nexus. In other words, all persons residing in Chile as a result of the performance of dependent or independent employment are obligated to be part of the Chilean social security system. This is valid unless they are eligible for an exception system, with the main one being

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9. CL: *Decreto Ley 824 Ley sobre Impuesto a la Renta* [Decree Law 824 Law on Income Tax], 1974, art. 2 No.12, available at <https://www.bcn.cl/leychile/navegar?idNorma=6368> (accessed 18 Mar. 2024).

10. CL: *Decreto Ley 824 Ley sobre Impuesto a la Renta* [Decree Law 824 Law on Income Tax], 1974, art. 2 No.12, available at <https://www.bcn.cl/leychile/navegar?idNorma=6368> (accessed 18 Mar. 2024).

that which is applicable to foreign qualified technicians or professionals hired by national companies under Law No. 18,156.

## **5.2. Residence, tiebreaker rules and mobility of work: Individuals and entities**

Law Number 21,210 was published in the Official Gazette of 24 February 2020, which replaced the concept of resident contained in article 8 No.8 of the Chilean Tax Code. Until 2020, tax resident status was acquired after 6 months of permanence in the country, which – in the opinion of the tax administration – had to be counted uninterruptedly. Therefore, any absence from the national territory, no matter how minimal, prevented persons with long stays in Chile – but with successive departures from the territory – from acquiring resident status. This situation changed radically with the new definition, according to which resident status is acquired once 184 days of presence in the country have been completed (i.e. when a stay of 183 days is exceeded), whether uninterrupted or not in a period of 12 consecutive months. By means of Circular Letter 63 of 2021, the Chilean tax administration interpreted such legal rule regarding the conditions under which resident status may be acquired or lost for tax purposes. The circular states that the qualification as a resident is merely objective and does not consider the intention of the individual and, therefore, depends solely on the number of days that a person stays in the country in a given period. Neither the law nor the circular makes mention of cases in which such a stay could be forced by acts of God or acts of authority. On this basis, it can be stated that the new definition of “tax residence” is an example of the impact that the greater degree of labour mobility is having on domestic legislation. The previous concept of residence was not compatible with a high level of worker mobility since it prevented workers from acquiring a broader link with Chile if, in practice, they had moved to work in the country. On the other hand, the administrative interpretation mentioned previously demonstrates that – in order to acquire resident status – it is currently irrelevant whether the foreigner stays in the country voluntarily or is forced by travel restrictions due to measures of the authority to address the pandemic.

As explained previously, the tax residency of a company in Chile does not depend primarily on substantive requirements (i.e. whether there are bodies located in Chile that assume the management functions of the company or whether there is a minimum number of workers occupying the company’s premises), but on formal requisites. Consequently, in the authors’ opinion,

if all employees were to work from their homes and the company ceased to have a workplace available to such employees, the company would continue to maintain its tax resident status in Chile. There would also be no risk of the company losing its tax treaty entitlement in Chile.

It is obviously easy to comply such a formal criterion to invoke the application of any tax treaty subscribed by Chile. For this reason, the country follows – with the purpose of avoiding abuse of its tax treaties – the alternative tiebreaker rule (*see* paragraph 24.1 of the Commentary on Article 4 of the OECD Model) in the case of companies being resident of both contracting states. Thus, in this case, the tax treaty partners will determine by a mutual agreement procedure (MAP) in which of the contracting states a company is resident.<sup>11</sup>

It is possible that a highly mobile lifestyle is beginning to influence the circumstances under which the authority is qualifying the criteria set out in article 4(2) of the OECD Model to determine whether and how a person acquires or loses tax resident status.

Indeed, until now, when dealing with terms, such as “permanent domicile”, “centre of vital interests” or “habitual domicile”, the Chilean tax administration had primarily considered non-economic aspects to qualify the acquisition of tax residence (for example, the place where the taxpayer’s family lives or where their children study).<sup>12</sup> However, it recently clarified that, for tax purposes, the economic element must be considered first (i.e. the place where the taxpayer carries out the activity that earns the most income and where the principal place of business is located). On the other hand, the family factor may not be a necessary or essential element if it is not accompanied by the economic element.<sup>13</sup>

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11. J. Madariaga & F. Yáñez, *Chile*, in *The Impact of the OECD and UN Model Conventions on Bilateral Tax Treaties* (M. Lang et al. eds., Cambridge University Press 2012).

12. This is stated, for example, in CL: *Ordinario Nr. 2066* [Private Ruling Nr. 2066], 2012, available at <https://www.sii.cl/pagina/jurisprudencia/adminis/2012/renta/ja2066.htm> (accessed 18 Mar. 2024).

13. CL: *Circular 63, Imparte instrucciones sobre la definición de residente contenida en el N° 8° del artículo 8° del Código Tributario, reemplazada por la Ley N° 21.210 y sobre el concepto domicilio para fines tributarios* [Circular Letter 63, Instructs regarding the concept of tax residence as provided for in Nr.8 of Article 8 of the Tax Code, as amended by Law Nr. 21,210 and regarding the concept of domicile for tax purposes], 2021, Chilean tax administration database, available at [https://www.sii.cl/normativa\\_legislacion/circulares/2021/circu63.pdf](https://www.sii.cl/normativa_legislacion/circulares/2021/circu63.pdf) (accessed 18 Mar. 2024).

In the case that the board members of a company decide to move from one country to another country or from one country to Chile or vice versa (with all countries involved being tax treaty partners) and work from there, the tiebreaker clause of article 4(3) of the OECD Model should operate as follows. In the event that the board of directors considers that the company is now a resident of a second state (Country 2) with which Chile has signed a tax treaty and has a certificate of residence issued by Country 2, Chile must, in principle, accept the qualification of “resident” made by Country 2. This is true even if the company had previously been a resident of a third state (Country 1) and whether the latter has a tax treaty with Chile. In this regard, the tax administration states that – in order to be a resident of a contracting state – in accordance with the article on residence of the tax treaty signed by Chile, such company must have a link with the contracting state that subjects its income to general taxation in that state. If the Chilean tax authority does not agree with Country 2 that the company is a tax resident of Country 2, it may challenge such qualification through a MAP regulated in the same tax treaty. Additionally, if the competent authorities do not reach an agreement within the indicated procedure, the referred person is not entitled to obtain the benefits of the tax treaty as a general rule.<sup>14</sup>

On the contrary, if the board of directors considers that the company moves from Chile to a second state (Country 2) with which Chile has entered into a tax treaty and has a certificate of residence issued by Country 2, Chile should, in principle, reject the qualification of “resident” made by Country 2. This is because, according to Chilean corporate law provisions, a company incorporated under Chilean law can only reside in Chile. In this context, if a company incorporated in Chile intends to change its residence from Chile to Country 2, this could only be qualified by the Chilean tax authority as the creation of a PE in Country 2 but maintaining its original tax residence in Chile. If Country 2 were to not accept such a qualification as a PE, this case should trigger a dispute to be resolved under the MAP. If both countries do not reach an agreement within the indicated procedure, the referred company is not entitled to obtain the benefits of the tax treaty as a general rule.

The main impact of problems that could arise in the context of article 4(3) of the OECD Model on the rules of apportionment (such as articles 8 or 16) if a company moves to a different state of residence is the inability of that company to access the benefits of the respective tax treaty. The authors have

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14. CL: *Oficio N° 2400* [Ruling Nr 2, 400], 2017, Chilean tax administration database, available at [https://www.sii.cl/normativa\\_legislacion/jurisprudencia\\_administrativa/ley\\_impuesto\\_renta/2017/ja2400.doc](https://www.sii.cl/normativa_legislacion/jurisprudencia_administrativa/ley_impuesto_renta/2017/ja2400.doc) (accessed 18 Mar. 2024).

no information of actual cases in which this problem has arisen because, so far, they are not aware of any company incorporated in Chile that has tried to transfer its tax residence to another state.

If the board of directors of a company incorporated in Chile begins to carry out its activities in a state other than the state of residence of such company, the main tax consequences for the company itself would be that Chile should consider such activities as being carried out outside Chilean territory while maintaining its right to tax the income derived therefrom.

In practice, Chile has limited possibilities to effectively track the residency of individuals who carry out activities in the country under a non-resident status. Elements including (i) the records of departures and entries to different countries provided by the immigration authorities; (ii) the financial information they exchange; and (iii) the information provided by the companies that pay for their services are elements that can help to cross-check the information declared by such individuals.

### **5.3. Permanent establishments and mobility of work**

Chile recognizes several types of PE within its tax treaties, namely (i) the basic definition of PE (i.e. a fixed place of business); (ii) the case of a permanent representative (so-called agency PE); (iii) a work/construction or installation project; (iv) the provision of independent services by a natural person; and (v) the provision of independent services by a company, including consultancy.<sup>15</sup> In this respect, the authors will briefly address the possible creation of a PE with respect of particular issues within the context of mobility of work.

Given the movement restrictions brought about by COVID-19, working from home became prevalent during 2019 and 2020. Thus, if a person works from home – not just temporarily – the home office may be considered to have a certain degree of permanence.

Under these circumstances, the question arose as to under what circumstances the domicile of an employee of a foreign company in their country of residence could be considered a form of PE. In this regard, it is necessary to distinguish between the different types of PEs recognized in the tax treaties subscribed by Chile. The first one refers to a fixed place of business.

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15. Madariaga & Yañez, *supra* n. 11.

In this case, the question involved is asking under what circumstances the worker's domicile is "at the disposal" of their company.

In this sense, it would be difficult to affirm that the worker's private residence could meet such requirements even if it had a separate place to work. This is because companies can only operate in places authorized for such purposes (authorized by the communal authority through the granting of a municipal license) and, except for microcompanies, private residences cannot be used for such purposes. It would be different if the employee rents an office for such purposes since, in that case, it would be necessary to ask whether the property is at the disposal of the foreign company. This would require a case-by-case analysis to determine whether the office is occupied on behalf of or for the account of the foreign company if there are signs that associate the office to the foreign company, such as a sign or an indication on the company's website.

Another case to consider is that of the dependent agent PE. In this case, there is not a dependent worker but an independent employee, which is equally challenging. In the Chilean case, a parallel could be drawn between the employment situation and the existence of a dependent agent. If the dependent worker could be qualified as a disguised employee (i.e. because they receive instructions, is accountable for their actions, etc.), then it could equally be argued that they are a dependent agent and, therefore, their activities trigger a PE for the foreign company.

The authors are not aware of any administrative pronouncements regarding digital nomads (working from a flex office instead of a home office), but the authors' opinion is that a flex office may not constitute a PE as a fixed place, but the nomad's activity may trigger a PE as a dependent agent.

Chilean tax treaties include the alternative of a service PE but follow UN Model provisions with some modifications. In the case of the performance of services, Chile establishes a period of 183 days in its tax treaties.<sup>16</sup>

A home office in Chile will constitute a PE for tax treaty purposes if such activities continue within the country for a period or periods aggregating more than 183 days within any 12-month period. For computing such a time limit, activities carried on by one agent shall be aggregated with the period during which activities are carried on by another agent of the same company, provided that those activities are substantially the same unless

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16. Madariaga & Yáñez, *supra* n. 11.

those activities are carried on at the same time. To this respect, it makes no difference whether a home office is fully voluntary or imposed or recommended by government in line with a public health measure.

The Chilean tax treaties deviate from article 5(3) of the OECD Model, as they provide for a 6-month period instead of a 12-month period. Despite this fact, the authors are not aware of any case related to projects located in Chile in which the supervisory activities are exercised outside the country. Therefore, it is not possible to determine how labour mobility affects the geographic and economic consistency of a construction project.

As explained previously, the authors believe that the increasing labour mobility has already affected the concept of a PE since the tax authority is giving more importance to economic elements when determining whether a person has acquired or lost their tax resident status in Chile due to their mobility as a worker.

#### **5.4. Physical presence according to articles 15(1) and 17 of the OECD Model**

Chilean tax treaties follow article 15 of the OECD Model, which allocates taxation rights exclusively to the state of residence, unless the employment is exercised in the other contracting state. In the case of home office, according to Chilean tax provisions, the activity is always considered to be carried out in the state where the home office is located unless the employee moves to another territory for work purposes. In that case, the domestic rule on the source of labour income follows the physical place where the work is performed which, in this case, would be abroad.

However, the connecting factor for the taxation of earned income in Chilean tax law is broader than the definition used in article 15 of the OECD Model since all income derived from work with a Chilean employer is taxed regardless of the place where the activity is actually performed. It makes no difference whether the home office is entirely voluntary or imposed by government measures (e.g. COVID-19 prevention measures). In the event that the employment is partially or totally exercised in home office mode in the state of residence (Chile), if the employment is terminated and the employer is obligated to make a severance payment, it will receive the same treatment applicable to regular salaries. It will be taxed in the state of residence for its full amount and be subject to the general provisions relating to this type of payment.

Stranded workers who, due to travel restrictions, are unable to return to their state of residence or to the state where they are habitually employed should be taxed under Chilean general rules for their local source income (i.e. work performed in Chilean territory), to the extent that they are physically present in the country. The general rule does not distinguish whether such a situation is involuntary, and the authors are not aware that the tax administration has made a pronouncement on this matter. However, it is necessary to point out that, in the case that the employer paying the income is a non-resident entity, the possibilities of the Chilean tax authority to detect situations like this are low unless the worker starts to make expenses or investments that are specially monitored by such authority.

Something similar happens with employees who are forced to remain in their home state, due to travel restrictions or public health measures. This is the case for employees who cannot work in a home office, for example, because they usually work in a factory. They cannot exercise their work in Chile, but they are still treated as if they were actually working in the country, receiving their salary from their employer and paying taxes in Chile thereon. Under the assumption that artists and athletes maintain their domicile in Chile even when they train or rehearse in another state, according to article 17 of the OECD Model, they will continue to be subject to taxation in Chile as the state of residence. They will be able to be taxed in that other state provided that such country qualified their income as being connected to their rehearsing or training activity.

The authors are not aware of any administrative opinion as to which country may tax an artist or athlete resident in Chile who is supposed to carry out their activities in the other contracting state, but who – due to travel restrictions and public health measures – is prevented from doing so and still receives remuneration, either under contract or with government funds from that other state. The authors' opinion is that both countries will demand the payment of taxes on that remuneration: the country of residence precisely because of this link to the artist or athlete, while the other state will probably require taxation because such remuneration is paid by an entity domiciled there and through accounts also located there.

The authors are not aware of any administrative opinion dealing with a case that affected an influencer in Chile.



## 5.5. Article 15(2) and (3) of the OECD Model

As explained previously, in the case of the provision of services, Chile establishes a term of 183 days in its tax treaties. A head office in Chile will constitute such a PE for tax treaty purposes if its activities continue within the country for a period or periods totalling more than 183 days within any 12-month period.

For the purposes of computing said time limit, the activities carried out by an agent will be added to the period during which the activities are carried out by another agent of the same company. This is provided that those activities are substantially the same, unless those activities are performed at the same time. In this regard, it does not matter if the home office is entirely voluntary, imposed or recommended by the government in accordance with public health measures.

As explained previously, the tax residency of a company in Chile does not depend primarily on substantive requirements (i.e. whether there are bodies located in Chile that assume the management functions of the company or whether there is a minimum number of workers occupying the company's premises), but on formal requisites. Consequently, in the authors' opinion, if all employees were to work from their homes and the company ceased to have a workplace available to such employees, such company would continue to maintain its tax resident status in Chile. Additionally, there would be no risk of the company losing its tax treaty entitlement in Chile. Under these circumstances, even if the employer lacks a substantial presence in Chile, it would still qualify as an employer for the purposes of article 15(2) (b) of the OECD Model ("not a resident of").

As explained previously, the fact that the members of the board of directors are working from home and do not attend the company's facilities in Chile will not generate a change of residence of the employer for the purposes of article 15(2)(b) of the OECD Model, even if the employees also remain working from their homes in another country.

The authors' opinion is that, in Chile, the doubt should not be raised as to whether the worker's domicile can constitute a PE of the employer according to article 15(2)(c) of the OECD Model, by which the worker's remuneration is supported. This is provided that – as explained previously – the employer does not lose the condition of residence in Chile given it lacks material resources in which to receive its employees. In the authors' opinion, under the formalistic logic that prevails in Chile, the only case in which

the resident status of the employer could be questioned would be if – along with lacking material means in the country – its workers also remained doing activities in home offices from other countries. It makes no difference whether the home office is entirely voluntary or imposed by government measures (e.g. COVID-19 prevention measures).

In the case of Chilean tax treaties, it does not make sense to ask whether article 15(3) of the OECD Model can constitute an alternative to article 15(1) and (2) given that Chile departs from that model in that article. Instead of using the expression “place of effective management”, it makes reference to the employer’s residence. Such a difference is consistent with the wording of articles 4 and 8 of Chilean treaties. This is because Chile does not have any definition in its domestic law of the concept “place of effective management” so it prefers to refer to “residence”, which is a regulated concept within its income tax law.<sup>17</sup>

### 5.6. Frontier workers

Due to Chile’s geographic particularity, there are no specific rules that regulate the taxation of workers with bordering countries. The only regulation in place for a particular mining project, called Pascua Lama, is to facilitate the procedure for the movement of Chilean and Argentinean workers between the two countries for the development of this mining project. However, this legal norm emphasizes customs and movement matters rather than tax aspects. Therefore, these measures contained in the OECD Model do not apply to the Chilean case.

### 5.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)

The authors’ understanding is that, during the pandemic, some companies resident in Chile continued to pay remunerations to employees working in a home office from another country as if they were actually residing in the country. The reasons for this was the interest of the companies in preventing the tax administration from questioning such payments as tax deductible expenses and, on the other hand, in the interest of the workers themselves in keeping their health and pension savings plans in force.

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17. Madariaga & Yañez, *supra* n. 11.

The authors are not aware whether the Chilean government has raised this option as a criterion for applying the tax treaties because the authors believe that there would have been no legal basis for doing so. However, it is estimated that – to the extent that the home office workers have had the status of tax residents in Chile – their remuneration would also have been subject to taxation in the country. This is because, according to Chilean domestic regulations, tax resident status is not lost by the mere physical absence from the country. This is provided that the main source of their income remains in Chile, which would be precisely the case of these workers, who kept their employment contract with a company resident in Chile.

The authors are not aware of any consultation or MAP in which the Chilean government would be involved because of this matter.

### **5.8. The future of the mobility of work: A need for adjusting the existing treaty rules?**

As several authors have pointed out, due to the COVID-19 crisis, the situation of many workers who moved from their country of residence to another state to work – which became the source state – came to light.<sup>18</sup> As long as the workers remained in the state of source, no major difficulties were generated. However, on the contrary, the conflicts arose when these workers returned to their countries of origin and were prevented from returning to the workplace due to restrictions imposed by the authority. Under this assumption, the general principle contained in article 15(1) of the OECD Model – which attributes tax power to both the country where the activities are carried out and to the country of residence of the worker – generates a potential situation of double taxation. The question that can be asked under this scenario is whether said principle of distribution of tax power between both states is still reasonable under a situation of extreme mobility and also unpredictable situations of confinement.

The authors are not aware of any debate on this issue at the governmental, legislative or academic level in Chile. Nor have any cases been raised at the administrative (MAP) or judicial level. The authors' personal opinion is that the treatment of personal work, especially of highly mobile workers, poses two problems.

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18. R. Collier, A. Pirlot & J. Vella, *Tax policy and the COVID-19 crisis*, 48.8 Intertax 9, pp. 794-804 (2020).

On the one hand, the question is which state has the best right to tax income derived from labour, i.e. only the state of residence? If so, (i) should it be understood that residence is maintained in the country of origin; (ii) is it transferred to the place where the main source of the worker's income is located; or (iii) is shared taxation between the two states the best criterion for resolving this issue?

On the other hand, there is the problem that the worker's remuneration is one of the employer's production costs. As such, the employer deducts such payments from its corporate taxable income. This means that the state in which the company is taxed sees its tax revenue diminished in proportion to the amount of labour income. In an environment of low labour mobility, this circumstance does not generate major difficulties because the decrease in the employer's tax collection is compensated by the collection of taxes on labour income. However, in a home office scheme, this compensation may disappear with the result that one state is forced to bear the drop in tax collection while another benefits from the collection of the tax on salaries, without assuming the burden of its cost in the corporate tax base. For this reason, it seems reasonable to find a new way to associate both taxes under the criterion that they should be levied where the value generation process takes place.

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## Chapter 6

### **The Impact of Tax Treaties on International Mobility of Work in China (People's Rep.)**

Na Li

#### **6.1. Mobility of work and domestic tax law**

##### **6.1.1. Influence of a higher degree of mobility of work**

A higher degree of mobility of working in China may result in more people becoming Chinese tax residents who shall be subject to Chinese individual income tax on the basis of their worldwide income. This is because the Individual Income Tax Law of China (IIT Law)<sup>1</sup> provides that an individual shall become a Chinese tax resident when either of the following two tests is satisfied:<sup>2</sup>

- a domicile test which refers to the situation when an individual habitually resides in China because they have a household registration or have family or economic ties in China; or
- a physical presence test which counts whether the days that an individual has stayed in China reaches 183 days or more in a calendar year (i.e. from 1 January to 31 December).

Clearly, in the texts of the Chinese IIT Law, neither of these two tests take into account the factors of nationality, citizenship or places of working or family. Furthermore, these two tests do not take consider the reasons for or willingness of an individual staying in China when determining whether such an individual is a Chinese tax resident. In other words, only the objective factors of the place of domicile or physical presence will be taken into account. Therefore, when the Chinese tax authorities apply the above-mentioned two tests strictly in accordance with the wording of the IIT Law, they are not required by law to consider the factors of whether an individual is forced to spend more or less time in China due to factors, such as travel restrictions or limitations for office use, etc.

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1. PRC: Individual Income Tax Law of the People's Republic of China, 1980 (amended 2022).

2. PRC: Implementation Regulation on the Individual Income Tax Law of the People's Republic of China, 1994 (amended 2018), art. 2.

### 6.1.2. Risk of exit tax

China does not yet have an exit tax. Thus, a Chinese tax resident who works or stays in another country for a longer period will not trigger any exit tax issue in China, regardless of whether such a person stays abroad voluntarily or due to travel restrictions.

### 6.1.3. Impact on corporations by management board members

If the management board members of a corporation live and work in China, it will increase the likelihood that such a corporation may become a Chinese tax resident. This is because the Enterprise Income Tax Law of China (EIT Law)<sup>3</sup> defines the concept of a Chinese tax resident for a corporation in a quite broad approach. That is, a corporation shall become a Chinese tax resident that is subject to Chinese enterprise income tax for its worldwide income if it may satisfy either of the following two doctrines:

- the place of incorporation doctrine which refers to the situation in which a corporation is incorporated in China in accordance with Chinese laws; or
- the place of actual management doctrine which refers to the situation in which a corporation is incorporated outside of China under foreign laws, but its place of actual management is inside China.

Therefore, even if a corporation is incorporated outside of China, it is a still a Chinese tax resident under the EIT Law if its board members factually exercise the substantial and overall management and control of the corporation within the territory of China. This is because this corporation shall be deemed as having its place of actual management in China. Such terms of “management and control” requirements refer to the corporation’s production and business operations, personnel, finance, assets, etc., to which the burden of proof should be undertaken by the corporation itself. Once the corporation becomes a Chinese tax resident, it shall be subject to Chinese enterprise income tax for its worldwide income.

Even if the board members of this corporation change their residence from China to one or more other countries, or vice versa, such a change will not impact the Chinese tax residence status of that corporation as long as they manage and control the corporation within the territory of China. In

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3. PRC: Enterprise Income Tax Law of the People’s Republic of China, 2007.

other words, the above-mentioned two doctrines in the Chinese EIT Law with regard to Chinese tax residents do not take into account the place of residence of any board member of the corporation.

There is no exit tax applicable to corporations in China.

#### 6.1.4. Impact on corporations by employees

If all employees of a foreign corporation work from home in China to factually exercise the management and control of the corporation in China, then the above-mentioned “place of actual management” doctrine shall apply to determine that the foreign corporation is a Chinese tax resident. In comparison, as for the corporations incorporated in China in accordance with Chinese laws, they will remain Chinese tax residents under the place of incorporation doctrine even if all of their employees work from home outside of China. A Chinese tax resident corporation shall be subject to Chinese income tax on its worldwide income basis, regardless of whether the corporation is a Chinese corporation or a foreign corporation.

There is no notion of “permanent establishment” used in the text of Chinese domestic laws because the term “permanent establishment” is a treaty concept that is used in article 7 (business profits) and article 5 (permanent establishment) of all Chinese tax treaties. The definition of the “permanent establishment” in article 5 was negotiated either referring to the UN Model or the OECD Model. Meanwhile, the concept provided in the EIT Law is only the term “establishment”,<sup>4</sup> which is much broader than the notion of “permanent establishment”. The state council interpreted the term “establishment” provided in the EIT Law as the place where production activities and business operations are performed within the territory of China, including (i) management institutions, operational institutions and offices; (ii) factories, farms and places for the exploitation of natural resources; (iii) establishments for the provision of labour services; (iv) establishments for engineering operations with respect to construction, installation, assembling, repairing, surveying, etc.; and (v) other institutions and establishments where production activities and operations are carried out.<sup>5</sup> Clearly, in light of such an interpretation, the term “establishment” does not cover any fixed, permanent or “at disposal” factors that are necessary for constituting a permanent establishment under the Chinese tax treaties.

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4. Id., at art. 3.

5. PRC: Implementation Regulation on the Enterprise Income Tax Law of the People’s Republic of China, 2007, art. 5.

Furthermore, the state council interpreted that an agent shall be regarded as an institution or establishment of the non-resident created within China when a non-resident enterprise entrusts any agent to carry out production activities or business operations within the territory of China, including the entrustment of any entity or individual to sign contracts on its behalf, to handle the warehousing or delivery of goods, etc.<sup>6</sup> This interpretation is broader than the provisions about agency permanent establishments in the Chinese tax treaties, too. Therefore, if a person works from their home in China for a foreign corporation that is not a Chinese tax resident, their home may constitute an establishment of that foreign corporation in China according to the Chinese domestic law, unless the applicable Chinese tax treaties provide otherwise. As a consequence of having an establishment in China, this foreign corporation shall be subject to Chinese income tax for the income attributable to its establishment in China.

## **6.2. Residence, tiebreaker rules and mobility of work: Individuals and entities**

### **6.2.1. Impact of a higher degree of mobility of work for treaty residence**

A higher degree of mobility of work in China will also trigger more dual-treaty residence issues because more individuals and corporations may be deemed as Chinese tax residents under the Chinese IIT Law and the EIT Law. The tests and the doctrines (as mentioned in previous sections) do not take into account whether one is forced to spend more time in China or in the contracting states voluntarily or due to travel restrictions during a pandemic.

As long as a corporation is a Chinese tax resident or a resident of both China and the contracting states, the treaty entitlement shall be available to such corporation even if all its employees work from home and the corporation no longer has (sufficient) workplaces. The tax treaties that China has concluded so far in general did not impose any specific substantial requirements for treaty entitlement except for the beneficial owners, the principal purpose tests and the limitation of benefits provisions. Therefore, the Chinese tax authorities in practice have been determining the tax residence status of taxpayers for treaty purposes in accordance with article 4(1) of the applicable

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6. Id.



Chinese tax treaties that adopted the provisions of article 4(1) of the OECD Model.<sup>7</sup>

Accordingly, for a non-resident taxpayer to enjoy treaty benefits under the Chinese tax treaties, they should complete the procedures in a sequence of (i) self-assessment; (ii) claiming treaty benefits; (iii) enjoying treaty benefits; and then (iv) keeping all relevant materials and documents for future reviews.<sup>8</sup> In other words, once a non-resident taxpayer determines through self-assessment that they are eligible for treaty benefits, this taxpayer will be able to enjoy tax treaty benefits when filing tax returns or entrusting a withholding agent. The Chinese tax authorities, if necessary, may review the relevant proof documents kept by this taxpayer and then decide whether to deprive the treaty benefits from the taxpayer later.

### 6.2.2. The tiebreaker rules for individuals

The tiebreaker rules for individuals in Chinese tax treaties generally follow the provisions of article 4(2) of the OECD Model, and it does not make a difference whether an individual staying in a certain country is on a voluntary basis. The State Tax Administration (STA) stipulated that the Chinese tax authorities will apply the factors of the tiebreaker rules as follows:<sup>9</sup>

- Permanent home: A permanent home shall include any form of domicile such as a house or apartment rented by an individual and a rented room, but such domicile must be permanent, that is, the individual plans to live in it long-term instead of temporarily for some reasons (such as travel and business tours).
- Centre of vital interests: The centre of vital interests shall be comprehensively determined by referring to the family and social relations of

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7. PRC: Notice of the State Administration of Taxation on Issuing the Interpretation of the Articles of the Agreement between the Government of the People's Republic of China and the Government of the Republic of Singapore for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and the Protocol Thereof, 2010.

8. PRC: Announcement of the State Taxation Administration on Issuing the Measures for Non-resident Taxpayers' Enjoyment of Treaty Benefits, 2019, art. 3.

9. PRC: Notice of the State Administration of Taxation on Issuing the Interpretation of the Articles of the Agreement between the Government of the People's Republic of China and the Government of the Republic of Singapore for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and the Protocol Thereof, 2010.

the individual, occupational, political, cultural and other activities, business places, the place of management of property and other factors. Special attention shall be paid to the individual's behavior, that is, the state where the individual has been living and working and has a family and property is usually the place where the centre of vital interests is situated.

- Habitual abode: In any of the following two circumstances, the resident status of an individual shall be determined according to their habitual abode. The first is that the individual has a permanent home available to them in both contracting states and the state in which they have their centre of vital economic interests cannot be determined. The second is that the individual does not have a permanent home available to them in either contracting state, for example, the individual constantly shuttles between the hotels of a contracting state and the other contracting state.

In the first circumstance, the determination of the habitual abode shall focus on how long the individual has stayed in their permanent homes in both states and shall consider how long they have stayed at different locations within the same state. In the second circumstance, the determination of the habitual abode shall consider the total time the individual has stayed in a state regardless of the reasons for their stay.

- nationality: if the individual has a habitual abode in both contracting states or in neither of them, their nationality shall determine his resident status; or
- mutual agreement procedure: if the residence status of the individual still cannot be determined by using the criteria mentioned before, in turn, the competent authorities of the contracting states shall settle the question by mutual agreement in accordance with the procedures that are usually provided in article 24 of the Chinese tax treaties.

A highly mobile lifestyle will impact some factors of the tiebreaker rules, especially when determining the person's "permanent home", "centre of vital interests", as well as "habitual abode". However, given that China does not allow Chinese citizens to hold a passport of other jurisdictions, the factor of "nationality" as previously listed may normally determine that China shall be the residence state for the taxpayer for the treaty purpose if the taxpayer is a Chinese national. Even if the taxpayer does not satisfy any of the previous four factors, a mutual agreement procedure under the Chinese tax treaties can also be the last resort for the STA and the competent authorities of the other contracting states to resolve the dual-residence

issue. So far, there is no special interpretation issue with regard to increased mobility of work.

### 6.2.3. The tiebreaker rules for corporations

The tiebreaker rules for a person other than an individual (a company or any other body of persons) in the Chinese tax treaties, in general, adopt the “place of effective management” test. Additionally, a dual-resident corporation under a Chinese tax treaty is usually deemed as a resident of the contracting state where its “place of effective management” is situated. This “place of effective management” test in the Chinese tax treaties is consistent with the “place of actual management doctrine” provided in the Chinese EIT Law, and both of them do not take into account the place of residence of any board member of the corporation. Therefore, in the case that the board members of a corporation decide to move to China, that corporation will be treated as a Chinese tax resident for treaty purposes only if the place of effective management of such corporation is moved in China as a consequence of the board members moving.

However, with the BEPS Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI), which entered into force in China on 1 September 2022, the present tiebreaker rules for a corporation in the Chinese tax treaties have been modified. China committed to amend article 4(3) of all of its 100 covered tax agreements by applying article 4 of the MLI, which replaces the tiebreaker rule by providing that the competent authorities are only obligated with “having regard to” the place of effective management, the place of incorporation and any other relevant factors. Hence, after modification, there will be no uniform rule for which of these factors should prevail when the contracting states give different weight to those factors.

There were some board members and senior management officials of foreign companies who stayed in China longer than they originally planned due to travel limits and quarantine measures taken by some countries for controlling the COVID-19 pandemic in recent years. The STA particularly published its opinion on its website to interpret what kinds of situations may occur during the pandemic control time.<sup>10</sup> In the opinion of the STA, the

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10. PRC: *STA Answers to Some Issues of General Interests on implementation of tax Treaties during the Pandemic Control Time* (2020), available at <http://www.chinatax.gov.cn/chinatax/n810219/n810744/c101510/c101520/c5155584/content.html> (accessed 15 May 2022).

place of making management decisions by these individuals during such a special time period shall not be taken into account when determining the place of effective management of the corporation. Hence, if China and the other contracting states cannot reach a consensus due to different criteria for determining the place of effective management, the competent authorities of the contracting states shall settle the question by mutual agreement in accordance with the procedures as prescribed in article 24 of the tax treaties.<sup>11</sup>

#### 6.2.4. The distributive rules in articles 8 and 16

In the Chinese tax treaties, article 8 in general follows the OECD Model, which provides exclusive taxing rights to the residence state of the taxpayer for its income derived from the operation of ships or aircrafts in international traffic in the other contracting state. In the meantime, article 16 of the Chinese tax treaties also follows the OECD Model, which allocates the taxing rights over a director's fee exclusively to the residence state of the corporation.

Therefore, if the corporation moves from China to a different state, it will not significantly impact the distributive rules in article 8 (shipping and air transport) and article 16 (director's fee) of the Chinese tax treaties as long as the "place of effective management" of the corporation remains in China. The reason is, as discussed in section 6.2.3., the present tiebreaker rules for a corporation in the Chinese tax treaties in general adopt the "place of effective management" test rather than the place of incorporation doctrine when resolving the dual-residence issue of a corporation. So far, there are no tax disputes published in China for or relating to such a move of a corporation.

#### 6.2.5. Tracking residence

Tracking residence of an individual in China is currently done by count the total number of days the individual stays in China. In the STA's opinion, a day that an individual stays in China for more than 24 hours will be counted in the number of days; if the day of that individual staying in China is less than 24 hours, then that day should not be counted as the number of days

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11. PRC: Notice of the State Administration of Taxation on Issuing the Interpretation of the Articles of the Agreement between the Government of the People's Republic of China and the Government of the Republic of Singapore for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and the Protocol Thereof, 2010.

of their staying in China.<sup>12</sup> This counting rule is applicable to all individuals without considering the nationality or the purpose or willingness of an individual staying in China.

Obviously, persons commuting daily between China and their residence states may benefit mostly from the above-mentioned counting rules, for example, if a tax resident of a Hong Kong Special Administrative Region (SAR) goes to work every morning in Shenzhen, a neighbouring city in Mainland China, and then he returns to Hong Kong SAR every evening. Since the time of stay in Mainland China in a day is less than 24 hours, their day for working in Shenzhen should not count towards the calculation of the days for determining his residence in Mainland China. In other words, this counting rule is quite friendly to the frontier workers in China, although there is no any specific rule applicable to those frontier workers in the Chinese tax treaties or in the Chinese domestic tax laws.

In practice, the Chinese tax authorities deem the individuals with no domicile in China to be non-tax residents in China until these persons have stayed in China for 183 days in a calendar year. The STA and the Minister of Finance, in their tax circular issued in 2019, imposed a reporting obligation on those individuals having no domicile in China to the Chinese tax authorities for disclosing their stays in China when reaching the 183-day threshold and also for recalculating their individual income tax liability as Chinese tax residents.<sup>13</sup> As mentioned in section 6.1.1., Chinese tax residents shall be subject to Chinese individual income tax on the basis of their worldwide income, while non-tax residents shall be subject to Chinese individual income tax on a territorial basis.

## **6.3. Permanent establishments and mobility of work**

### **6.3.1. Home office as a business PE**

If an individual works from home in China, not just temporarily, the home office may be considered to constitute a fixed place of business PE in China for tax treaty purposes. This is because the STA, in its Circular no. 75 [2010], interpreted the treaty concept of “permanent establishment” in quite

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12. PRC: Announcement on the Days of Residence in China for Individuals Having No Domiciles in China, Individuals Who Are Not Domiciled in China, 2019.

13. PRC: Announcement on Relevant Individual Income Tax Policies Regarding Non-Resident Individuals and Resident Individuals Who Are Not Domiciled in China, 2019.

a broad approach,<sup>14</sup> and such a home office will be deemed as one if it satisfies the following four factors:

- the home office is a physical existence of a place of business that is not necessarily owned or leased by the enterprise and could be partly used for the business of the enterprise;
- the STA only requires that the place of business is relatively fixed and somewhat permanent in terms of time (the term “business” shall not only include production and business activities but also the business activities carried on by non-profit organizations, excluding the preparatory or auxiliary activities for such organizations);
- a fixed place of business PE could be offices or other similar facilities, such as a long-term hotel room rental used to engage in business operations of an enterprise; and
- the home office of such individual is not used for a temporary purpose, even if the enterprise may have different locations carrying on business in the state of this home office.

### 6.3.2. Dependent agents

An employee of a foreign enterprise home office in China may constitute a dependent agent of that enterprise in China in accordance with article 5 of the Chinese tax treaties that, in general, follow the OECD Model when such employee has and habitually exercises an authority to conclude contracts in the name of the enterprise. Furthermore, a self-employed person can also trigger a dependent agent PE in the same conditions as the employee of the foreign enterprise because the STA took a broad approach in its Circular no. 75 [2010] to interpret that a dependent agent can be an individual, an office, a company or any other form of organization. It is not required to be either formally authorized by the enterprise or be an employee or department of the enterprise. In addition, a dependent agent is not necessarily a Chinese tax resident in which the agency activities are carried on and is not required to have a place of business in China.<sup>15</sup>

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14. PRC: Notice of the State Administration of Taxation on Issuing the Interpretation of the Articles of the Agreement between the Government of the People's Republic of China and the Government of the Republic of Singapore for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and the Protocol Thereof, 2010.

15. PRC: Notice of the State Administration of Taxation on Issuing the Interpretation of the Articles of the Agreement between the Government of the People's Republic of China and the Government of the Republic of Singapore for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and the Protocol Thereof, 2010.

According to No. 75 [2010], the conditions in which the STA determines the employee of the foreign enterprise and the self-employed person to be a dependent agent in China shall include the following:

- The element of “concluding contracts in the name of the enterprise” shall also be construed in a broad sense. It shall include the concluding of a contract not in the name of the enterprise but having a binding force on the enterprise. The term “conclude” refers not only to the act of concluding contracts itself but also to the agent’s right to participate in the negotiation of contracts, agreement upon the clauses of contracts, etc., on behalf of the enterprise.
- The term “contracts” refers to the business contracts related to the business activities of the principal. If the agent has the authority to conclude the contracts that only involve the internal affairs of the enterprise (for example, to employ staff in the name of the enterprise to assist in its work for the enterprise), it cannot be deemed to constitute a permanent establishment of the enterprise.
- There is no precise and uniform standard for the term “habitually” which shall be comprehensively determined according to the nature of the contract, the nature of business of the enterprise and the frequency of the relevant activities of the agent, etc. In some cases, the nature of the business of an enterprise determines that significant time is required for the conclusion of a contract even though the quantity of its transactions is not large, such as the sale of an aircraft, huge ship or other high-value merchandise. If an agent looks for a buyer in a state for such an enterprise, participates in the sales negotiation, etc. – even if the agent only concludes a sales contract on behalf of the enterprise – such agent shall be deemed to meet the standards for “habitually” and constitute a dependent agent of the enterprise.

With regard to the question of whether the home office of the employee is “at the disposal” of the foreign enterprise, the STA interpreted that it will make a decision on a case-by-case basis in accordance with the principle of substance over form. For example, it shall be deemed that the agent has exercised the authority of concluding contracts in the other contracting state. When such an agent carries on various activities in China relevant to the conclusion of a contract (including negotiating contracts which have a binding force on the enterprise), even if the contract is finally concluded by someone else in a place where the enterprise is situated, however, if the

activities that an agent carries on in China are of a preparatory or auxiliary character, it shall not constitute a dependent agent of the enterprise.

### 6.3.3. PEs during the pandemic control period

Performing activities of digital nomads so far has not been addressed in any Chinese tax treaties or interpreted by the STA in the form of issuing circulars. Additionally, there is no particular Chinese tax law addressing those digital activities. In the opinion of the STA, whether it is a home office or a flex office does not matter when determining whether such office constitutes a PE in China; the focus of the Chinese tax administration is on the question of whether the office is only used as a fixed place of business temporarily during the pandemic.

The STA has applied the same approach to determine whether there is an agency PE in China. The STA interpreted that, if it is only a temporary use of a home office located in China during the pandemic – where the individual works and enters into contracts in the name of the foreign enterprise – it is normally an occasional activity and it, therefore, does not constitute a PE in China. However, if an individual conducted their activities in a home office on behalf of the foreign enterprise in China prior to the outbreak of the pandemic or will continue to conduct such activities after the pandemic, then this home office will be deemed as the foreign enterprise having an agency PE in China.<sup>16</sup>

### 6.3.4. Service PEs

Provisions for constituting a service PE by contracting projects or furnishing services have been included in the Chinese tax treaties through reference to the UN Model. The STA, in its Circular no. 75 [2010], interpreted that implementing these service PE provisions shall focus on the time requirement and concept of the “services” rather than on any home office that might be relevant to the provision of such services.

Therefore, the start and end dates of the services and construction projects, as well as the relevant supervisory activities, shall be computed from the

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16. PRC: *STA Answers to Some Issues of General Interests on implementation of tax Treaties during the Pandemic Control Time* (2020), available at <http://www.chinatax.gov.cn/chinatax/n810219/n810744/c101510/c101520/c5155584/content.html> (accessed 15 May 2022).



date on which the contract signed by it starts to be implemented (including all preparatory activities) to the date on which the operation (including the trial operation) is fully completed and delivered for use. As long as the service activities continue for more than the time threshold, it shall be deemed that the foreign enterprise has a PE in China.<sup>17</sup>

During the COVID-19 pandemic, some construction projects reached the time threshold for constituting a PE because work and management teams had to leave the construction sites due to temporary shutdown of the project. However, in the opinion of the STA, such a time of temporary shutdown caused solely by the pandemic should be deductible when calculating the time of the construction project for PE purposes under the Chinese tax treaties.<sup>18</sup>

The relevant supervisory activities mean those carried out on a building site or in the process of carrying out a construction, assembly or installation project including, in the case of subcontracting, the general contractor commanding and supervising the subcontractor's operations. Additionally, the relevant supervisory activities also include the supervisory activities carried out by an independent supervisory enterprise. For the supervisory activities carried out by the general contractor, the computation of time shall be consistent with the duration of the entire site and project; the supervisory activities contracted by the independent supervisory enterprise shall be deemed as an independent project, and the duration of the activities shall be determined according to the duration of the site, construction or project of which it is responsible for the supervision. Hence, even if the supervisory activities are exercised outside of the state where the construction site is located, it does not impact the geographical and economic coherence of the construction project.

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17. PRC: Notice of the State Administration of Taxation on Issuing the Interpretation of the Articles of the Agreement between the Government of the People's Republic of China and the Government of the Republic of Singapore for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and the Protocol Thereof, 2010.

18. PRC: *STA Answers to Some Issues of General Interests on implementation of tax Treaties during the Pandemic Control Time* (2020), available at <http://www.chinatax.gov.cn/chinatax/n810219/n810744/c101510/c101520/c5155584/content.html> (accessed 15 May 2022).

### **6.3.5. Profits attributable to the PEs**

In circular number 75 [2010], the STA interpreted that the profits attributable to the PE shall include not only the profits derived from China by the PE but also various other types of income derived in and out of China that are effectively connected with such PE, including dividends, interest, rents, royalties and other income. This is quite a broad approach for defining the scope of the profits attributable to the PEs. The phrase herein “effectively connected with”, in the opinion of the STA, generally means having direct ownership or actual business operation and management and other relations with the shares, claims, industrial property, equipment and related activities, etc. Additionally, the PE shall be treated as an independent tax entity and, as to the business transactions of the PE, it does not matter if they are conducted with the head office or with other PEs of the enterprise. The profits attributable to such a PE shall be computed on the basis of the fair market value under the arm’s length principle.

When computing the profits of a PE, the expenses that are incurred should be deductible no matter where they are incurred, including some expenses that do not directly reflect the actual expenses of the PE (such as the executive expenses, general administrative expenses, etc.) as apportioned by the head office to the PE. However, these expenses must be incurred for the purposes of the PE, and the apportionment ratio shall be within a reasonable range. If the accounting books of the PE can accurately record its true profits, the PE shall be taxed for its recorded profits. Otherwise, the profits of the PE shall be determined by applying a formulary apportion method by the Chinese tax authorities.<sup>19</sup>

## **6.4. Physical presence according to articles 15(1) and 17 of the OECD Model**

### **6.4.1. Independent personal services**

The provisions of article 15(1) of Chinese tax treaties have followed the OECD Model to allocate the taxation rights exclusively to the state of

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19. PRC: Notice of the State Administration of Taxation on Issuing the Interpretation of the Articles of the Agreement between the Government of the People’s Republic of China and the Government of the Republic of Singapore for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and the Protocol Thereof, 2010.

residence, unless the employment is exercised in the other contracting state. There are also no specific taxing rules applicable to severance payments which are, in general, taxed as part of the employment income in China.

So far, there are no treaty provisions in the Chinese tax treaties, and no interpretation of the STA has ever specifically addressed the situations of whether the employment is exercised partly or exclusively in a home office in the state of residence or in the other state, whether the home office is imposed by government measures, for example, and the COVID-19 prevention measures. Furthermore, there are no exceptional rules enacted in China with regard to those “stranded workers” who, due to travel restrictions, are prevented from returning to their state of residence. Moreover, there are no exceptional rules concerning the employees who cannot exercise their employment and, due to travel restrictions or public health measures, have to stay in their state of residence (without being able to work in a home office, e.g., because they usually work in a factory).

#### 6.4.2. Artists and athletes

The provisions of article 17(1) of the Chinese tax treaties have followed the OECD Model to provide that the state shall have the right to tax the income derived by artists or athletes from their personal activities exercised in that state regardless of how long they have stayed in that state. Therefore, exercising personal activities in China is the sole criterion for China as the source state to tax artists or athletes. If the artists or athletes rehearse or train in one state, China may tax them when they perform publicly in China. In contrast, China should not have taxing rights if the artists or athletes are supposed to perform their activities in the other contracting state but, due to travel restrictions and public health measures, are prevented from doing so and still receive remuneration either under contract or from government funds.

So far, China has not imposed any income tax on artists and athletes when their performances are live-streamed in China because it has not taken any legislative action for the purposes of taxing digital businesses. There is no new tax that is the same or similar to the digital service tax being introduced in China, and no modification has been made to the laws of Chinese income taxes for the purposes of taxing the digital economy.<sup>20</sup> Additionally, there is

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20. N. Li, *Taxing Digital Businesses in China*, 26 Asia-Pac. Tax Bull. 2 (2020), Journal Articles & Opinion Pieces IBFD.

no interpretation from the STA with regard to any impact on the implementation of article 17 by the COVID-19 pandemic.

## **6.5. Article 15(2) and (3) of the OECD Model**

### **6.5.1. Counting the 183-days rule in article 15(2)**

In Circular no. 75 [2010], the STA interpreted that, when implementing the exceptional criterion provided in article 15(2) of the Chinese tax treaties, the counting for the 183-day threshold is not as strict as that of the 183-days rule for determining a Chinese tax resident. Hence, different from the counting rules provided in section 6.2.5., in computing the number of days for implementing article 15(2) of the Chinese tax treaties, if a person leaves China at the halfway mark (including leaving China and entering China within the validity period of the visa), the number of days of absence from China shall be deductible. However, all of the days of their stay in China shall be included, including the day of arrival or departure – regardless of whether it is less than 24 hours in a day. Additionally, even if the days of their staying in China are weekends, festivals and holidays – for their vacations spent in China before, during and after the exercise of employment, etc. – those days should also be counted towards their days in China for the purposes of implementing article 15(2) of the Chinese tax treaties.

### **6.5.2. Concept of “employer” in article 15(2)**

In Circular no. 75 [2010], the STA interpreted the term “employer” as one who has the right to the work results of the employees and assumes the relevant responsibilities and risks thereof. Therefore, the concept of “economic ownership” should also be taken into account when applying the principle of substance over form to look into the following factors for the purposes of determining the actual employer in article 15(2):

- the enterprise of China has command over the work exercised by the personnel mentioned previously;
- the workplace of the personnel in China is under the control or charge of the enterprise of China;
- the remunerations paid by the enterprise of China to the agency are computed on the basis of the working hours of the personnel or has a certain connection with the wages of the personnel (for example, the remunerations paid to the agency are determined according to a certain proportion of the total amount of the wages paid to the personnel);

- the tools and materials used by the personnel for work are mainly provided by the enterprise of China; and
- the quantity and standards of the personnel to be employed by the enterprise of China are determined by the enterprise of China rather than the agency.

An employer (corporation) may lose its substance (premises) if its place of effective management moves to the other contracting state, provided that all its employees are working from home in the other contracting state. This fact is closely related to the tiebreaker rule for dual residence that is described in section 6.2.2. The same consequence may also arise for a change of residence state of the employer if its place of effective management moves to the other contracting state as a result of its board members working from home in the other contracting state. The home office of the employee constitutes a PE of the employer according to article 15(2) of the OECD Model, by which the remuneration of the employee is borne if the employee works from home permanently in China and not only temporarily (*see* the reasons described in section 6.2.3.). It does not make a difference whether the home office is imposed or recommended by the government in line with public health measures.

### 6.5.3. Employees working in international traffic

With regard to the employees working in international traffic, Chinese tax treaties have adopted the provisions following article 15(3) of the OECD Model. Therefore, for the remunerations derived by the personnel from the employment exercised aboard a ship or aircraft operated in international traffic, such remunerations shall be taxable in the state of which the enterprise operating such traffic is a tax resident according to the principle rule in article 8 of the tax treaty.

## 6.6. Frontier workers

There is no specific rule for taxation of frontier workers in the Chinese tax treaties or in the domestic tax laws in China.

## 6.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)

The STA published a statement on its website in August 2020 expressing the following opinions about the issues relevant for implementing the Chinese tax treaties during the COVID-19 pandemic.<sup>21</sup> The STA may express the previous opinions because it is entitled by the Chinese domestic law to interpret provisions of Chinese tax treaties in terms of the implementation of these tax treaties. However, such a statement is still not any legislative document (such as a law, regulation or circular, which have binding effects on both taxpayers and tax administrative authorities in China). However, the STA's statement expressly presented its opinions with regard to some special treatment in terms of tax administrations concerning certain activities during the pandemic control time. Given that the STA is the highest level tax administration institution that instructs and supervises the tax administration work of all tax authorities throughout China, it may expect that such opinions published on its website shall be implemented by all the Chinese tax authorities in practice. The STA's opinions are as follows:

- temporary changes made to the residence place of an individual due to the pandemic control measures shall not lead to a change of the tax residence of such individual under a tax treaty because a permanent home and places of vital interest factors, in general, shall not be changed;
- the place of making management decisions by these individuals during the COVID-19 pandemic shall not be taken into account when determining the place of effective management of the corporation;
- a temporary change to a home office during the pandemic, where the individual works and enters into contracts in the name of the foreign enterprise from a home office located in China, is normally an occasional activity and therefore does not constitute a PE in China (however, if the individual permanently conducted such activities on behalf of the foreign enterprise in China prior to the outbreak of the pandemic or will continue to conduct such activities after the pandemic, then it will be deemed to have been an agency PE in China); and
- the time of temporary shutdown of projects caused solely by the COVID-19 pandemic should be deductible when calculating the time of the construction project for PE purposes under the Chinese tax treaties.

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21. PRC: *STA Answers to Some Issues of General Interests on implementation of tax Treaties during the Pandemic Control Time* (2020), available at <http://www.chinatax.gov.cn/chinatax/n810219/n810744/c101510/c101520/c5155584/content.html> (accessed 15 May 2022).

Clearly, it can be determined from the above-mentioned opinions of the STA that it is not a relevant criterion for the application of tax treaty law whether a taxpayer decided voluntarily to work in a certain country or was forced to make such a decision by the travel restrictions or public health measures. Furthermore, there is no force majeure relevant in the application of tax treaties in China. Hence, it will make a difference if the STA does not unilaterally make such opinions but concludes a mutual agreement or a consultation agreement with other tax treaty partners because Chinese tax treaties shall prevail if any treaty provisions conflict with the provisions of Chinese domestic laws. However, so far, China has not concluded any agreements with other governments with regard to tax issues under the COVID-19 pandemic.

## **6.8. The future of the mobility of work: A need for adjusting the existing treaty rules?**

The existing Chinese tax treaty rules currently still make sense in an environment of increased mobility of work because, on the one hand, the Chinese income tax laws are quite broad with regard to the definition of Chinese tax residents and, on the other hand, the STA also took a broad approach in the interpretation and implementation of the Chinese tax treaties.

The increasing mobility of work will conceptually change the way that tax authorities approach the value creation process in terms of enterprise income tax. This is because, as mentioned in section 6.2.3., China has committed to amending article 4(3) in all of its 100 covered tax agreements by applying article 4 of the MLI, which replaces the tiebreaker rule by providing that the competent authorities are only obligated to “having regard to” the place of effective management, the place of incorporation and any other relevant factors. It is foreseeable that more dual-residence issues for enterprises would have to rely on the results of a mutual agreement procedure between the Chinese STA and the competent authority of the other contracting states when the MLI comes into force in China upon completing the domestic ratification process. Accordingly, the approach of the Chinese tax authorities on taxing enterprises will be impacted by the higher likelihood of dual-residence issues as a result of a higher mobility of work. However, it is unlikely that an issue will be raised for the attribution of income because the STA has been taking a quite broad approach in terms of the interpretation and implementation of the Chinese tax treaties.





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## Chapter 7

### **The Impact of Tax Treaties on International Mobility of Work in Colombia**

Cristian Camilo Rodriguez Peña

#### **7.1. Mobility of work and domestic tax law**

Regardless of the increased importance of work mobility in Colombia, the current normative framework does not factor in “mobility” to determine tax residence or apply other rules related to international taxation. However, even under the existing rules, the recent higher mobility of individuals may have an impact on the residence of both natural and corporate persons, and the allocation of taxing rights between Colombia and its counterparties.

##### **7.1.1. Tax residence of individuals**

According to the Colombian Tax Code (CTC), residents are liable for income tax on their worldwide income. In contrast, non-residents are only subject to income tax on Colombian-source income (article 9 of the CTC). To be considered a tax resident, an individual must fulfil either one of the following conditions (article 10 of the CTC):

- to be present continuously or non-continuously in the country for more than 183 calendar days within any period of 365 calendar days. If the individual is present in Colombia for more than one taxable year, the person is deemed to become a resident from the second year; or
- to be a Colombian national and during the taxable year be in one of the following scenarios: (i) their significant other (either in a marriage or consensual union) or dependent underage children are resident in Colombia; (ii) more than 50% of their income comes from Colombia; (iii) more than 50% of their assets are administered in Colombia; (iv) more than 50% of their assets are deemed to be possessed in Colombia; (v) are not able to prove their residence in another country, after the tax administration requires doing so; or (vi) are resident in a country classified as a tax haven.

It can be seen from the above rules that the only factor for non-Colombian nationals to be considered as tax residents is the length of time spent in the

country. Furthermore, although “residence” is the only criterion to impose worldwide taxation in Colombia, citizenship plays a significant role in determining such residence. Therefore, if a national individual has their centre of vital interest in Colombia,<sup>1</sup> as reflected in their personal and economic ties, that person will be resident in the country unless 50% or more of their income or assets are, respectively, perceived or located in the country where they are domiciled. Thus, domestic law gives more weight to economic factors than personal ones when determining the centre of vital interest of Colombian nationals. As stated in the academic literature, the end effect of using citizenship as a “backup for other connecting factors” is to extend the country’s taxing rights over expatriated individuals.<sup>2</sup>

After the outbreak of the COVID-19 pandemic, Colombia, like many other countries around the globe, imposed border restrictions that impeded individuals from returning to their countries. These circumstances raised the question of how the time the person spent in Colombia due to the travel restrictions should be considered to determine their residence. Initially, the Colombian Tax Administration (*Dirección de Impuestos y Aduanas Nacionales*, DIAN) stated through Tax Ruling no. 100208221-612 of 26 May 2020 that the physical presence in Colombia of individuals unable to leave the country due to travel restrictions was going to be taken into account to determine residence according to the 183-day rule of article 10 of the CTC. Subsequently, not more than a month after, the DIAN issued Tax Ruling no. 100208221-687 of 11 June 2020, through which it reconsidered its previous position. Indeed, the tax authority stated that act of God or force majeure events – as defined in article 64 of the Colombian Civil Code – might be considered in order to disregard the days of undesired presence by stranded individuals. In this regard, the DIAN illustrates the point with the case of a foreigner who cannot leave the country due to travel restrictions but can prove that he had a return ticket and the intention to leave the country. Thus, the days the individual found himself forced to stay in the country might not be considered to determine the residence under the 183-day criterion.

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1. According to the Statement of Purpose of Law 1739 of 2014, art. 10(3), the Colombian Tax Code (CTC) determines when the centre of vital interest of nationals is in Colombia, and that they are consequently resident in the country. However, to determine that their centre of vital interest is not in the country, nationals only have to meet economic conditions concerning their income and assets (*Congressional Gazette* no. 743, p. 7, 24 Nov. 2012).

2. G. Beretta, *Citizenship and Tax*, 11 World Tax J. 2, pp. 241 (2019), Journal Articles & Opinion Pieces IBFD.

### 7.1.2. Tax residence of companies

Article 12 of the CTC establishes the criteria to consider an entity as “national”. In practice, although the wording uses the expression “national”, being considered a national entity has equivalent effects to being considered a resident entity,<sup>3</sup> i.e. unlimited tax liability for income tax purposes. Entities are considered tax residents in Colombia if they fulfil any of the following conditions (article 12.1 of the CTC): (i) have their place of effective management (PoEM) in Colombia; (ii) have been incorporated under Colombian tax law; or (iii) have their main domicile in Colombia.

According to article 12.1.1 of the CTC, an entity has its PoEM in Colombia if the key commercial and managerial decisions are substantially made therein. For this purpose, all pertinent facts and circumstances should be considered, especially regarding the place where the executives and managers of the entity exercise their functions, and where the daily managerial activities take place. The mere fact that the board of directors (BoD) of a company meets up in Colombia, or that its shareholders are natural persons resident in Colombia or Colombian resident entities does not necessarily imply that an entity is considered a resident for tax purposes (article 12.1.2 of the CTC).

According to the Colombian TA (Tax Ruling no. 058445 of 16 Sept. 2013), the PoEM must be determined according to the place where decisive commercial and managerial decisions are actually made. According to the DIAN, this can occur without requiring a minimum time threshold. Thus, an entity could be considered a resident if, at any point in time, the day-to-day management took place in Colombia, which could be the case due to the travel restrictions occasioned by COVID-19. However, this position has been criticized, as it conflicts with article 12.1 of the CTC, which establishes that the day-to-day management must be habitually performed in the country.<sup>4</sup>

As seen above, Colombia relies on two formal tests (incorporation and domicile) and one substantive (PoEM) to determine whether a company is a resident. However, these tests are easily prone to manipulation and do

3. O.S. Cabrera Cabrera, *La residencia fiscal de las entidades jurídicas en el sistema tributario colombiano*, Revista de Derecho Fiscal 20, p. 165 (2022), available at <https://doi.org/10.18601/16926722.n20.04>.

4. O.S. Cabrera Cabrera, *El impacto del COVID-19 sobre las reglas de residencia fiscal de individuos y compañías: una aproximación desde la óptica latinoamericana*, Revista de Administración Tributaria CIAT no. 48, pp. 38-39 (2021).

not factor in appropriate substance requirements to consider an entity as a resident. The only way to counteract abusive residency shifts for entities and individuals might be through the domestic general anti-avoidance rules (GAAR) provisions. Nevertheless, no other defensive measures, such as exit taxes, are currently in place in the country.

### 7.1.3. Permanent establishments

The concept of permanent establishment (PE) is fleshed out in article 20.1 of the CTC, and it determines that a PE is a fixed place of business in Colombia through which a foreign enterprise conducts in whole or in part its business activity. This definition encompasses branches, agencies, offices, factories, workshops, mines, oil or gas wells, or any other places relating to exploring or exploiting natural resources. Furthermore, a PE also exists in the country when a person (other than an agent with independent status) is acting on behalf of an enterprise and has or habitually exercises, in Colombian territory, the authority to conclude contracts on behalf of the enterprise.

The note published by the OECD regarding tax treaties and the impact of COVID-19 seems skewed towards interpreting that the displacement of individuals due to the pandemic would not give rise to new PEs due to “the exceptional and temporary change of the location where employees exercise their employment.”<sup>5</sup> However, it is not likely that this recommendation might significantly affect Colombian domestic law and the concept of PE. Indeed, there are no intentional or subjective elements in the definition of the PE concept that would allow the exclusion of forced stays in the country due to the pandemic. Furthermore, only the requirements set out by law and the regulations shall be considered to determine the existence of a PE.

In fact, in Tax Ruling no. 000742 of 27 May 2021, the DIAN had to determine whether a Finland tax resident moving to Colombia and working from home for a Finnish company would constitute a PE for such company. According to the tax authority (TA), the employee could give rise to either an agency or general PE if the requirements set out in article 20.1 of the CTC and article 1.2.1.3.5 of Executive Order 1625 of 2016 were met. Thus, a home office PE might exist in Colombia if there is a fixed place of business, with a certain degree of permanency and through which the

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5. OECD, *OECD Secretariat analysis of tax treaties and the impact of the COVID-19 crisis*, OECD Policy Responses to Coronavirus (COVID-19), para. 5 (3 Apr. 2020), available at [https://www.oecd-ilibrary.org/social-issues-migration-health/oecd-policy-responses-to-coronavirus-covid-19\\_5b0fd8cd-en](https://www.oecd-ilibrary.org/social-issues-migration-health/oecd-policy-responses-to-coronavirus-covid-19_5b0fd8cd-en) [hereinafter *OECD Secretariat Analysis*].

enterprise's economic activity is carried out. However, the TA has given no further or specific guidance in this regard. Echoing the concerns raised by some authors and the OECD,<sup>6</sup> the most challenging aspect will be determining whether the home office is "at the disposal" of the employer.

#### 7.1.4. Social security

In principle, no resident foreigners in Colombia are subject to social security contributions. Their liability in this regard only commences if they live and are employed in the country or once they get a foreigner's identification card, which is issued after they have applied for a visa to stay in the country and perform certain economic activities therein. Therefore, foreigners who are not residents for tax purposes might still be subject to social security obligations if employed in Colombia. In the case of self-employed individuals, the social security obligations will only start once they become residents for tax purposes. Moreover, only one exception applies with respect to foreigners. They do not have to contribute to the pensions system if they can prove that a pension regime covers them in another country.

### 7.2. Residence, tiebreaker rules and mobility of work: Individuals and entities

#### 7.2.1. Article 4(1) of the OECD Model

Article 4(1) of the OECD Model (2005) does not establish a definition of the concept of resident; it simply refers to such a concept under the domestic legislation of the contracting states. However, such reference is subject to limits, which require "the taxpayer's personal attachment to the State concerned."<sup>7</sup> Thus, the mere unlimited tax liability of a person should not suffice to consider such a person as a resident and entitled to tax treaty

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6. G. Beretta, "Work on the Move": *Rethinking Taxation of Labour Income under Tax Treaties*, 5 Intl. Tax Stud. 2 (2022), Journal Articles & Opinion Pieces IBFD; A. Báez Moreno & H. Lopez, *Reflexiones sobre la pandemia y sus efectos en la fiscalidad internacional a partir de la Nota de la OCDE de 3 de abril de 2020 (Some Reflections on the Pandemic and the International Tax Regime Based upon the OECD Secretariat Note of 3 Apr. 2020)* pp. 1-47 (11 Jun. 2020); *OECD Income and Capital Model Convention: Commentary on Article 5*, paras. 18 and 19 (21 Nov. 2017), Primary Sources IBFD.

7. R. Ismer & K. Riemer, *Article 4. Resident*, in *Klaus Vogel on Double Conventions* n. 3 (E. Reimer & A. Rust eds., 4th ed., Kluwer Law International 2015).

benefits. Instead, there should be a territorial connection between the person and the jurisdiction.<sup>8</sup>

In the case of individuals, as their residence under domestic law is determined by a minimum period of stay in the country (*see* section 7.1.), their higher degree of mobility will not affect their entitlement to treaty benefits, as the link between the taxpayer and the country is based on a substantive connecting factor. Therefore, if individuals are present in the country for more than 183 days within any period of 365 days, they will be considered residents in Colombia and entitled to treaty benefits. Regarding the nationality criterion set out in the domestic legislation, some Colombian practitioners have mentioned that this requirement would be limited by the treaties as it is not a factor mentioned in article 4(1),<sup>9</sup> as clearly pointed out by some authors.<sup>10</sup> Therefore, this requirement should be limited, as it does not have a strong link between the taxpayer and the concerned state.

Likewise, in the case of companies, although higher degrees of mobility might affect the place where these companies are resident, the current domestic law requirements to determine residency do not adequately factor in substance requirements. Thus, in the case of a company, which no longer provides workplaces and in which all employees work from home, that company will remain a resident if the PoEM remains in Colombia, has its domicile in Colombia or was incorporated in Colombia.

## 7.2.2. Article 4(2) of the OECD Model

It should not make any difference whether a person stays in Colombia due to unexpected circumstances. However, the TA seems to factor in force majeure occurrences in this regard (*see* section 7.1.1.). In such a scenario, the person would be considered a tax resident due to their stay in the country. In the case of dual residents, the tiebreaker rules of article 4(2) will apply according to the criteria laid out in that provision. In this regard, the DIAN gives the example of a resident individual in Colombia and Spain who has a permanent home in both countries but whose personal and economic relations are closer to Spain. Thus, this person would be considered a resident in Spain because their centre of vital interest is therein (Tax Ruling no. 100208221-687 of 11 June 2020). Therefore, it seems that the TA

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8. Id., at m. no. 57.

9. L.O. Sánchez Neira, J. Vargas Cifuentes & A. Parra Ramirez, *Convenios para evitar la doble imposición en Colombia. Teoría y práctica* p. 17 (Legis, Ernst & Young 2019).

10. Ismer & Riemer, *supra* n. 7, at m. no. 56-57.

supports the idea that even if the length of time of physical presence in the country during “forced stays” were to be considered, applying the tiebreaker rules under article 4(2) would ultimately solve the dual-residency issue.

The ultimate residence of taxpayers will continue to depend largely on the facts and circumstances of the case. Mostly, in the case of highly mobile individuals, some of the factors contained in article 4(2) are easily disregarded, e.g. permanent home, which has prompted some authors to consider this criterion as “elective”.<sup>11</sup> However, if the person maintains a permanent home in both states, the residence will be settled according to the other connecting factors: centre of vital interests, habitual abode, nationality and mutual agreement procedures (MAPs). Most likely, in the case of digital nomads, the residence will remain in the place of departure of the individual if the person neither stays for long in any other country nor develops strong economic or personal links there while working in transit. Due to the existence of border controls in the country, residence can easily be calculated with the aid of the Colombian border control agency.

### 7.2.3. Article 4(3) of the OECD Model

Various Colombian tax treaties in force use a similar language to that found in the OECD Model (2017). In contrast, the other treaties in force still give precedence to the PoEM criterion, as was typical before the 2017 update. In the case of those treaties in which the mutual agreement is the tiebreaker, determining the residence country will depend on the facts and circumstances of the case. Among the factors to consider, article 4(3) provides for the PoEM, place of incorporation, and any other factor. In this regard, the OECD determined – at least during the COVID-19 pandemic – that such MAPs should be resolved according to the place where executive board meetings would “habitually” occur.<sup>12</sup>

As the determination of corporate residency in Colombia considers both key management and day-to-day management, it is crucial to determine where the company members in charge of daily management activities are physically located. In addition, it is important to determine where the management bodies meet. Furthermore, although the location of the BoD members

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11. Y. Brauner, *Brain Drain Taxation as Development Policy*, 55 St. Louis University Law Journal 221-268, p. 254 (2010); A. Báez Moreno, *Un sistema fiscal del siglo XIX frente a un contribuyente del siglo XXI: el irrefrenable éxodo fiscal de los youtubers al Principado de Andorra*, Revista de Contabilidad y Tributación CEF 466, p. 70 (2022).

12. Para. 17 *OECD Model: Commentary on Article 5* (2017).

is not decisive in determining the PoEM of a company, insofar as the BoD may have an impact on the management of the company, their presence in the country might indicate that the PoEM is also therein.<sup>13</sup>

### **7.3. Permanent establishments and mobility of work**

#### **7.3.1. Material PE**

The Colombian TA has recognized that employees of foreign enterprises can constitute PE under the fixed place of business rule.<sup>14</sup> Unlike individuals who started telecommuting due to the pandemic, the new “normality” has consolidated new job positions that are entirely online. Thus, the intermittent nature of these circumstances during the pandemic,<sup>15</sup> which prevented them from being considered “permanent”, no longer applies. In addition to the permanence, the home office must meet the other criteria of article 5(1) to constitute a PE, i.e. be at the disposal of the taxpayer, carry on the activity through the place of business, and not be an activity of an auxiliary or preparatory character. It is worth mentioning in passing that the UN Tax Committee observed that no PE would arise in the case of special circumstances such as a pandemic.<sup>16</sup>

According to the Commentary, a home office would constitute a PE whenever the permanency requirement is met and the enterprise “has required the individual to use that location [...] e.g. by not providing an office to an employee.”<sup>17</sup> In addition, it would constitute a PE if the employer has provided its employee with office equipment<sup>18</sup> and the activities performed by the employee are part of the enterprise’s core business. However, pinpointing these requirements in an increasingly digitized environment in which work has been fragmented by many individuals working remotely might prove challenging.<sup>19</sup>

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13. In this regard, *see* Cabrera Cabrera, *supra* n. 4, at pp. 171-173 (2022), who suggests that the place of residence of the members of the board and other personnel of the company with management functions is also important to determine the PoEM of a company under Colombian domestic tax law.

14. DIAN, Tax Ruling no. 000742 of 27 May 2021.

15. Paras 5, 9 *OECD Model: Commentary on Article 5* (2017).

16. Para. 18 *UN Income and Capital Tax Model: Commentary on Article 5* (2021).

17. Para. 18 *OECD Model: Commentary on Article 5* (2017).

18. Beretta, *supra* n. 6, at sec. 5.3.

19. *Id.*



Another aspect worth considering when assessing whether an employee's home office can constitute a PE is the objectives outlined in article 5(1);<sup>20</sup> legal certainty and enforceability of the tax liability.<sup>21</sup> Thus, although a home office might help determine the taxpayer's identity, it might not prove helpful in enforcing tax liability. Thus, the claimed purpose of the provisions bifurcates into two different results without a clear principle-based solution.<sup>22</sup>

### 7.3.2. Agency PE

An employee can also constitute an agent and be deemed a PE under article 5(5) for a foreign enterprise/employer. In fact, the Colombian TA has confirmed this assertion. It is worth mentioning that if a PE is already triggered under the general rule, it is not necessary to revise the application of article 5(5).<sup>23</sup> For a dependent agent PE to arise, the agent has to be present in the source country, which might most likely happen when employees work from home. It is also likely that a self-employed dependent agent arises in these scenarios, considering that self-employed individuals may keep their residence in the other contracting state (that is, the state of the enterprise of the self-employed individual). In addition, this individual might have a significant presence in the source state, where they habitually play a role in the conclusion of contracts binding the principal, in this case, themselves.

### 7.3.3. Service PE

Various Colombian tax treaties include a service PE provision along the same lines as article 5(3)(b) of the United Nations Model or the Commentary on Article 5(166) of the OECD Model. Insofar as this is a deeming provision,<sup>24</sup> it is not necessary to have a fixed place of business in the other contracting state for the PE to arise. Of course, if an individual renders the services from their home in the source state, and the time threshold is surpassed,

20. Báez Moreno & López, *supra* n. 6, at pp. 11-12.

21. F.A. García Prats, *OECD - Commentary on Article 5 of the OECD Model* sec. 3.1.2 (2022), Global Topics IBFD; B.J. Arnold, *Article 5: Permanent Establishment - Global Tax Treaty Commentaries*, sec. 1.1.2.1.2.-1.1.2.1.3. (2020), Global Topics IBFD.

22. Báez Moreno & López, *supra* n. 6, at p. 12.

23. García Prats, *supra* n. 21, at sec. 3.4.; para. 100 *OECD Model: Commentary on Article 5* (2017).

24. Arnold, *supra* n. 21, at sec. 5.1.1.2.3.

the presence requirement would be satisfied. Furthermore, in the case of a service PE, the presence of the individual in the source country should not depend on the intention of remaining therein, because this is an objective provision that only takes into account the days of stay and furnishing of services in the source country.<sup>25</sup> However, as long as domestic law does not provide for a service PE definition, it is not possible to derive such a definition from the domestic rule concerning other types of PEs such as those of a material or personal nature. Therefore, no service PE would arise in Colombia, even though a tax liability would be incurred in the country due to the services rendered therein. Such tax liability will arise regardless of the service's use or the payer's presence in the national territory.<sup>26</sup> Some authors<sup>27</sup> have questioned whether the effects of the pandemic were adequately anticipated in the service PE proviso, which was devised to permit the source country – i.e. where the consumers are located – to tax the services of the non-resident service providers. However, does this rule also apply to a service provider located in a source country regarding services rendered to consumers in third states? It seems that the general understanding of this rule simply requires fulfilling the physical presence requirement to consolidate a service PE.<sup>28</sup>

#### 7.3.4. Construction PE

The tax treaties between Colombia and other contracting states establish a 6-month period for the constitution of a construction PE in the country,<sup>29</sup> thus following the UN Model. Although the pandemic took a toll on the construction sector in Colombia, this industry did not shut down completely. For example, in the second month (May) after the first lockdown in the country,<sup>30</sup> 12.9% of companies in the sector reported having continued their everyday activities, and by September of the same year, 71.1% of construction companies were already back to working in normal conditions.<sup>31</sup> Thus, the interruptions to the construction works have been limited and of

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25. Báez Moreno & López, *supra* n. 6, at p. 20.

26. *See* art. 24 CTC.

27. Báez Moreno & Lopez, *supra* n. 6, at p. 22.

28. *Id.*, at pp. 22-23.

29. Recently negotiated tax agreements, not yet in force at the time of writing, establish periods of less than 6 months, e.g. the tax treaties with Uruguay and the United Arab Emirates.

30. The first mandatory lockdown was mandated by the Colombian government through Executive Order 457 of 22 Mar. 2020 starting on 24 Mar. at 11:59 p.m.

31. L. Andrián & J. Hirs, *Colombia: desafíos de desarrollo en tiempos de COVID-19*, Documento para Discusión, IDB-DP-00838, p. 29 (IDB 2020).

short duration, which would confirm their temporary nature, as asserted by the OECD.<sup>32</sup> Therefore, following the OECD Commentary,<sup>33</sup> temporary interruptions, such as those occasioned by the pandemic, cannot deduct these interruptions from the counting towards the constitution of a construction PE.

Factoring in the mobility of work element, and whether activities such as those of supervision could be exercised outside the state of construction and still give rise to a PE, it must be assessed first whether article 5(3) could be considered as a deeming provision or a special rule that must fulfil the requirements of article 5(1).<sup>34</sup> If considered as *lex specialis*, the requirements set out in article 5(1) should be met to determine that a construction PE exists. Thus, there must be geographical and commercial coherence. Then, suppose the general contractor performs the supervisory activities, which are performed remotely? In that case, they will not give rise to a PE insofar as there is no geographical coherence in the source state. Likewise, if the activities are not performed by the general contractor and these activities are performed remotely, there would not be a PE if we consider that article 5(3) is a *lex specialis* of article 5(1), simply because there is no physical presence in the source state.

Conversely, if we consider that article 5(3) is a deeming provision, the requirements of article 5(1) do not have to be met. Thus, if the general contractor performs the supervisory activities, a construction PE could exist due to a construction in the source state. If, however, these activities are not exercised by the general contractor and performed remotely, there would be a solid argument to argue that no construction PE exists due to the performance of these activities, because the activities would fall under article 5(1), and insofar as there is no physical presence in the source state, no PE would arise. As Colombia follows, in general, the construction PE provision set out in the UN Model, which might be more easily interpreted as a deeming provision,<sup>35</sup> the reasoning fleshed out above in the case of article 5(3) as a deeming provision could be applicable.

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32. Para. 13 *OECD Model: Commentary on Article 5* (2017).

33. Para. 55 *OECD Model: Commentary on Article 5* (2017).

34. Arnold, *supra* n. 21, at sec. 2.3.2.; A.A. Skaar & J. Sasseville, *General Report: Is there a permanent establishment?*, pp. 45-46 (IFA Cahiers vol. 94A, 2009).

35. Skaar & Sasseville, *supra* n. 34, at p. 46.

## 7.4. Physical presence according to articles 15(1) and (17) of the OECD Model

### 7.4.1. Employment income: Article 15(1) of the OECD/UN Model

The rule contained in article 15(1) gives exclusive taxing rights to the residence state of the employee unless the employment is “exercised” in the other contracting state. Moreover, according to the Commentary on the OECD Model,<sup>36</sup> the employment is exercised in the state where the employee is physically present when performing the employment activities. This interpretation seems to be the one adopted in the case of Colombia, insofar as the government did not make any observation with respect to the Commentary on Article 15 of the OECD Model during its accession process into the OECD.<sup>37</sup> In the case of a home office, the activity will always be exercised in the state where the home office is located, assuming that the employee is physically present therein.

Domestically, non-residents are taxed in the country only for income sourced therein (article 9.2 of the CTC). In the case of employment income, non-residents will be taxed only insofar as they perform their working activities in the country (article 24.4 of the CTC). Therefore, in the case of employment income perceived by non-residents working remotely and outside of Colombia, this income will not be taxed in the country under domestic tax rules, even if the payer of the income is resident in Colombia.<sup>38</sup> Despite this, the work performed by non-residents might be taxed in the country, even if the service providers are not present in the country, if the services are qualified as technical services, consulting services, or technical assistance, and used in the country (article 24.8 of the CTC).<sup>39</sup>

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36. Para. 1 *OECD Income and Capital Tax Model: Commentary on Art. 15* (2017).

37. According to the adhesion agreement with the OECD, Colombia had to point out which provisions of the OECD Model were reserved and which parts of the Commentary were observed. Law 1950 of 2019 approved the treaty of adhesion to the OECD.

38. The TA, in several of its rulings, has confirmed this reasoning, stressing the necessity that the work be carried out in the country to deem its source therein. DIAN, Tax Rulings no. 011214 of 09 Dec. 2008 and no. 011665 of 23 Apr. 2015.

39. In fact, art. 408 CTC establishes that payments for consulting services, technical services and technical assistance rendered by non-residents or non-domiciled persons are subject to a withholding tax of 20% regardless of the place where they are provided. However, there are no definitions in the domestic tax law of what should be understood by these concepts (consulting services, technical services, and technical assistance). Thus, the judiciary and the TA have put forward definitions for the same along the following lines: (i) technical services refer to the application of a technique while rendering the services without transmission of knowledge; (ii) technical assistance is the application

Under a strict understanding of the sourcing rule in article 15(1), the place where work is exercised will be where the employee is physically present, even if they are stranded in the country due to unforeseen circumstances such as a pandemic. However, according to the OECD, force majeure circumstances preventing employees from returning to their usual place of employment should not involve a change in the allocation of taxing powers.<sup>40</sup> Although the Colombian TA has not explicitly set out its position concerning the interpretation of article 15 in these circumstances, it seems that stays in the country enforced due to travel restrictions could be discarded following the TA's acceptance of force majeure scenarios when applying the 183-day criterion for determining residency.<sup>41</sup> As the higher mobility of individuals might give rise to more scenarios of dual-residence, article 15(1) "should be read in the light of the tiebreaker rules of article 4(2) of the OECD Model."<sup>42</sup>

Severance payments are treated as employment income under Colombian domestic tax law.<sup>43</sup> Therefore, due to the lack of definition in the text of the treaty, the domestic law definition can be used in this regard (article 3(2)). As domestically, this type of income is considered employment income, at the treaty level, it should be covered by article 15, as it would constitute a "similar remuneration" in respect of employment. As the severance payment constitutes remuneration derived from the employment, the allocation of this income should take into consideration where the employment was exercised; if exercised in a home office, the place where that home office is located should be the one with primary taxing rights on such income.

The TA has not stated its position regarding cases of employees who are stranded in Colombia, restricted from exercising their employment activity in the other contracting state and who cannot perform this activity remotely, but who nevertheless gets paid. Although no employment activity is exercised in Colombia, following the Commentary on the OECD Model, such income should be taxed in the "State where the recipient resides at the

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of a technique while rendering the services and the transference of such knowledge to third parties; and (iii) consulting services, which adopt the definition set out for public law purposes in art. 32 of Law 80 of 1993, are services that look to advise the customer (*see* in general DIAN, Tax Ruling no. 068312 of 31 Dec. 2014, no. 650 of 4 May 2018 and no. 17764 of 10 July 2019).

40. Para. 21 *OECD Model: Commentary on Article 5* (2017).

41. DIAN, Tax Ruling no. 100208221-687 of 11 June 2020.

42. P. Pistone, *Article 15: Income from Employment - Global Tax Treaty Commentaries* sec. 3.1.2. (2021), Global Topics IBFD (accessed 8 May 2022).

43. This position has been confirmed by the TA in Tax Ruling no. 0912 of 19 July 2018.

time the payment is received.”<sup>44</sup> Conversely, similarly to the “replacement approach” advanced by the courts in other jurisdictions to determine the place of exercise of payments for inaction,<sup>45</sup> the place of activity could also be deemed to be in the other contracting state. In the case in discussion, due to the causal connection between the salary paid by the employer and the work that they would have performed in situ if they had been able to travel, the salary could be covered under article 15 and allocated to where the employment activity would have been exercised. However, as this approach might not be entirely aligned with the Commentary on the OECD Model, it is reasonable to assume that Colombia’s TA will not adopt such a position.

#### 7.4.2. Artists and entertainers

The TA has not set out an official position regarding artists or sportspersons that rehearse or train in Colombia and perform publicly in another state and vice versa. However, following in part the Commentary on the OECD Model,<sup>46</sup> it is likely that these training activities will be taxed in the source state whenever they are closely connected with public performance, even if these training activities occur in different countries.<sup>47</sup> Conversely, suppose the activities are not closely connected to the performance in the other contracting state. In that case, they could only fall under the scope of article 17 if they constitute a “public performance” and “show by itself”.<sup>48</sup> Other training activities that are not open to the public would not be covered by article 17.

The remuneration received by an artist or sportsperson without an actual performance in the other state due to travel restrictions should not be covered by article 17 because there is no connection of any type to a public performance, which is a requisite sine qua non for the application of this provision.<sup>49</sup> This result will remain the same regardless of the source of the income. In the case of article 19, insofar as these payments apply only to

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44. Para. 2.9 *OECD Model: Commentary on Art. 15* (2017).

45. Pistone, *supra* n. 42, at sec. 3.3.2.5.2.; L. De Broe, *Art. 15 Income from Employment*, in *Klaus Vogel on Double Taxation Conventions* vol. II, n. 63 (E. Reimer & A. Rust eds., 4th ed., Kluwer Law International 2015).

46. Para. 9.1 *OECD Model: Commentary on Article 17* (2017).

47. P. Pistone & E. Schaffer, *Entertainers According to Art. 17 OECD Model Convention*, in *The OECD-Model-Convention and its Update 2014*, sec. 4 (M. Lang ed., IBFD 2015), Books IBFD.

48. A. Cordewener, *Art. 17. Entertainers and Sportspersons*, in *Klaus Vogel on Double Taxation Conventions* vol. II, n. 91 (4th ed., Kluwer Law International 2015).

49. See para. 9 *OECD Model: Commentary on Article 17* (2017); see also *id.*, at n. 92.

services rendered by government employees, article 7 would be applicable (either under contract or from government funds) whenever no actual performance takes place. Even in the cases of special provisions allowing taxation in the residence state only, if the performance is financed through public funds, article 17 will not apply, because there is no performance.<sup>50</sup> It can be seen from the above analysis that, even in times of COVID-19, the rule of article 17 remains the same, which will have the end effect of fewer appearances taking place and other rules such as articles 7 or 15 being activated.

To turn to the case of live-streamed events, although these could fall under the scope of article 17 through a “virtual stage”, the place of performance will be where the artists/sportspersons are located<sup>51</sup> regardless of the place where such performance is consumed, watched or made public.<sup>52</sup> Thus, in the case of the performance of an artist meant to take place in person, for example in Chile, but shifted online due to travel restrictions, and with the “performance” taking place in person (and being recorded) in Colombia, such activity will be taxed exclusively in Colombia.

Likewise, in the case of influencers, the first question concerns whether these individuals can be considered as entertainers or sportspersons. Some authors have affirmed that influencers might be considered entertainers,<sup>53</sup> whereas others are warier of categorizing them in such a way.<sup>54</sup> In a press release, the TA urged influencers to comply with their tax duties. According to the DIAN, many of these individuals have either failed to file taxes or underreported the income and capital they perceive from their activities as content creators. For example, as reported by Top Dollar Insight, Ami Rodríguez, the Youtuber with the most income in the country, has estimated monthly earnings of USD 244,000, which equals almost USD 3 million per year.

If considered as entertainers and therefore covered under the personal scope of article 17, then the question arises as to what types of income perceived by these individuals might be covered under this article.<sup>55</sup> A fundamen-

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50. See, for example, art. 17.3 of the tax treaties with Mexico, South Korea, India, France and Switzerland.

51. Para 9.2. *OECD Model: Commentary on Article 17* (2017), which applies the underlying logic of art. 15 *OECD Model*.

52. Cordewener, *supra* n. 48, at nn. 75-78.

53. S. Kostikidis, *Influencer Income and Tax Treaties*, 74 Bull. Intl. Taxn. 9 (2020), Journal Articles & Opinion Pieces IBFD.

54. D. Molenaar & H. Grams, *Influencer Income and Tax Treaties: A Response*, 74 Bull. Intl. Taxn. 9 (2020), Journal Articles & Opinion Pieces IBFD.

55. Báez Moreno, *supra* n. 11, at pp. 76-82.

tal feature of article 17 consists of the individual's personal performance, which, according to that explained above, corresponds with the place where the person is physically present. If, due to travel restrictions, the individual is forced to stay in one single country, even if the activities performed by this individual are considered as having an entertaining value, because they are rendered only in one state, there will be problems with regard to double taxation. In normal circumstances, i.e. without travel restrictions, the influencer might at different times be physically present in various states where they exercise personal activities, even if they take place indirectly or virtually.<sup>56</sup>

## **7.5. Article 15(2) and (3) of the OECD Model**

### **7.5.1. Article 15(2) of the OECD Model**

According to the Commentaries on the OECD Model,<sup>57</sup> the counting of days under article 15(2)(a) includes – in general – all days of presence of the individual in the source state. However, some days might be excluded, based on the individual's intention to leave, e.g. transit days in the source state or days on which the individual is ill and prevented from leaving the source state. In the same vein, the OECD has asserted that the days of stay in the source country due to travel restrictions should not count towards the 183-day clause of article 15(2)(a).<sup>58</sup>

Although Colombia has not stated an official position concerning this point, its tacit acceptance of the force majeure measures in other areas (e.g. counting of the days for residence purposes) might be a good indicator that the recommendation of the OECD might be followed in this regard. However, in a typical scenario due to the pandemic, the days spent in the home office will be considered towards the 183-day clause of article 15(2)(a).

It is up to the state of work to determine whether the employer, either an individual or corporate entity, is resident therein.<sup>59</sup> Thus, similar considerations to those of section 7.2. should be considered here. As corporate

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56. Cordewener, *supra* n. 48, at nn. 32, 78.

57. Para. 5 *OECD Model: Commentary on Article 15* (2017).

58. OECD, *Updated guidance on tax treaties and the impact of the COVID-19 pandemic* (OECD Policy Responses to Coronavirus (COVID-19), paras 53-56 (21 Jan. 2021)), available at [https://www.oecd-ilibrary.org/social-issues-migration-health/updated-guidance-on-tax-treaties-and-the-impact-of-the-covid-19-pandemic\\_df42be07-en](https://www.oecd-ilibrary.org/social-issues-migration-health/updated-guidance-on-tax-treaties-and-the-impact-of-the-covid-19-pandemic_df42be07-en).

59. De Broe, *supra* n. 49, at n. 243.



residence in Colombia does not rely sufficiently on substance requirements, namely on the existence of the premises of a company in the country, the employer will likely be considered a resident in the country for the purposes of article 15(2)(b), even if there are no physical premises therein. In addition, if the place of residence changes and ceases to be in Colombia due to the fact that board members are working remotely (in different jurisdictions), then article 15(2)(b) would not be applicable, and the work performed in the state of activity will only be taxable therein if the employee is physically present (even if working from home) for more than 183 days or the remuneration is borne by a PE of the employer (which might be the case if the company's residency was there before). Similarly, an employee may give rise to a PE for the employer in the source state.<sup>60</sup> In this regard, the considerations set out in section 7.3. should also be considered here.

In the situations mentioned above, the effects might differ if it is the government who imposes the home office. For example, in the case of the 183-day clause, although the days the individual was forced to stay in the country might not count towards the fulfilment of article 15(2)(a), they might do with regard to the individual's residency, in which case article 15(1) would become applicable. In the other two scenarios, it is not likely that the clauses contained in article 15(2)(b) and (c) would change due to the imposition of restrictions and working-from-home mandate, as seen before in sections 7.2. and 7.3.

### 7.5.2. Article 15(3) of the OECD Model

An argument has been put forward regarding the suitability of interpreting article 15 according to the same reasoning as article 15(3).<sup>61</sup> Thus, instead of considering the employment to be exercised in the state where the employee is physically present, as currently stated by the Commentary,<sup>62</sup> the place of employment or activity could be where the employee or employer resides. However, this position might rival the underlying principles of the provision and the Commentary on the OECD Model,<sup>63</sup> and it would perhaps be easier to explicitly incorporate mobile workers under the scope of article 15(3).<sup>64</sup>

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60. Id., at n. 293.

61. Pistone, *supra* n. 42, at sec. 3.3.2.4.

62. Para. 1 *OECD Model: Commentary on Article 15* (2017).

63. Id.

64. F. Pötgens, *Income from International Private Employment*, IBFD Doctoral Series, sec. 2.5.4. (IBFD 2007), Books IBFD.

## 7.6. Frontier workers

There are no frontier worker rules in the bilateral tax treaties of Colombia. However, the country shares land borders with various countries (Venezuela, Brazil, Peru, Ecuador, and Panama). Moreover, various frontier workers reside in Colombia and work in these countries or vice versa. Nonetheless, the only bordering countries Colombia has a treaty with are Ecuador and Peru, which are part of the Andean Community (*Comunidad Andina*, CAN). Among the members of the CAN there is a multilateral tax treaty in place (Decision 578 of 2004). Nevertheless, this treaty does not include a specific provision regarding frontier workers, simply because frontier workers' regimes,<sup>65</sup> such as those that exist in various European countries' tax treaties, are not needed in Decision 578, which favours the source principle. Therefore, employment income is taxable exclusively in the country in which the employment is exercised (article 13 of Decision 578). Unlike frontier workers clauses, which usually provide for exclusive taxation in the state of residence,<sup>66</sup> this precedence of the source principle in the allocation of the taxing rights might give rise to double non-taxation scenarios and problems with the entitlement of personal deductions.

## 7.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)

### 7.7.1. Government measures concerning COVID-19

During the pandemic, the Colombian government took several tax measures orientated to mitigating the adverse effects occasioned by the pandemic.<sup>67</sup> Many measures were taken through executive orders, which have the same hierarchical level as the law. However, none of these measures dealt with aspects of international tax law such as residence, the exercise of employment activity, or PE.

Although no measures were taken at the legislative level, the TA has, through administrative rulings, set out its position concerning some aspects

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65. Para. 10 *OECD Model: Commentary on Article 15* (2017).

66. Pistone, *supra* n. 42, at sec. 2.2.2.1.

67. See, in general, C.C. Rodríguez Peña & O.S. Cabrera Cabrera, *Tax measures implemented in Colombia during the health and economic emergency triggered by COVID-19*, *Opinio Juris in Comparatione* 2020 (2021).

of international tax law addressing COVID-19-related scenarios. These rulings are, hierarchically speaking, secondary to the law and only bind the TA. Therefore, taxpayers must rely exclusively on the law and the interpretation of the law that they consider correct.

The only COVID-19-related positions taken by the TA concerned the counting of days for determining the residence of individuals (*see* section 7.1.), in which the DIAN stated the possibility of taking into account force majeure scenarios when determining if the 183-day criterion was fulfilled. This position goes against the text of the law as set out in article 10 of the CTC. Therefore, taxpayers might not rely on it to determine their residence, and rather simply follow the text of the law. However, because the position adopted by the TA might be beneficial for some taxpayers, it is not likely that the same will be challenged before the judiciary.

### 7.7.2. Force majeure consideration

When applying tax treaty rules, forced or voluntary factors should not be decisive elements. As these rules are based on objective criteria (days of stay, physical presence) and not subjective points (willingness to stay in a country), force majeure or act of God scenarios should not hamper the adequate application of tax treaty provisions. In fact, there would be no legal basis to apply such subjective elements in the application of the treaties, and only consequent laws (to change domestic law provisions) or treaties (to amend tax treaties in force) would suffice in this regard.

Force majeure does not prevent the attribution of the tax liability, but rather it has an effect at a later stage, nullifying the payment or fulfilment of the tax obligation.<sup>68</sup> Furthermore, even if force majeure could inhibit the attachment of the tax liability, the concept should be enshrined in a legal source with at least the same hierarchical level as a treaty to counteract the rules already in place domestically and internationally. Domestically, force majeure as a legal category stems from article 64 of the Colombian Civil Code and could be considered a *lex specialis* to the CTC. Internationally, however, there is no definition of force majeure as such, although the International Law Commission<sup>69</sup> has stated that force majeure and fortuitous events are regarded, within the context of the law of treaties, as cases of supervening

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68. Báez Moreno & López, *supra* n. 6, at p. 40.

69. ILC, *Force majeure and fortuitous event as circumstances precluding wrongfulness*, Document A/CN.4/315, 1978, vol. II(1) (UN 1978), available at [https://legal.un.org/ilc/documentation/english/a\\_cn4\\_315.pdf](https://legal.un.org/ilc/documentation/english/a_cn4_315.pdf).

impossibility of performance of treaty obligations under article 61 of the VCLT. In this regard, a state can “suspend” treaties due to the impossibility of performing its obligations. However, suppose this suspension right refers to only specific provisions? In that case, such a right must be exercised in mutual agreement with the other party (article 44 of the VCLT), unless the treaty provides otherwise. So far, Colombia has not concluded any mutual agreement in this regard.

## **7.8. The future of the mobility of work: A need for adjusting the existing treaty rules?**

### **7.8.1. Suitability of the current rules for a digitalized economy**

As stated by Kostić, in reading the text of the OECD/UN Model, “one cannot resist the impression that one is standing before a world of huge blast furnaces, steel mills and coal, sirens leading to thousands of workers going through huge factory courtyards.”<sup>70</sup> This, however, does not necessarily mean that the current international tax regime should be reshaped without first thinking carefully about the possible new changes, and the policy arguments for amending the present system.<sup>71</sup> Due to current economic advances, various tax treaty rules must be rethought if we consider that they are not aligned with prevailing theories justifying taxation (the origin principle of taxation, destination principle and benefit principle).<sup>72</sup> In the context of mobility of work, and echoing the proposals put forward by various academics, changes can be devised in respect to articles 4, 5, 15, and 17 of the OECD/UN Model, among others.

First, article 4 might be revamped with regard to individual and corporate residence. On the one hand, the nexus for individuals might be changed, as suggested by Beretta,<sup>73</sup> using a physical presence test as a connecting factor

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70. S.V. Kostić, *In Search of the Digital Nomad – Rethinking the Taxation of Employment Income under Tax Treaties*, 11 World Tax J. 2, p. 191 (2019), Journal Articles & Opinion Pieces IBFD.

71. W. Schön, *Ten Questions About Why and How to Tax the Digitalized Economy*, SSRN Journal 27, p. 278 (May 2018), available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3091496](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3091496).

72. S.V. Kostić, *A Plea for a Workforce Presence PE Concept in a Post-Covid Digitalized World*, 40 Intertax 10, p. 762 (2021); Kostić, *supra* n. 70, at p. 209.

73. G. Beretta, *Cross-Border Mobility of Individuals and the Lack of Fiscal Policy Coordination Among Jurisdictions (Even) After the BEPS Project*, 47 Intertax 91, p. 107 (Jan. 2019).

that might be more appropriate for the current era. On the other hand, and more importantly, in the case of entities, clearer criteria should be fleshed out in article 4 taking into account the new decentralized ways of managing companies and establishing more substantive residence tests that are less prone to manipulation.<sup>74</sup>

Second, more radical amendments are also needed with respect to article 5, not only within the context of the OECD's Unified Approach, but also concerning mobility of work. Thus, the Commentary should provide clearer guidance regarding what constitutes a home office PE. To that effect, a day-counting test could be included to clarify the degree of permanence needed to constitute a PE.<sup>75</sup> In addition, a more fundamental problem seems to arise in relation to the notion of PE, i.e. the possibility of creating and providing products and services without a permanent place of business in the jurisdictions where those products and services are created.<sup>76</sup> Thus, the problem is no longer restricted to not having a physical presence in market jurisdictions, but rather to not having a physical presence (understood as a permanent place of business) anywhere. In this regard, Kostić proposes including a new workforce presence PE in which "the existence of certain personnel of the foreign enterprise in the source state, personnel without the existence of a fixed place of business of the enterprise for which they are working, may be deemed to constitute the PE of that enterprise."<sup>77</sup>

Third, amendments might also be needed regarding article 15. One possible change would be to delete article 15(2)(b) and (c) of the OECD/UN Model. In fact, according to Kostikidis, article 15(2)(b) should be deleted because it does not meet an adequate – i.e. substantial – nexus for source taxation of mobile service providers.<sup>78</sup> Similar considerations could also be made in respect to article 15(2)(c) of the OECD/UN Model. In this respect, deleting article 15(2)(b) and (c) might also be a sensible option, considering the evolution of employment relationships and the "elusive notion of a single employer."<sup>79</sup> Another point worth considering is lowering the pres-

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74. E. Escribano, *Jurisdiction to Tax Corporate Income Pursuant to the Presumptive Benefit Principle: A Critical Analysis of Structural Paradigms Underlying Corporate Income Taxation and Proposals for Reform*, Series on International Taxation no. 70, pp. 94-95 (Kluwer Law International 2019).

75. Beretta, *supra* n. 6, at p. 26.

76. Kostić, *supra* n. 72, at p. 767.

77. *Id.*, at p. 768.

78. S. Kostikidis, *Nexus for Source Taxation of Mobile Individual Service Providers in Tax Treaties*, SSRN Journal, pp. 27-28 (2022), available at <https://ssrn.com/abstract=4444617>.

79. Kostić, *supra* n. 70, at p. 223.

ence threshold in article 15(2)(a) to a more appropriate level.<sup>80</sup> In addition, a further reasonable consideration would be to introduce some elements of a definition of what an “employment” relationship encompasses in this day and age (e.g. collaborative platforms).<sup>81</sup> In fact, some authors propose to reinsert article 14, merging it with article 15<sup>82</sup> in order to encompass new ways of working and provide a neutral treatment for the provision of services, regardless of whether they are rendered on an entrepreneurial basis, as part of a liberal profession or within an employment relationship.

Finally, arguments have been put forward that article 17 should be removed from the OECD/UN Model, as its justification relied upon the lack of information regarding the residence taxation of artists and sportspersons.<sup>83</sup> Currently, with the widespread adoption of exchange of information mechanisms, it does not seem to remain a justification for keeping article 17, apart from the fact that contracting states want to tax income sourced in their jurisdictions.<sup>84</sup> Thus, a higher nexus, along the lines of the Commentary on the OECD Model,<sup>85</sup> could be included in article 17 so that only performances exceeding certain monetary thresholds are taxed in the source state.<sup>86</sup>

### 7.8.2. Use of new technologies

New technologies will play a key role when considering amendments to the rules mentioned above. For example, advances in transparency through exchange of information might be enough to justify the elimination of article 17. Similarly, technological advances in general might ease a transition into a new set of rules that better factor in the new ways of working. Although passport stamps remain important in countries with border controls, GPS technology might also be important in the case of countries without border controls. This technology is already incorporated into the devices we use daily, and it might prove helpful in tracking the place of work of individuals to apportion the income according to the effective presence within a jurisdiction. In this regard, a “redistribution mechanism”, in

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80. See in this regard, Beretta, *supra* n. 6, at p. 25; Kostić, *supra* n. 70, at p. 212.

81. Kostić, *supra* n. 70, at p. 223.

82. Beretta, *supra* n. 6, at p. 25; Kostikidis, *supra* n. 78, at p. 28.

83. OECD, *Issues related to Art. 17 of the OECD Model* (OECD 2014).

84. B.J. Arnold, *The Taxation of Income from Services under Tax Treaties: Cleaning Up the Mess – Expanded Version*, 65 Bull. Intl. Taxn. 2, sec. 2.3.9. (2010), Journal Articles & Opinion Pieces IBFD.

85. Para. 10.1 *OECD Model: Commentary on Article 17* (2017).

86. In this regard, see also Kostikidis, *supra* n. 78, at p. 27.

which the residence state transfers the portion of tax revenue to the source states, should be devised.<sup>87</sup>

### 7.8.3. Value creation

The decentralization of key functions within multinationals enterprises (MNEs) might have an effects on both personal and corporate income taxes. Regarding personal income taxes, and under the current status quo, workers will continue to be taxed in their state of residence, and wherever they decide to work on the move, they most likely will continue being taxed only in the state where they are already residents.<sup>88</sup> Furthermore, because the workforce of MNEs may to be found anywhere, resident individuals of a country might work for foreign enterprises, giving rise to problems with the enforceability of tax and social security obligations.

Similarly, concerning corporate income taxes, the decentralization of workers might occasion issues of income allocation. In principle, if these workers perform development, enhancement, maintenance, protection and exploitation (DEMPE) functions, the returns will go to the companies that have employed them unless they form PEs, in which case, part of the returns will be allocated in the jurisdictions where these PEs are located.<sup>89</sup> Under the current transfer pricing rules, and considering the complex functions performed by various parts of MNEs, the profit split method would be the most suitable one, relating as it does to complex activities.

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87. Kostić, *supra* n. 70, at p. 212.

88. Kostić, *supra* n. 72, at pp. 766-767.

89. J. García Berdonce, V. Chand & X. Ditz, *Answering Eight Key Questions about Transfer Pricing during the COVID-19 Era*, 28 Intl. Transfer Pricing J. 4, p. 226 (2021), Journal Articles & Opinion Pieces IBFD.





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## Chapter 8

### The Impact of Tax Treaties on International Mobility of Work in Croatia

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#### 8.1. Mobility of work and domestic tax law

The Croatian system of taxation of resident natural persons relies on the principle of worldwide taxation. According to article 43(1) of the General Tax Act (GTA),<sup>1</sup> a natural person shall become a tax resident if they have their permanent home (*prebivalište*) or habitual abode (*uobičajeno boravište*) in the Republic of Croatia. The law considers that a taxable person has their permanent home where they either own an apartment in the Republic of Croatia or have one in their possession for at least 183 days in 1 or 2 calendar years. The actual physical stay in the apartment is not required in order to constitute a permanent home.

If a taxable person in the Republic of Croatia owns or has in their possession more apartments, their permanent home shall be determined according to the permanent home of the family, and for a taxable person who is a single person according to the place in which the taxpayer predominantly resides or from which they predominantly depart to work or to perform activities (article 43(2) of the GTA).

The domestic law also provides for a tiebreaker rule in the case of concurring residences in more than one country. Namely, according to article 43(3) of the GTA, if the taxpayer has residence in Croatia, as well as abroad, they are considered to have a residence in the country where the family has a permanent home, and for a single taxpayer or if the family's permanent home cannot be determined, the taxpayer is considered to have residence in the country from which they mostly work or perform an activity or in which place they predominantly remain.

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1. HR: General Tax Act, Official Gazette of the Republic of Croatia 115/16 - 42/20, art. 43 (2000), Primary Sources IBFD [hereinafter GTA].

This version of article 43(3) came into force in 2019.<sup>2</sup> The previous domestic tiebreaker rule deemed that if a taxable person has a permanent home in Croatia and abroad, it was considered that they have a permanent home in Croatia. This was not in line with international tax law standards and was thus changed to the version described in the preceding paragraphs. At the same time, a new article 43(4) (saving clause) was introduced, according to which Croatia will claim residency over a taxpayer who has a permanent home in another country, but the other country does not assume tax residency over the person.

A person can also become a tax resident of the Republic of Croatia if they have a habitual abode there, which occurs if the person stays in Croatia under circumstances based on which it may be concluded that they do not only reside in that place or area temporarily. In this sense, a habitual abode shall be considered to be the place where a person remains continuously or in a time-linked stay for at least 183 days in 1 or 2 calendar years. For the determination of the habitual abode, short interruptions in the stay not exceeding a period of 1 year shall not be considered relevant.

From the foregoing, one can ascertain that the Croatian concept of permanent home is based on rather “material” proxies, such as ownership of a home, or simple possession of a home (or a part of a home) (e.g. owned by parents of the taxpayer, a landlord, a life partner or even a friend). While ownership is easy to establish based on land registry data, possession is a purely factual exercise and will have to be determined on a case-by-case basis. The key factors in ascertaining possession are possibility of access, possibility to exclude unsolicited access of third persons, etc. during more than 6 months in 1 or 2 calendar years.

In this sense, one could argue that *prima facie* a higher degree of mobility of workers will not necessarily impact the “effectiveness” of the basic Croatian tax residency requirement, since the duration of the stay in the territory is not the primary criterion. Namely, as has been shown in the preceding paragraph, the primary criterion for having a permanent home is ownership or possession of a physical space, and the brevity or even absence of a stay in the premises will not detrimentally affect Croatian residency.<sup>3</sup> Therefore, if a Croatian tax resident moves abroad but leaves behind a physical space (owned or in possession), they will remain tax resident there, according to

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2. HR: Amendments to the General Tax Act, Official Gazette of the Republic of Croatia, NN 106/2018, art. 43 (2018).

3. Explicitly stated in the last sentence of art. 43(1) GTA.

purely domestic law (naturally, Croatia would reassess the position in light of the applicable tax treaty).

However, even without having a physical space owned or possessed, a person can also be considered to be a tax resident of Croatia if they have a habitual abode in Croatia, meaning that it is evident from the circumstances of the case that they are in Croatia on a “non-temporary” basis. Here, time spent in the country will certainly play a decisive role, because the determining factor in deciding whether the stay is only temporary or permanent will be the physical stay in the country of least 183 days in 1 or 2 calendar years (which is, as a reminder, not necessary under the permanent home criterion), and the circumstances of the stay must be such as to indicate that the stay is not only temporary.

Additionally, even though time spent in Croatia is not a decisive factor per se for determining the permanent home according to article 43(1) of the GTA, it may certainly be considered as an important criterion under the habitual abode definition in article 43(5) and the domestic tiebreaker rule of one’s centre of vital interests under the new version of article 43(3) of the GTA or under the one used in tax treaties based on the centre of vital interests.

In Croatia, there is, in principle, no risk of exit taxation if a natural person works and stays in another country for a prolonged period of time, since exit taxation applies only to entities subject to corporate income tax (transposition of the Anti-Avoidance Tax Directive (ATAD)). However, a natural person that is self-employed and opts for or is obliged to pay corporate income tax instead of personal income tax<sup>4</sup> can potentially be faced with exit taxes. Namely, even though taxable persons for corporate income tax purposes are primarily companies and other legal persons, also natural persons carrying out an economic activity are covered by the definition of a taxpayer contained in article 2(1) of the Corporate Income Tax Act (CITA).<sup>5</sup> Article 30d of the CITA states that a taxpayer subject to corporate income tax needs to pay exit taxes transferring its tax residence to another EU Member State or to a third country, except for those assets that remain effectively connected with a permanent establishment in Croatia.

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4. HR: Income Tax Act, Official Gazette of the Republic of Croatia 115/16 - 138/20, art. 36 ([2000]), Primary Sources IBFD [hereinafter ITA].

5. HR: Corporate Income Tax Act, Official Gazette of the Republic of Croatia 177/04 - 138/20 ([2000]) [hereinafter CITA].

Since exit taxes have only been in force since 1 January 2022, and since the majority of self-employed natural persons (e.g. IT specialists providing services to companies abroad) prefer to be taxed under a special system of lump-sum taxation available for self-employed natural persons (explained in section 8.8.),<sup>6</sup> there are currently no such reportable situations.

COVID-19 restrictions did not make an impact on the change in residency. On the one hand, if a Croatian tax resident left the country prior to the outbreak of the pandemic and was stranded abroad for a longer period of time, they most probably would not have “lost” their tax residency in Croatia, due to the fact that the primary nexus with Croatia is the ownership or possession of a physical space. Under the presumption that the person did not dispose of the property in Croatia, they would remain a Croatian tax resident. On the other hand, according to the OECD’s Updated guidance on tax treaties and the impact of the COVID-19 pandemic (2021)<sup>7</sup>, many countries that had hard lockdowns issued guidance according to which a person who is not a resident for tax purposes in that country, but is located there temporarily for some weeks or months because of COVID-19 will not become resident for tax purposes provided that the person usually lives abroad permanently and intends to return there as soon as they are able to.<sup>8</sup> Accordingly, the domestic tiebreaker rule in article 43(3) of the GTA would not come into play, since there would be no dual residency caused by COVID-19 travel restrictions. Hence, Croatian tax residency would be maintained.

In the opposite scenario, non-residents who would “end up” in Croatia during the hard lockdown would have most likely also not become residents, since the hard lockdown in Croatia lasted only 2 months in 2020. After

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6. HR: *Pravilnik o paušalnom oporezivanju samostalnih djelatnosti* [Ordinance on flat-rate taxation of self-employment activities], Official Gazette 1/20, 1/21 ([2001]). For more information, see sec. 8.8. of this chapter.

7. OECD, *Updated guidance on tax treaties and the impact of the COVID-19 pandemic* (21 Jan. 2021), available at [https://read.oecd-ilibrary.org/view/?ref=1060\\_1060114-o54bvc1ga2&title=Updated-guidance-on-tax-treaties-and-the-impact-of-the-COVID-19-pandemic](https://read.oecd-ilibrary.org/view/?ref=1060_1060114-o54bvc1ga2&title=Updated-guidance-on-tax-treaties-and-the-impact-of-the-COVID-19-pandemic). (accessed 1 Mar. 2022).

8. See Australian Tax Office Guidance, available at <https://www.ato.gov.au/General/COVID-19/Support-for-individuals-and-employees/Residency-and-source-of-income/#ChangeoftaxresidencyduetoCOVID19> (accessed 17 Apr. 2022); and Canada’s Revenue Agency, *International income tax issues: CRA and COVID-19*, available at <https://www.canada.ca/en/revenue-agency/campaigns/covid-19-update/guidance-international-income-tax-issues.html> (accessed 10 Apr. 2022) (applicable from 16 Mar. until 30 Sept. 2020). For others, see OECD, *Updated guidance on tax treaties and the impact of the COVID-19 pandemic* (21 Jan. 2021), available at <https://www.oecd.org/coronavirus/policy-responses/updated-guidance-on-tax-treaties-and-the-impact-of-the-covid-19-pandemic-df42be07/#back-boxnote-d1e961> (accessed 1 Mar. 2022).

that, the person was free to leave the country, making it improbable that the breach of the 183-day threshold, necessary to establish residency in Croatia, would occur. Even if, due to the lockdown, exit from the country had not been possible, the Croatian tax administration would not have deemed tax residency in Croatia if the taxpayer could prove that there was intent to leave the country.

A habitual abode, which can also cause a person to be considered a resident of Croatia, depends on the circumstances of the individual case, and since in these cases the circumstances for remaining in Croatia were extraordinary, the tax administration would not have concluded that the person was in Croatia on a non-temporary basis.

When it comes to corporations, Croatia applies both the *siège réel* theory as well as the registered seat approach.<sup>9</sup> In this aspect, if a company were to be registered in the commercial or other registry or records in the Republic of Croatia, it would remain a Croatian tax resident despite the fact that the board members would live and work in other countries under domestic law. However, if a tax treaty is in force between those countries and the tiebreaker rule gives precedence to the place of effective management, then most certainly the residency would change to the detriment of Croatia. This in turn could lead to the application of exit taxes, as discussed previously.

It is, however, unlikely that this transfer of residency to another state would happen due to COVID-19 measures, since, similarly to rules regarding individuals, many countries explicitly waived their right to establish taxing rights over companies due to a temporary change in location of board members or other senior executives because of COVID-19 measures.<sup>10</sup>

The authors believe that if a person works from home for a foreign corporation, their home could constitute a permanent establishment and therefore trigger taxation for the corporation. The question arises as to whether the taxpayer's home is available to a foreign entrepreneur, or put differently, whether the office is "at the disposal" of the enterprise. In Croatia, legislative consultations are underway regarding amendments to the Labour Law, which should regulate work from home, i.e. enable employers to cover the overhead costs of their employees who work from home. This in turn

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9. Art. 3 CITA.

10. See OECD, *Updated guidance on tax treaties and the impact of the COVID-19 pandemic* (21 Jan. 2021), available at <https://www.oecd.org/coronavirus/policy-responses/updated-guidance-on-tax-treaties-and-the-impact-of-the-covid-19-pandemic-df42be07/#back-boxnote-d1e961> (accessed 17 Apr. 2022).

could point to the fact that the employer has a certain “impact” on the taxpayer’s home as a place of work, thus fulfilling the condition that the place is available to the employer and can represent a permanent establishment of the employer. In light of the newly developing ways of doing business at a distance, it is necessary to interpret broadly the conditions for the existence of a permanent establishment.

In this context, current substance requirements based upon premises do not appear to still be appropriate in the context of increased mobile work patterns. It is the authors’ belief that it would be opportune to equate office work with home office or teleworking. This would include changes in the conditions for the existence of permanent establishments that are no longer in line with the increase in mobility of work and IT capabilities that allow a person to work from anywhere where there is adequate Internet connection, which means that an employee can work from home or, for example, from a coffee shop on the beach.

However, even if a worker’s home office were considered to constitute a permanent establishment, the question of allocation of profits attributable to that permanent establishment might prove to be very difficult to solve. Indeed, how much profit of an enterprise could be ascribed to the activity performed by a worker performing mere administrative tasks? On the other hand, costs, such as the salary of the workers, the costs of the apartment taken over by the employer and a portion of the overhead costs would be easily attributable to this newly founded permanent establishment. This in turn could even create negative bases in countries where the worker’s home office constitutes a permanent establishment for the employer. Finally, generally speaking, the treatment under social security law is more or less aligned with the tax residence nexus in Croatia.

## **8.2. Residence, tiebreaker rules and mobility of work: Individuals and entities**

A significant increase in labour mobility due to new working arrangements and working conditions that, with advanced IT solutions, enable the employee to work from home or any other place where they can connect to the Internet creates opportunities for the worker to no longer be fixed in a specific place or even a particular country. An example of this is digital nomads travelling around the world and working from where they are temporarily located. They do not often have either a fixed place of work or a fixed place where they live. They remain in a specific country for a shorter period, often

insufficient to satisfy the existing temporal and substantive conditions of the state for tax residence. Therefore, the authors consider that the once broadly defined criteria set out in article 4(1) of the OECD Model are becoming inadequate to face modern mobility models. The relevant provision refers to the criteria for determining tax residency from domestic tax laws, which are generally linked to physical presence in the territory of that state, or to the possession of real estate suitable for living situated in the state concerned. Since modern migrants, especially in the case of digital nomads, often do not stay anywhere long enough to meet the temporal criteria of residence or do not own any real estate based on which the domestic conditions for residence laid down by domestic tax regulations would be met, one can speak of the advent of taxpayers who are not tax residents in any of the countries. As such, they are no longer covered by the provisions of a tax treaty and the provisions of article 4 of the OECD Model thus cannot be applied.

In other cases, states often succeed in making the taxpayer subject to their domestic conditions for tax residence, but it is often impossible to identify the centre of vital interest of those persons for the purposes of resolving a conflict of residence pursuant to article 4(2)(a) of the OECD Model. This is often so, since the taxpayer is not connected enough to either of those states because they frequently change the place of residence from one country to another or even a third country from where the person works remotely. It is also often extremely difficult to determine where the predominant centre of vital interest is, especially when it comes to single persons who constantly move between countries and are often socially integrated in both or even more countries. According to the Croatian tax regulations and practice, the mobility of workers, especially when they work in several countries, will not affect their tax residence in Croatia in cases where they retain their home in Croatia, they own real estate in Croatia or they are in possession of a property in Croatia to which they are constantly returning. Such a situation is even clearer if they remain living in Croatia with their family because, according to Croatian practice, family ties prevail over economic when determining the centre of vital interest as a criterion for determining residence in domestic tax rules and article 4(2)(a) of the OECD Model.

The COVID-19 pandemic has not had a significant impact on the change in the application of the Croatian tax rules for determining residence, as they are primarily based on the concept of residence linked to the ownership or possession of a dwelling, regardless of the actual stay in it. In some cases, however, it did affect the determination of the habitual abode as a supplementary criterion for determining residence. Namely, the determination of a habitual abode in Croatian tax law depends on a general appreciation of

all the facts during a 183-day period in 1 or 2 calendar years, from which it can be concluded that the taxpayer is not only temporarily staying in Croatia. During the times of COVID-19, the Croatian tax administration disregarded the fact that the taxpayer stayed in Croatia for more than 183 days in 1 or 2 calendar years because of the impossibility to leave Croatia due to pandemic-imposed travel restrictions, since they considered that the taxpayer did not have the *intention* to stay in Croatia. Therefore, in a way, the Croatian tax administration deviated from the legal definition in these extenuating circumstances.

Teleworking does not affect the residence status of the enterprise but could lead to establishing the permanent establishment of a foreign enterprise in the state of work from the home of their employees. The authors do not see the risk that an enterprise, under Croatian law would lose the privilege of access to an individual tax treaty due to loss of tax residence, since the tax residence of an enterprise is attached not only to the place of effective management in Croatia but also the place of registration of the enterprise, which is one of the criteria existing in parallel. However, possible problems with the interpretation of certain articles of a tax treaty could arise in cases where a new wording in article 4(3) of the OECD Model was introduced in 2017, according to which residency of entities other than natural persons will be determined by a mutual agreement procedure (MAP). Croatia prefers to maintain the wording regarding dual residence conflict resolution in tax treaties prior to the OECD Model 2017 changes.

Furthermore, the authors consider that the changed mode of work of the company's employees, now working remotely, meets the substance requirements, since it is still in the pursuit of the company's activities. Certainly, there is a potential risk that the new working arrangements will be used to conceal, and to make it more difficult to prove, the real activity of an enterprise that would actually be fictitious. Such situations can be solved by general anti-avoidance rule (GAAR) and specific anti-avoidance rule (SAAR) provisions, which can be found in, or be incorporated into, certain tax treaties through the MLI (Multilateral Instrument), such as the principal purpose test, the limitation on benefits provision or domestic GAAR and SAAR provisions. Croatia transposed from the ATAD the GAAR provisions into its tax system. The proposed EU Unshell Directive also plans to address the issue of letter box companies.



### 8.3. Permanent establishments and mobility of work

Based on the OECD's work on the issue of the "home office" from the 2011-2012 discussion draft on the interpretation and application of article 5 (Permanent Establishment of the OECD Model<sup>11</sup> and 2017 Commentary on Article 5 of the OECD Model), it can be concluded that an individual's home is not automatically at the disposal of a foreign enterprise merely because an individual is conducting their work from home. The decision whether a home represents a "home office" or, more precisely, whether the individual's home is at the disposal of the enterprises, will depend on the facts and circumstances of each case and should, therefore, be dealt with on a case-by-case basis in these post-pandemic times. When making the decision, the Croatian tax authorities should take into account whether the foreign enterprise has offices in Croatia or whether it does not wish to set up an office, and by doing so de facto forces the employee to maintain an office in their home, regardless of whether there is an explicit or implicit agreement regarding a "home office". When deciding whether the "home office" is "at the disposal of" the enterprise (employer), it is necessary to take into account whether the employer pays the rent or covers the cost of the location (home) by renting out a room from the employee or pays a specific remuneration for the use of some of the employee's home office equipment, such as computer and office equipment.

In this regard, it is worth mentioning that the Croatian Ministry of Labour, Pension System, Family and Social Policy, as a state body in charge of the Labour Law, is currently holding a public consultation with the interested public in order to regulate the issue of work from home, which emerged from the COVID-19 crisis, as an issue of significant interest to the Croatian interested public. One of the issues regarding the regulation of work from home is the question of the cost of reimbursement for employees who are working from home and use their resources in order to get the job done for the employer. During that public consultation process, representatives from the Croatian Employers' Association and representatives of Croatian Trade Unions gave their contribution to the public consultations to find a common solution for reimbursement of costs to workers working from home. The Ministry of Labour, Pension System, Family and Social Policy announced that they plan to amend the Labour Law in 2022 and that its application would be from 1 January 2023. The main idea is that the employer needs to conclude a formal contract with the employee so that the employee can

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11. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 5* (22 Jul. 2010), Treaties & Models IBFD.

benefit from a reimbursement of the cost or part of the cost when they work from home and use their own resources during the work. The public consultation raised a plethora of work-related issues such as the treatment of injuries at work while working from home. The results of the deliberations regarding the amendments to the Labour Law will hopefully also give answers to the raised tax law issues, at least for some time, since it is difficult to give longer-term guidelines for this area.

Another fact that should be considered is whether business activity is regular and on a continuous basis and whether the activity of the employees represents core business activity of the foreign enterprise. Regarding the connection between the “home office” and dependent agent under article 5(5) of the OECD Model, the Croatian tax administration considers that if the conditions for a dependent agent under article 5(5) of the OECD Model are fulfilled and a permanent establishment is created, then the previous discussion regarding whether a “home office” can create a permanent establishment would become obsolete. Regarding the connection between self-employed persons and dependent agents under article 5(5) of the OECD Model, Croatia endeavours to follow the OECD Commentary.

Foreign enterprises can trigger a dependent agent permanent establishment in Croatia, without maintaining a fixed place of business in Croatia, if that foreign enterprise exercises control over a self-employed person in Croatia and if that person acts exclusively or almost exclusively concludes contracts on behalf of one or more enterprises to which it is closely related. In order to consider a self-employed person a dependent agent, the individual should conduct activities on behalf of the enterprise and the individual should have, and continue to habitually exercise, an authority to conclude contracts in the name of the enterprise that are binding to the enterprise.

From the Croatian perspective, the issue of digital nomads should be considered from the points of view before the pandemic, during the pandemic and in this so-called “post-pandemic” period. Firstly, the authors will elaborate on the period before the pandemic. Work from home was primarily tied to the IT sector because characteristics of the job allowed IT employees to work from home, but it was not so often used and it was not so publicly interesting. At the beginning of the pandemic in 2020, many workers were left stranded in locations outside their residence and/or work state. One could say that the pandemic stranded many Croatian frontier, posted and seconded workers – some in Croatia, some in the work state. It could also be said that the pandemic raised awareness of the tools for teleworking from various locations. During that short period, the world passed through

a “stress test”, and both workers and employers needed to adapt to the new working conditions. After the hard lockdown, Croatia found itself in challenging times, especially the tourism sector. At that moment, the image of tourists also started to change rapidly. Everybody was looking for a place in which to isolate and work and enjoy as well as to stay healthy. At that time, Croatia decided to join several other countries that opened their doors to digital nomads, offering them a 1-year stay without paying tax on income earned working as employees or self-employed persons. From 1 January 2021, a person can submit a request for the realization of the so-called digital nomad visa. It should be clarified that a digital nomad visa is not really a visa, but a residence permit which, unlike a tourist visa, allows a person a longer stay in Croatia. More precisely, this residence permit for digital nomads is prescribed in the Croatian Foreigners Act (Official Gazette, no. 133/20), which has been in force since 1 January 2021.

Article 3 of the Foreigners Act defines a “digital nomad” as a third-country national (this means a non-EU/EEA/Swiss citizen) who is employed or performs work through communication technology for a company or their own company that is not registered in the Republic of Croatia and does not perform work or provide services to employers in the Republic of Croatia. Furthermore, article 57(1)(11) of the Foreigners Act stipulates that temporary residence is granted to a third-country national who intends to reside or resides in the Republic of Croatia for the purpose of residence of digital nomads. Article 57(4) also stipulates that an application for regulation of temporary residence for other purposes or purposes of residence of digital nomads may be submitted by a third-country national after 6 months from the expiration of temporary residence granted for other purposes or purposes of residence of digital nomads. It should also be mentioned that article 61 of the Foreigners Act stipulates that temporary stay is granted for up to 1 year (possibly even less) and it cannot be extended. A new application for regulating the stay of digital nomads can be submitted 6 months after the expiry of the previously granted temporary stay of digital nomads.

During that period, the person is not liable to pay tax on the income earned as a digital nomad. Article 9(1)(26) of the Income Tax Act (Official Gazette, no. 115/16, 106/18, 121/19, 32/20, 138/20) stipulates that income tax shall not be paid on receipts of natural persons generated on the basis of employment or activity for an employer not registered in the Republic of Croatia on the basis of gaining the status of digital nomad under special regulation.

To summarize: A digital nomad visa is granted to a third-country national who intends to reside in Croatia as a digital nomad for a period of 1 year.

After 1 year, 6 months need to elapse so that person can submit a new request for a digital nomad visa. During that 1-year period, the person must be employed or perform work through communication technology for a company or their own company that is not registered in the Republic of Croatia, and the person must not perform work or provide services to employers in Croatia. Furthermore, digital nomads granted temporary residence in the Republic of Croatia may be joined in the Republic of Croatia by close family members (on the basis of temporary residence for the purpose of family reunification). The holder of a digital nomad visa is not liable to pay tax on the receipts of natural persons generated on the basis of employment or activity for an employer not registered in the Republic of Croatia on the basis of gaining the status of digital nomad under special regulation.

After Croatia enacted rules for digital nomads, the domestic legislation tourism sector started to reorient to a new category of tourists who have their own requirements. In this post-pandemic period, it should be emphasized that Croatia will in future reconsider extending the duration of the digital nomad visa from 12 months to 18 months.

Croatia endeavours to follow the OECD Model when negotiating a new tax treaty and accordingly it can be concluded that Croatia will endeavour to apply the OECD Commentary when it is possible. Based on the OECD work on the issue of the “home office” from the 2011-2012 discussion draft on the interpretation and application of article 5 (Permanent Establishment of the OECD Model Tax Convention<sup>12</sup> and 2017 Commentary on Article 5 of the OECD Model), it can be concluded that an individual’s home is not automatically at the disposal of a foreign enterprise merely because an individual conducts their work from home. A decision whether a home represents a home office, more precisely, whether an individual’s home is at the disposal of the enterprises, will depend on the facts and circumstances of each case and should therefore be dealt with on a case-by-case basis especially in this post-pandemic period. During the decision-making process, Croatia should consider the facts relating to whether either the foreign enterprise has offices in Croatia or if it does not want to set up an office, and so forces the employee to maintain an office in their home, regardless of whether there is an explicit or implicit agreement regarding a home office. When deciding whether home offices are “at the disposal of” the enterprise (employer), it is necessary to consider whether the employer pays rent or somehow covers the cost of the location (home) by renting a room from the employee or paying specific remuneration for using some of the employee’s

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12. Id.

home office equipment, such as a computer and other office equipment. Regarding the time period condition, it should be mentioned that, although various formulas have been used by countries to calculate the 183-day period, in the authors' opinion, there is only one way that is consistent, and that is method calculating "days of physical presence".

Croatia adheres to the OECD Model and its Commentaries, and accordingly, since 2017, it has changed its negotiation policy regarding article 7. Croatia now tries to include the new article 7 of the OECD Model into all new tax treaties. By including the new article 7 of the OECD Model, Croatia plans to gradually make the transition to the Authorised OECD Approach (AOA). Also, it should be stressed that the OECD formally launched accession talks with Croatia and five other candidate countries on 25 January 2022.<sup>13</sup> Individual roadmaps for the detailed assessment process will be prepared, provided those countries confirm their adherence to the values, vision and priorities reflected in the OECD's 60th Anniversary Vision Statement and the Ministerial Council Statement adopted in 2021. One of the legal instruments that Croatia needs to adopt is the Recommendation of the Council concerning the Attribution of Income to Permanent Establishments with respect to the Model Tax Convention on Income and Capital.<sup>14</sup> Croatia adheres to the OECD 2010 Report on the Attribution of Profits to Permanent Establishment<sup>15</sup> and Additional Guidance on the Attribution of Profits to Permanent Establishments.<sup>16</sup>

Croatia considers that it makes a difference whether the home office is imposed or recommended by the government in line with public health measures. If the home office is imposed, then it means that workers could not go to their work in another state. Therefore, days worked in Croatia should not be included in the calculation of the days of physical presence in Croatia because the workers were stranded in Croatia. However, if the

13. See OECD, *OECD takes first step in accession discussions with Argentina, Brazil, Bulgaria, Croatia, Peru and Romania* (25 Jan. 2022), available at <https://www.oecd.org/newsroom/oecd-takes-first-step-in-accession-discussions-with-argentina-brazil-bulgaria-croatia-peru-and-romania.htm> (accessed 30 June 2022).

14. OECD, *Recommendation of the Council concerning the Attribution of Income to Permanent Establishments with respect to the Model Tax Convention on Income and Capital* (2022), available at <https://legalinstruments.oecd.org/public/doc/86/86.en.pdf> (accessed [11 Mar. 2022]).

15. OECD, *Report on the Attribution of Profits to Permanent Establishment* (2010), available at <https://web-archives.oecd.org/2012-06-14/104309-45689524.pdf> (accessed 17 May 2022).

16. OECD, *Additional Guidance on the Attribution of Profits to Permanent Establishments*, (2018), available at <https://www.oecd.org/tax/beps/additional-guidance-attribution-of-profits-to-a-permanent-establishment-under-beps-action7.htm> (accessed 17 May 2022).

home office is just a recommendation, then days spent in Croatia should be calculated as days of physical presence, and Croatia would then decide whether or not the home office is a permanent establishment of the foreign enterprise in Croatia.

Regarding consequences for the constitution of a permanent establishment if the COVID-19 situation continues for a longer period, it should be repeated that Croatia imposed a hard lockdown only at the beginning of the pandemic, and by applying balanced measures, it managed to avoid a longer hard lockdown. Croatia would probably try to avoid a hard lockdown in any future scenarios by using balanced measures that would be in line with public health measures. By avoiding a hard lockdown, there is no reason to apply the OECD Model and Commentaries in deciding whether or not there is a permanent establishment.

Regarding article 5(3) of the OECD Model, Croatia is of the opinion that mobility of work is not something new in this area. This area was very mobile even before the pandemic, especially regarding posted and seconded workers who worked on building sites or construction or installation projects in other countries. The question can be raised of what has changed in respect of article 3(3) of the OECD Model. The problem that the pandemic raised concerning article 5(3) was that, in some situations, there was a 12-month threshold breakthrough and a permanent establishment was established. When considering what happens if supervisory activities are exercised outside the state where the construction site is located, it is worth bearing in mind that article 5(3) of the OECD Model mostly deals with fieldwork concerning building site, construction or installation projects in other countries, and supervisory activities would deal with expert fieldwork to analyse results of the building site, construction or installation project. Based on that, it is difficult to comprehend that supervisory activities can be done without physical presence on the building site, construction or installation project, especially since most of the projects are divided into several stages and that in practice, payment is usually done according to the fulfilment of certain “situations” and on actual performed construction situations.

When analysing how mobility of work affects geographical and economic coherence of the construction project, it can be argued that mobility of work can affect geographical and economic coherence especially if countries decide to follow the zero-COVID strategy and regularly practise hard lockdowns to achieve zero-COVID. By regularly practising hard lockdowns, mobility of work becomes strained and slows down, which could have an effect on geographical and economic coherence of a construction project.

Mobility of work would probably have an effect on discussions on the future of permanent establishment status. The pandemic changed how a particular job can be done. The fixed base criteria could lose its meaning in the future; and a permanent establishment should be determined under similar conditions as for dependent agent permanent establishment.

#### **8.4. Physical presence according to articles 15(1) and 17 of the OECD Model**

Croatia considers that rules set out in article 15(1) clearly define which state has the right to tax income from employment. The first part of article 15(1) prescribes that the state of residence has the exclusive right to tax salaries, wages and other similar remunerations derived by the resident of the residence state (first rule). The second part of article 15(1) introduces the possibility of shared taxation under the condition that employment is exercised in the other contracting state – working state (second rule). In relation to the second rule, Croatia is of the opinion that the recipient must be present in the working state and exercise their employment, so that the working state has the right to tax receipts on the basis of employment exercised.

If a person has a home office in their state of residence, and their employment is in a third country, that third country will have to consider whether, under a tax treaty, it has acquired the right to tax receipts of the employee, or whether the right to tax such receipts lies with the state of residence, since the state of employment (state of the formal employer) certainly has no right to tax that income.

Croatia considers that it makes a difference whether the home office is imposed or recommended by the government in line with public health measures. If home office is imposed, then it means that workers could not go to their work in another state and days worked in Croatia should not be taken into calculation of the days of physical presence in Croatia because the workers were stranded in Croatia. However, if the home office is just a recommendation, then days spent in Croatia should be taken into the calculation of days of physical presence, and Croatia would look into whether or not the home office is a permanent establishment of the foreign enterprise in Croatia.

Croatia considers that in the case of employment exercised partly or totally in a home office in the state of residence, severance payment should be properly allocated between the state where the employee worked earlier and

the state of residence (where the employee worked until recently). However, since Croatia imposed travel restrictions for only several months, there was no reason that employees of foreign enterprises could not go to the state of work and work from the territory of the state of work, thus avoiding the undesirable modality of taxation. The method for elimination of double taxation in tax treaties between Croatia as residence state and the work state must also be kept in mind. If the tax treaty is referring to the credit method, then the severance payment will probably be taxable in Croatia. Only in a situation where the tax treaty between Croatia and the work state applies the exemption method would it be possible for there to be exclusive taxation of the part of the severance payment that can be attributable to the work state and the part of the severance payment that can be attributable to Croatia as a residence state where employees worked for a foreign enterprise during a pandemic (and Croatia became a work state). Of course, this depends on whether the decision to work in Croatia from a home office was a voluntary decision by the employee or whether they were forced to make such a decision by travel restrictions or public health measures. By imposing a hard lockdown only for several months at the beginning of the pandemic and, with the relaxation of measures and by allowing the possibility of travel outside Croatia, working from home in Croatia became work on a voluntary basis. Having said that, each case needs to be considered individually.

Croatia considered that “stranded workers” should not be taxed during the hard lockdown and did not impose any tax obligation on stranded workers during that lockdown. However, when travel restrictions were lifted, there was no reason for Croatia not to apply regular legislation and to consider applying pre-pandemic accepted domestic and international tax rules.

In Croatia, employees who could not work in a factory due to travel restrictions and public health measures received their salary from the employer, and the employer was subsidized by the government for the amount of wages, taxes and social security contributions for each worker, especially those sectors that suffered significant losses due to the pandemic, such as tourism, restaurants and bars and passenger transport.

Employees from abroad also received their salary from their employer. If one would look at those payments in isolation, article 15 of the OECD Model would apply. However, since the employees are tax residents of another country and are not physically present in Croatia, then Croatia would not have the right to tax those salaries – only the residence state would have the right to tax such salaries. Conversely, when employees who are Croatian residents receive payments that represent compensation for not



working during a pandemic, Croatia would not tax those payments since, at the beginning of the pandemic, Croatia decided that payment as a compensation for not working because of the pandemic should not be taxed.

Article 17 stipulates that notwithstanding the provisions of article 15, income derived by a resident of a contracting state as an entertainer during that resident's personal activities exercised in the other contracting state may be taxed in that other state. The Commentary on Article 17 of the OECD Model provides principles on how to determine whether a particular item of income is derived by a person as an entertainer or sportsperson from that person's personal activities as such. It follows:<sup>17</sup>

Preparation, such as rehearsal and training, is part of the normal activities of entertainers and sportspersons. If an entertainer or sportsperson is remunerated for time spent on rehearsal, training or similar preparation in a State (which would be fairly common for employed entertainers and sportspersons but could also happen for a self-employed individual, such as an opera singer whose contract would require participation in a certain number of rehearsals), the relevant remuneration, as well as remuneration for time spent travelling in that State for the purposes of performances, rehearsal and training (or similar preparation), would be covered by the Article. This would apply regardless of whether or not such rehearsal, training or similar preparation is related to specific public performances taking place in that State (e.g. remuneration that would be paid with respect to the participation in a pre-season training camp would be covered).

Based on article 17 and the accompanying commentary, it can be concluded that if an entertainer or sportsperson is remunerated for time spent on rehearsal, training or similar preparation in a state whose contract would require participation in a certain number of rehearsals, the relevant remuneration would be covered by article 17 of the OECD Model. Article 17 would apply regardless of whether or not such rehearsal, training or similar preparation is related to specific public performances taking place in a state.

As mentioned previously, article 17 of the OECD Model represents a special provision that is not related to article 15 of the OECD Model and the condition of physical presence. Based on that, it can be concluded that there is no reason not to apply article 17 of the OECD Model in a situation where an artist or athlete is supposed to perform their activities in the other contracting state but, due to travel restrictions and public health measures, is prevented from doing so and still receives remuneration.

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17. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 1*, point 9.1 (23 Nov. 2017), Treaties & Models IBFD.

The fact that concert performances are returning to the way they were performed before the pandemic shows that the tax rules regarding the treatment of artists and athletes do not need to be changed for the future. Croatia considers that, for now, it cannot impose taxation on live-streaming of artists and athletes. The future will provide solutions for this issue, and Croatia will adhere to global situations and responses. Concerning influencers, Croatia considers that most influencers are taxed in their state of residence. The onset of the pandemic just clarified and affirmed this situation that they should pay tax in the state of residence.

### **8.5. Article 15(2) and (3) of the OECD Model**

Article 15(1) of the OECD Model sets the general rule of shared taxing rights between residence and source state if work is conducted in the territory of the source state. Article 15(2) and (3), however, limit the right of the source state to tax employment income, despite the fact that the work is taking place in the territory of that state, reverting the taxing rights exclusively to the state of residence of the employee.

When it comes to the first exception provided in article 15(2), the source state shall be denied taxing rights if three cumulative conditions are fulfilled: (i) the recipient is present in the other state for a period or periods not exceeding in the aggregate 183 days in any 12-month period commencing or ending in the fiscal year concerned; (ii) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other state; and (iii) the remuneration is not borne by a permanent establishment that the employer has in the other state.

The object and purpose of subparagraphs (b) and (c) of article 15(2) are to avoid the source taxation of short-term employments to the extent that the employee does not remain in the territory of the source state for a prolonged period of time and that the remuneration for the work is not deductible in the source state (borne either via or on behalf of a resident employer or a permanent establishment of the employer in the territory of the source state). If only one of the conditions is lacking, the source state retains its right to tax the income from employment.

The Commentary to Article 15 of the OECD Model very clearly states that when it comes to the method on how to calculate the 183-day period, “there is only one way which is consistent with the wording of this paragraph: the ‘days of physical presence’ method. The application of this method is

straightforward as the individual is either present in a country or he is not.”<sup>18</sup> Any day during any part of which, however brief, the taxpayer is present in a state counts as a day of presence in that state for purposes of computing the 183-day period. Therefore, working from a home office situated outside of the territory of the source state should not count towards the 183-day threshold.

As a reminder, Croatia applies both the approach of the registered seat as well as the *siège réel* theory. Therefore, if an employer (corporation) were to lose its substance (premises) because all employees are working from home, according to Croatian domestic law, if the company is registered at the commercial court, it would still qualify as a tax resident of Croatia in general, and would therefore also qualify under article 15(2)(b) of the OECD Model (“not a resident of ...”).

A problem might arise if both contractual states consider the company as their respective resident. Since companies cannot be registered in two countries, a dual-residence situation would normally occur if one contracting state considers the company resident, due to their local registration, while the other considers the company resident, based on the place of effective management (PoEM). Article 4(1) of the OECD Model only defines “residence” for “the purposes of [the] Convention”, so Croatia would rely on article 4(3) of the OECD Model to resolve the issue. The OECD Model, prior to 2017, gave precedence to the PoEM. Accordingly, Croatia in all its tax treaties (apart from the tax treaty with Japan)<sup>19</sup> also opted for the tiebreaker rule based on the PoEM.

If one followed this logic, then in the case of the management of the company moving to a home office in the source state, this would certainly lead to a change in the “residency”, also for the application of article 15(2)(b) of the OECD Model, since the tiebreaker rule would accord the residency to the other (“source”) state.

If, on the other hand, the board moved to a home office in Croatia, this would either have no impact on the residency (if Croatia was also the country of registration), or it might “create” residency to the benefit of Croatia if it could now be considered that the PoEM was in Croatia.

18. *OECD Model Tax Convention on Income and on Capital*, p. 310 (27 Nov. 2017), Treaties & Models IBFD.

19. *Croatia - Japan Income Tax Treaty*, art. 4.3. (2018), Treaties & Models IBFD.

In the case of the board being “dispersed” in both countries (logging in online to a board meeting in both countries), then the PoEM would be impossible to apply. The problem would have to be solved in a MAP. Depending on the outcome of that procedure, a “change of residency” of the employer might also have an impact on the taxation of employment income of workers under article 15(2)(b) of the OECD Model. If the board were to be dispersed in many countries (i.e. not including only the contracting states), then, provided that the company is registered in Croatia (and is thus resident there), article 15(2)(b) of the OECD Model would remain fulfilled since it only requires that the salaries are not borne by a corporation resident in the source state, which would not be the case since the PoEM is dispersed and is not located in the source state.

Whether the home office of the employee can constitute a permanent establishment of the employer according to article 15(2)(c) of the OECD Model, and by which the remuneration of the employee is borne, has not yet been resolved. Therefore, the authors can only offer their own opinion that a person’s home office should create a permanent establishment for the employer. However, again, a certain degree of permanence would be needed, as for the construction permanent establishment, for instance.

In the context of article 15(2) of the OECD Model, the specific issue of digital nomads in Croatia, described in section 8.3., needs to be mentioned.<sup>20</sup>

Regarding the tax residency of digital nomads in Croatia, the amendments introduced in 2021 did not touch upon the issue of the Croatian tax residency of those persons, meaning that general rules apply regardless of digital nomad status. Since digital nomads can remain in the country for up to 1 year, they can easily fulfil the requirements of tax residency or habitual abode, as per article 43 of the ITA. A digital nomad might, therefore, also easily be considered a dual resident by Croatia and at least one other country

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20. S. Gadzo, *Croatia: A New (Tax-Free) Promised Land for Digital Nomads? (Part I)*, Kluwer International Tax Blog, available at <http://kluwertaxblog.com/2022/02/24/croatia-a-new-tax-free-promised-land-for-digital-nomads-part-i/> (accessed [24 Apr. 2022]). See also literature cited there: O. Hannonen, *In Search of a Digital nomad: Defining the Phenomenon*, Information Technology & Tourism 22, (2020); R.A. Woldoff & R.C. Litchfield, *Digital Nomads: In Search of Freedom, Community, and Meaningful Work in the New Economy* (Oxford University Press 2021), S.V. Kostić, *In Search of the Digital Nomad – Rethinking the Taxation of Employment Income under Tax Treaties*, 11 World Tax Journal 2 (2019); C. Bonneau & J. Aroles, *Digital Nomads: A New Form of Leisure Class?*, in *Experiencing the New World of Work* (Cambridge University Press 2021); and T. Dagan, *International Tax Policy: Between Competition and Cooperation* (Cambridge University Press 2018).

(e.g. by virtue of domicile, ownership of an apartment, nationality, etc.). If the digital nomad were to be treated as a resident in another country with which Croatia has signed a tax treaty (currently 63 are in force), then the tiebreaker rule, frequently based on article 4(2) of the OECD Model, would need to be applied. Based on these proxies – permanent home, centre of vital interests, habitual abode or nationality – there is a high probability that Croatia would “lose the battle” since a digital nomad would most likely fulfil those proxies in a country other than Croatia. On the other hand, if the digital nomad came from a third country with which Croatia does not have a tax treaty in force, the domestic tiebreaker rule in article 43(3) of the GTA, would most likely point to residency in Croatia, since digital nomads (most often single people travelling for work), would be “going to work” in Croatia. Examples of countries with which Croatia does not have a tax treaty in force (yet) and which can be considered as countries “exporting digital nomads” are Pakistan and the United States.

It is questionable to what extent the issue of tax residency is an issue that would cause the digital nomad problems. Namely, article 9(1)(26) of the ITA, which enumerates receipts that are not considered income, was expanded to include receipts of natural persons earned on the basis of acquired status of digital nomads. Thus, it is prescribed that income tax is not paid either on the income of natural persons earned on the basis of self-employment or activity for an employer who is not registered in the Republic of Croatia on the basis of acquired digital nomad status. The issue of tax residency would, therefore, become relevant if the digital nomad started earning income from other sources apart from the exempt ones, such as work performed for a Croatian employer, income from real estate or income from capital. Since Croatian tax residency (which should be assumed after 183 days living in the country) is based on the worldwide taxation principle, the cast net would be rather wide. Having in mind the profile of a typical “digital nomad” as younger, highly mobile people who cherish the “nomadic” life, it is likely that they will not invest in real estate, even though investments in shares or cryptocurrencies are certainly possible (even highly likely). The Croatian tax administration would certainly be faced with enforcement issues in detecting such “other sources of income”.

Overall, the authors would conclude that the digital nomad exemption does not represent a huge budgetary dent for the time being. On the one hand, it seems that only up to a hundred visas were issued since the regime was introduced. This might be due either to travel restrictions caused by COVID-19 or the fact that the scope of the eligible nomads is limited to third-country persons. Therefore, the extent of the benefits is not huge. On the other hand,

even though Croatia is giving up taxing the (self) employment income of these people, as well as probably inadvertently giving up taxing their other sources of income due to the inability to trace it, Croatia boasts one of the highest consumption taxes in the European Union (25% VAT). Therefore, one can argue that the income of the nomads will be taxed at the point of consumption during their stay in Croatia.

Questions remain, such as whether this deviation from horizontal equity, in the sense that all persons earning the same amount of income should be taxed at the same rate, is justified. Moreover, what does Croatia stand to gain from this “marketing trick”? Is it gaining more visibility in the IT sector? Would people come to stay and eventually start paying their fair share of taxes in Croatia? Alternatively, might they just leave and move on to the next tax-exempt country once their privileges in Croatia are over or the circumstances change for the worse?

## **8.6. Frontier workers**

Croatia is aware that many countries in the world concluded tax treaties in which they regulated the issue of tax treatment of frontier workers. Although Croatia has several neighbour countries, it did not negotiate tax treaty special tax treatment concerning frontier workers. Croatia is aware that the term “frontier worker” refers to an employee of a contracting state who:

- is resident for tax purposes in a municipality, the territory of which lies wholly or partly within 20 km of the border with the other contracting state;
- works as an employee in the border area of the other contracting state for a resident employer, a permanent establishment or a fixed base of that other state; and
- returns, in principle, daily to their principal abode in their state of residence.

Since Croatia does not have a special provision in tax treaties concerning frontier workers, it is important to stress that provisions similar to article 15(1) of the OECD Model would apply. It can be concluded that if a Croatian tax resident works from a home office in Croatia, then Croatia has the exclusive right to tax income earned in Croatia. That is in line with the first sentence of article 15(1) of the OECD Model (the so-called first rule): “Subject to the provisions of Articles 16, 18 and 19, salaries, wages and other similar remuneration derived by a resident of a Contracting State

in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State.”

Since Croatia does not have a provision regarding frontier workers in its tax treaties, it does not have a practical problem that would arise due to a change of residence state of the employer or board members who are more mobile.

From the Croatian point of view, it makes a clear difference whether the home office is imposed or just recommended by the government due to public health measures. If a home office was imposed by the government due to public health measures, then it was referred to as “lockdown”, which may vary in intensity from country to country. If, on the other hand, restrictions for going to work were applied, then Croatia would apply guidelines issued by the OECD Secretariat<sup>21</sup> as well as the Updated guidance on tax treaties and the impact of the COVID-19 pandemic.<sup>22</sup> However, if one is only referring to a recommendation, then regular OECD Model rules would be applicable. It should be reiterated at this point that Croatia only imposed a hard lockdown for a few months at the beginning of the pandemic in 2020. After that, it employed balanced measures related to the pandemic. The home office was a recommendation rather than imposed, and every enterprise was allowed to organize their work as they wished but had to adhere to epidemiological measures.

In relation to the issue whether frontier worker rules still make sense in times of increased mobility of workers, Croatia cannot give a practical empirical response since it does not have such provisions in tax treaties. Such provisions may help people living along the border who work in another country and return daily to the state of residence. This situation is not strange in Croatia, especially since some Croatian towns and villages are split by borders. In addition, this issue raises tax residence and (also automatically) taxation issues for people who are living along the border, because they can easily manoeuvre and use the benefits of both states and try to avoid paying taxes in a state that has higher tax brackets. It also needs to be pointed out that such a situation creates additional costs for the tax

21. OECD, *OECD Secretariat analysis of tax treaties and the impact of the COVID-19 crisis* (3 Apr. 2020), available at <https://www.oecd.org/coronavirus/policy-responses/oecd-secretariat-analysis-of-tax-treaties-and-the-impact-of-the-covid-19-crisis-947dcb01/> (accessed 17 Apr 2022).

22. OECD, *Updated guidance on tax treaties and the impact of the COVID-19 pandemic* (21 Jan. 2021), available at <https://www.oecd.org/coronavirus/policy-responses/updated-guidance-on-tax-treaties-and-the-impact-of-the-covid-19-pandemic-df42be07/> (accessed 17 Apr 2022).

administration of both border countries and further complicates the process of determining tax liabilities of taxpayers living along their borders.

Regarding the subsidies related to COVID-19, Croatia considers those remunerations non-taxable, and if they are received from abroad, the recipient of those receipts only has to report it to the Croatian Tax Administration so that the Croatian Tax Administration have information on the amount of receipts received by the recipient, because other rights depend on the amount the recipient received in Croatia and abroad, for example, certain rights provided by the Ministry of Labour, Pension System, Family and Social Policy.

### **8.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)**

Concerning the issue of whether Croatia deemed that employees working from a home office in Croatia as state of residence were still exercising their activities in their previous state of activity, it is worth mentioning that Croatia adhered to the guidelines issued by the OECD<sup>23</sup> and the Updated guidance on tax treaties and the impact of the COVID-19 pandemic.<sup>24</sup> During the hard lockdown, Croatia did not consider a home office in Croatia as a permanent establishment. After suspension of the hard lockdown and when states reopened their borders, there was no obstacle to consider that it was possible to apply the usual rules regarding the establishment of a permanent establishment since the home office was no longer imposed by the government but rather recommended in line with public health measures, and thus enterprises could decide for themselves.

It should be emphasized, however, that although Croatia applied appropriate measures from time to time, it maintained a balance throughout the pandemic without the imposition of a series of repetitive hard lockdowns. Based on that openness, there was no reason to consider that employees could not

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23. OECD, *OECD Secretariat analysis of tax treaties and the impact of the COVID-19 crisis* (3 Apr. 2020), available at <https://www.oecd.org/coronavirus/policy-responses/oecd-secretariat-analysis-of-tax-treaties-and-the-impact-of-the-covid-19-crisis-947dcb01/> (accessed 17 Apr. 2022).

24. OECD, *Updated guidance on tax treaties and the impact of the COVID-19 pandemic*, (21 Jan. 2021), available at <https://www.oecd.org/coronavirus/policy-responses/updated-guidance-on-tax-treaties-and-the-impact-of-the-covid-19-pandemic-df42be07/> (accessed 17 Apr 2022).



leave Croatia and go to their state of work in order to work from an apartment (home office) in that state without triggering the issue of potential home office permanent establishment of the foreign enterprise.

The position of Croatia is that, since the pandemic was an extraordinary event limited in time, it is not necessary to consider the idea of concluding mutual agreements or to have a consultation agreement with other treaty partners.

### **8.8. The future of the mobility of work: A need for adjusting the existing treaty rules?**

The Croatian Tax Administration has increased the requirement to change residency in relation to increasing work mobility, both for Croatian tax residents working in other countries and non-residents who came to work and live in Croatia. The immigration of foreign pensioners is also on the rise, both those with Croatian roots and those with no previous connection with Croatia but who are attracted by the low effective tax rate on pensions (below 10%) and the natural beauty of Croatia. As explained in section 8.3., digital nomads also come to live in Croatia, attracted by the ease of obtaining residence and work permits, as well as unparalleled tax benefits.

Setting aside the issue of digital nomads, where Croatia conscientiously made the choice not to tax a certain group of highly skilled IT workers in order to attract them to Croatia, the other main issue in the country seems to revolve predominantly around the question of whether a person is treated as an employee or a self-employed person.

Therefore, it is not so much the issue of whether existing tax treaty rules still make sense in an environment of increased mobility of work but rather how “work” is defined.

This phenomenon, which is not only characteristic to Croatia but also to all countries that have forms of sharing economy present in their territory, has been exacerbated in Croatia by the fact that Croatia has a particularly favourable tax treatment for “self-employment activities”, popularly called “flat-rate craft businesses” (*obrt*).<sup>25</sup> The regime provides that natural persons who earn income from a self-employment activity – i.e. income from crafts

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25. HR: *Pravilnik o paušalnom oporezivanju samostalnih djelatnosti* [Ordinance on flat-rate taxation of self-employment activities], Official Gazette 1/20, 1/21.

(and activities equal to crafts) or income from agriculture and forestry<sup>26</sup> up to HRK 300,000 annually (EUR 40,000) – could opt to pay personal income tax as a fixed annual amount ranging from HRK 1,275 to HRK 4,500 (approximately EUR 170 to EUR 600) paid quarterly. This regime, in which expenses were estimated as a lump sum at 85% and the 10% tax rate was applied on the deemed tax base, became very popular for many small businesses since taxes were easy to calculate and were very affordable. The regime implemented these measures in order to facilitate compliance of microbusinesses, and it has proved to be very popular, with the number of such registered “crafts” exploding since its introduction in 2017. For illustration purposes, in 2016, there were 9,300 registered craft businesses, whereas in 2022 the number was already around 60,000.<sup>27</sup>

However, many entrepreneurs have recognized this regime as a way to covertly employ people who would then act as service providers for their covert employers, paying far less personal income tax and social contributions than under the regime of a regular employment contract. Therefore, instead of the traditional “self-employed persons” like hairdressers, manicurists and florists increasing, it is the number of service providers, such as IT specialists, that has risen. Croatian legislators have responded by proposing amendments to the GTA by specifying criteria for determining the difference between employment and self-employment, based on three criteria, namely control of behaviour, financial control and relationship between the parties, all of which will be more detailed in the Ordinance on the Income Tax Act. In this sense, the authors consider that there is a need to specify, through an amendment to the OECD Model, new definitions of employer and employee in order to ensure a harmonized application of the OECD Model.

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26. Income from professions, trade and restaurateurs are excluded.

27. L. Gatarić, Veliki dossier: Država je pokrenula hajku na paušalce obrtnike. Što dalje i dokud su stigle kontrole?, Večernji list (31 Mar. 2022), available at <https://www.vecernji.hr/techsci/veliki-dossier-drzava-je-pokrenula-hajku-na-pausalce-obrtnike-sto-dal-je-i-dokud-su-stigle-kontrole-1574883> (accessed 1 Apr. 2022).

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## Chapter 9

# The Impact of Tax Treaties on International Mobility of Work in Cyprus

Eleni Apostolidou

### 9.1. Mobility of work and domestic tax law

The COVID-19 pandemic had an unprecedented impact on Cyprus due to the insular character of the jurisdiction. The governmental measures of travel restrictions and the cancelled flights resulted in a generalized ban on departures and arrivals to the island for the period from 21 March 2020 to 9 June 2020. Temporary interruptions for business in all sectors were imposed as a public health measure, and the Cyprus government largely subsidized corporations with stimulus packages.

It is a fact that, globally, the COVID-19 pandemic has led to the adoption of special measures; among them were the imposition of travel restrictions, the mandatory stay at home, the provision of remote working, and/or suspension of employment contracts. These measures placed restrictions on the physical presence of individuals in the workplace and thus raised concerns related to the possible effect on the status of tax residence of individuals and legal persons/entities; also, a legal risk arose as to the impact of these measures on the existence of a permanent establishment for businesses. The matter was material as Cyprus has tax incentives for taxpayers earning most of their employment income abroad and schemes for retired expatriates<sup>1</sup> whose links with the previous home country remain solid.

In that context, the Cyprus tax authorities issued specific guidance following the OECD Secretariat analysis of tax treaties and the impact of the COVID-19 crisis.<sup>2</sup> The guidance on the application of tax residence and permanent establishment provisions under the income tax law in the context of the COVID-19 crisis was released in the form of an implementing directive in

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1. CY: Ο περί Φορολογίας του Εισοδήματος Νόμος, 118(I) του 2002, [Income tax law 118(I)2002], arts. 36(5) and 20.

2. OECD, *OECD Secretariat analysis of tax treaties and the impact of the COVID-19 crisis* COVID-19(OECD 3 Apr. 2020), available at <https://www.oecd.org/coronavirus/policy-responses/oecd-secretariat-analysis-of-tax-treaties-and-the-impact-of-the-2019-crisis-947dcb01/> (accessed 15 June 2022).

October 2020<sup>3</sup> (Income tax law COVID-19 guideline). A second directive providing for the extension of the COVID-19 regime to 2021 followed up to stay enforced as long as specific COVID-19 measures applied worldwide (the extending guideline).<sup>4</sup>

The Cyprus tax authorities acknowledged that the guidance issued by the OECD is not compulsory, yet adopted the approach of transposing that guidance into domestic law and expressed a commitment to incorporate any future OECD guidelines concerning the impact of COVID-19 on the interpretation of tax treaties. Despite the legal significance of this fiscal public policy stance taken, it is important to note that the practical impact of this provision has been limited, as there have been no subsequent updates from the OECD on the COVID-19 impact on tax treaties interpretation since the adoption of this approach. It was thus clarified that the Income tax law COVID-19 guideline was introduced into domestic law on an optional basis and that it would only apply if and when the taxpayer explicitly opts in; otherwise, the pre-COVID-19 legislation remains enforced.

It is worth noting that the Cyprus tax authorities subsequently released a set of interpretative circulars for COVID-19 subsidies granted by the Ministry of Labour, Welfare and Social Insurance<sup>5</sup> (the guidelines on COVID-19

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3. Tax Department, Εφαρμοστική Οδηγία 04/2020, Εφαρμογή των διατάξεων περί φορολογικής κατοικίας και μόνιμης εγκατάστασης σύμφωνα με τον περί Φορολογίας του Εισοδήματος Νόμου (άρθρο 2) στο πλαίσιο της κρίσης που προκλήθηκε λόγω της πανδημίας COVID-19 [Implementing Directive on the application of the tax residence and permanent establishment provisions under the Income tax law (article 2) in the context of the crisis caused by the COVID-19 pandemic], (27 Oct. 2020), CTA. Ann. 2020-04, point 1.3.

4. Tax Department, Εφαρμοστική Οδηγία 07/2021 Εφαρμογή των διατάξεων περί φορολογικής κατοικίας και μόνιμης εγκατάστασης σύμφωνα με τον περί Φορολογίας του Εισοδήματος Νόμου (άρθρο 2) στο πλαίσιο της κρίσης που προκλήθηκε λόγω της πανδημίας COVID-19 [Implementing Directive 07/2021 on tax residency and permanent establishment under the Income tax law (article 2) in the context of the COVID-19 pandemic] (25 Jan. 2021), CTA. Ann. 2021-07.

5. Tax Department, Ερμηνευτική Εγκύκλιος 44-Φόρος Εισοδήματος, Φορολογικός χειρισμός επιδομάτων που παραχωρούνται από το Υπουργείο Εργασίας, Προνοίας και Κοινωνικών Ασφαλίσεων [Interpretative Circular 44, Income Tax, Tax treatment for subsidies granted by the Ministry of Labour and Social Insurance] (22 June 2020; Tax Department, Ερμηνευτική Εγκύκλιος 48-Φόρος Εισοδήματος, Φορολογικός χειρισμός κρατικής χορηγίας λόγω COVID-19 [Interpretative Circular 48, Income Tax, Tax Treatment for State subsidies due to COVID-19] (20 July 2021); Tax Department, Ερμηνευτική Εγκύκλιος 49-Φόρος Εισοδήματος, Φορολογικός χειρισμός επιδομάτων που παραχωρούνται από το Υπουργείο Εργασίας, Προνοίας και Κοινωνικών Ασφαλίσεων [Interpretative Circular 49, Income Tax, Tax treatment for subsidies granted by the Ministry of Labour, Welfare and Social Insurance] (20 July 2021).

subsidies). These separate guidelines deal with the tax regime for subsidized employment income and social contributions under domestic law.

Differently, the Income tax law COVID-19 guidelines cover the impact of COVID-19 on the interpretation of the definitions of “tax resident” and “permanent establishment” not only for securing Cyprus tax residency under domestic law, but also for the purposes of determining Cyprus tax residence for tax treaties purposes.<sup>6</sup>

As a general statement, it is notable the Income tax law COVID-19 guideline precisely refers exclusively to the tax treatment from the Cyprus side notwithstanding the tax treatment of the targeted income and tax residency status of the individuals or businesses in any other state involved and irrespective of whether the other jurisdiction is the state of residence or of source. This has implications for “dual residence” individuals and “stateless” corporations, to be further discussed under section 9.2.

The Income tax law COVID-19 guideline sets a temporary and factual fiction for the period from 21 March 2020 to 9 June 2020.<sup>7</sup> This was the period of restricted travel and strict quarantine requirements during which cross-border workers and business people were unable to physically perform their duties in their country of employment and/or duty. For taxpayers to benefit from the COVID-19 tax treatment, no evidence is requested that the inability to travel results from the COVID-19-related restriction. However, if the determined period extends before 21 March 2020 or after 9 June 2020, the tax treatment depends upon all the facts and circumstances over the determination period, and the taxpayer is required to provide relevant supporting documents for the objective inability to reach the location of employment or duty.

Moreover, this text is normative in the sense of setting a general framework to stand as a range of factors for the determination of tax residency. The authorities deal with fact patterns on a case-by-case basis.<sup>8</sup> The extending guideline kept the regimes’ validity until the end of 2021,<sup>9</sup> and provided for the initial rules to remain the same and apply “by analogy”. This may engender interpretative challenges as this period, the second year of the pandemic, did not witness the imposition of absolute travel restrictions. This lack of stringent travel limitations could complicate the application and

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6. CTA. Ann. 2020-04, point 1.3.

7. Id., at point 1.4.

8. Id, at point 2.9.

9. CTA. Ann. 2021-07, point 1.

understanding of the rules on factual patterns and on a case-by-case basis assessment by analogy during a time when movement was less restricted compared to the initial phase of the pandemic and beyond.

Tax law in Cyprus was enriched with the Income tax law COVID-19 guideline to facilitate the determination of tax residency status for both individuals and corporations during this unprecedented period. It is crucial to contextualize this guideline within the broader framework of the national tax system, which is strategically designed to attract foreign investment by offering incentives for individuals and corporations to establish tax residency in Cyprus. This strategy aligns with the global shift towards substance requirements prompted by the base erosion and profit shifting (BEPS) initiative. Within this strategy, Cyprus has introduced two notable regimes: the non-domiciled regime<sup>10</sup> and the 60-day rule,<sup>11</sup> both aimed at enabling individuals to ensure their Cyprus tax residency status, and a new legal provision for “stateless companies”. Moreover, Cyprus has put in place tax exemptions for income from abroad, notably the schemes on foreign employment income, investment income and capital gains.<sup>12</sup> The COVID-19-specific guideline is intended to operate in conjunction with these established regimes, ensuring continuity and coherence in the application of tax residency regimes during the pandemic.

As per the general rule, the Cyprus tax system is modelled after worldwide taxation, and Cyprus tax residents are entitled to the benefits of the Cyprus tax treaties network. No tax residents are subject to tax on a limited basis which only covers Cyprus-source income.<sup>13</sup> Cyprus domestic law sets two sets of tax residence tests, i.e. the 183-day rule and the 60-day rule.<sup>14</sup> Individuals are deemed to be Cyprus tax residents and are relieved from double taxation in virtue of international conventions if they either reside in Cyprus for at least 60 days per year provided they are not resident in any other state within the same tax year, or remain in Cyprus for 183 days in that tax year.

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10. CY: Ο Περί Έκτακτης Εισφοράς για την Άμυνα της Δημοκρατίας Νόμος του 2002 (117(I)/2002) [Special Contribution for Defence 2002 (117(I)/2002)], art. 2(3).

11. CY: Ο περί Φορολογίας του Εισοδήματος Νόμος, 118(I) του 2002 [Income tax law 118(I)2002], art. 2.

12. CY: Ο Περί Έκτακτης Εισφοράς για την Άμυνα της Δημοκρατίας Νόμος του 2002 (117(I)/2002) [Special Contribution for Defence 2002 (117(I)/2002)], art. 3(6).

13. CY: Ο περί Φορολογίας του Εισοδήματος Νόμος, 118(I) του 2002 [Income tax law 118(I)2002], art.5(2).

14. Id., at art. 2.

Both residency statutes apply similar rules for the physical presence test related to the computation of days spent on the island that are not necessarily consecutive and may be spread over the calendar year as follows:

- the day of departure from Cyprus shall be deemed to be a day outside Cyprus;
- the day of arrival in Cyprus shall be deemed to be a day in Cyprus;
- arrival in Cyprus and departure from Cyprus on the same day shall be deemed to be one day in Cyprus;
- departure from Cyprus and return to Cyprus on the same day shall be deemed to be a day out of Cyprus; and
- the individuals maintain a permanent residence in Cyprus that is owned or leased by the individuals themselves.

Besides and above the requirement for physical presence within the jurisdiction, a set of factors establishes the nexus to the Cyprus jurisdiction. Therefore, individuals need to have sufficient economic links and permanency to satisfy the conditions to be met for Cyprus to be the place of their habitual abode. Nexus factors are set in virtue of statutory and administrative law. The statutory law prescribes,<sup>15</sup> for business activity in Cyprus, an employment appointment by an entity resident in Cyprus and/or holding an office in a Cyprus tax resident company at any time during the relevant tax year; nevertheless, termination of the economic activity during the tax year incurs the loss of residency.

As per the non-domiciled rules,<sup>16</sup> individuals who reside in Cyprus for either 60 or 183 days during the tax year but do not hold a “domicile of origin” received at birth, benefit from tax exemptions on their worldwide income. This is conditional upon not having resided in Cyprus for at least 17 out of 20 years before the relevant tax year. Individuals who hold a Cyprus domicile of origin are eligible for the scheme provided they had acquired and maintained a domicile outside Cyprus for the decisive period of 20 consecutive years before the determined tax year or had not been Cyprus tax residents for a determined period.

If the regimes mentioned above do secure a tax residency in Cyprus, such a position provides for tax exemptions on employment and investment income. Cyprus-source employment income benefits from a 50% or 20% exemption if the annual remuneration exceeds certain thresholds and the individuals have not been Cyprus tax residents prior to the commencement

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15. Id., at art. 2.

16. CY: Ο Περί Έκτακτης Εισφοράς για την Άμυνα της Δημοκρατίας Νόμος του 2002 (117(I)/2002) [Special Contribution for Defence 2002 (117(I)/2002)], art. 2(3).

of their employment.<sup>17</sup> As for worldwide employment income, a specific regime applies to employment income from an appointment exercised outside of Cyprus for more than 90 days in aggregate in the tax year. Under this regime, the employer needs to be a non-Cyprus tax resident or a foreign permanent establishment of a Cyprus tax resident company.<sup>18</sup> Investment income benefits from tax exemptions on capital gains if generated from the disposal of securities; passive income such as dividend and interest is exempted<sup>19</sup> from both the income tax and the special contribution for defence in the hands of non-domiciled tax residents. Differently, domiciled taxpayers do suffer taxation on the above mentioned items of income but only under the special contribution for defence. Besides, other earnings benefit from a full exemption, such as retiring gratuity, commutation of pension, death gratuity, or as consolidated compensation for death or injury, lump-sum repayment from life insurance schemes or approved provident funds, and capital gains from the disposal of intellectual property rights under the R&D regime.<sup>20</sup>

Briefly, under the Cyprus tax regime, the degree of mobility of work and the physical presence is decisive for triggering worldwide taxation; however, the thresholds are low and, at the same time, broad income exemptions apply to those who only have a limited presence. As the threshold is set at 60 days per year, COVID-19 travelling restrictions could undermine the residence status of individuals:

- who wished to secure their tax residency although not present for 60 days or 183 days; and
- who wished to maintain their non-residence status and had been stranded on the island for a period of 60 days or 183 days in Cyprus.

The Cyprus Income tax law COVID-19 guideline addresses these concerns by admitting COVID-19 imposed exceptional circumstances when individuals may have been prevented from travelling to Cyprus on their intended day of arrival and/or have been unable to be physically present in their station of duty. For defining their residence status, the absence of physical presence during the COVID-19 determined period is disregarded, and their tax residency status is maintained.

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17. CY: Ο περί Φορολογίας του Εισοδήματος Νόμος, 118(I) του 2002 [Income tax law 118(I)2002], art. 8(23).

18. Id., at art. 21.

19. Id., at art. 8(19), 8(20), 8(22).

20. CY: Ο Περί Φορολογίας Κεφαλαιουχικών Κερδών Νόμος του 1980 (52/1980) [Capital Gains taxation 1980 (52/1980)], arts. 4 and 5.



Regarding the individuals with a residence status under the 60-day rule, the Income tax law COVID-19 guideline provides an example of individuals who only resided in Cyprus for 30 days instead of 60 within the year. The example notes that, if the individuals spent the rest of the time abroad, including the entire period of restrictive measures, they are deemed to have been physically present in Cyprus for the period covered. The COVID-19 days are counted for attaining the 60 days under the physical presence test provided that all other conditions are met.

Similarly, concerning individuals with a residence status under the 183-day rule, there is a presumption of deemed physical stay covering the period of COVID-19. The calendar days failing under the COVID-19 period are counted for reaching the aggregate number of 183 days provided all other conditions are met, i.e. the taxpayer maintains a permanent residence in Cyprus, carries out business in Cyprus, is employed in Cyprus or holds an office in Cyprus, and has not remained in any other state for more than 183 days.

It is noteworthy that the Income tax law COVID-19 guideline does not provide explicit instructions on the method for calculating the days presumed to determine whether the individuals have not reached the 183 days in another state. Conversely, a separate piece of administrative law, a circular<sup>21</sup> introducing a fast-track procedure to obtain the 60-day rule tax residency certificate, elaborates on the calculation of the 183 days spent abroad. Pursuant to that circular, individuals that reside in a jurisdiction where the tax year that does not align with the calendar year are eligible for Cyprus tax residency. An example of such a jurisdiction is the United Kingdom, where the tax year spans from 6 April to 5 April. Consequently, UK residents are considered to meet the requirements of the 60-day rule after accumulating 60 days of physical presence in Cyprus, whether consecutive or not, within the tax year. Under this scheme, the rules are relaxed, permitting individuals to apply for the Cyprus tax certificate before completing 60 days of residence within the year.

As an anti-abuse provision, the tax residency status is lost if, within the year, the economic activity of the individual in Cyprus ceases, i.e. the exercise of any business and/or the employment or holding of an office is terminated.<sup>22</sup>

21. Tax Department, Εγκύκλιος 1/2022, Φορολογική κατοικία σύμφωνα με τη νομοθετική διάταξη των 60 ημερών παραμονής στη Δημοκρατία [Circular 1/2022, Tax residence pursuant the legislative provision of sixty days of residence in Cyprus] (1 Feb. 2022).

22. CTA. Ann. 2020-04, point 13.

Inversely, the physical presence test and the exceptional stay in Cyprus due to COVID-19 measures shall not trigger any change for individuals with a non-tax residency status.<sup>23</sup> The days of physical presence are disregarded for the period from 21 March 2020 to 9 June 2020 for those individuals whose stay in Cyprus is solely due to reasons related to the pandemic and the relevant travel restrictions. The days of physical stay within the covered period are disregarded for the purposes of determining their tax residency status.

The Income tax law COVID-19 guideline provides an example in which an individual having his habitual abode abroad remains in Cyprus for 220 days until the end of 2020, of which 60 days concern the period of travel restrictions. The days are not counted to attain the tax residency status unless the individual fails to provide relevant evidence under the facts and circumstances to secure that position.<sup>24</sup> A set of factors are decisive, i.e. the evidence of no prior tax residency in Cyprus the year before and/or a tax residency certificate from a foreign jurisdiction if relevant. However, this anti-abuse provision is not a catch-all rule; stateless tax residents are not deemed to be Cyprus residents solely because they are stranded in Cyprus during the COVID-19 period.

The corporate tax residence treatment under COVID-19 is shaped by the rules applying to individuals. Some background information on Cyprus corporate tax residence is useful. As per the general principle, the Cyprus corporate residency depends upon the place of effective management of the entity. Until recently, the Cyprus system only relied on this prong. The definition of the place of management under domestic law aligns with the definition under international tax law. The place of effective management is located where the meetings of the corporate body appointed to make strategic management decisions are held. More recently, the legal seat prong has been added to the test as supplementary. The statutory law is to be enforced by the end of 2022. Pursuant to this law, a stateless tax entity is deemed to be a Cyprus tax resident if incorporated or registered in Cyprus.<sup>25</sup>

COVID-19 had an impact on the place of effective management, raising concerns for directors of non-resident companies stranded on the island. The Cyprus Income tax law COVID-19 guideline waived those concerns noting

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23. Id., at point 13, and example 1.

24. Id., at point 14.

25. CY: Ο περί Φορολογίας του Εισοδήματος Νόμος, 118(I) του 2002 [Income tax law 118(I)2002], art. 2.

that<sup>26</sup> a non-Cyprus tax resident entity is not to become a resident in Cyprus for tax purposes due to the temporary stay of its personnel, directors, representatives, or employees if that stay results exclusively from COVID-19.

Conversely, COVID-19 has compromised the ability of the members of the corporate body to physically attend the meetings and take management decisions in Cyprus. The guideline clarifies that the tax residence status of a legal entity is not affected by the inability of a director to travel to Cyprus and failing to attend a meeting of the board of directors for reasons exclusively related to COVID-19.<sup>27</sup> It is further addressed that all factors and circumstances are to be considered on a case-by-case basis, and evidence may need to be provided for tax audit purposes.

Cyprus authorities took the stance that COVID-19 must not undermine the concept of substance as conceived under BEPS. The need for premises and significant people exercising special functions and assuming risks continues to determine the creation of a permanent establishment. Digital work processes only fit in the concept of work mobility for the duration of COVID-19.

The Cyprus Income tax law COVID-19 guideline sets a legal fiction with a general presumption of inability to travel and physically be present at the premises. Thus, the days of remote work and telework are counted as days of physical presence. Put in these terms, what has not been asserted is the extension of these practices in the business and employment models beyond the COVID-19 period. As previously described, for someone to benefit from the COVID-19 regime, their physical absence needs to be involuntary and temporary. The legal test relies upon the fact and circumstances of the person's conduct the year before and after the COVID-19 period. As such, the legal test does not encompass any elements related to the post-COVID-19 attitudes or life changes. Consequently, it may be assumed that the substance test remains intact; the prongs of physical presence and the existence of premises are not abandoned.

In addition, the Income tax law COVID-19 guideline spells out that no permanent establishment is deemed to be created and no entity gains the tax residency status by the sole fact that employees resided in Cyprus.<sup>28</sup> It can be argued that this statement may lead to understanding that the home office is assimilated to business premises and weighed in for asserting the

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26. CTA. Ann. 2020-04, point 10.

27. *Id.*, at point 11.

28. *Id.*, at point 10.

substance requirement. However, as no provision explicitly treats the home office, it remains unanswered when the home office is deemed to be business premises under the corporations' substance test, determining the outcome of the corporation's tax residency test.

Also, the shortfall of an entity to meet the substance requirements in Cyprus and the empty permanent establishment of a foreign company in Cyprus or the Cyprus empty permanent establishment abroad has an impact on the tax treatment of the entity's income. While it is acknowledged that Cyprus imposes identical tax rates and treatments on resident and non-resident companies, yet such companies are subject to limited tax liability covering the only Cyprus-sourced income. Inherently, this results in the allocation of worldwide income to jurisdictions other than Cyprus, which may subsequently lead to an increased tax burden. This outcome is pertinent to the disparities in tax rates between Cyprus and the other jurisdictions given that the Cyprus corporate tax rate is relatively low. Additionally, it is important to note that no other domestic tax liabilities arise as passive income received by non-resident companies is not subject to the special contribution for defence.

Further, the beneficial ownership status of the company as the recipient of passive income under the tax treaties is compromised. Under the treaties, dividend income, interest, and royalties benefit from reduced withholding taxes if the recipient of the payment is the beneficial owner.<sup>29</sup> Consequently, higher withholding taxes may be levied abroad for income received by an entity established in Cyprus if the entity ceases to meet the substance requirements and no longer qualifies as the beneficial owner.

Moreover, the loss of corporate tax residency may result in exit taxes; the same applies for the transfer of tax residence. The Cyprus exit tax regime covers legal entities, Cyprus corporations, and Cyprus permanent establishments of foreign corporations.<sup>30</sup> The gains realized on the transferred assets are subject to corporate tax provided they are not subject to redemption to the benefit of another entity subject to tax in Cyprus within a period of 12 months following the transfer. Liquidation proceeds after the termination of business are subject to a special contribution for defence within the hands of the shareholders as dividend income if they are tax residents in Cyprus. The rules are only triggered upon the transfer of assets to another

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29. *OECD Model Tax Convention on Income and on Capital* arts. 10-12 (21 Nov. 2017), *Treaties & Models* IBFD.

30. CY: Ο περί Φορολογίας του Εισοδήματος Νόμος, 118(I) του 2002 [Income tax law 118(I)2002], art. 33b.

entity established in the European Union or a third country and not upon liquidation proceeds from the termination of business.<sup>31</sup> Therefore, exit taxes have a limited impact on businesses.

In the context of the enhanced substance requirements for determining a corporation's tax residency status, as prescribed by the BEPS initiative, and the updated commentary from the OECD in 2017 on residency criteria, which reintroduces the legal seat as a supplementary criterion in the sequence of criteria to determine tax residency, Cyprus enacted the "stateless company regime." This regime, to be further discussed in section 9.2., revises the corporate residency test in Cyprus to incorporate an additional fiscal nexus based on the company's place of incorporation. According to this revised test, a company that would otherwise be considered tax stateless under the place of effective control criterion gains Cyprus tax residency if it is incorporated there. This piece of legislation showcases the limitations of the legal seat supplementary criterion and the necessity of a transactional-based analysis under substance rules, emphasizing the physical location of the executives who have conducted significant activities and assumed risks for the pertinent transactions.

## **9.2. Residence, tiebreaker rules and mobility of work: Individuals and entities**

The determination of tax residency under article 4 of the OECD Model (2017) allocates the taxing rights between states. The tiebreaker rule determines one sole state of residence, and the matters of dual residency are resolved for the benefit of only one of the contracting states. The amended version of the OECD Model notably adds the criterion of the place of an entity's legal seat to the legal test of corporate tax residency and prescribes a set of factors to determine the place of effective management of the company. Moreover, it imposes the denial of tax treaty benefits unless a mutual agreement procedure for resolving dual residence matters reaches a conclusion. The forthcoming analysis will explore the tax consequences of these revised 2017 OECD guidelines, illustrating potential shortcomings in achieving the intended reduction of dual residency cases and profit shifting, particularly when these rules interact with the domestic tax legislation of Cyprus concerning "stateless" individuals and companies. This interaction

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31. CY: Ο Περί Έκτακτης Εισφοράς για την Άμυνα της Δημοκρατίας Νόμος του 2002 (117(I)/2002) [Special Contribution for Defence 2002 (117(I)/2002)], art. 3b.

may inadvertently transform “stateless” taxpayers into dual residents, thus contravening the original objectives of the OECD provisions.

Considering the tax residency for individuals, dual residency cases may arise under the Cyprus tax residency scheme of 60 days of stay. As has been previously described under section 9.1., Cyprus (State B) does not treat an individual who holds a tax residency in a jurisdiction applying a tax calendar different than the civil year (State A) as tax resident of State A. That individual becomes eligible for tax residency in State B for the whole calendar year, covering the period the individual resided in State A, provided certain conditions are met, such as the 60-day stay in State B. Under this pattern, dual residency may arise during the overlapping period when the person did not reside in Cyprus. It is worth noting that, under the OECD Commentary,<sup>32</sup> both State A and State B should treat the individual as a State A resident for the period having resided in State A and as a State B resident for the shorter period of residency in State B. The situation becomes more complex since the Cyprus rule is shaped in such a way that the individual is deemed to be a resident for the whole year. The conflict of dual residency covering the overlapping period is most probably to be resolved in favour of the other jurisdiction involved (State A).

In the light of the above example, it becomes disputable whether international tax law should rely on the physical presence and its duration along with the habitual and permanent abode to decide on an individual’s dual tax residency case. When it comes to resolving cases of short durations of overlap, these factors are inoperative to some extent or may give unsatisfactory results for resolving the issue.

Regarding the corporate tax residency, new Cyprus rules maintain the place of effective management of the company as the principal factor. A supplementary test was added<sup>33</sup> for stateless companies that either have their place of effective management in no jurisdiction or have their place of effective management in a jurisdiction that applies the legal seat test. From this mismatch, the entity falls under the definition of a “stateless tax residency” company. The Cyprus amended law provides for tax residency for these entities if registered in Cyprus.

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32. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 4*, para. 2 (18 Dec. 2017), Treaties & Models IBFD.

33. CY: Ο περί Φορολογίας του Εισοδήματος Νόμος, 118(I) του 2002 (amended 2022) [Income tax law 118(I)2002], art. 2.

The new supplementary rule is introduced as an anti-abuse provision following the OECD post-2017 amendment for dual companies pursuant to article 4(3) of the OECD Model (2017). Under the previous version, the decisive factor for resolving dual residency was the place of effective management based on the definition of the place where the entity is managed regarding the place where the meetings of the board of directors are held. However, a determination based on only a single factor was considered not to be tax abuse proof. It was admitted that core decisions on financial, legal, audit, commercial and trade strategies are not taken daily, and meetings may be held for tax purposes in one specific place rather than another.

The amended version suggests that the competent authorities resolve dual residency cases considering a set of nexus factors: where the executives usually carry on their activities, where the senior day-to-day management is performed, where the legal and audit records are kept, and which countries' laws govern the status of the person, where the headquarters are located, and the place of the legal seat of the entity. In the former version, the preference was given to the place of effective management, which meant the place where the executive board makes the strategic decisions. The criterion becomes irrelevant when the strategic decisions are the outcome of long processes with diverse milestones, held by digital means, and the only last point of that process is considered. Differently, under the new rule, all prongs are equal with no primary or decisive factor. Hence, the purely formal criterion of the place of registration has been reintroduced.

These developments merit some observations. Firstly, it is uncontestably preferable to rely on a set of factors rather than on one factor to avoid circumventing the rule. However, the new version may cause concerns. Firstly, the factors mentioned above are easy to flex. An entity may opt for the jurisdiction of its preference for which country's laws govern its status, where the legal and audit records are kept, and the place of its incorporation without compromising its activity in targeted markets.

Secondly, as for the factors relevant to the place where the executives usually carry on their activities and the seniors perform the day-to-day management, it may be said that these factors are somehow outdated and inoperative due to the digitalization of daily micro and medium management. Senior executives are not necessarily physically present at the premises to perform the day-to-day management and even less at the headquarters. This is more probable to become the rule for companies in consulting, audit and tax advisory, where the projects are carried out at the premises of the client and executives work on a project basis. It also holds true for other industries,

such as the energy supply, the construction industry and transport, without exhaustively listing all sectors concerned.

Thirdly, the executives may share most of their time between their home office and the premises of the client and only spend some days a month at their premises. If the senior executives hold their residency in different jurisdictions for personal reasons other than the jurisdiction of the establishment of the company, the rule becomes difficult to put in place. For instance, an entity keeps its headquarters in Luxembourg and some of the executives opt for residency in jurisdictions with non-domiciled tax regimes like Cyprus, Greece or Portugal in order to reduce their tax burden, whereas others move back to their home states, such as Italy or Spain. The place of daily management performed by these executives is not one but as many as the jurisdictions of their personal domiciliation. Moreover, the test makes use of the day rule regarding how executives' days are allocated through jurisdictions. Moreover, there is an extra layer to be added to the equation, namely temporariness. The executives having opted for a non-domiciled tax regime do not elect for a permanent abode; their stay may end upon termination of tax holidays from which they benefit. Hence, the tax residency of the company is to depend upon the relocation of individuals in different periods of their personal life. The result is that the company's tax residency becomes unstable.

The post-2017 dual residency rules have squashed the need for a deciding factor to resolve these cases and instead introduced a mandatory mutual agreement procedure; unless a solution is reached, tax treaty benefits in both jurisdictions are denied. In a setup as previously discussed, where the headquarters are in Luxembourg, the status of the company is drafted under UK law, and the legal, compliance, insurance and financial audit is outsourced to firms established in Cyprus, the permanent establishment is disputed between multiple jurisdictions. Taking it from there, there is a risk of multiplication of mutual procedures to be launched by all jurisdictions involved on a bilateral basis. It is assumed that companies are to react by electing tax jurisdictions where tax residency companies are subject to a reduced corporate tax rate with no taxes on passive income in order to make the use of tax treaty benefits unnecessary for them. It is obvious that companies cannot afford to monitor two or three mutual agreement procedures on their expenses until a solution is reached.

Alternatively, companies may seek to put policies in place forcing the executives not to make use of their remote working days for turning back to their place of residence. However, such a business practice may be contested



before the courts to infringe equality between employees regarding the constitutional right of personal and family life.<sup>34</sup> In any sense, the maintenance of remote and hybrid work practices inevitably results in allowing the use of home offices.

The Cyprus corporate tax residence supplementary legal test was meant to be a tool against treaty shopping; however, it may result in having the opposite effect. The entities may intentionally spread their nexus factors to different jurisdictions to make the criterion of effective management inoperative. It would result in those entities becoming “stateless” tax residents. Consequently, the determination of their corporate tax residency would fall back to the criterion of the legal seat, which stands as the rule for securing their tax residency in Cyprus. The OECD’s new set of factors, intended to be a step beyond the flexible criterion of effective management, reintroduced the place of the board of directors’ meetings. Unexpectedly, it could result in restoring primacy for the disused criterion of legal seat to determine the corporate tax residency.

By way of conclusion, Cyprus’ fiscal policy beyond tax technicalities merits attention. The jurisdiction has undertaken substantial efforts to enforce substance for corporate entities; the concept relies on the presence of premises and staff recruited onshore. Cyprus maintains a firm stance on the necessity of these premises and employees. It is understood that this limits the reputation risks for the jurisdiction and sustains the local economy. However, an opening was missed for Cyprus to model a new set of factors dealing with substance concerns more accommodating to the digitalization of businesses. Such a breakthrough would have allowed to overcome the insufficiency of workplaces and for the increase of mobile work patterns for companies making use of the jurisdiction as a regional hub.

### 9.3. Permanent establishments and mobility of work

Cyprus’ Income tax law COVID-19 guideline covers the non-creation of a permanent establishment resulting from the stay of individuals working for foreign companies. Moreover, it emphasizes the decisive character of the involuntary stay in Cyprus for the permanent establishment not to be

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34. SE: ECJ, 1 July 2004, Case C-169/03, *Florian W. Wallentin v. Riksskatteverket*, Case Law IBFD (accessed 31 May 2022); SE: ECJ, 19 Nov. 2015, Case C-632/13, *Skatteverket v. Hilikka Hirvonen*, Case Law IBFD (accessed 31 May 2022); GE: ECJ, 18 July 2017, Case C-566/15, *Konrad Erzberger v. TUI AG*.

created<sup>35</sup> together with the factor of temporariness. These are the two prongs set under the legal test for the non-creation of a permanent establishment. Entering into the technicalities, Cyprus' Income tax law COVID-19 guideline provides as an example the employees under contract appointment, the directors and representatives of foreign companies with no premises stranded in Cyprus; their physical presence does not create a permanent establishment for the foreign company. Conversely, Cyprus' permanent establishment continues to exist even if employees, directors, or representatives are involuntarily stranded abroad. The temporary and involuntary character of the individuals' stay is asserted based on the facts and circumstances within an extended timeframe that covers the pre and post-COVID-19 periods.

#### **9.4. Physical presence according to articles 15(1) and 17 of the OECD Model**

This development is dedicated to the tax treatment of employment income under tax treaties and domestic law, notably for tax exemption schemes affected by COVID-19 and the tax qualification of COVID-19 subsidies.

Cyprus' Income tax law COVID-19 guideline notes that “stranded workers” prevented from returning to their state of residence or the state of their employment remain taxed in the state where article 15 would otherwise allocate the taxing rights. The determined period sets a legal fiction of presence in the state of duty or habitual state of physical presence, and all kinds of remuneration from employment are taxed as per the usual rules.

The Cyprus Income tax law COVID-19 guideline does refer to the influence of the COVID-19 crisis on service PEs and on independent personal services of article 14 of the OECD Model (2017). In both cases, the physical presence of independent service providers does not give rise to tax liability and no permanent establishment is created provided that the change of place remains involuntary.<sup>36</sup>

The Cyprus tax system provides two schemes of income tax exemption that could have been affected by COVID-19. These are the tax exemptions for executives in work mobility and the first employment income exemption.

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35. CTA. Ann. 2020-04, point 6.

36. Id., at points 2.5. and 2.6.

The Cyprus Income tax law COVID-19 guideline brought arrangements for the COVID-19 period for both regimes.

Under domestic law, the tax exemption of executives in work mobility is granted for remuneration from employment performed abroad for at least 90 days per year.<sup>37</sup> The Cyprus Income tax law COVID-19 guideline deals with the issue of the executives being unable to go abroad for the performance of their work<sup>38</sup> and at risk to have their exemption revoked. These rules clarify that the tax treatment of employment in work mobility is not affected in any way, considering the usual practice of the employment contract of these executives and the normal course of their business practice, the actual conditions, as well as the practice of previous years. The example<sup>39</sup> of an individual is put forward. The person remained in Cyprus for 325 days, of which 60 days are due to the pandemic, and stayed abroad for 40 days. For this fact pattern, the 60 days are deemed as days of a stay abroad and aggregated with the 40 days of actual stay, so that the overall days abroad are 100. This allows reaching the 90-day threshold for the purposes of the income tax exemption.

Regarding the first employment income exemption, Cyprus' Income tax law COVID-19 guideline explicitly refers to the 50% exemption of the remuneration from any employment exercised in Cyprus by a person who was resident outside Cyprus before the beginning of his employment if the income from such employment exceeds EUR 100,000 per year.<sup>40</sup> Moreover, it clarified that<sup>41</sup> the exemption still applies even if the employee suffers a reduction in his income from employment and receives less than EUR 100,000 per year due to reductions made solely for the reasons of the extraordinary measures taken by the government and/or employers in the context of the pandemic. The individual is deemed to have received an employment income of more than EUR 100,000 per year based on evidence such as a certificate of remuneration, monthly payrolls, a decision of the employer to impose a reduction of pay across all the staff, or on a selective basis.

A brief development is dedicated to the tax treatment of COVID-19 subsidies granted by the Ministry of Labour, Welfare and Social Insurance

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37. CY: Ο περί Φορολογίας του Εισοδήματος Νόμος, 118(I) του 2002 [Income tax law 118(I)2002], art. 36(5).

38. CTA. Ann. 2020-04, point 19.

39. Id., at example 2.

40. CY: Ο περί Φορολογίας του Εισοδήματος Νόμος, 118(I) του 2002 [Income tax law 118(I)2002], art. 8(23).

41. CTA. Ann. 2020-04, point 18.

pursuant to the guidelines issued, i.e. the guidelines on subsidies.<sup>42</sup> The regime in place distinguishes between employees on the one side, and self-employed and companies on the other.

Pursuant to the guidelines on subsidies, the government grants allocated to employees are not assimilated into employment income. These arguments are put forward: the subsidies are not paid as emoluments arising from the contract of employment in respect of work delivered, they lack recurrence, they are not related to a stable source of income and they are allocated on a temporary basis. Consequently, these grants qualify as allowances and are not subject to income tax.<sup>43</sup>

The subsidies are allocated to the self-employed, and companies are exempt from income tax. However, the income generated for the self-employed remains subject to social security and contributions relating to the implementation of the general health system (NHS). The social contributions follow the income tax nexus principle.<sup>44</sup>

The tax treatment of the COVID-19 subsidies granted to companies merits some more attention. The subsidies are not deemed to be business profits for the purposes of corporate tax. The company is not subject to corporate tax on these allowances and does not suffer any employers' social insurance contributions on the amounts granted, i.e. the social cohesion fund, redundancy fund, industrial training fund and holiday fund. The tax administration provides the legal reasoning to defend this position. Firstly, the guidance<sup>45</sup> indicates that the allowances for the benefit of the employees are subject to conditions, notably, the employee is not laid off and the financial situation of the company faces a decrease of a quarter of its income. It derives that the allowances are not deemed as State aid for the benefit of the employer to cover the remuneration of the employee but rather qualify as an aid allocated to the employees for them to recover from the conditions of social distress they faced.

Differently, the corporate COVID-19 subsidies are deemed to be dividend income within the hands of the shareholders and are subject to a special contribution for defence and to health social security contributions upon the distribution of dividends out of these payments for the tax years when the subsidies are allocated.

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42. CTA. Ann. 2020-44, para. 2.

43. CTA. Ann. 2021-48, para. 1.

44. Id., at para. 2.

45. CTA. Ann. 2020-44, para. 4.

## 9.5. Article 15(2) and (3) of the OECD Model

The Cyprus Income tax law COVID-19 guideline does not deal with the allocation of taxing rights under article 15(2) of the OECD Model (2017) except for the computation rules of the aggregate number of days. The suggested rules allow the allocation of taxing rights to not change from one year to the other only due to COVID-19 unprecedented circumstances.

Concerning article 15(3) of the OECD Model (2017), allocating the right to tax the remuneration derived from employment as a member of a ship or aircraft to the state of residence of the employee, the matter is of no relevance to Cyprus. The Cyprus tax treaty model deviates from the OECD wording and, in most cases, Cyprus is awarded the right to tax the remuneration of the employees in the aircraft and shipping industry since the right to tax is vested in the state of the company employing the crew. This allocation is constant and present in most treaties concluded recently.<sup>46</sup>

## 9.6. Frontier workers

Cyprus has no specific rules dealing with commuting, frontier, or cross-border workers, neither under its domestic law nor under its tax treaties. No competent authorities' agreements have currently been signed on this matter.

Cyprus employs the rule of the granting state to assert its taxation rights over Cyprus-subsidized employment income. There are no distinct provisions addressing the treatment of subsidized income derived from foreign employment. Individuals receiving subsidized income from overseas employment, whether from a foreign corporation or a foreign permanent establishment of a Cyprus corporation, are subject to taxation in Cyprus provided their stay outside the country does not surpass 90 days annually. It is inferred that the rules of article 15 of the OECD Model (2017) are applicable to subsidized income having benefited funds from a state other than Cyprus.

The matter of frontier workers is to be brought to the Cyprus insular reality under the issue of "inpatriates". Cyprus' labour market includes a

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46. *Convention between Cyprus and the Netherlands for the Avoidance of Double Taxation with Respect to Taxes on Income and Capital* (1 June 2021), Treaties & Models IBFD.

community of expatriates, mostly from Greece, that have returned to their “home countries” accidentally or not having anticipated the travelling restrictions as the so-called COVID-19-inpatriates.<sup>47</sup> The Cyprus Income tax law COVID-19 guideline applies differently to COVID-19 inpatriates during their second year of employment compared to those that had only commenced their employment some months before. The former have their days spent in the home country disregarded in view of the facts and circumstances of the year before COVID-19. Similarly, the Cyprus Income tax law COVID-19 guideline does not cover the latter who only commenced their employment some months before COVID-19 and are soon after accidentally stranded in their home. Besides, the involuntary character and bona fides of the stranded individuals are subjective factors and not decisive enough in this context. Furthermore, Cyprus follows the OECD guidelines, and the physical presence abroad is disregarded only for the period of the travelling ban; moreover, there is no mention of hybrid and remote work schemes. It is evident that, in the post-COVID-19 period, many of the COVID-19 inpatriates may be tempted to spend their teleworking days in their home country. In that context, the balance of taxing rights under article 15 of the OECD Model (2017) needs to be revised in order to introduce some new factors to that test.

It is posited that the novel business models that emerged amidst the COVID-19 pandemic are set to be permanent fixtures within the corporate environment. Should this be the case, the introduction of new nexus factors is needed to maintain the balance of taxing rights under article 15 of the OECD Model (2017). For instance, the digital tools employed for monitoring remote employees, alongside the nexus factors derived from digital taxes, could be pertinent in this context.

### **9.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)**

The Cyprus Income tax law COVID-19 guideline acknowledges the involuntary character of an individuals’ physical presence or absence from their state of duty, establishing a legal fiction that covers the COVID-19-period. No explicit legislative basis is introduced for the treatment of fictitious

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47. A.B. Moreno, *COVID-19 and Fiscal Policies: Unnecessary and Yet Harmful: Some Critical Remarks to the OECD Note on the Impact of the COVID-19 Crisis on Tax Treaties*, 48 Intertax 8, pp. 814-830 (2020).

income and stay in Cyprus. The tax administration's decision to forego statutory rules for the application of fictitious income in tax audits might be attributed to the reliance of Cyprus constitutional law on the doctrine of necessity.<sup>48</sup> This doctrine allows for administrative actions, including the employment of legal fiction to re-establish institutional order and economic stability, with no constitutional control over those actions.

### **9.8. The future of mobility of work: Need for adjusting the existing treaty rules?**

Mobility of work calls for reflection on the adjustment of treaty rules regarding the tax residency rules for corporations and individuals, the substance and, to some extent, the controlled foreign company (CFC) rules and the concept of ownership.

Domestic legislations typically perceive mobility of work either as a factor for the increase of the national fiscal income or, inversely, as a practice of base erosion. COVID-19- has resulted in more digitalization in business models, less business travelling and less daily commuting. Still, the criterion of physical presence for the allocation of taxing rights under article 15 of the OECD Model (2017) remained intact. From that, more dual residency cases may arise. The Cyprus tax residency scheme with 60 days of stay per year combined with mismatches between tax years and calendar years stands as an example of those dual residency cases. The need then arises for explicit and material rules under the treaties.

The OECD mutual agreement scheme and the EU Tax Dispute Resolution Mechanisms Directive (2017/1852) may be useful tools for establishing the process, but additional material law is needed for taxpayers to anticipate with a substantial degree of certainty the outcome of such agreement. Moreover, the imbalance in negotiation power between states may undermine individuals' and legal entities' tax security.

An area of tax law that has not been exhaustively discussed yet, but where COVID-19 may have some impact, are the anti-avoidance rules, overriding the allocation of taxing rights under the treaties and, more specifically, the CFC rules and exit taxation.

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48. C. Paraskeva, *Κυπριακό Διοικητικό Δικονομικό Δίκαιο* [Cyprus Administrative Law] pp. 13-15 (Nomiki Vivliothiki 2020).

Pursuant to the CFC rules, income and losses from foreign companies are channelled to resident shareholders if the significant people carrying functions and assuming risks for the business activity abroad are instead physically present onshore. In Cyprus, the CFC rules rely exclusively on the physical absence of those significant individuals abroad and their cumulative presence in Cyprus.<sup>49</sup> This policy option was taken after transposing the EU Anti-Tax Avoidance Directive (2016/1164) (ATAD) laying down rules against tax avoidance practices that directly affect the functioning of the internal market. Pursuant to article 7(2)(b) of the ATAD, the significant people generate the controlled company's income, and their presence is crucial for determining the relevant jurisdiction. The physical presence of the people performing the significant function may no longer be the decisive factor to determine the source of income on a transactional basis. This is due to the fact that factors other than the professional appointment may intervene for deciding the place of stay and the travelling conditions of those people.

The combination of these rules with the computation rules of article 8(2) of the ATAD impose further complexity. Pursuant to that rule, the income to be included in the tax base of the taxpayer shall be limited to amounts generated through assets and risks that are linked to significant people functions carried out by the controlling company. The attribution of CFC income shall be calculated in accordance with the arm's length principle. Hence, when transfer pricing rules are triggered, the link to significant people functions may undermine the outcome of computation rules. The matter may not be resolved under the transfer pricing literature and, provided the CFC rules are per se anti-avoidance rules, special attention needs to be paid to a narrow interpretation of the legal prescription, for the exception not to reverse the principle, and vice-versa, due to extensive use of CFC rules.

Mobility of work calls for reflection on the dichotomy between economic and legal ownership. These concepts rely on management activities, the persons performing them<sup>50</sup> and their localization. The mobility of work makes

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49. E. Apostolidou, *Controlled Foreign Company Cyprus National Report*, in *Controlled Foreign Company Legislation* (G. Kofler et al. eds., IBFD 2020), Books IBFD; OECD, *OECD Secretariat analysis of tax treaties and the impact of the COVID-19 crisis* (OECD 3 Apr. 2020).

50. L. De Broe, *Corporate Tax Residence in Civil Law Jurisdictions*, in *Residence of Companies Under Tax Treaties and EC Law* pp. 102–118 (G. Maisto ed., IBFD 2009), Books IBFD; F.P.G. Potgens et al., *The Impact of a Corporate Governance System on the Place of Effective Management Concept in Spain, France, the United Kingdom, the Netherlands, Germany, and Italy – Part 1*, 54 *European Taxation* 9, pp. 374–384 (2014), Journal Articles & Opinion Pieces; L. Cerioni, *The “Place of Effective Management” as*



this identification less scrutable. The digital platform economy adds new elements. For instance, the legal ownership of assets is shifted from the corporation and platform to the professional users themselves. It is the same for a brand when users build and scale up its value. More interestingly, steering committees composed of citizens, stakeholders, intermediaries, providers, users and experts bear the risk in digital platform cooperatives.

Reflecting on a plausible solution, with reference to the current stage of law, it may be considered that, under the ATAD CFC scheme, other factors than the significant persons are used to establish the link between the income generated and the taxing rights of the relevant jurisdiction. In particular, article 7 of the ATAD does quote the assets of the foreign company, i.e. the intellectual property rights and machinery, insurance, reinsurance, and legal, financial and audit risks are relevant factors for determining whether the scheme is genuine and the structure is accurate. At the same time, these prongs do not weigh as much under the legal test. Once more, the rules address the artificial character of the transaction at stake and do not set the general framework for the tax residency rules.

It remains to be evaluated to which extent the general principle needs to remain as such or be transformed into an anti-avoidance rule. In the author's view, incurring the risk of tautology in general rules and anti-abuse provisions should be avoided since the latter becomes redundant. Alternatively, other prongs can be used under the anti-abuse provision, no matter if the latter is general or specific. Yet, an underlying logic shall transcend these two blocs of law for consistency reasons. Consequently, it may be anticipated that CFC rules will require adjustments to accommodate the new realities and factual patterns of a digitalized economy.

In that sense, relying on the factors already laid down in the ATAD may be the path to take so as to attribute more weight to the assets of the foreign company, i.e. the intellectual property rights and machinery, insurance and reinsurance, as well as legal, financial and audit risks for establishing the economic link on a transactional basis. Taking that option allows a smooth evolution of the rules, for the accounting records to align with the corporate structure, notably where it relates to the assets' amortizations and depreciations recording, with an impact on the allocation of taxing rights between jurisdictions.

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*a Connecting Factor for Companies' Tax Residence Within the EU vs. the Freedom of Establishment: The Need for a Rethinking?* 13 German Law Journal 9, pp. 1095-1130 (2012).

The second block of rules that is expected to be impacted by the mobility of work and falls under the category of anti-abuse provisions is the exit taxation rules. The triggering event for these rules to apply is prescribed under article 5 of the ATAD. According to the text of article 5(1)(c), a taxpayer is subject to tax at an amount equal to that of the market value of the transferred assets at the time of exit of the assets when they transfer their tax residency to another Member State or to a third country. The rules are shaped in such a way that the change in the tax residency of an individual when the exit taxes apply to a corporation may have some impact on the company's tax residence as such. It is therefore reasonable to reflect on whether work mobility as well as remote and hybrid models of professional appointments may frustrate the way these rules apply. Hence, it is valuable to reflect on a new system for ring-fencing the tax residency of corporations from a mutation in the tax residency status of directors and members of the board or the significant people making the strategic decisions and engaging in management activities on a daily basis. Having said that, since the exit rules are anti-abuse provisions with a heavy administrative burden for their implementation, a pre-screening test on the transfer of residence can be appropriate. Such a test would allow waiving some factors that would be easily interpreted as a change of tax residency status, such as the mobility of work for the members of the council of administration, the directors and managers, when such elements are decisive for the company's tax residence according to domestic legislation. The issue at stake is quite sensitive for corporations to ensure their directors can afford to manage foreign branches and support subsidiaries abroad actively with or without their physical presence as appropriate. The real needs for performing the managing tasks shall not be conditioned by tax considerations with increased tax risks where tax rules do not follow the reality on the ground. When it relates to exit taxes, the consequences are not minor and the question merits review.

In the shaping of a new set of rules for corporate tax residency that better accommodates the digital work models, prongs that do not relate to individuals' tax residence should be considered. In tax literature and domestic legislation worldwide, the most common criteria tested are the place of incorporation and the place of management of the members of the board of the administration. Moreover, the place of incorporation was a legal criterion that was easy to flex since it is based on the contractual prescription determining the place of incorporation of the business that is a one-off action and not tested on a permanent basis. As for the place of management, as the term of management was shaped in a narrow manner and only included the place of strategic decisions, it was proved that it was not more reliable. These decisions, only taken once or twice at the most per year, could be wrapped

up in a few meetings, and the notes from the board of directors meetings could not stand as solid evidence of the place of management. Moreover and inversely, both criteria as described above have proven not to meet the needs of the business as high mobility and digital presence of a larger group of individuals interferes and may compromise the outcome. For securing the permanency of a corporation's tax residency, it remains important to detect factors that have a high degree of stability and durability.

Other prongs are therefore of some relevance to be tabled in looking into the activity and the market of the company rather than in the corporate governance as such. Had this been an option, the law governing the employees' contracts could be a factor to consider as social security systems have tight rules already monitored by public administrations officers. As for the targeted markets, the competition law connecting factors under the screening procedures may be a useful tool for asserting the financial presence of the company on an extraterritorial basis. Such a factor would allow following up on a voluntary compliance basis, without frustrating the business more and adding extra layers of tax compliance. It would also make it possible to consider subsidies and income that, although not taxed, remains decisive for the development of a company and its persistence in specific markets such as transport and energy.

To reshape the tax treaty rules, some appealing arguments can be sought in taxing the value created in the collaborative economy.<sup>51</sup> Engaging a thoughtful study of the new nexus factors could be much more appropriate compared to the OECD COVID-19 "frozen reality".

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51. C. Remeur, *Taxing the value created in the collaborative economy* (European Parliament 28 Feb. 2018), available at [https://www.europarl.europa.eu/thinktank/en/document/EPRS\\_IDA\(2018\)614718](https://www.europarl.europa.eu/thinktank/en/document/EPRS_IDA(2018)614718) (accessed 23 Apr. 2024).



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## Chapter 10

### The Impact of Tax Treaties on International Mobility of Work in the Czech Republic

Jiří Kostohryz and Jana Tepperová\*

#### 10.1. Mobility of work and domestic tax law

In the Czech Republic, the tax treatment of mobility of work at the national level is governed by the Income Tax Act (ITA).<sup>1</sup> The ITA defines tax residency and source income, and includes further specification of employment income taxation. Social security is treated separately by a set of legal acts for pension/sickness insurance and health insurance. Payments (tax, pension/sickness contributions and health insurance) are also administered separately by the tax administration, social security offices and health insurance agencies.

The Czech domestic criteria for tax residency use traditional connecting factors of place (permanent home) and length of stay in the country. It is enough to fulfil only one of the two conditions to become a tax resident according to the ITA. Thus, an individual is considered to be a Czech tax resident (under domestic law) if they have a permanent home or/and normally stay in the Czech Republic. A permanent home is interpreted as a place (either owned or rented) where a person has the intention of staying permanently. This criterion is not affected by the prolongation of a stay due to temporary circumstances or travel restrictions. However, the second criterion, i.e. a normal stay, counts the days of physical presence in the Czech Republic. An individual is considered to be a Czech tax resident if they stay in the Czech Republic at least 183 days in a given calendar year. This criterion does not differentiate between an intentional or forced stay in the country, but its fulfilment can naturally be influenced by travel restrictions.

There are exemptions from the time test of 183 days for those who stay in the Czech Republic solely for the purpose of study or medical treatment. These cases are considered to be Czech tax non-residents even if the

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1. CZ: Zákon o daních z příjmů [Income Tax Act] 586/1992 Coll. (as further amended), Primary Sources IBFD [*hereinafter* ITA].

threshold of 183 days is met. At the same time, it is unlikely that the place of stay would be considered a permanent home, as both study and medical treatment should be of a temporary character.

There is further specification of a possible split residency throughout the taxable year. According to the interpretation of the financial authority,<sup>2</sup> a change in residency due to a change in permanent home should lead to a separate assessment of each part of the year, thus a split residency is possible. However, if the threshold of 183 days is met, then an individual is considered to be a Czech tax resident for the whole calendar year under domestic law. In practice, this interpretation can be difficult to apply to cases not covered by a double tax convention (DTC). In situations covered by a DTC, this inconsistency is overcome by the tiebreaker rules.

A longer stay outside of the Czech Republic can impact the residency of a person and result in other consequences that will be discussed in this chapter. In some countries, an exit tax may be applied. However, the Czech Republic only applies an exit tax to corporations – or, to be more precise, to all taxpayers that fall within the scope of corporate income tax. Thus, there is no risk of an exit tax being levied on an individual.

Theoretically, the tax residence of an individual can have further implications for corporations in which the individual is involved. A corporation is a Czech tax resident if it has either a registered seat or a place of effective management in the Czech Republic. When assessing the place of effective management, the place of stay of the management board members is relevant but not the sole criterion. In general, the place of effective management is the place where the main decisions relating to the company, including company policy, are taken. According to the financial authority's interpretation,<sup>3</sup> it is also the place where adequate material and personnel equipment is commonly present. Most likely, a forced short stay of management board members outside the Czech Republic due to COVID-19 measures would not affect the tax residence of their corporation. The authors are not aware of any such case during the COVID-19 restrictions. However, the Czech tax authority has not issued any official interpretation of this matter.

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2. See Czech General Financial Directorate, *Pokyn D-22 k jednotnému postupu při uplatňování některých ustanovení zákona č. 586/1992 Sb., o daních z příjmů, ve znění pozdějších předpisů*, 5606/15/7100-10, available at [https://www.financnisprava.cz/assets/cs/prilohy/d-zakony/Pokyn\\_GFR\\_D-22.pdf](https://www.financnisprava.cz/assets/cs/prilohy/d-zakony/Pokyn_GFR_D-22.pdf).

3. On the terminology of “effective management” and “beneficial owner”, see Ministry of Finance, *Sdělení k problematice pojmů „místo vedení“ a „skutečný vlastník“*, 251/122 867/2000, FZ 1/2001, available at [https://www.financnisprava.cz/assets/cs/prilohy/ms-prime-dane/FZ\\_1-2001.pdf](https://www.financnisprava.cz/assets/cs/prilohy/ms-prime-dane/FZ_1-2001.pdf).

If, after the COVID-19 restrictions have passed, a change in the place of stay of the management board members becomes long term, it can affect the residency of the corporation and relevant consequences will apply, e.g. the levying of an exit tax on the corporation. This needs to be assessed on a case-by-case basis.

During the COVID-19 restrictions, working from home became a highly discussed issue, with implications not only for the tax residence of a person but also for the taxation of foreign corporations (enterprises), if a permanent establishment (PE) was created. The issue of PEs will be covered in detail in section 10.3. In brief, in the Czech Republic, working from home for a foreign corporation can constitute the creation of a PE, depending on the kind of activities the employee performs (in light of the overall activity of the whole enterprise). The Czech tax authority declares that, in general, the creation of a PE is interpreted, in line with the DTCs, as a fixed place of business.<sup>4</sup> However, in the definition of a PE in the ITA, the condition that the place must be “fixed” is missing. A home office can undoubtedly be considered a place and so, if the activity of the employee is considered to be business (or part of a business) of the foreign corporation and is not only of a temporary character, a PE can arise. In contrast to the definition of a PE in the DTCs, a PE according to the ITA is defined without using any exemptions (such as the supplementary or auxiliary character of activities). However, in the situations (and activities) for which a PE does not arise, the foreign employer might still have duties as a taxpayer of payroll taxes (withholding agent) if employing employees in the Czech Republic for more than 183 days.

Individuals pay personal income tax in the Czech Republic and may also be eligible to make social security contributions. There are two basic parts of social security in the Czech Republic: social insurance and health insurance. Social insurance consists of pension and sickness insurance and fees for an employment policy.

The conditions for participation in the social security programmes differ from tax residency rules. An individual can participate in the public health insurance scheme if they have a permanent stay (official) in the Czech Republic or are employed by a Czech employer. A permanent stay, which is an official state, differs from the permanent home used for the purposes of

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4. On the topic of PEs, see the guidance of the Czech General Financial Directorate, „Metodický pokyn k postupu při zdaňování příjmů daňových nerezidentů z činností vykonávaných prostřednictvím stálé provozovny“, 9599/19/7100-40113-010370, available at [https://www.financnisprava.cz/assets/cs/prilohy/ms-prime-dane/Methodicky\\_pokyn\\_k\\_SP.PDF](https://www.financnisprava.cz/assets/cs/prilohy/ms-prime-dane/Methodicky_pokyn_k_SP.PDF).

tax residency. As for the tax residency, an official permanent stay might be taken as an indication of a permanent home, in the sense of the place where there is the intention for the individual to stay permanently. This would not work the other way around for the purposes of participation in the health insurance system.

Participation in pension and sickness insurance is based on economic activity – i.e. employment or self-employment in the Czech Republic. Neither of these conditions would be influenced by forced temporary work in a home office.

Participation in the Czech social security scheme is also governed by the EU regulation on the coordination of social security<sup>5</sup> and bilateral treaties on this matter. In the context of COVID-19, contrary to the action taken by the financial authorities, the social security authorities issued an interpretation stating that changes in the place of work caused by COVID-19 measures would not influence applicable legislation. In practice, all of the A1 forms issued prior to COVID-19 measures remained valid even if an individual worked in another EU Member State, on the condition that this temporary change was due to COVID-19 measures.

## **10.2. Residence, tiebreaker rules and mobility of work: Individuals and entities**

The Czech Republic has not adopted any interpretation, either in general or on a bilateral basis, for the specific treatment of situations caused by a forced stay in the Czech Republic or another country, e.g. due to travel restrictions during the pandemic. As a result, there are no specifics regarding the application of DTC residence provisions in light of situations caused by the COVID-19 pandemic (article 4 of the OECD Model). The same is true for the application of the tiebreaker clause of article 4(2) of the OECD Model. It is not relevant whether the stay in the Czech Republic or another country was voluntary.

Thus, it could happen that a prolonged stay in one country, i.e. one longer than expected prior to the COVID-19 pandemic, would be decisive for the tax residence of a person. For example, if Czech law determined tax residency solely according to the number of days spent in the Czech Republic,

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5. Regulation (EC) No. 883/2004 of the European Parliament and of the Council of 29 April 2004 on the coordination of social security systems, OJ L 166, 30 Apr. 2004.



then a decrease in days spent in the country would mean an individual was not considered a Czech tax resident according to the ITA. In this case, article 4(2) of the OECD Model would not apply. However, as tax residency depends on circumstances other than solely the length of stay, changes in tax residency due to a short forced stay inside or outside the country were probably rare. Of course, all situations need to be assessed on a case-by-case basis.

In situations of a highly mobile lifestyle, when there is no substantial stay in any country and it is difficult to determine the place of residence, terms such as “permanent home”, “centre of vital interests” and “habitual abode” need to be assessed according to the circumstances at hand. The tax authority might consider supporting evidence such as bank accounts, participation in social security schemes, payments into pension savings, etc. If the overall circumstances of a case show a strong intention to stay in the Czech Republic, then the term “permanent home” might be interpreted more expansively by the tax authority. The reason being that, if the term “permanent home” under the domestic legislation is not fulfilled, then DTC tiebreaker rules cannot be used. This was the case for one taxpayer when the Czech Supreme Administrative Court decided that an official permanent residence registered at the taxpayer’s parents’ home could be considered the permanent home of the taxpayer. However, in this case, the Supreme Administrative Court commented on domestic law only, as the taxpayer failed to prove his tax residency in the United Arab Emirates, which was other country in question.<sup>6</sup>

A taxpayer needs to provide evidence to claim Czech tax residency and receive confirmation from the Czech tax authority. However, when a conflict about tax residency arises, it is difficult for the tax authority to find evidence to argue against a taxpayer’s claim regarding their tax residency (such as tracking the number of days or proving the centre of vital interests, etc.). However, in some court decisions, various evidence has been involved, such as participation in social security schemes, pension savings, bank accounts, etc.

Theoretically, a change in the place of activities exercised by the board members of a corporation could influence the tax residence of that corporation, even bearing in mind that the board members are not necessarily the only decisive “effective management” body. However, the tax residence would only be affected if the major strategic decisions were moved outside

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6. CZ: SAC, 7 Afs 120/2014 - 68, 13 Nov. 2014.

the current state of residence. So long as major decisions are still undertaken in the residence state, the residence of the corporation will not be questioned, and the taxation of the corporation will not be impacted. Only if the activities of the board members are of such a character that they create a PE would the overall taxation of the corporation be affected. As COVID-19 travel restrictions were limited in character, it is improbable that corporations would have been forced to take major long-term decisions fully out of their current state of residence.

### **10.3. Permanent establishments and mobility of work**

The issue of PEs became one of the three<sup>7</sup> most discussed international tax-related topics within the professional community during the COVID-19 pandemic. It is crucial to remember that, in the Czech Republic, the rules governing the creation and existence of a PE were not changed due to the COVID-19 situation.<sup>8</sup> Assessments must be done on a case-by-case basis, but no change to the rules has been made in recent years. It is therefore, for example, not decisive whether the home office regime has any relation to COVID-19.

The question that now arises is the same as in other cases in which there is a need to assess the “risk” of having a PE, i.e. is there “a fixed place of business through which the business of an enterprise is wholly or partly carried on”?<sup>9</sup> What is crucial for such an assessment is the character of the activity performed by the employee themselves (in the case of a home office regime) in relation to the overall activities of the enterprise. Activities of a preparatory or auxiliary character will normally not lead to a PE.

From point of view of the authors’ of this chapter, the condition “at the disposal of the enterprise” mentioned in paragraph 10 et seq. of the Commentary on Article 5 of the OECD Model seems problematic. The OECD Commentary tries to present this condition as an additional condition for the existence of a PE, but not in a very convincing way. The definitions

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7. That is: tax residency, income from employment, and PEs.

8. As mentioned in other parts of this chapter (namely, section 10.7.), the competent authorities of the Czech Republic did not release any guidance or special rules concerning the assessment of a PE in the context of the COVID-19 pandemic. The same is true for bilateral agreements and consultations.

9. *OECD Model Tax Convention on Income and on Capital*, art. 5(1) (21 Nov. 2017), Models IBFD [hereinafter *OECD Model*]. The wording of treaties may differ. It is therefore always necessary to work with the wording of the relevant DTC. It is interesting that the definition of a PE in Czech domestic tax law does not contain the adjective “fixed”.

of a PE, for the purposes of the OECD Model and DTCs, do not in general contain such a condition. Therefore, this particular assessment is basically irrelevant and only confusing.<sup>10</sup> The real relevance of the “at the disposal” criterion as described in the OECD Commentary is that it creates a risk of the circumvention of the existence of a PE, since a home office as such is never really “at the disposal” of an employer – a company director cannot enter the apartment of an employee at any time to make coffee, etc. The situation differs from that of a normal office, but the assessment of whether a PE exists and what defines situations in which PEs exist should depend on factors other than being “at the disposal” of an employer.

If the home office regime will be applied only temporarily, as a one-off or in the short term, the chance of having a PE is extremely low.

This is also true for a dependent agent PE, for which both the DTCs<sup>11</sup> and Czech domestic law<sup>12</sup> require a certain level of usualness<sup>13</sup> of the performance of certain activities. It is unlikely that a foreign employer has a PE in the Czech Republic if their employee’s stay in the territory of the Czech Republic is of a purely temporary nature and caused by the restriction of the free movement of persons. A self-employed person can basically trigger a dependent agent PE under the same circumstances as those stated in the concrete DTCs and domestic law,<sup>14</sup> with a clear distinction from situations in which such a person acts as an independent person in the ordinary course of their business.<sup>15</sup>

10. In this context, there is a lack of clarity in the last sentence of *OECD Model Tax Convention on Income and on Capital: Commentary on Article 5*, para. 11 (23 Nov. 2017), Treaties & Models IBFD, which states that “a permanent establishment could exist where an enterprise illegally occupied a certain location where it carried on its business”. Is such a place really “at the disposal of the enterprise”?

11. Art. 5(5) *OECD Model*.

12. Sec. 22(2) ITA.

13. The authors leave aside the very problematic and unclear formulations used in art. 5(5) *OECD Model* to define a dependent agent PE, such as “plays the principal role”, “routinely concluded” or “without material modification” since the newest (2017) wording is not used in any of the existing Czech DTCs.

14. Sec. 22(2) ITA. The important condition is that the person “usually exercises the right to conclude contracts which are binding on that taxpayer”.

15. CZ: SAC, 2 Afs 103/2018 – 46, 25 Apr. 2019. The Czech Supreme Administrative Court (SAC) cited several important facts about the approach when assessing the criterion of dependence of the representative. The case was based on the *Convention between the Federal Republic of Germany and the Czechoslovak Socialist Republic for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital* (1984), Treaties & Models IBFD. The SAC set out the most relevant criteria for assessing dependence: the legal and economic independence of an agent; whether the business risk is borne by the agent in question; and whether the representative relies on the specific skills and knowledge of

Digital nomads are great examples of the mobility of work. It seems that the COVID-19 pandemic and related travel restrictions caused certain problems for digital nomads (for a certain period). At least some of them were forced to stay (and work) in a certain spot for longer than they expected. In such cases, the existing rules for the existence of a PE must once again be followed. With this in mind, it is clear that even the so-called flex office could constitute a PE. After all, what is the difference if a digital nomad works remotely from a single spot (home office) or works remotely from various coffee places near the place in which they stay?

The authors are of the opinion that the digital nomad trend will be accelerated by the COVID-19 pandemic, as a home/flex office and remote working in general are becoming a new norm for many employers (as well as employees and individual workers). Countries are introducing special regimes to attract digital nomads<sup>16</sup> and other types of individuals (highly skilled individuals, inward expatriates, high-net-worth individuals and frontier workers). Therefore, it will be necessary in future to assess whether the current PE rules lead to desired conclusions. The authors are of the opinion that a certain level of permanency will always be needed for a PE to exist. The authors are of the opinion that the taxation of the income of individuals themselves will become a more serious problem in future and therefore require serious attention from policymakers.

A service PE is one the phenomena broadly discussed in connection with the mobility of work and the COVID-19 pandemic. It is true that both the OECD Commentary and the UN Model contain (slightly different) rules for a service PE. However, this does not mean that, if a particular treaty does not explicitly provide for it, a service PE may not exist.<sup>17,18</sup> As always, it depends on the wording of (typically) article 5 of a given DTC. If the

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said agent. It is necessary also to take into account the number of represented enterprises (independence is less likely if the agent's activities are performed exclusively, or almost exclusively, for one enterprise for a long period of time).

16. See, for example, S. Gadzo, *Croatia: A New (Tax-Free) Promised Land for Digital Nomads? (Part I)*, Kluwer International Tax Blog (24 Feb. 2022), available at <http://kluwertaxblog.com/2022/02/24/croatia-a-new-tax-free-promised-land-for-digital-nomads-part-i/> (accessed 30 Apr. 2022); and S. Gadzo, *Croatia: A New (Tax-Free) Promised Land for Digital Nomads (Part II)*, Kluwer International Tax Blog (28 Feb. 2022), available at <http://kluwertaxblog.com/2022/02/28/croatia-a-new-tax-free-promised-land-for-digital-nomads-part-ii/> (accessed 30 Apr. 2022).

17. It is the same principle as in the case of a building site or construction or installation project PE. These activities are mentioned in the DTCs not because they would not fulfil the general condition of the fixed place of business, but due to the time threshold making them a kind of exemption from the basic rule.

18. Paras. 174 and 191 et seq. *OECD Model: Commentary on Article 5*.

DTC explicitly addresses the provision of services,<sup>19</sup> the situation is clear to everyone and there is no doubt when a service PE exists. Most of the Czech DTCs provide, within this context, for a threshold of 6 months in any 12-month period.

The situation becomes more complicated when a given DTC does not explicitly deal with a service PE. In such a scenario, only the general rule applies, i.e. a “a fixed place of business through which the business of an enterprise is wholly or partly carried on”<sup>20</sup> must exist. There is a long-lasting interpretation of the Czech government and tax authorities<sup>21</sup> concerning a service PE. If a given DTC does not explicitly deal with a service PE, income for services provided by a foreign enterprise in the Czech Republic will be considered income achieved through a PE in the Czech Republic if the three general conditions (existence (location), permanence and performance of activity) for the establishment of a PE are met. The condition of permanence, which is not dealt with in the DTC itself, is then assessed in the context of a time test of 6 months in any 12-month period according to domestic law.<sup>22</sup> The period for which the services are provided is added up regardless of whether the services are provided on the basis of one or more contracts (projects) or whether they are related contracts (projects), unless the relevant DTC provides otherwise.

The time test does not include the period during which the provision of services in the Czech Republic is interrupted (only interruptions for substantial periods are relevant, not weekends etc.). The time test also does not include the time for which the services are provided from abroad.

If a home office (or any other form of remote work) constitutes a PE, the question arises of how to determine the profit that is attributed to this PE. Setting the tax base is subject to the same regime, regardless of whether an employee works within the home office regime. The respective domestic

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19. E.g. *Convention between the Czech Republic and the Republic of Austria for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital* (8 June 2006), Treaties & Models IBFD; and *Agreement between the Slovak Republic and the Czech Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital* (26 Mar. 2002), Treaties & Models IBFD.

20. The exact wording of certain DTCs differs from the wording of the models.

21. See Czech General Financial Directorate, Metodický pokyn k postupu při zdaňování příjmů daňových nerezidentů z činností vykonávaných prostřednictvím stálé provozovny [Guidance of the Czech General Financial Directorate on the issue of PEs], 79599/19/7100-40113-010370, available at [https://www.financnisprava.cz/assets/cs/prilohy/ms-prime-dane/Metodicky\\_pokyn\\_k\\_SP.PDF](https://www.financnisprava.cz/assets/cs/prilohy/ms-prime-dane/Metodicky_pokyn_k_SP.PDF).

22. Sec. 22(2) ITA.

law<sup>23</sup> contains a general rule (not only for PEs) that the books or other relevant evidence are the primary starting point when determining a tax base. The tax base of a PE may not be lower than the amount a Czech tax resident would achieve from the same or similar activity performed under similar conditions.<sup>24</sup> The law<sup>25</sup> also provides examples of alternative methods (profit margin for comparable taxpayers or activities, division of the total profit/loss of the foreign enterprise, etc.) that can be used to determine the tax base in the event that the tax base cannot be determined in a standard way, i.e. on the basis of books. The domestic law contains an extraordinary tool for situations in which there is not enough available evidence and any proper records are missing,<sup>26</sup> which is that the tax authorities may negotiate the tax liability with the taxpayer. It has to be highlighted that missing documents should not, in any case, lead to beneficial treatment of a taxpayer. Last but not least, the law provides (since 2018) the option for taxpayers to ask the tax administration for a “binding assessment” of the method of determining the tax base of a tax non-resident related to activities carried out through a PE.<sup>27</sup>

The authors are of the view that it does not make a difference whether a home office is imposed or recommended by the government (in line with public health measures). The existing tax rules simply do not differentiate between these situations. The same is true for the constitution of PEs.

It is useful to briefly mention the construction PE as defined in article 5(3) of the OECD Model, in order to cover the main types of PE. In the case of a construction PE, mobility will likely have less effect, as the core activities of a construction or installation project must be done in a certain place. There is still no situation in which it is possible to erect a building fully “on distance”.

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23. Sec. 23(10) ITA.

24. Sec. 23(11) ITA.

25. Sec. 23(11) ITA.

26. CZ: Daňový řád [Tax Procedure Code], 280/2009 Coll. (as further amended), Sec. 98.

27. Sec. 38nd ITA; and CZ: Guidance D-32 Sdělení Generálního finančního ředitelství k závaznému posouzení způsobu, jakým byla vytvořena cena sjednávána mezi spojenými osobami a ke způsobu určení základu daně daňového nerezidenta z činností vykonávaných prostřednictvím stálé provozovny [Notification by General Financial Directorate in respect of binding ruling on transfer price in related party transactions and the method of determining the non-resident tax base from activities performed through a PE], available at [https://www.financnisprava.cz/assets/cs/prilohy/d-zakony/Pokyn\\_GFR\\_D\\_32.pdf](https://www.financnisprava.cz/assets/cs/prilohy/d-zakony/Pokyn_GFR_D_32.pdf). In 2021, the Czech tax administration received 39 requests for a binding assessment regarding the way in which a price negotiated between associated enterprises was created or concerning the method of determining the tax base of a PE.

However, this is not the case for supervisory activities. The Czech Republic holds a narrow interpretation of this term and has made an observation on the OECD Commentary stating as follows:

[T]he Czech Republic adheres to an interpretation that supervisory activities will be automatically covered by paragraph 3 of Article 5 only if they are carried on by the building contractor. Otherwise, they will be covered by it, but only if they are expressly mentioned in this special provision. In the case of an installation project not in relation with a construction project and in the case that supervisory activity is carried on by an enterprise other than the building contractor and it is not expressly mentioned in paragraph 3 of Article 5, then these activities are automatically subject to the rules concerning the taxation of income derived from the provision of other services.<sup>28</sup>

The shortcomings of the PE concept and its future have come under scrutiny in recent years due to the BEPS Project and the ensuing “Tax Challenges Arising from the Digitalisation of the Economy” project.<sup>29</sup> The mobility of work must also be taken into account when assessing whether the PE concept still fulfils its role. It can be assumed that increased mobility will make it harder for taxpayers to meet the PE criteria (existence (location), permanence and performance of activity), especially in connection with certain types of PE.

#### **10.4. Physical presence according to articles 15(1) and 17 of the OECD Model**

Under domestic rule, the employment income of a Czech tax non-resident is taxable in the Czech Republic only if the work is performed<sup>30</sup> in the Czech Republic. Similarly to in article 15 of the OECD Model, an exemption<sup>31</sup> is given if the work does not exceed 183 days in any subsequent 12-month period and/or costs are not attributable to a PE of the foreign corporation in the Czech Republic.

The determination of the place of taxation is important not only for the taxation of current income but also in relation to possible severance payments or bonuses. In general, a severance payment/bonus related to employment should be taxed in the country in which the work has been performed. If an

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28. Para. 175 *OECD Model: Commentary on Article 5*.

29. For more information *see*, for example, <https://www.oecd.org/tax/beps/beps-actions/action1/>.

30. Sec. 22(1)b ITA.

31. Sec. 6(9)f ITA.

original salary has been taxed in the state of the home office, the taxation of a severance payment should follow. However, if a severance payment is payable for a longer period of time, during which the place of taxation has changed, it should be split and allocated accordingly.

If an employee still receives a salary for work performed in a given country, that salary is taxable in the country in which the work has been performed. This should also apply to employees who cannot exercise their employment and, due to travel restrictions or public health measures, have to stay in their state of residence without being able to work in the other country.

Travel restrictions also influence another group of often highly mobile individuals such as artists and athletes (article 17 of the OECD Model). Artists, athletes and other independent workers are taxable in the Czech Republic under its domestic law if their activity is performed in the Czech Republic.<sup>32</sup>

As the presence of artists and athletes is important for the taxation of their income, working from home during the COVID-19 pandemic could have influenced their taxation. It makes no difference whether working from a home office was imposed by government measures or not. As has been mentioned in section 10.3., the Czech tax authority has not issued any special interpretation of taxation in light of the COVID-19 lockdown, for neither employees nor artists, athletes, board members or others. In general, income from the public performances of artists and athletes should be taxed in the state of the performance. However, other income that is not related to a particular public performance is, in general, taxable in the residence state of the artist or athlete. These general rules are also applicable if the activities of the artist or athlete are constrained due to travel restrictions.

As performances might have been livestreamed more often than usual during the COVID-19 pandemic, the question arises of whether there were some specific rules for such events. So far, no special rules for digital/livestreamed performances of artists or athletes have been made. Thus, so long as a public performance is physically in the Czech Republic, the related income is also taxable in the Czech Republic.

In contrast with the rules for employees and artists/athletes, board members are taxable in the Czech Republic on payment from a Czech residential company, regardless of the place of performance.<sup>33</sup>

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32. Sec. 22(1)f ITA.

33. Sec. 22(1)g6 ITA.



A practical issue arose in the Czech Republic with the application of articles 15 and 16 of the Czech Republic's DTC with Germany. The issue was not caused by COVID-19 restrictions, but it did gain importance due to the COVID-19 lockdowns. Czech executive directors are considered to be board members, and the Czech tax authority considers their remuneration to fall under article 16 of the DTC. This means that the Czech Republic has right to tax their full remuneration, regardless of the place of activity. However, Germany considers the remuneration of executive directors to fall under article 15 and claims the ultimate right to tax the remuneration of their tax residents (board members of corporations, Czech tax residents) if their activity is performed in Germany. Under article 16, the tax credit method applies; under article 15, the exemption method applies, but only for the days of activity in the Czech Republic. Thus, the Czech Republic claims the right to tax the whole remuneration, whereas Germany wants to exempt only that part of the remuneration that relates to the days of work in the Czech Republic. The authors are of the opinion that the approach of the Czech administration is the correct one. A very narrow interpretation of the term "directors fees" by some countries creates difficulties in such cases.

### **10.5. Article 15(2) and (3) of the OECD Model**

When an employee works in the Czech Republic for a foreign employer, the application of article 15(2) of the OECD Model and the tracking of the 183-day rule is relevant. The counting of 183 days depends on the particular wording of each DTC. Most of the Czech DTCs use 183 days in a subsequent 12-month rule. However, some old treaties still refer to 183 days in a calendar year. In general, there is an effort to include all days of presence in the country and not just working days. That means that also weekends, national holidays and so on are included in the 183 days, as well as the days of arrival and departure. However, Czech policy is to limit the 183-days rule in article 15(2) of a given DTC to the days of performing employment, rather than simply being present, in the other state. At the same time, there are still some treaties according to which only days of work are included.

So far, within the Czech tax setting, there is no direct approach to a substance rule in connection with employees working from home. It is hard to imagine that solely the fact of employees being forced to work from home during the COVID-19 pandemic for a temporary time would influence the residence of their employer (corporation) either for the purposes of corporate taxation or for the application of article 15(2)(b) of the OECD Model. The same applies to board members working from home and the potential

impact of that on the residence of their company. A forced stay of board members in another country during the COVID-19 pandemic would hardly change the tax residency of their corporation. However, if an employer decides to follow a business model according to which all employees work from home even after the COVID-19 pandemic, and not only for temporary purposes, then the substance rule can be argued. In this context, it might become more important in the future.

As discussed in detail in section 10.3., the home office of an employee can constitute a PE of their employer. If this happens, the remuneration of that employee would probably be borne by the PE, which would limit the possibility of using the exemption from taxation under article 15(2) of the OECD Model. It makes no difference whether the home office is imposed or recommended by the government or simply the common decision of the employee and employer.

With a further increase in mobile work, the question of changes to the current rules might arise. So far, no fundamental changes to article 15(1) and (2) of the OECD Model are being discussed. It is not expected that a different concept, such as that for employees working in international traffic in Article 15(3), will be discussed. Special rules for international traffic make sense, due to the day-to-day mobility of the work, but they do not seem appropriate for other types of dependent work.

However, the Czech Republic suggests (not only when negotiating DTCs) some partial modifications to article 15(1) and (2) of the OECD Model regarding the counting of the days, the definition of an economic employer and the confirmation of the “if all the following conditions are met” clause.

For the counting of the 183 days, the use of “is present” is insufficient. It would be more suitable to focus on the performance (exercising) of the activity rather than the presence (article 15(2)(a)). This should be followed by a new article 15(3) explaining the counting of the days to make sure that countries proceed in the same way. It is also recommended that the definition of an employer be added to article 15, in order to cover the issue of an economic employer. This becomes especially important when the contractual country has no concept of an economic employer in its domestic law. For the sake of certainty, the clause “if all the following conditions are met” should be added to article 15(2). As there is no doubt regarding the interpretation from the Czech side, in practice the interpretation that only one condition is enough for the application of article 15(2) emerged within discussions with some taxpayers.

## **10.6. Frontier worker rules in bilateral tax treaties**

None of the 94 Czech DTCs<sup>34</sup> that are currently in force contain a provision dealing with specific rules for the taxation of frontier workers. Therefore, the issues of how to apply these rules in specific situations (the required daily return to the state of residence of the taxpayer in situations in which employees work from a home office, the possible change of residence state of the employer, etc.) do not arise in the Czech Republic. The authors are of the opinion that, in these situations, it once again does not make a difference if the home office is imposed or recommended by the government due to public health measures (unless the law allows the respective country to adopt measures leading to a different conclusion).

The frontier worker rules still make sense in situations in which both contracting states wish to divide the right to tax in a different way than that of the general rules for taxation of income from employment (article 15 of the OECD Model). That is the only reason for having such rules, and increased mobility will not change much about it.

Of course, every exception adds complexity. Contracting states should very carefully weigh the advantages and disadvantages of having another set of special rules in place. Sometimes, even if the treatment would not be fully “fair” in all possible scenarios, it is better to keep to simplicity rather than to have various rules for various situations and end up in a situation in which taxpayers are not sure about their duties, and the whole system is vulnerable to abuse. The mobility of work is already posing a number of serious challenges to frontier workers as a group, with more to come in future.

## **10.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)**

The competent authorities of the Czech Republic did not issue unilateral guidance or agree on a bilateral competent authority agreement or memorandum of understanding to govern specific fictions related to a home office regime, PEs or a tax residency. The common feature of such documents (if in place) is the declaration of the possibility to apply certain fictions in certain situations. Namely, taxpayers (and/or their employers) may, under certain conditions, assess a situation of mainly home-office work (for tax

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34. Covering 95 jurisdictions.

treaty and/or domestic law purposes) as if no COVID-19-related restrictions were in place. The reality is simply ignored.<sup>35</sup>

The Czech authorities thoroughly studied and internally discussed all circumstances relating to a competent authority agreement when confronted with a proposal from other (mainly, but not exclusively, neighbouring) countries. However, the Czech authorities are of the opinion (and the authors support this position) that the existing article 15 of the OECD Model (articles of a concrete treaty dealing with income from employment) clearly lays down rules that also cover, without any doubt, the situation of working from a home office. Even when the situation was highly specific (regarding COVID-19), both contracting states were required to follow the existing rules. The existence of opinions and recommendations from the OECD Secretariat<sup>36</sup> does not change that.

A rule introducing the fiction described in the first paragraph of this section, introduced by some states during COVID-19, could not be applied bilaterally, at least not from the Czech side, because Czech domestic law does not allow the taxing of a foreign (e.g. German, picked randomly as an example) tax resident working in Germany from a home office for a Czech employer. Setting up the proposed new rule could, from the Czech point of view, lead to situations of double non-taxation (especially when taxpayers or their employers are free to choose the regime).

The question then arises of whether German tax law allows for the taxation of a Czech tax resident working in the Czech Republic (i.e. not in the territory of Germany) for a German employer. Czech law does not allow it in a mirror situation, and it does not matter whatever the authorities agree. Would Germany provide an exemption<sup>37</sup> for an employee (German tax resident) working in Germany for a Czech employer in such a case? If yes, double non-taxation occurs. If not, the new proposed measure will not be fulfilled, and the standard rules of the relevant DTC once again apply. It is worth mentioning that the existing bilateral agreements often contain a condition that the underlying income must be subject to tax as a result of new alternative rules in order to avoid double non-taxation.

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35. The authors (not being experts in all of the general principles of public international law) have serious doubts regarding whether the justification of a force majeure can be claimed in these situations. Czech domestic law does not provide for such a basis.

36. OECD, *Updated guidance on tax treaties and the impact of the Covid-19 pandemic*, OECD Policy Responses to Coronavirus (COVID-19) (OECD 2021).

37. Art. 23 *Czech.-Ger. Tax Treaty* (1984) provides an exemption as a method for the elimination of double taxation in the case of income from employment.

Is there a legal basis for such bilateral agreements? The Czech competent authorities are not authorized by domestic law to negotiate amendments to the DTCs or any provisions that would deviate from the DTC provisions without the approval of the parliament and without undergoing the standard legislative procedure (either for domestic law or for DTCs).

The competent authority agreements often refer to the provision of the DTCs that states, “The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention”<sup>38</sup> or to an equivalent to this provision. The authors do not see this provision as a relevant or sufficient legal basis. It is quite obvious that no difficulties or doubts arise when applying or interpreting the DTCs. The rules of article 15 of the OECD Model are clear and comprehensive, and movement restrictions do not diminish their relevance. The fact that the result (which is clear, and the existing rules do not leave any doubt) is not ideal from someone’s perspective cannot justify, on its own, any interpretation that quite clearly goes against the original rules of the article of the DTCs dealing with taxation income from employment. Such an approach is very dangerous from the rule of law perspective.

In light of these facts, the authors are of the opinion that such measures would not only be contrary to the rules of the DTCs and domestic law provisions but could also bring many problems to the employees concerned. Without any special agreement, in most situations income tax will be paid only once, i.e. in the country where employees are residents.<sup>39</sup>

However, serious complications may arise if an employer becomes a withholding agent in the country of the residence of their employee. This is usually connected with certain new administrative and payment obligations. This happens in the Czech Republic only in situations in which an employer has a PE in the country of residence of their employee (Czech Republic) or if they have employed their employee(s) in the Czech Republic for a period longer than 183 days.<sup>40</sup>

The main and, most probably, the only reason why the issue of legality is not (sufficiently) addressed is that, if there is no plaintiff, there is no judge. In fact, taxpayers (and their employers) have an alternative option to the

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38. Art. 25(3) *OECD Model*.

39. This is logical, as such employees do not receive any income from foreign sources.

40. Sec. 38c(2) ITA.

normal rule, and it is up to them to choose which one they want to exploit. Tax administrations will obviously not challenge any procedure that was agreed by the competent authorities of the contracting states (or its own unilateral, publicly known interpretation).

Health protection is one of justifications that is not often mentioned in relation to tax measures but that is definitely worth considering when evaluating the need for extraordinary (i. e. contrary to the existing legal order) rules. The authors have significant doubts as to whether taxation rules really had a significant influence on work mobility and, subsequently, on the spread of the virus. Moreover, purely health issues must be governed and influenced primarily by healthcare measures, especially in such a serious situation as the beginning of the COVID-19 pandemic.

If countries realize that the existing rules are no longer acceptable for them, there is a clear and unquestionable way to proceed. It is necessary to change the existing rules using the ordinary legislative procedure, i.e. to change the DTC and/or domestic law. The existing law should always be confronted and tested against reality. The (not only) Czech experience shows that, if the need for an amendment arises, even an ordinary procedure can be significantly accelerated in urgent situations. It is also possible to change the claims for the procedure but, again, this should be done with an ordinary process. The authors are of the opinion (with hindsight) that various competent authority agreements signed due to COVID-19 could have been avoided.

### **10.8. Future of mobility of work: Need for adjusting the existing treaty rules?**

The term “geographically mobile economic activities” is often used when talking about activities giving rise to passive income flows. There is still a prejudice that only capital is mobile. This is not true anymore, and policy-makers should seriously start think about and devote attention to the current rules regarding the taxation of individuals.

The authors are of the opinion that the current rules work, and tax practitioners are already familiar with them. On the other hand, it is true that future development may require certain reconsiderations or at least adjustments (in cases leading to double non-taxation because of no existing sufficient ties to any of the jurisdictions).

During its negotiations of new DTCs, the Czech Ministry of Finance constantly proposes certain provisions of article 15 that differ from the OECD Model (even if these are not directly related to the issue of mobility). These improvements seem to help prevent disputes; two of them are worth mentioning here. The first is a reference to the “exercisement of employment” instead of a reference to simply “presence”, as in article 15(1) of the OECD Model. This is, in an ideal situation, accompanied by clear rules on how to compute days. Second, the definition of the term “employer” was added to many of the Czech DTCs, especially those with countries that do not follow (or know) the principle of economic employer.

With future development of the mobility of work, not only personal income tax but also social security rules might need some review. Within the European Union, discussions have already taken place regarding the possible harmonization of existing treaty rules for income tax and rules for applicable legislation for social security purposes.<sup>41</sup> Although different rules for tax and social security can create practical difficulties when tax is paid in one country and social security contributions in the other, alignments of the rules do not seem to be helpful. Both tax and social security rules are based on specifics of each system and have good reasons for their current approach. It is thus expected that the systems will react to future challenges in their own ways, rather than with mutual alignment.

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41. See J. Tepperová, Daida Hadzic & K. Kim Egholm Elgaard, *Tax and Social Security: EU perspective* (24 Jan. 2018), available at <https://assets.kpmg/content/dam/kpmg/dk/pdf/Acor/2018/01/tax-and-social-security-eu-perspective.pdf>.





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## Chapter 11

### The Impact of Tax Treaties on International Mobility of Work in Finland

Mika Nissinen

#### 11.1. Mobility of work and domestic tax law<sup>1</sup>

##### 11.1.1. Individuals

Pursuant to section 11 of the Finnish Income Tax Act (*Tuloverolaki*, TVL), natural persons are considered to reside in Finland, and thus be resident taxpayers, when:

- they have their main abode and home in Finland;
- they have a permanent home abroad, but they reside in Finland for more than 6 months due to work, for instance, in which case a temporary absence is not considered as interrupting such a continuous period of residency; or
- they are Finnish citizens residing abroad who moved abroad less than 3 years previously and who have not demonstrated that they did not have substantial ties with Finland during the tax year.<sup>2</sup>

National residence regulations do not distinguish between situations in which a person spends time in Finland due to, for example, governmental travel restrictions. Based on the Finnish tax administration's guidance, COVID-19 has no effect on determining a person's tax residency; tax residency status in Finland (general or limited tax liability) is determined based on the provisions of sections 9 and 11 of the TVL.<sup>3</sup> Regardless of national regulations, residence issues are ultimately resolved by the provisions of tax treaties.

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1. The Finnish Foundation for Share Promotion grant has helped to focus on this research area also from a co-investment perspective.

2. The provision also contains some special provisions relating to diplomats and the governmental or EU missions of Finland abroad, which are not dealt with in this context.

3. FI: Tax Administration, *Koronaviruspandemian vaikutus ulkomaantyöskentelyn verotukseen (kuuden kuukauden sääntö ja pakottava syy)*, VH/72/00.01.00/2021, available at [www.vero.fi/syventavat-vero-ohjeet/kannanotot/82178/koronaviruspandemian-vaikutus-ulkomaanty%C3%B6skentelyn-verotukseen-kuuden-kuukauden-s%C3%A4%C3%A4nt%C3%B6-ja-pakottava-syy3/](http://www.vero.fi/syventavat-vero-ohjeet/kannanotot/82178/koronaviruspandemian-vaikutus-ulkomaanty%C3%B6skentelyn-verotukseen-kuuden-kuukauden-s%C3%A4%C3%A4nt%C3%B6-ja-pakottava-syy3/) (accessed 23 Aug. 2022).

### 11.1.2. Corporations

Similarly, in corporate taxation, there are no specific national residence provisions for situations such as force majeure. Pursuant to section 9(1)(1) of the TVL, Finnish organizations, benefits under joint administration and estates are considered resident taxpayers in Finnish income taxation. As of 1 January 2021, organizations established and registered abroad with the place of effective management (PoEM) located in Finland are also resident taxpayers.<sup>4</sup>

A corporate entity's PoEM is in Finland if its board of directors (e.g. a body making the top-level decisions on daily management) is located here. However, when tests are carried out for PoEM, other circumstances relevant to the company's organization and business operations are also taken into account (section 9(8) of the TVL). Therefore, the physical location of the board members is not necessarily a decisive factor. The relevant government proposal gives the impression that the definition covers, to a significant extent, the aspects related to the resolution of dual residence situations covered by the OECD Model (2017).<sup>5</sup>

In Finland, the national right to tax a limited taxable person's business is not only based on the permanent establishment but on a broader principle: the principle of economic connection. Under national tax law, it is sufficient if a limited taxable person receives income from the business activities carried out in Finland.<sup>6</sup> However, the tax treaty generally requires the establishment of a permanent establishment. The right to tax at source may also arise based on a certain type of income, such as dividends, interest and royalties.

The question is, how is it appropriate to determine taxing rights between countries when mobile businesses and employees are fragmented across countries? Similarly, the question is how the right to tax should be distributed in a situation when a company decides to decentralize its business by purchasing services from another company. It is also important to consider (i) whether these functions are ancillary or preparatory; (ii) whether the company's core business functions are involved; and (iii) who, among other

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4. See also FI: Tax Administration, *Resident and nonresident tax liability of corporate entities*, 4/1/2021, ch. 1, available at <http://www.vero.fi/en/detailed-guidance/guidance/95551/resident-and-nonresident-tax-liability-of-corporate-entities/> (accessed 23 Aug. 2022).

5. See FI: government proposal HE 136/2020, p. 24.

6. See sec. 10 TVL; and M. Nissinen, *Suomessa harjoitettavan yritystoiminnan kansallinen tuloverotusoikeus – kontekstina nykytila ja hyvän verojärjestelmän kriteerit* ch. 5.6 (University of Eastern Finland 2019).

aspects, has the business risk and various responsibilities towards the end customer.

### 11.1.3. Collective investment business

Issues related to the mobility of work and business may also arise in investment fund activities. This is illustrated by the following two Finnish advance rulings.

The Finnish Central Board of Taxation (KVL) issued an advance ruling (2021/15). In this advance ruling, the management company (D [Oy]) was registered in Finland. D (who belonged to the J Group) set up a branch in State C. The applicant (Fund A) was an open-ended investment fund in the form of an association under the C-State Mutual Funds Act. The application concerned one sub-fund. D represented the applicant in the manner permitted by the local laws implementing the Undertakings for Collective Investment in Transferable Securities (UCITS) Directive and acted on their behalf in the day-to-day affairs. However, the portfolio management or distribution function related to the applicant was not handled from Finland or by D. D's branch in State C was primarily responsible for the management of the applicant in accordance with the UCITS legislation. The applicant's board of directors was given its approval to the applicant's other sub-funds outsourcing portfolio management to K in "another country". In addition, the applicant's board of directors had approved the outsourcing of the applicant's back office functions and other administrative functions to companies belonging to the same group as D. The distribution of fund units was outsourced to several companies in "another country" belonging to the J Group or a branch located in State C. The applicant's fund units were not sold or marketed in Finland to Finnish investors.

The risk management of the funds was the responsibility of D and was largely based on cooperation with K, which was part of the same group and provided the service to D. K provided this service outside Finland. The risk control function was performed both in Finland and "another country". Meetings of both the board and the unitholders were held in State C. The KVL considered that the fund's operations could not be managed from Finland and, thus, Finland did not have the right to tax any income. In addition to the national provision, the tax treaty between the Nordic countries was applied.

In another case, the Finnish Supreme Administrative Court (KHO) upheld in the case of T 192 (21 Jan. 2016) advance ruling 2015/2 issued by the KVL.<sup>7</sup> The applicant was a company and legal entity registered in the Cayman Islands (no tax treaty with Finland). The applicant was not a taxable person in the Cayman Islands. The applicant had one fund, which was not an independent legal entity, and the applicant managed the fund. The applicant was an AIF under the Alternative Investment Fund Managers Directive (2011/61). The applicant's board of directors had four members, three of whom were Irish and non-Irish nationals and one Finnish national resident in Finland. No board meetings were held in Finland. The statutory obligations in the Cayman Islands took place in the so-called registration agent. An Irish company was responsible for the general administration of the fund.

The applicant, who was licensed as an AIF manager, intended to enter into an agreement with Finnish Company A to manage the fund from Finland in accordance with the rules of Finnish Alternative Investment Fund Managers Law (AIFML). Company A would be responsible for the risk management and portfolio management of the fund, as well as certain other tasks assigned to the AIF manager by the AIFML. Company A was not responsible for the fund's normal market risk. There was no ownership relationship between A and the applicant. A's business consisted of managing Finnish special investment funds. Company A intended to outsource the fund's investment activities and trade to another Finnish portfolio manager, Company B, which would manage the investment activities and trading under A's supervision. A and B received market-based compensation for the services they provided to the fund. The KVL considered that the services provided by the Finnish companies A and B were their own business, for which the applicant paid market compensation. The applicant could not be considered to have a place of business in Finland through which their business would be conducted here. Finland did not have the right to tax any income.

These two cases illustrate the issues of business mobility and its decentralization, as well as the question of the core business functions. What activities are performed in different countries, core functions or ancillary or preparatory activities? May there be a taxing right for the fund itself or for the investors in the fund<sup>8</sup> in a jurisdiction other than that in which the fund is registered or in which the investors are resident? May the effective management be located outside the country of fund's establishment? What

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7. The author was a referendary official in the KVL in this case.

8. In pass-through situations.

is the business of a fund, a fund manager and a possible third party? Who is responsible for the operation of the fund, and where do these core functions of the fund take place? The situation also raises the question of whether a taxing right can be established on the basis of a dependent agent.

## **11.2. Residence, tiebreaker rules and mobility of work: Individuals and entities**

### **11.2.1. Individuals**

Based on the Finnish tax administration's guidance, COVID-19 has no effect on the interpretation of the provisions of the country of residence under the tax treaties. The country of residence under the tax treaty is determined in accordance with the residence article of the applicable tax treaty. The tax administration's guidance on personal taxation does not refer to the guidance published by the OECD at the time.<sup>9</sup> Although the legal status of this OECD publication may be somewhat "questionable",<sup>10</sup> the purpose of this publication is to assist countries in interpreting the provisions of the OECD Model in exceptional circumstances. Nevertheless, the content of the OECD guidance and the Finnish tax administration's guidance is consistent. Both state that COVID-19 does not necessarily require different interpretations.

As concluded by the OECD guidance, even if the person is or becomes a resident under national rules, if a tax treaty is applicable, it seems in most situations that the tiebreaker test would mostly award treaty residence to the home jurisdiction. This is because it is normally unlikely that the person would have a "permanent home" or "habitual abode" in the host jurisdiction.<sup>11</sup>

### **11.2.2. Legal persons**

In the case of companies, it is important to determine which factors are decisive in determining the country of residence of the company under the tax treaty. The fact that employees work from a home office and the company

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9. See OECD, *Updated guidance on tax treaties and the impact of the COVID-19 pandemic* (21 Jan. 2021), available at <http://www.oecd.org/coronavirus/policy-responses/updated-guidance-on-tax-treaties-and-the-impact-of-the-covid-19-pandemic-df42be07/> (accessed 23 Aug. 2022) [hereinafter OECD Guidance].

10. The guidance represents only the Secretariat's views.

11. OECD Guidance, *supra* n. 9, at paras. 30-35.

itself does not have any physical place may, as such, have an impact on the assessment of the country of residence for tax purposes. On the other hand, similar questions have already arisen with regard to the permanent establishment and – instead of a certain physical point – the decisive factor may be the place of business activity or the place of management. A company usually conducts business through its employees (including members of effective management), due to which one of the determining factors in the country of residence may be the location of the company's employees, such as executives or managers.

There are no published case laws in Finland in which the PoEM under the tax treaty would have been changed due to COVID-19. The guidance of the Finnish tax administration states that, if it is due to the pandemic that a corporate entity's PoEM has temporarily been relocated, it does not mean that the entity's PoEM has transferred to the other country.<sup>12</sup> This is very much in line with the OECD guidance 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”.<sup>13</sup>

The issue of the country of residence applies to all legal persons. The issue of the country of residence must always be resolved, also in the collective investment business. It may be possible that, for example, the fund's country of residence may change if that fund does not have any (major) core activities in the country of registration. One question is also whether the fund is eligible for tax benefits at all.<sup>14</sup> The general understanding in Finland is that at least Finnish funds are separate taxpayers and usually entitled to tax treaty benefits.

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12. FI: Tax Administration, *COVID-19-related restrictions and their effects on the taxes on foreign corporate entities' income*, VH/1642/00.01.00/2021, at Place of effective management, available at <http://www.vero.fi/en/detailed-guidance/statements/96125/covid-19-related-restrictions-and-their-effects-on-the-taxes-on-foreign-corporate-entities-income> (accessed 23 Aug. 2022) [hereinafter Tax Administration COVID-19 Guidance].

13. OECD Guidance, *supra* n. 9, at para. 35.

14. See R.P.C. Adema, *Domicile Issues Arising from the Management Company Passport – A Comparison of the UCITS Regulatory Framework and Tax (Treaty) Law*, in *The tax treatment of collective investment vehicles and real estate investment trusts* pp. 190-200 (H. Vermeulen ed., IBFD 2013), Books IBFD.

## 11.3. Permanent establishments and mobility of work

### 11.3.1. General rule

The definition of a permanent establishment in a tax treaty is linked to principles created in the early 20th century, the relevance of which in today's society can be questioned – at least in some part. One of the important issues relates to the condition of a physical place (spot), which, however, has never been the sole decisive factor or – in general – an absolute condition in assessing the conditions of a permanent establishment. For example, the OECD Commentary of the Model (1977) already states that there has to be a link between the place of business and a specific geographical point (not a point of premises).<sup>15</sup> Depending on the nature of the business, the business does not necessarily require any physical point but may be mobile.<sup>16</sup> The importance of a physical location can be a clarifying factor, especially in non-mobile activities, but it cannot be the only decisive factor.

It is, therefore, more a question of where the actual business is located and where it is carried out. In mobile businesses, the geographical business area can be, for example, a city, a municipality or – at its broadest – the entire country (or even the world). If the definition of a permanent establishment in a country is constructed in a way that always requires a single physical spot, such an interpretation may cause problems for the mobile business.

The Finnish tax administration's guidance emphasizes three main points in a similar way to the Commentary of the OECD Model.<sup>17</sup> With regards to the location, a fixed place of business can be made up from a larger area within which the actual business location varies, if the business operations in the area constitute a coherent whole (commercially and geographically) with respect to the business. A single commercial and geographical unit could be, for example, an office hotel, a pedestrian street, a mine, an outdoor market or a fair.<sup>18</sup>

15. See para. 5 *OECD Model Tax Convention on Income and on Capital: Commentary on Article 5(1)* (11 Apr. 1977), Treaties & Models IBFD.

16. See para. 19 *OECD Model: Commentary on Article 5(3)* (1977).

17. See para. 6 *OECD Model Tax Convention on Income and on Capital: Commentary on Article 5* (23 Nov. 2017), Treaties & Models IBFD.

18. FI: Tax Administration, *Income taxation of nonresident foreign corporate entities*, A70/200/2018, ch. 3.2, available at <http://www.vero.fi/en/detailed-guidance/guidance/47806/income-taxation-of-nonresident-foreign-corporate-entities> (accessed 23 Aug. 2022) [hereinafter Tax Administration Guidance].

If the permanent establishment is formed on the basis of a commercial and geographical entity, there is no longer a need to assess the so-called home office question. However, if the issue of the home office is assessed – either as an additional argument in favour of the creation of a permanent establishment or as a completely separate ground – the question of a home office raises another problematic question. How can the location (home office) be at the disposal of that enterprise if it is an employee’s home? The additions to the OECD Commentary on the home office help to reflect this diversification of business practices in modern society.<sup>19</sup> Similar interpretations can also be found in the guidance of the Finnish tax administration.<sup>20</sup>

In a home office situation, “at the disposal” is mainly relevant to the fact that the company conducts business in and through the home of the person in question (e.g. an employee). Regarding the creation of a permanent establishment, in particular with mobile businesses, the question arises to what extent weight must be given in determining the concepts of “location” and “through a place of business”. Furthermore, to what extent is it sufficient to simply assess whether the mobile business in question is physically carried out in that country on a permanent or sufficiently regular basis?

The exceptional situation of COVID-19 regarding the permanent establishment has been taken into account in the Finnish tax administration’s guidance in a similar way as in the relevant OECD guidance. It states that if the pandemic causes exceptional and temporary changes to a foreign corporate entity’s circumstances, these new circumstances do not automatically mean that the corporation would be treated as having a new permanent establishment in Finland.<sup>21</sup>

Public health measures, not employer orders, can be a reason for the exceptional work situation. Based on the Finnish tax administration’s guidance, the foreign company would not be treated as having a permanent establishment in Finland at the Finnish employee’s home unless – after the public health measures are lifted – the employee keeps working from Finland.<sup>22</sup> The view is strongly related to country-level restrictions and the temporary nature of the arrangement.

It is also a question of subcontracting. If it is decided to establish a business in a particular country, but the business is subcontracted to several

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19. See paras. 18-19 *OECD Model: Commentary on Article 5* (2017).

20. Tax Administration Guidance, *supra* n. 18, at ch. 3.2.5.

21. Tax Administration COVID-19 Guidance, *supra* n. 12, at Permanent establishments.

22. *Id.*, at Home office.



operators in different countries, might there be a possibility of a taxing right in other countries? Based on the Commentary of the OECD Model (2017), the existence of a permanent establishment (based on paragraph 1) in these circumstances will require that these subcontractors perform the work of the enterprise at a fixed place of business that is at the disposal of the enterprise.<sup>23</sup>

### 11.3.2. Construction and installation projects

While, under the general rule, the “permanent” business activity can constitute a permanent establishment, the construction clause applies only to an individual project or site. The question is usually more about whether physically or temporally related projects can form a single whole when applying a construction clause. In Finland, the tax administration’s guidance is generally in line with the OECD Commentary.<sup>24</sup>

If either Finland’s or the other country’s public health measures have caused an interruption on a construction site, the interruption can be excluded from the calculation of time. After the public health measures are lifted and the construction workers have returned to the site, the calculation of time thresholds is resumed immediately.<sup>25</sup> As such, this would seem to be very much in line with the OECD’s views.<sup>26</sup> However, contrary to the OECD’s guidance, the tax administration’s guidance is based on the moment of returning to the site – not the days when activity was blocked due to COVID-19. This may leave the possibility of delaying the return to the site without fear of exceeding the time limit.

### 11.3.3. Dependent agent

The question of permanence and regularity also relates to the definition of a dependent agent. It is also essential to assess whether the activity is habitual as required by the provision. The activity of a dependent agent is not considered “habitual” under the meaning of treaty provisions if the person has started working from home in Finland only due to public health measures

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23. See para. 40 *OECD Model: Commentary on Article 5* (2017).

24. Para. 51 *OECD Model: Commentary on Article 5(3)* (2017); and Tax Administration Guidance, *supra* n. 18, at ch. 3.3.1.

25. Tax Administration COVID-19 Guidance, *supra* n. 12, at Construction and installation projects.

26. OECD Guidance, *supra* n. 9, at Construction site PE.

(e.g. COVID-19), and they will not continue working from home when the measures are lifted.<sup>27</sup>

The dependent agent question may arise in the collective investment business. One significant question is whether a separate legal body acts dependently on behalf of a fund. If the fund is managed in another country, can the fund be taxed in that country?<sup>28</sup> If the core activities of a fund are subcontracted to other legal persons, may this result in a permanent establishment based on a dependent agent? It is important to determine which (legal) person has a right to make any binding decisions on behalf of the fund. If this right of the core business is exercised outside the country in which the fund is registered, it may raise a question of the permanent establishment if the permanent establishment provision applies to fund activities. At the same time, however, it may also be somewhat unclear whether the funds are subject to the permanent establishment rule relating to business income or some other articles.<sup>29</sup> Moreover, if the activities of the local advisory firm are limited to an advisory role only – with no right to make any binding decisions on behalf of the fund – the activity is likely ancillary.

## **11.4. Physical presence according to articles 15(1) and 17 of the OECD Model**

### **11.4.1. Workers**

According to section 10.4 of the TVL, income received from Finland is a salary received from a non-public entity if the work has mainly or exclusively been performed on behalf of an employer in Finland. The work has been performed mainly in Finland if more than half of the work is done in Finland. This is considered on a pay period basis. The provision is narrower than the tax right under the OECD Model, as more than half of the work must be done in Finland during the pay period. On the other hand, the provision is broader if more than half of the work has been done in Finland.

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27. Tax Administration COVID-19 Guidance, *supra* n. 12, at Dependent agent; and *id.*, at Agency PE.

28. See European Commission, *Report of Expert Group on removing tax obstacles to cross-border Venture Capital Investments* pp. 17-19 (European Commission 2019).

29. From the perspective of private equity funds, see P.K. Schmidt, *Permanent Establishment for Investors in Private Equity Funds – A Legal Analysis in Light of the Changes to the OECD Model (2017)*, 2019 Nordic Tax Journal 1, pp. 25-26 (2019).

Then, also a smaller part of work abroad is income received from Finland.<sup>30</sup> A tax treaty (when applicable) may always limit the right to tax.

The activity may be exercised also in the other country where the home office is located. The question is whether the work is interpreted as unrelated to the home office or whether the work has a connection to the home office. For example, if the main focus of the work is on work at home, and the work involves client meetings located in another country, a connection to the home office may still exist. On the other hand, it is not just a question of home office situations. The same question can arise in any mobile situation and in a situation where an employee works in two or more countries.<sup>31</sup>

Finland does not have any specific national or tax treaty provisions relating to the COVID-19 situation, regarding articles 15 and 17. There is also no guidance by the tax administration in this regard. However, the tax administration has guidance on the national so-called 6-month rule in the COVID-19 situation. For a taxable person resident in Finland, wages and salaries received from employment abroad are not taxed in Finland if the following requirements under section 77 of the TVL are fulfilled (6-month rule):

- the employee stays in a foreign country for reasons relating to the work for an uninterrupted period of at least 6 months;
- the tax treaty signed between the foreign country and Finland confers the primary right to tax wages on the foreign country where the work is done (or there is no tax treaty between Finland and the foreign country); and
- the length of time that the employee spends in Finland does not, on average, exceed 6 days per month of work abroad.

The provision of the TVL contains an exception that refers to a situation of force majeure. It is not seen as an interruption if the employee must return to Finland for a reason that is unexpected, serious and unrelated to the employer or employee, on the condition that the employee eventually goes back to the foreign country in order to continue working outside Finland (section 77.3 of the TVL).

In addition, the provisions that outline the above-mentioned exception allow for the possibility that the employee must discontinue the performance of work outside Finland due to a reason characterized as unexpected, serious

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30. FI: Tax Administration, *Ulkomailla työskentelyn verotus*, VH/5712/00.01.00/2021, ch. 2, available at [www.vero.fi/syventavat-vero-ohjeet/ohje-hakusivu/49111/ulkomailla-ty%C3%B6skentelyn-verotus4/](http://www.vero.fi/syventavat-vero-ohjeet/ohje-hakusivu/49111/ulkomailla-ty%C3%B6skentelyn-verotus4/) (accessed 23 Aug. 2022).

31. See id., at chs. 4.2.4 and 6.6.

and unrelated to the employee and the employer. In this case, the individual's income received for the work in the foreign country is not treated as subject to Finnish taxes, despite the fact that the period of working in the foreign country turned out to be shorter than the estimated minimum time of 6 months (section 77.5 of the TVL).

According to the tax administration's guidance, the outbreak of an epidemic disease is cited as an unexpected change in circumstances in the country where the employee works, amounting to a force majeure.<sup>32</sup> Because COVID-19 is a pandemic that extends itself to all continents, it is deemed a force majeure as referred to in section 77.3 of the TVL. If the employee must stop working due to the pandemic before the date set out by the original plans for the work in the foreign country, the pandemic has been deemed a reason characterized as unexpected, serious and unrelated to the individual and the employer within the meaning of section 77.5 of the TVL.<sup>33</sup>

Wages received from working in Finland are usually taxable in Finland. If a person works abroad for a Finnish employer, the employee may accrue working in Finland during the posting from the so-called reporting dates. The 6-month rule can be applied to the salary received from working for the same employer for a maximum of a few days and working in Finland that is substantially related to working abroad. Thus, the salary received from the reporting dates may be tax exempted in Finland if the conditions of the 6-month rule are otherwise met.<sup>34</sup>

The 6-month rule tax exemption does not apply to any work done in Finland because the rule only concerns work carried out in foreign countries. Accordingly, an employee's income from work done in Finland is subject to Finnish tax (including any arrangements to work from home over a remote connection), unless the provisions of an applicable tax treaty prevent Finland from imposing a tax on that income.

The tax administration's guidance expressly states that for COVID-19 and similar situations, taxing rights with respect to wages are divided between Finland and the other contracting state of a tax treaty in accordance with the

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32. FI: Tax Administration, *Taxation of work abroad*, 4/18/2019, ch. 4.2.3, available at <http://www.vero.fi/en/detailed-guidance/guidance/49111/taxation-of-income-earned-abroad4> (accessed 23 Aug. 2022).

33. Tax Administration, *supra* n. 3, at Kannanotto.

34. Tax Administration, *Ulkomaantyöskentelystä saatua palkkaa koskeva kuuden kuukauden sääntö*, VH/5713/00.01.00/2021, ch. 3.2.3, available at [www.vero.fi/syventavat-vero-ohjeet/ohje-hakusivu/106872/ulkomaanty%C3%B6skentelyst%C3%A4-saatua-palkkaa-koskeva-kuuden-kuukauden-s%C3%A4nt%C3%A4nt%C3%B6/](http://www.vero.fi/syventavat-vero-ohjeet/ohje-hakusivu/106872/ulkomaanty%C3%B6skentelyst%C3%A4-saatua-palkkaa-koskeva-kuuden-kuukauden-s%C3%A4nt%C3%A4nt%C3%B6/) (accessed 23 Aug. 2022).

treaty article on employment income. No specific view is put forward. The way double taxation is avoided is agreed upon in the treaty article that sets out the method of removal of double taxation.<sup>35</sup> There has been no published tax practice or case law in Finland in this respect concerning COVID-19 or similar challenges. As COVID-19 did not reduce such situations, the tax administration has issued guidance for Finnish-resident individuals in situations where a person does mobile work in two different countries.<sup>36</sup>

#### 11.4.2. Severance pay and other salary-related benefits

Concerning the question of severance pay, the allocation of the right to tax is based on the principle of accrual in Finland. The purpose of severance pay is more related to the present and the future when it is often intended to cover the loss of future income on termination of employment. Therefore, the 6-month rule concerning generally taxable persons (section 77 of the TVL) has not been applied to it. There is also published case law in Finland,<sup>37</sup> which is highlighted in the guidance of the tax administration. By way of derogation from this general principle, the 6-month rule may be applied to remuneration where it is based exclusively on work done abroad to which the 6-month rule applies.<sup>38</sup>

Similar principles apply, to a limited extent, to the taxation of a limited-liability taxable person. When an employer pays a voluntary one-time compensation for the termination of employment to an employee who resigns or voluntarily resigns, there is no post-paid compensation for work done in Finland. Therefore, the compensation received by a limited-liability employee has not been considered as taxable income in Finland on the sole grounds that they have been generally taxable in Finland for part of their employment. An exception to this is the situation where the lump sum paid for the termination of employment is based solely on work done in Finland. The lump-sum allowance is taxable income in Finland, even if it is paid to the former employee after the move abroad. In addition, the remuneration

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35. Tax Administration, *supra* n. 3, at Kannanotto.

36. FI: Tax Administration, *Working from home for a foreign employer*, 3/3/2022, available at [https://www.vero.fi/en/individuals/tax-cards-and-tax-returns/moving\\_away\\_from\\_finland/overseas\\_work/working-for-a-foreign-employer/working-from-home-for-a-foreign-employer/](https://www.vero.fi/en/individuals/tax-cards-and-tax-returns/moving_away_from_finland/overseas_work/working-for-a-foreign-employer/working-from-home-for-a-foreign-employer/) (accessed 23 Aug. 2022).

37. FI: KHO, 23 July 1993, t. 2671; and FI: KVL, 15 Feb. 1996, 1996/41.

38. FI: Tax Administration, *Työsuhteen päättymiseen liittyvien suoritusten verotus*, VH/3188/00.01.00/2022, ch. 16.1.1, available at <https://www.vero.fi/syventavat-vero-ohjeet/ohje-hakusivu/47870/tyosuhteen-paattymiseen-liittyvien-suoritusten-verotus3/#16-kansainv%C3%A4liset-tilanteet> (accessed 23 Aug. 2022).

received from the position of a member of the board of directors of a Finnish entity or group (or other equivalent administrative body) is always taxable income in Finland, including the severance pay.<sup>39</sup>

The tax administration states that termination benefits are subject to the provisions of the tax treaty on income from employment, directors' fee and government service. However, the effect of the tax treaty must always be determined on a case-by-case basis.<sup>40</sup> It is considered reasonable that if a person has worked abroad, the country of employment has the right to tax according to the Commentary of the OECD Model for the previous 12 months and Finland will reimburse the tax.

In addition to severance pay, similar issues may arise regarding employee stock options and employee offerings in cross-border circumstances. Also in these situations, the allocation of the right to tax is based on the principle of accrual. Applying the principle of accrual means that the income is divided into taxable and tax-exempt parts based on the working periods in the residence country and abroad. This principle is also applied to other incentive schemes that are stock based and where the vesting period is agreed upon, and the stage when the benefit is received or when the stock options are fully vested. To apply the principle of accrual, the first step is to define the start and end dates of the period of accrual, i.e. the period between when the benefit has been granted and when it is fully vested or when the employee's employment contract has ended. The next step is to establish which part of the wages, received for the same period, is subject to the country of residence and source.<sup>41</sup>

The KHO has stated (KHO 2013:93) that the period when the recipient earns the income is the period when he was expected to work in order to obtain the right to exercise the employee stock options. This means that the period when the income is accrued is the period between the date when options were granted and the date when they are fully vested. If the employee has been a non-resident in Finland for part of the time and has not primarily worked in Finland for a Finnish employer, the employee stock options benefit that relates to this part of the time is not sourced to Finland. The KHO addressed the question when applying the provisions of Finnish

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39. Id., at ch. 16.2.

40. Id., at chs. 16.1.2 and 16.2.

41. FI: Tax Administration, *Taxation of employee stock options and employee offerings in cross-border circumstances*, 12/22/2020, ch. 2, available at <http://www.vero.fi/en/detailed-guidance/guidance/77581/taxation-of-employee-stock-options-and-employee-offerings-in-cross-border-circumstances2/> (accessed 23 Aug. 2022).

national legislation. However, the Court's text explaining the reasoning for the ruling cited the Commentary of the OECD Model. The tax administration states that there are good reasons to apply the principles from KHO's ruling also, if the provisions of a tax treaty restrict the country's taxing rights with respect to a benefit received by a taxpayer from employee stock options.<sup>42</sup>

### 11.4.3. Artists and athletes

The tax administration seems to follow the principles of the Commentary of the OECD Model and states that education and preparation are often related to the artist's actual performance. Therefore, the income related to training and preparation can be part of the artist's personal activities. Thus, other income can also be considered to have accrued from the artist's personal activities if they are very closely linked to the artist's performance in the source country. If the artist's personal performance is cancelled and the artist is compensated for the cancellation, the article on artists in the tax treaty does not apply, but the right to tax the compensation is determined by other articles (salary or business income article). If the income from advertising or sponsorship is related to the performance in the source country, it can be considered as income from the personal activities of the artist. For example, when a singer is on tour, various products (such as T-shirts, posters and other similar products bearing the singer's name) can be sold on tour. An artist may receive a portion of the proceeds from the sale of such products. Such promotional income is not generally considered to be derived from the artist's personal activities, even if they relate to a concert, for example. Such income is treated as either royalty income or business income.<sup>43</sup> The views expressed by the tax administration seem to follow the principles set out in the Commentary of the OECD Model.<sup>44</sup>

The condition for the use of article 17 would seem to consistently require that the income relates to the performance of activity physically in the source country. Other articles would apply when there is no close connection between income and the performance of activities in the source country.

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42. Id.

43. FI: Tax Administration, *A performing artist's tax treatment in international situations*, 3/15/2022, ch. 3.2, available at <http://www.vero.fi/en/detailed-guidance/guidance/107528/a-performing-artists-tax-treatment-in-international-situations/> (accessed 23 Aug. 2022).

44. See paras. 9-9.5 *OECD Model: Commentary on Article 17* (2017).

There are no specific regulations or guidance concerning COVID-19 or other exceptional situations in Finland. Nor is there any published or otherwise known case law or tax practice. As a result, there may be challenges in interpreting current article 17 of the OECD Model so that it can also be applied to performances (online) that do not take place in the source country.

### **11.5. Article 15(2) and (3) of the OECD Model**

The home office may have the effect of applying article 15 of the OECD Model. However, the home office itself is unlikely to affect the application of paragraph 2(a) if the person is not present in the home office and in the country for a sufficient period of time. The 183-days rule applies to the person, not the home office. However, the home office may – in certain circumstances – constitute a permanent establishment within the meaning of article 5, in which case the country of employment may be entitled to tax under paragraph 2(c). In some exceptional situations, the home office could also affect the country of residence of the company, in which case the conditions of paragraph 2(b) would be met. However, as already stated, in COVID-19 and similar exceptional force majeure situations, the impact on the permanent establishment (article 5) or a change of country of residence (article 4) is unlikely.

Even though an employer (corporation) would not have any premises but only the employee's home office, the employer can still meet the requirements of article 15(2)(b). However, the application of article 15 is only a direct consequence of what is considered to be the country of residence under article 4. Home offices may influence the determination of the country of residence of a company, but this is a matter for article 4 – not article 15. The same applies to article 15(2)(c) (permanent establishment).

### **11.6. Frontier workers**

Finland has special provisions related to frontier workers in the Nordic tax treaty, and these apply to Sweden and Norway. An individual is considered a cross-border commuter if (i) they live in a municipality located next to the border between Finland and Sweden or the border between Finland and Norway; and (ii) they work in another municipality next to the same border in the other country. The individual's home municipality and their work municipality on the other side of the border do not need to be neighbouring



municipalities. In order to be considered a cross-border commuter in accordance with the provision on cross-border commuters, the individual must regularly stay in their country of residence. Staying is considered to be regular when, in normal circumstances, the taxpayer stays in their permanent residence in their country of residence at least once a week and these stays last at least 2 days and one night. Even a part of a day is treated as a full day.<sup>45</sup>

There is no published tax practice or case law in Finland where the home office has caused problems in applying the regulations for frontier workers. This also applies to COVID-19 and other exceptional situations. COVID-19 usually caused many of the Nordic frontier workers to work remotely from home in their country of residence. There is no effect on taxation because, according to the Nordic agreement, the country of residence taxes the salary of a frontier worker.

### **11.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)**

Based on the principle of legality, it is challenging to see, for example, an interpretation in which the former country of employment considers that the right to tax still exists in an exceptional situation – even if the person no longer works in that country but works remotely from the residence country. The conditions for taxing in the ex-country of employment are no longer met (i.e. the person no longer works physically in that country). If, in such a situation, it is desired to grant the country the right to tax on the basis that there is a payer in the country, such right to the tax must be agreed upon separately between the countries. It is essential to identify whether the intention is to use the mutual agreement procedure or to negotiate a change in the provision of the tax treaty. These are two different processes with different legal procedures.

One of the main goals of the mutual agreement procedure *initiated by the taxpayer* (paragraph 1 of article 25 of the OECD Model) is to secure the taxpayer's rights (elimination of double taxation or taxation not in accordance

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45. Protocol VI to the *Nordic Income and Capital Tax Treaty* (1997). See also FI: Tax Administration, *Taxation of cross-border commuters*, 4/28/2022, ch. 5, available at <http://www.vero.fi/en/detailed-guidance/guidance/49150/taxation-of-cross-border-commuters3/> (accessed 23 Aug. 2022).

with the provision of the tax treaty). The provision on the mutual agreement procedure in the tax treaty allows the competent authority to negotiate in principle, in one way or another, the elimination of double taxation or taxation contrary to the tax treaty. Thus, it is, in principle, possible for the mutual agreement procedure to lead to any solution – including the allocation of the right to tax in any way – as long as it eliminates double taxation. The taxpayer must accept this agreement, but the taxpayer may have an interest in accepting any agreement, as long as it eliminates double taxation. Exceptional ways of allocating the right to tax in exceptional circumstances, such as COVID-19, could therefore be agreed upon in a mutual agreement procedure initiated by the taxpayer.

Paragraph 3 of article 25 of the OECD Model authorizes the competent authorities to resolve difficulties of interpretation or application by means of mutual agreement.<sup>46</sup> However, this does not give the legislative power to negotiate actual changes to the provisions. Changes to the provisions of the tax treaty must always take place in a legal process whereby tax treaties and their amendments are negotiated.

The decisions regarding the individual taxpayer in the mutual agreement procedure are usually not public in the countries. This creates a challenge to critically assess how the mutual agreement procedure is used in different situations. In principle, nothing would prevent the results of the mutual agreement procedure from being published anonymously.

## **11.8. The future of the mobility of work: A need for adjusting the existing treaty rules?**

### **11.8.1. Understanding the principle of economic connection**

The principle of *physical* economic connection is related to the determination of the country of residence, in addition to the taxing right of the source country. Regarding the taxation right of the source country, tax treaties may limit countries' broad national taxing rights. In many source countries, the right to tax business is based nationally on the physical business activity (economic connection) instead of the concept of permanent establishment. Although, in some countries, the right to tax may also be based on the concept of a permanent establishment, it is systematically a broader concept than a permanent establishment concept under the OECD Model. The

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46. Para. 50 *OECD Model: Commentary on Article 25* (2017).

country may also establish the right to tax business activities nationally, both on the basis of a permanent establishment and more broadly on the basis of the exercise of business activities, such as certain service activities.<sup>47</sup> In all cases, the question is largely whether the business is carried physically in that country; it is the principle of the physical economic connection.

Another economic connection justification for the right to tax business relates to whether that country is a source of income. For example, royalty income, dividends and various profit shares of the funds are based on this principle. In this case, it is sufficient that the income comes from the country, regardless of where the actual (business) activity is carried out or where the tax residency is located. On this basis, some countries may have extended the taxing right both nationally as well as in tax treaties; for example, in the case of certain service activities, the country has the right to tax business income – even if the service is provided from another country.<sup>48</sup>

The principles of economic connection, such as the location of the physical activity and the country of source of income, are not mutually exclusive but complementary; the conditions related to the principle can be met at the same time. On the other hand, the threshold of the right to tax based on the economic connection can be different, for example, with regard to activities taking place physically in the country and the taxing right of the country of source of income.

Regarding tax issues related to mobility, it is particularly important to first understand how a country's national taxing right is determined and how it should be defined in *de lege ferenda*. The country may have determined its right to tax nationally in a way that the right to tax arises only in a situation where the activity is carried out physically in that country. Therefore, if the country wants to extend the right to tax (for example, to digital services regardless of where the service is provided), the country must amend its national legislation and its basic principles, as necessary.

One important issue in mobile businesses is how the right to tax should be shared between countries in the case of the sale of goods and services

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47. Nissinen, *supra* n. 6, at pp. 214-216. See also for example R. Ekkehart, S. Schmid & M. Orell, *Permanent establishments – a domestic taxation, bilateral tax treaty and OECD perspective* (5th ed., Kluwer L. Intl. 2016); and R. Baker & R. Collier, *General Report*, in *The attribution of profits to permanent establishments* (vol. 91b, IFA 2006).

48. See *United Nations Model Double Taxation Convention between Developed and Developing Countries: Commentary on Article 12A* (1 Jan. 2017), *Treaties & Models* IBFD.

from abroad. It is justified for businesses to contribute to the maintenance of publicly funded infrastructure and public services by paying taxes.<sup>49</sup> On the other hand, businesses from abroad do not burden the country's public structure similarly. Therefore, the reasons for taxing right cannot be based – at least not entirely – on the same principles as in the case of intra-country business.

The taxing right of the source country may be justified to be seen, for example, on the basis that society enables foreign companies to have solvent customers, and the income from the country forms an economic link to the country. A company benefits (directly and indirectly) from the society of a country and its services and infrastructure, regardless of whether the business is conducted in that country or from abroad. The company benefits remotely, among other things, from the infrastructure provided and secured by societies (such as electricity and telecommunications network), as well as from security and the rule of law. Businesses need a market and solvent customers enabled by society. The sale and customers in the country ultimately determine whether or not the business generates revenue.<sup>50</sup>

It is also important to assess the limitations of the taxing right based on the principle of economic connection (thresholds). It may be justified to give importance to whether the business exploits the market on a permanent basis or whether it is only temporary. An overly complicated fragmentation of the right to tax can be prevented by limiting the taxing right for small incomes received from the country (income amount threshold). Limitations related to temporary activities and the amount of income can reduce the amount of administrative work. If the taxing right is highly fragmented between countries, this can lead to significant additional administrative work for both the taxpayer and administration.

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49. See for example OECD, *Addressing the Tax Challenges of the Digital Economy – Action 1: 2015 Final Report* pp. 24-27 (OECD 2015), Primary Sources IBFD.

50. See also for example W. Schön, *Taxation and Democracy* pp. 37-41 (New York University 2018); W.F. Richter, *Taxing Direct Sales of Digital Services: A Plea for Regulated and Internationally Coordinated Profit Splitting*, CESifo Working Papers pp. 19-20 (2018); European Commission, *Expert Group on Taxation of the Digital Economy* pp. 19-20 (28 May 2014); N. Tadmor, *Source Taxation of Cross-Border Intellectual Supplies – Concepts, History and Evolution into the Digital Age*, 61 Bull. Intl. Taxn. 1, pp. 3-4 (2007), Journal Articles & Opinion Pieces IBFD; OECD, *Are the Current Treaty Rules for Taxing Business Profits Appropriate for E-Commerce?* para. 44 (OECD 2004). See also for example OECD, *Tax Challenges of Digitalisation: Comments Received on the Request for Input – Part 1* (OECD 2017).

Other social and political dimensions may also be taken into account. For example, international taxation should not endanger the essential needs of society. Tax revenues on small parts of a business are not necessarily critical to the country's economy. It may also be possible that tax revenue generated by the taxing right of foreign companies will be lost as domestic taxpayers expand their business to another country. Limiting the right to tax may increase the willingness of foreign companies to invest and start a business in that country. Taxes other than income tax alone must also be taken into account when determining the right to tax between countries.

### 11.8.2. Understanding the definition of “core business functions”

It is important to understand the different ways in which business, especially mobile businesses, can be decentralized and what effect this has on the distribution of taxing rights of businesses and workers. Decentralization can take place, for example, through own employees or by purchasing services from other companies. It is also important to recognize which activities in the decentralized business are carried out in different locations and whether the activities are, for example, a core part of the company's business or only an ancillary or preparatory.

The solutions must always bear in mind the fair distribution of the right to tax between countries and how the rights of the individual taxpayer are sufficiently fulfilled. It should also be emphasized that it is up to the company to decide whether it wants to fragment its business, for example, by having its employees or activities located in several different countries.

There is also the question of whether the result should be different for tax purposes, depending on whether the legal person's own activity is carried out (in whole or in part) by subcontractors. For example, if a legal firm is registered in a particular country but its activity is carried out wholly or mainly elsewhere in other countries by subcontractors, should this have an effect on the determination of the right to tax or tax residence? Does it matter whether, in subcontracting, the business risk is transferred (in whole or in part) to the subcontractor, or does the company still retain the same risk despite the subcontracting agreement? Can the conclusions be affected by whether the arrangements have been made between related parties? Should a tax conclusion be drawn between the levels of “at the disposal”, dependency, non-taxation and tax avoidance?

In addition, it is important to understand and identify core functions in the collective investment business. Presumably, at least portfolio management (function) is one, and the distribution of fund units is another (function) of the core and value-creating activities in the collective investment business. It is also possible that all (or main) aspects of the fund's core business will be "subcontracted" to a management company located in another country or a separate legal person. If the activities of these other legal persons are considered to be independent<sup>51</sup> – due to which they do not affect the country of residence of the fund or the taxation of the fund in other countries – are we in a situation where the fund can be set up in any country without tax consequences in other countries, even though there would be no significant core activity in the fund's founding country?<sup>52</sup> In general, can the rules of an existing permanent establishment apply to the fund at all? Does it differ if the fund's investment activities are active or passive? The current provisions of international tax law would seem to be quite unsatisfactory for investment fund businesses, which can also be very mobile. After all, it is always possible to apply different international taxation right principles between collective investment funds and "normal" business, as these activities are normally easily identifiable as separate and usually have very different purposes (collective investment vs. individual business). If, on the other hand, there are no separate provisions, the provisions must be applied in a uniform manner.

### 11.8.3. Importance of reciprocity in tax treaties

It may be appropriate to deviate from the principle of economic connection in accordance with the principle of reciprocity when utilizing tax treaties. The definition of a permanent establishment is an example of a restriction on the right to tax based on an economic connection, in which case the right to tax arises only on the basis of sufficient permanence (permanent establishment). In the future, the permanence of business in the country may be more relevant than requiring premises or spots for business.

Once the basis for a taxing right has been agreed upon between countries, it is necessary to define how the income is considered to be allocated between countries. In many situations, the allocation of income should be clear. For example, the revenue from a physical place is logically considered to accrue from where the place is located. However, there are situations in which

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51. From the perspective of private equity funds, *see* Schmidt, *supra* n. 29, at p. 38.

52. *See also* Adema, *supra* n. 14, at pp. 188-189.

several persons from different countries, through which the right to tax has been established, participate in the sale. It is a question of mobile activity, i.e. where the sale of a service or good can be achieved remotely from where the employees are located. In addition, consideration should be given to situations where automation can constitute a nexus and sales income, regardless of where the people who maintain the automation are located.

#### 11.8.4. Need for force majeure provisions?

COVID-19 initiated a debate on the so-called force majeure provisions or principles in international tax law. Should international tax law have its own provisions at the national and international levels for the so-called force majeure situations? Or are the international tax law provisions flexible enough to allow for an appropriate outcome, even in exceptional circumstances? Even in the absence of actual provisions, should the existence of the principle of force majeure be recognized or at least accepted in international tax law? Does that principle already exist in international tax law, even though it may not have been so clearly identified in the past? Could such a legal principle go beyond a literal interpretation of the international tax law, or does a principle of the legality of tax law require a statutory principle of force majeure? If force majeure existed solely at the level of legal principles, would its scope be limited to situations that improve the legal fairness of the taxable person? Finally, what would be a solution, for example, in a situation where the question would be which country has the right to tax income?

The Commentary of the OECD Model (2017) makes no mention of the term “force majeure”. This does not mean that the issue is not known at the OECD level.<sup>53</sup> Force majeure issues are not only related to the issue of mobility but also, for example, to transfer pricing.<sup>54</sup> Nationally, in Finland, section 77 of the TVL has been considered to contain the so-called force majeure exception.

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53. See for example OECD Guidance, *supra* n. 9, at para. 58.

54. See for example F. Hader & R. Hartmann, *Germany - Coronavirus: No Need to Rush – Transfer Pricing Crisis Management in Germany*, 27 Intl. Transfer Pricing J. 4 (2020), Journal Articles & Opinion Pieces IBFD; and M. Cataldi & A. Alfano, *Italy/International - The Impact of COVID-19 on Transfer Pricing: Issues Arising during the Economic Downturn and Possible Solutions*, 27 Intl. Transfer Pricing J. 4 (2020), Journal Articles & Opinion Pieces IBFD.

At the same time, when assessing the need for force majeure, it is necessary to consider whether countries' right to tax and taxpayers' legal protection can also be secured in other ways. Would it be sufficient if, in all situations – including the so-called force majeure situations – single taxation could be secured (prevention of double taxation)? Would it ultimately be ensured if there were effective and efficient provisions between countries in mutual agreement procedure and arbitration, which would ensure the implementation of single taxation from the point of view of both the countries and the taxpayers?



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## Chapter 12

### The Impact of Tax Treaties on International Mobility of Work in Germany

Michael Mautsch and Gilles Querbach

#### 12.1. Mobility of work and domestic tax law

##### 12.1.1. World income principle

German resident individuals are subject to unlimited tax liability on their worldwide income and assets (section 1, paragraph 1 of the Income Tax Law (*Einkommensteuergesetz* (EStG))).<sup>1</sup> An individual is considered resident in Germany if their domicile or habitual place of abode is in Germany. According to section 8 of the General Tax Code (*Abgabenordnung* (AO)), an individual's domicile is the place where they occupy a home in circumstances which indicate that they will retain and use it. According to consistent case law, this needs to be assessed from both a factual and economic point of view.<sup>2</sup> Only the actual facts are relevant, not the intention of the taxpayer.<sup>3</sup> The domicile needs to include suitable premises on which to live and has to be at the taxpayer's disposal.<sup>4</sup> They must use the domicile on a regular basis, although there is no minimum number of days that they need to stay there.<sup>5</sup> An individual's habitual place of abode is the place where they are present in circumstances which indicate that their stay is not just temporary (section 9, sentence 1 of the AO). A habitual place of abode is deemed to exist if an individual has been continuously present in Germany for a period of more than 6 months (section 9, sentence 2 of the AO). A short interruption during the stay is not taken into account, i.e. it is included in the calculation of the 6-month period. A presence of less than 6 months may also create a habitual place of abode if the presence is not temporary.<sup>6</sup> If the taxpayer's presence in Germany is exclusively for a visit, recuperation, cure or similar private purpose, a habitual place of abode is deemed to exist if the stay exceeds 1 year. Section 9 of the AO also applies to involuntary

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1. A. Perdelwitz, *Germany - Individual Taxation* sec. 1, Country Tax Guides IBFD.
  2. DE: BFH [Federal Tax Court], 28 Aug. 1968, I 254/65, BStBl. II 1968, 818 (819); DE: BFH, 5 Nov. 2001, VI B 219/00, BFH/NV 2002, 311.
  3. DE: BFH, 7 Apr. 2011, III R 77/09, BFH/NV 2011, 1351.
  4. DE: BFH, 10 Apr. 2013, I R 50/12, BFH/NV 2013, 1909.
  5. DE: BFH, 28 Jan. 2004, I R 56/02, BFH/NV 2004, 917.
  6. DE: BFH, 30 Aug. 1989, I R 215/85, BStBl. II 1989, 956.

sojourns.<sup>7</sup> As the total worldwide income of a German resident taxpayer is subject to German income tax, income from abroad or from work performed in foreign countries is also subject to German taxation (section 34d, no. 5 of the EStG). Any foreign tax imposed on the employment income may be credited against the equivalent German tax, provided certain conditions are satisfied, if double taxation is not avoided by tax treaty rules (section 34c of the EStG).

Individuals who are not resident in Germany generally have limited tax liability on their income tax with respect to German-source income explicitly listed in the law (section 1 paragraph 4 and section 49 of the EStG). If an individual becomes resident or non-resident during a year, German-source income derived during the period of non-residence is added to the income derived in the period of residence (section 2, paragraph 7, sentence 3 of the EStG). This means that the taxpayer is taxed as a resident in respect of all German-source income derived during that year.<sup>8</sup> With respect to frontier workers who have a limited tax liability, section 1, paragraph 3 of the EStG offers an opt-in possibility of unlimited taxation in Germany.<sup>9</sup>

### 12.1.2. Exit tax

According to section 2 of the Foreign Tax Law (*Außensteuergesetz* (AStG)), a German national who moves to a foreign country remains, under certain circumstances, subject to an “extended tax liability as a non-resident” for 10 years from their departure. Under section 6, paragraph 1 of the AStG and section 17, paragraph 1, sentence 1 of the EStG, an individual who has been subject to unlimited German income tax liability for at least 10 years prior to emigrating to another country, and who is thereby now no longer subject to unlimited German income tax liability, is subject to tax on emigration in respect of the unrealized increase in the value of their shares in a domestic company in which the individual owns, or has owned at any time within the preceding 5 years, directly or indirectly, at least 1% of the share capital. This exit tax applies to individuals who have been subject to unlimited domestic income tax liability for at least 7 years within the 12 years preceding the emigration to another country (section 6, paragraph 2 of the AStG). Where the termination of subjection to tax as a resident is due to temporary absence

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7. D. Birk, M. Desens & H. Tappe, *Steuerrecht* Rz. 687 (C.F. Müller 2021/2022).

8. Perdelwitz, *supra* n. 1, at sec. 6.

9. For example, if more than 90% of the total individual’s income is already liable for German taxation.

and when the taxpayer again becomes subject to tax as a resident within the following 7 years, the tax claim ceases to exist, subject to certain conditions (section 6, paragraph 3 of the AStG).

### 12.1.3. Resident entities

Resident entities are subject to tax on their worldwide income, whereas non-resident entities are taxed only on their German-source income.<sup>10</sup> Under the Corporate Income Tax Law (*Körperschaftsteuergesetz* (KStG)), a company is resident in Germany if either its legal seat or its place of management is located in Germany (section 1 of the KStG). The term “place of management” (section 10 of the AO) is normally defined as the place where the persons who have final authority make their decisions concerning the management of the business.<sup>11</sup> Owing to technological progress and the dynamic development of business structures, the place of management in a specific case might be found in different places.<sup>12</sup> This does not contradict paragraphs 1 and 3 of article 4 of the OECD Model. Whereas the latter determines which of the two contracting states should be treated as the taxpayer’s residence state for tax treaty purposes, section 10 of the AO establishes unlimited tax liability given a genuine link to the state’s territory.<sup>13</sup>

According to domestic corporate law, a German corporation must have its legal seat in Germany (section 4a of the *Gesetz betreffend die Gesellschaften mit beschränkter Haftung* (GmbHG), section 5 of the *Aktiengesetz* (AktG)). If a corporation relocates its legal seat or its place of management to outside of Germany, thus ceasing to be subject to unlimited tax liability in Germany, there is a deemed disposal of assets<sup>14</sup> so that all hidden reserves are realized and subject to corporate income tax at the regular rate (section 11 of the KStG). As the place of management is sufficient to establish residence for tax purposes, exit tax might be triggered for the corporation in cases where the board members change their residence to another country, and therefore the place of management – aside from the legal seat – has been transferred to outside of Germany (section 12 of the KStG) without any

10. Perdelwitz, *supra* n. 1.

11. Id.

12. S. Lampert, in *Gosch* KStG § 1 Rn. 47a (4th ed., C.H. Beck 2020).

13. Id.

14. DE: BGH [Federal Court of Justice], 11 July 1957, II ZR 318/55, BGHZ 25, 134 [144]; DE: OLG Hamm [Higher Regional Court Hamm], 1 Feb. 2001, 15 W 390/00, NJW 2001, 2183.

German-source income left.<sup>15</sup> Otherwise, the non-resident corporation is subject to limited corporate income tax if they derive German-source income (section 2 of the KStG and section 49 of the EStG).<sup>16</sup>

#### 12.1.4. Substance requirements, home office and permanent establishments

There exists neither a clear definition nor any criteria in terms of substance requirements regarding enterprises in German tax law. However, section 12 of the AO gives a definition on what constitutes a “permanent establishment” (PE). It means any fixed place of business or facility serving the business of an enterprise (e.g. the place of business management, branches, offices, factories or workshops, warehouses, purchasing offices or sales outlets, mines, quarries or other stationary, moving or floating facilities for the exploitation of natural resources, and – under certain circumstances – building sites or constructions or installation projects). Thus, in cases where a PE is given, so will the substance requirements.

The requirement of a PE is especially relevant to corporate taxation. According to section 1 of the KStG, a resident company is subject to unlimited tax liability. Corporations which derive their German-source income from commercial enterprise are subject to limited tax liability (section 2, no. 1 of the KStG and no. 2 of paragraph 1 of section 49 of the EStG). According to no. 2 lit. a of paragraph 1 of section 49, the commercial enterprise needs to be linked with a PE or permanent agent. Since the place of management is sufficient to constitute a PE, according to sentence 2 of no. 1 of section 12 of the AO, focus should be given to its precise determination, which is always decided on a case-by-case basis.<sup>17</sup> With regard to corporations, the place of management usually corresponds with the location of the office premises<sup>18</sup>, this being in certain cases the director’s residence.<sup>19</sup> The only decisive factor is where the relevant activities continually take place,<sup>20</sup> rather than where the management’s decision-making occurs.<sup>21</sup> A fixed place of business is not required.<sup>22</sup> In summary, it can be stated that a certain

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15. V. Pfirmann, in *Brandis/Heuermann: Ertragsteuerrecht* § 12 Rn. 40 ff., Werkstand: 160 (Franz Vahlen 2021).

16. Perdelwitz, *supra* n. 1.

17. E. Gersch, in *Klein, Abgabeordnung: AO* § 10 Rn. 3 (15th ed., CH Beck 2020).

18. DE: BFH, 29 Apr. 1987, X R 16/81, BFH/NV 88, 64.

19. Id.

20. U. Koenig, in *Koenig Abgabeordnung: AO* § 10 Rn. 7 (4th ed., CH Beck 2021).

21. Id., at Rn. 5.

22. Gersch, *supra* n. 17.

management-related location is sufficient to constitute a place of management. Arguably, the only exception to the substance requirements is the permanent agent who conducts the business of an enterprise in a sustained manner and, in so doing, is subject to its instructions (section 13 of the AO). According to the German Federal Fiscal Court (*Bundesfinanzhof* (BFH)), the working place must be at the disposal of the management.<sup>23</sup> The management needs to have a legal right over the place of work.<sup>24</sup> Consequently, teleworking spaces do not constitute a PE<sup>25</sup> and the home office does not therefore trigger taxation for the corporation in general.

#### 12.1.5. Tax residence nexus and social security law

The German compulsory social insurance scheme includes the following: pension insurance; unemployment insurance; health insurance; and nursing insurance for disability and old age.<sup>26</sup> These insurances are generally financed by equal contributions from employers and employees. Employees, as opposed to self-employed persons, are subject to the compulsory social security system. Foreign citizens employed in Germany are also covered by the compulsory social security system. Therefore, foreign workers are required to pay contributions to the statutory pension, health, unemployment and the nursing insurance for disability and old age.<sup>27</sup> Foreign employees seconded to Germany for a fixed period of time, but working for a foreign employer, are able to claim the coverage of their residence countries' social security insurance in line with EU Regulations and social security agreements as well as special provisions of the German Social Security Law (Book IV, sections 4 and 5).<sup>28</sup> According to section 14 of Social Security Regulation (71/1408), a stay in Germany of up to 1 year, which might be prolonged for a further year under certain conditions, will normally allow these employees to remain members of their residence country's systems. After that period, they will become members of the host country system if they are not covered by special provisions of the related agreements (e.g. article 17 of Social Security Regulation (71/1408)). The German Social Security Law (Book IV, sections 4 and 5) only requires that from the moment the work in the foreign country starts, the stay is expected to

23. Id., at § 12 Rn. 5.

24. DE: BFH, 16 May 1990, I R 113/87, BStBl. II 1990, 983.

25. H. Pasch & T. Utescher, *Die Telearbeit als Option zur Green Card – die steuerliche Behandlung von Telearbeitsplätzen*, Betriebs-Berater 33, p. 1160 et seq. (2001).

26. Perdelwitz, *supra* n. 1, at sec. 3.

27. Id.

28. Id.

be limited in time. The law does not mention a specific number of years. The same rules apply to a German individual working abroad for a German employer.<sup>29</sup> In conclusion, the treatment under domestic social security law depends on the employment relationship as opposed to the employer's/employee's residence.

## **12.2. Residence, tiebreaker rules and mobility of work: Individuals and entities**

### **12.2.1. Article 4, paragraph 1 of the OECD Model**

Paragraph 1 of article 4 of the OECD Model refers to the national tax laws of the contracting states. A resident must be liable to tax under the domestic laws of one of the contracting states. Sentence 2, paragraph 1 of article 4 of the OECD Model stipulates that it is not sufficient that the person is liable to tax only in respect of income from sources in that state or from capital situated therein. The reference to domestic law is not unqualified, as tax treaty residence can only be based on certain grounds for creating the liability to tax, namely “by reason of...domicile, residence, place of management or any other criterion of a similar nature”.<sup>30</sup> This indicates that tax treaty residence requires the taxpayers' personal attachment to the state concerned. Regarding individuals, “domicile” or “residence” (section 8 of the AO) as well as “habitual abode” (section 9 of the AO) determine their tax liability. Concerning corporate entities, it is their legal seat (section 11 of the AO) or place of management (section 10 of the AO) that determines their tax liability. Hence, the definitions and the impact of a higher degree of mobility of work in terms of article 4(1) of the OECD Model correspond with what has been mentioned above. The same applies to the aspect of substance requirements.

### **12.2.2. Article 4, paragraph 2 of the OECD Model – tiebreaker clause (individuals)**

The tiebreaker clause provides a priority ordering list in order to determine which of the two contracting states should be treated as the taxpayer's

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29. Id.

30. R. Ismer & K. Blank, *Art. 4*, in *Klaus Vogel on Double Taxation Conventions* m. no. 3 (5th ed., Reimer & Rust 2021).

residence state for tax treaty purposes in cases of dual residence.<sup>31</sup> Contrary to paragraph 1 of article 4 of the OECD Model, paragraphs 2 and 3 are subject to autonomous interpretation, independent of domestic law.<sup>32</sup> The reason being that, as the determination of residence is left to the domestic law of the contracting states, it therefore happens that, owing to the independent application in two contracting states of their domestic laws, a taxpayer might end up being classed as resident in both states. In the absence of any further provision, the taxpayer would face full tax liability in both contracting states.<sup>33</sup>

#### 12.2.2.1. Article 4, paragraph 2 of the OECD Model – “Permanent Home”, “Centre of vital interests”, “habitual abode”

The primary criterion under the tiebreaker rule is the permanent home criterion. The home must be available to the individual for their permanent use, as opposed to an arrangement indicating short-term occupation.<sup>34</sup> The actual form of the home is immaterial,<sup>35</sup> whereas its “permanence” is decisive. Although the individual is not required to live there constantly,<sup>36</sup> a certain degree of periodic use is necessary.<sup>37</sup> Those requirements are more stringent compared to section 8 of the AO.<sup>38</sup> An occupation of the home over a period of at least 12 months qualifies as “permanent”.<sup>39</sup>

If the taxpayer has a permanent home in both contracting states, one must then identify the contracting state with which their “personal and economic relations” are closest, also known as their “centre of vital interests” (CVI).

31. B.R. Obuoforibo, *Article 4: Resident - Global Tax Treaty Commentaries*, Global Topics IBFD (accessed 20 Apr. 2022).

32. Ismer & Blank, *supra* n. 30, at para. 170.

33. Obuoforibo, *supra* n. 31.

34. DE: FG BW [Tax Court Baden-Württemberg], 30 Jan. 2002, 2 K 3/02; DE: BFH, 16 Dec. 1998, I R 40/97, BStBl. II 1999, 207.

35. DE: FG BW, 3 May 1985, II (III) 271/82, EFG 1985, 483.

36. DE: FG BW, 22 Feb. 2006, 13 K 166/01, EFG 2006, 1175; DE: BFH, 5 June 2007, I R 22/06, BStBl. II 2007, 812.

37. I R 22/06, BStBl. II 2007, 812: *Convention between the German Federal Republic and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital* (11 Aug. 1971).

38. DE: BFH, 24 Jan. 2001, I R 100/99, BFH/NV 2001, 1402; I R 22/06 (2007), at BStBl. II 2007, 812: *Ger.-Switz. Income and Capital Tax Treaty* (1971).

39. DE: FG [Tax Court Cologne], 11 Aug. 1982, VIII 391/79, RIW 1983, 383 (384): *Convention between the Federal Republic of Germany and the Spanish State for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital* (5 Dec. 1966); F. Wassermeyer & C. Kaeser, in *Wassermeyer, Doppelbesteuerung, DBA, OECD-MA art. 4*, Rz. 59 (157th ed., CH Beck 2022).

The following factors are, inter alia, relevant in determining the taxpayer's CVI: family and social relations; occupations; and political, cultural or other activities.<sup>40</sup> The mere intention to stay in one state needs to manifest itself in a verifiable manner in order to be considered sufficient for a personal relation.<sup>41</sup> Economic relations are usually tied to local activities or income sources.<sup>42</sup> In cases where the personal relations are closest to one state but the economic relations to another, the decision has to be made with regard to the state's significance to the taxpayer.<sup>43</sup> If it is not possible to determine the taxpayer's CVI, one must then take a look at their place of habitual abode.<sup>44</sup>

The habitual abode test is activated in two situations: (i) where a dual-resident individual has a permanent home in two contracting states in which they are resident, but it is not possible to determine which is their CVI; and (ii) where a dual-resident individual does not have a permanent home in either of the contracting states in which they are resident. Regarding scenario (ii), one must identify the state where the individual usually lives.<sup>45</sup> Referring to subparagraph (c), the Commentary on the OECD Model states that "it is possible [...] to have a habitual abode in the two States, [...] if the individual was customarily or usually present in each State during the relevant period, regardless of the fact that he spent more days in one State than in the other."<sup>46</sup> To determine the individual's habitual abode under scenario (ii), also taken into account should be all their stays in each contracting state. The reasons for those stays are immaterial.<sup>47</sup> The Commentary recommends that the periods under consideration be those in which there are no major changes in personal circumstances that could affect the result (e.g.

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40. DE: BFH, 31 Oct. 1990, I R 24/89, BStBl. II 1991, 562 (563): *Convention between the United Kingdom of Great Britain and Northern Ireland and the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion* (12 Nov. as amended through 23 Mar. 1970).

41. DE: BFH, 23 July 1971, III R 60/70, BStBl. II 1971, 758: *Ger.-Switz. Income and Capital Tax Treaty* (1971).

42. I R 24/89 (1990), at BStBl. II 1991, 562 (563): *Ger.-UK Income and Capital Tax Treaty* (1964/1970); Wassermeyer & Kaeser, *supra* n. 39, at Rz. 42, art. 4 *Ger.-Switz. Income and Capital Tax Treaty* (1971).

43. I R 24/89 (1990), at BStBl. II 1991, 562 (563); III R 60/70 (1971), BStBl. at II 1971, 758 (759): *Ger.-UK Income and Capital Tax Treaty* (1964/70) and *Ger.-Switz. Income and Capital Tax Treaty* (1971).

44. DE: FG Berlin [Tax Court Berlin], 18 June 2002, 5 K 5386/00, Internationales Steuerrecht (ISr) 2002, 845: *Ger.-Spain Income and Capital Tax Treaty* (1966); B. Kaminski, in *Strunk/Kaminski/Köhler, Aussensteuergesetz, OECD-MA* art. 4, Rz. 49 (59th ed., Stollfuß Medien 2021).

45. Ismer & Blank, *supra* n. 30.

46. See *OECD Model Tax Convention on Income and on Capital: Commentary on Article 4* para. 19 (21 Nov. 2017), *Treaties & Models IBFD*.

47. *Id.*, at para. 18.



separation or divorce).<sup>48</sup> If it is not possible to determine the individual's habitual abode, preference should then be given to the contracting state of which the individual is a national. If the residence of an individual cannot be determined for convention purposes according to the tiebreaker criteria in subparagraphs (a), (b) and (c) of article 4(2) of the OECD Model, the competent authorities as defined in subparagraph (f) of article 3(1) of the OECD Model shall settle the question by mutual agreement (subparagraph (d) of article 4(2) of the OECD Model).<sup>49</sup>

#### 12.2.2.2. Article 4, paragraph 2 of the OECD Model – criteria in the light of mobility of work

Terms such as “permanent home”, “centre of vital interests” and “habitual abode” are strongly contested and differ considerably between the contracting states. Although the mode of working might change, and COVID-19 might act as a catalyst, a new interpretation of the specific terms does not necessarily have to follow. Article 4(2) of the OECD Model determines the taxpayer's residence according to certain measures which in themselves need to be evaluated specifically. Thus, a higher degree of mobility of work is just another example of the challenge in prioritizing for tax treaty purposes within the scope of the tiebreaker clause. Although the problem may not be new from an academic point of view, it certainly serves as a reminder to continue finding adequate guidance for the courts.

#### 12.2.3. Article 4, paragraph 3 of the OECD Model – tiebreaker clause (entities)

In its present form, sentence 1 of article 4(3) of the OECD Model tries to resolve instances of dual residence through a mutual agreement procedure (MAP) on a case-by-case basis.<sup>50</sup> In order to determine tax treaty residence, the competent authorities have to take into account the place of effective management (PoEM), the place where the dual-resident company is incorporated or otherwise constituted and any other relevant factors. Article 4(3) of the OECD Model follows a substance-over-form approach.<sup>51</sup>

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48. Id., at para. 19.1.

49. Ismer & Blank, *supra* n. 30, at para. 3.

50. See *OECD Model Tax Convention on Income and on Capital: Commentary on Article 4* para. 23 (26 July 2014).

51. Ismer & Blank, *supra* n. 30, at para. 135.

### 12.2.3.1. Principle

Under the former version, preference was given to a rule based on the effective management, which was to be understood as the place where the company was actually managed (PoEM test), over a purely formal criterion-based registration.<sup>52</sup> This approach had been criticized, particularly in cases where different forms of management (e.g. managers, board of directors, shareholders) are found in different countries (e.g. where a decision is made, or where it is enforced), thus failing to designate the PoEM exclusively to one country.<sup>53</sup> Moreover, with technical advances, an entity's key decisions need not be made in one place, much less a particular place, all the time.<sup>54</sup> Since the 2017 OECD Model update, the determination of treaty residence is no longer limited to a single deciding tiebreaker criterion.<sup>55</sup> Instead, the competent authorities are now enabled and required to take all relevant factors into account.

### 12.2.3.2. "Place of effective management"

According to the Commentary on the OECD Model, the PoEM is where the key decisions of a company are made.<sup>56</sup> Arguably, designating the PoEM to one state is only possible if it is where the board of directors (BoD) makes its key management and business decisions,<sup>57</sup> as decision-making executive staff at a lower hierarchical level of a multinational, globalized company structure are likely to be scattered over several countries.<sup>58</sup> If the director's meeting is held in two countries, the PoEM is located where the real control of the company is exercised.<sup>59</sup> Another interpretation observes that the PoEM refers to the place from which day-to-day affairs are carried on and not the place in which ultimate control of the company resides.<sup>60</sup> This alternative interpretation indicates that the PoEM is not determined solely on the basis of where the board of directors' meeting is centred, but rather

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52. See para. 22 *OECD Model: Commentary on Article 4* (2014).

53. Id., at para. 164.

54. Id.

55. Id., at para. 135.

56. Id., at para. 139.

57. E. Burgstaller & K. Haslinger, *Place of Effective Management as a Tie-Breaker-Rule-Concept, Developments and Prospects*, 32 *Intertax* 8/9, p. 380 (2004).

58. Ismer & Blank, *supra* n. 30, at para. 139.

59. UK: Appeal Cases (AC) 455 House of Lords, 30 July 1906, *De Beers Consolidated Gold Mines v. Howe* (*Surveyor of Taxes*).

60. IN: Authority for Advance Rulings, New Delhi (AAR), 16 July 1997, *DIJMB Mauritius Investment Co Ltd v. Commissioner of Income Tax*, 94 *Taxmann* 218.

where executive management involving senior executive functions of the entity is located.<sup>61</sup>

## 12.3. Permanent establishments and mobility of work

### 12.3.1. Article 5 of the OECD Model – “Permanent Establishments” overview

As the term “permanent establishment” is defined in article 5(1) and (2) of the OECD Model, it must be interpreted autonomously without recourse to domestic law (article 3(2) of the OECD Model).<sup>62</sup> The Commentary on article 5 of the OECD Model indicates that the definition of a PE in paragraph 1 contains the following components: (i) a place of business; (ii) the place of business must be established at a distinct place for a minimum period of time; and (iii) the business must be carried on through that place.<sup>63</sup> An enterprise can have a place of business where “it simply has a certain amount of space at its disposal”.<sup>64</sup> This will depend on whether that enterprise has the effective power to use that location as well as the extent of the presence of the enterprise at that location and the activities that it performs there.<sup>65</sup> The German BFH stipulates that the disposal of the location must not be merely transitory.<sup>66</sup> The mere possibility of using the location is also not sufficient, and the enterprise needs to have a legal right which cannot be withdrawn without its consent.<sup>67</sup> The place of business is fixed if it has both a link with a specific geographical point and a certain degree of permanence.<sup>68</sup> To determine a sufficient degree of permanence, the particularities of the business sector need to be taken into account.<sup>69</sup> The 12-month period in article 5(3) of the OECD Model is of no significance in that regard.<sup>70</sup>

61. S. Sharma & J. Cardozo, *A Paradigm Shift of Residence Rules*, 18 Asia-Pac. Tax Bull. 1, sec. 3.3 (2012), Journal Articles & Opinion Pieces IBFD.

62. M. Görl & C. Gradl, in *Vogel/Lehner, Doppelbesteuerungsabkommen: DBA, OECD-MC 2017*, art. 5, para. 7 (7th ed., CH Beck 2021).

63. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 5* para. 6 (21 Nov. 2017), Treaties & Models IBFD.

64. *Id.*, at para. 11.

65. *Id.*, at para. 12.

66. DE: BFH, 18 Mar. 2009, III R 2/06, BFH/ NV 2009, 1457.

67. *Id.*

68. DE: BFH, 17 Sep. 2003, I R 12/02, BStBl. II 2004, 396.

69. Görl & Gradl, *supra* n. 62, at para. 33.

70. *Id.*

### 12.3.2. Article 5 of the OECD Model – guidance in the light of COVID-19

With regard to the COVID-19 pandemic, the OECD remarks that individuals who stay at home to work remotely are typically doing so as a result of public health measures: it is an extraordinary event, not an enterprise's requirement.<sup>71</sup> Therefore, home office as a result of an extraordinary event or public health measures imposed, or else as recommended by the government does not create a PE for the business/employer, either because such activity lacks a sufficient degree of permanency or continuity or else because the home office is not at the disposal of the enterprise.<sup>72</sup>

#### 12.3.2.1. Agent permanent establishment – article 5, paragraph 5 of the OECD Model

Under article 5(5) of the OECD Model, the activities of a dependent agent such as an employee will create a PE for an enterprise if the employee habitually concludes contracts on behalf of the enterprise. The relevant “habitual” activities need to have a certain degree of permanency.<sup>73</sup> Once again, the specificities of the business sector need to be considered.<sup>74</sup> In cases of doubt, the criteria for determining a fixed place of business (article 5(1) of the OECD Model) may be applied accordingly.<sup>75</sup> It is crucial whether the business activities were taken up with a long-term vision from the start or merely transitorily.<sup>76</sup> The OECD takes a similar approach: An employee or agent's activity in a jurisdiction is unlikely to be regarded as habitual if they are only working at home in that jurisdiction because of either an extraordinary event or public health measures imposed or recommended by the government.<sup>77</sup> This does not apply, however, if the employee was habitually concluding contracts on behalf of the enterprise in their home jurisdiction before the COVID-19 pandemic.<sup>78</sup> Likewise, if the employee continues to

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71. *OECD Updated guidance on tax treaties and the impact of the COVID-19 pandemic* para. 16 (21 Jan. 2021) [hereinafter *OECD Guidance*].

72. *Id.*

73. DE: BFH, 28 June 1972, I R 35/70, BStBl. II 1972, 785.

74. Görl & Gradl, *supra* n. 62, at para. 273.

75. DE: BFH, 3 Aug. 2005, I R 87/04, BStBl. II 2006, 220: *Convention between the Federal Republic of Germany and the Portuguese Republic for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital* (15 July 1980), Treaties & Models IBFD.

76. Görl & Gradl, *supra* n. 62; Wassermeyer & Kaeser, *supra* n. 39, at Rz. 195, art. 5 OECD-MC.

77. *OECD Guidance*, *supra* n. 71, at para. 22.

78. *Id.*

work from home for a non-resident employer after the COVID-19 pandemic on a habitual basis, and continues to conclude contracts on behalf of the enterprise, it would be more likely that the employee would be considered to habitually conclude contracts on behalf of the enterprise.<sup>79</sup>

#### 12.3.2.2. Agent permanent establishment under domestic law

Under domestic law (section 13 of the AO), a person constitutes the PE of a company if the person is subject to the company's directives and usually concludes contracts for the company, or else maintains stock for the company and delivers the stock (permanent agent). Whereas the OECD Model focuses on dependent agents, a PE under domestic law generally also includes independent agents, such as commissionaires, who are usually excluded from the treaty definition of a PE.<sup>80</sup> To achieve consistency between domestic law and treaty provisions, the tax authorities have agreed not to tax the income derived by independent agents, such as commissionaires, even if they constitute a PE under domestic law (laid down in R 49.1 EStR).<sup>81</sup>

#### 12.3.2.3. Service permanent establishment

Germany has not adopted rules for a service PE in its basis for negotiations (*Verhandlungsgrundlage*), although corresponding clauses are included in some tax treaties, similar to the UN Model.<sup>82</sup>

#### 12.3.2.4. Article 5, paragraph 3 of the OECD Model – construction site permanent establishment

The paragraph provides expressly that a building site or construction or installation project constitutes a PE only if it lasts more than 12 months. The 12-month test applies to each individual site or project.<sup>83</sup> A site exists from the date on which the contractor begins their work in the country where the

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79. Id., at para. 23.

80. A. Perdelwitz, *Germany - Corporate Taxation*, sec. 7, Country Tax Guides IBFD (accessed 12 May 2022).

81. Id.

82. Görl & Gradl, *supra* n. 62, at para. 51.

83. DE: BFH, 19 Nov. 2003, BStBl. II 2004, 932: *Convention between the Federal Republic of Germany and the Grand Duchy of Luxembourg for the Avoidance of Double Taxation and the Establishment of Rules of Reciprocal Administrative and Legal Assistance with Respect to Taxes on Income and Capital, Business Tax and Land Tax* (23 Aug. 1958/15 June 1973), Treaties & Models IBFD.

construction is to be established.<sup>84</sup> This includes any preparatory work, as long as it directly serves the construction site.<sup>85</sup> A building site should be regarded as a single unit, even if it is based on several contracts, provided that it forms a coherent whole commercially and geographically.<sup>86</sup> The latter depends on the individual case.<sup>87</sup> The German competent authorities reject a geographical coherence in cases where there is a distance of more than 50 kilometres between the construction sites.<sup>88</sup> Due to an increase in mobility of work, supervisory activities are exercised outside of the state. This may be problematic in cases in which tax treaties explicitly include them in the substantive scope of the clauses governing construction sites<sup>89</sup>. Germany takes the view that business activities limited to on-site planning and supervision over a construction project can only constitute a PE if they meet the requirements specified in article 5(1).<sup>90</sup>

### 12.3.3. Prospect of a permanent establishment in case of ongoing COVID-19 pandemic

Although not explicitly stated, the Commentary on the OECD Model indicates that a time requirement is inherent in the concept of fixed place of business.<sup>91</sup> The word “permanent” itself also suggests that a fixed place of business that is used by an enterprise only temporarily is not a PE.<sup>92</sup> The practices of OECD member countries, although not consistent, generally show that a PE is considered to exist where the place of business exists for more than 6 months.<sup>93</sup> A taxpayer’s intentions may cause a place of business that exists for less than 6 months to be a PE. If the taxpayer intends the business to be carried on at the fixed place for a longer time, that place is considered to be a PE, even if the business is prematurely terminated for

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84. Para. 54 *OECD Model: Commentary on Article 4* (2017).

85. *Bundesfinanzministerium* (BMF) v. 24 Dec. 1999, BStBl. I 1999, 1076 Tz. 4.3.1; DE: BFH, 21 Apr. 1999, I R 99/97, BStBl. II 1999, 694; *Ger.-Switz. Income and Capital Tax Treaty* (1971/1978); DE: BFH, 16 May 2001, I R 47/00, BStBl. II 2002, 846; *Ger.-Hun. Income and Capital Tax Treaty* (1977).

86. Para. 51 *OECD Model: Commentary on Article 4* (2017).

87. DE: BFH, 19 Nov. 2003, I R 3/02, BStBl. II 2004, 932; *Ger.-Lux. Income and Capital Tax Treaty* (1958/1973).

88. BMF v. 24 Dec. 1999, BStBl. I 1999, 1076 Tz. 4.3.5.

89. E. Reimer, in *Klaus Vogel on Double Taxation Conventions* para. 264, art. 5 (5th ed., Reimer & Rust 2021).

90. Para. 172 *OECD Model: Commentary on Article 4* (2017).

91. Id., at para. 28.

92. B.J. Arnold, *Article 5: Permanent Establishment - Global Tax Treaty Commentaries*, Global Topics IBFD.

93. Para. 28 *OECD Model: Commentary on Article 4* (2017).

some reason.<sup>94</sup> The converse, however, is not true. If the taxpayer intends at the outset to carry on business at a fixed place only temporarily but, in fact, the business is carried on there for more than 6 months, a PE is considered to exist.<sup>95</sup> According to the OECD Guidance, if an individual continues to work from home after the cessation of the public health measures imposed or recommended by the government, the home office may be considered to have a certain degree of permanence. However, that change alone will not necessarily result in the home office giving rise to a fixed place of business PE. A further examination of the facts and circumstances will be required to determine whether the home office is now at the disposal of the enterprise following this permanent change to the individual's working arrangements.<sup>96</sup>

#### 12.4. Physical presence according to articles 15(1) and 17 of the OECD Model

Paragraph 1 of article 15 of the OECD Model stipulates the “general rule” that salaries, wages and other similar remunerations derived by a resident of a contracting state shall be taxed in the state of residence, except when the employee exercised their performance in the other contracting state (state of activity).<sup>97</sup> This exception introduces the place-of-work principle.<sup>98</sup> Article 15(2) of the OECD Model introduces exemptions to this principle and refers the right of taxation back to the state of residence exclusively. Applying article 15(1) of the OECD Model, the taxation will be split, but the state of residence should grant exemption or allow credit for the tax paid to the state of work (articles 23A and B of the OECD Model), while by application of the exemption of article 15(2) of the OECD Model, the right of taxation is shifted exclusively to the state of residence.<sup>99</sup>

Germany has verbally adopted article 15(1) and 2 of the OECD Model in its base for negotiation<sup>100</sup> and mainly follows the conception of the OECD

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94. Id., at para. 34.

95. Arnold, *supra* n. 92.

96. *OECD Guidance*, *supra* n. 71, at para. 17.

97. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 15* para. 1 (21 Nov. 2017), Treaties & Models IBFD.

98. L. De Broe, *Article 15*, in Klaus Vogel *on Double Taxation Conventions* m. no. 2 (5th ed., E. Reimer & A. Rust eds., 2021).

99. D. Höppner & S. Melkonyan, *Grenzüberschreitend tätige Arbeitnehmer in Zeiten der COVID-19-Pandemie – Implikationen und Lösungsansätze*, IStR 19, pp. 735 et seq. (2020).

100. Art. 14 *OECD Model* German base of negotiation.

Model Law.<sup>101</sup> In order to analyse the location where the employee exercises the performance, it strictly follows the principle of “physical presence”.<sup>102</sup> The German BFH stipulates that this principle shall even apply in situations where the tax treaty has no provision adopted similar to article 15 of the OECD Model.<sup>103</sup> Furthermore, the principle of physical presence applies, regardless to the type of performance.<sup>104</sup> Germany has concluded tax treaties that include special provisions concerning frontier worker rules, e.g. in article 1, paragraph 6 of the Austria-Germany Income and Capital Tax Treaty (2000),<sup>105</sup> article 13, paragraph 5 of the France-Germany Income and Capital Tax Treaty (1959)<sup>106</sup> and article 15 of the Germany-Switzerland Income and Capital Tax Treaty (1971).<sup>107</sup>

#### 12.4.1. Home office activities and the allocation methods of article 15 of the OECD Model

According to the place-of-work principle, the place of work is the place where the employment is exercised. This is the place where the employee is physically present during its activity.<sup>108</sup> If the employee exercises its activity in the home office, the place of work is usually to be considered as the place where the home office is located. In most cases this will be the place

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101. R. Prokisch, in *Vogel/Lehner, Doppelbesteuerungsabkommen: DBA, OECD-MA 2017* art. 15, para. 18a (7th ed., CH Beck 2021).

102. DE: BMF, 3 May 2018, IV B 2 – S-1300/08/10027, BStBl. I 2018.

103. DE: BFH, 3 Sept. 2020, I R 66/17, BFH/NV19, 1067: *Convention between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital and to Certain other Taxes* (29 Aug. 1989/2006), Treaties & Models IBFD.

104. C. Bourseaux & D. Sendler, in *Schönfeld/Ditz Doppelbesteuerungsabkommen (DBA), Abschnitt III, Besteuerung des Einkommens* art. 15, para. 94, *Einkünfte aus unselbstständiger Arbeit* (2nd ed., Dr Otto Schmidt 2019 (2019)); DE: BMF, 3 May 2018, IV B 2 – S-1300/08/10027, BStBl. I 2018, para. 78, 315 et seq; DE: BFH, 12 June 1996, X I R 43/94, BStBl. II 1996, 516; D. Höppner & F. Schade, *Steuerliche Aspekte der Home Office – Tätigkeit eines Grenzgängers*, Praxis Internationale Steuerberatung (PIStB) 1, p. 18 et seq. (2020).

105. *Convention between the Federal Republic of Germany and the Republic of Austria for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital and the Prevention of Tax Evasion and Avoidance* (24 Aug. 2000), *Bundesgesetzblatt [BGBl.]*, II 2002, 735; 29.12.2010 BGBl. II 2011, 1210.

106. *Convention between the Federal Republic of Germany and the French Republic for the Avoidance of Double Taxation and the Establishment of Rules for Reciprocal Administrative and Legal Assistance with Respect to Taxes on Income and on Capital, Business Tax and Land Tax* (21 July, 1959), Treaties & Models IBFD, BGBl. II 1961, 397.

107. *Ger.-Swiss Income and Capital Tax Treaty* (1971), BGBl. II 1972, 1022.

108. Para. 1 *OECD Model: Commentary on Article 15* (2017).



where the employee lives and thereby most likely be located in the state of residence.

However, concerns exist as to whether the place of activity is always the place where the home office is actually located. For instance, a few courts and also the German BFH have held in the past that it is important to distinguish between types of performance.<sup>109</sup> If the performance has a non-physical or passive character, e.g. in the case of directives or instructions or the duty to stay at disposal, it was held that the place of work of these activities is located where they fulfil their effects or at least at the place of the board management, and thereby the location can differ from the location of the physical presence of the employee during the performance. Still, the Commentary on the OECD Model expressly implements the place-of-work principle without distinguishing between the characters of the performances. The main aspect is whether or not the employee is physically present in the state.<sup>110</sup>

Another aspect that could lead to a deviation in home office cases could be derived from rules pertaining to how sickness days should be classified. According to the Commentary on the OECD Model, sickness days spent in the state of work should be considered as days spent in this state within the meaning of article 15(2) lit. a of the OECD Model, in as much as they prevent the individual from leaving the state, and thereby prevent the 183-day exemption.<sup>111</sup> Conversely, one could argue that days spent in the state of residence due to sickness should also not be considered as days spent in this state. Consequently, days spent in the home office at the place of residence due to health issues or measures during the usual working period should be considered as days spent in the state of work, therefore the taxing obligation could be allocated to this state. This would be in line with newer developments concerning the right to tax in cases of sickness. Some states, e.g. Dutch courts, thereby follow the “replacement approach” and allocate the taxing right to the state where the employee would have been performing their employment if that employee had not been hindered from doing so.<sup>112</sup> Besides these cases mainly dealing with the question of whether payments due to sickness are paid by the employer, the Commentary on the OECD

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109. E.g. DE: BFH, 15 Nov. 1971, GrS 1/71, BStBl. II 1972, 67; cf. Bourseaux & Sendler, *supra* n. 104, at para. 94; Prokisch, *supra* n. 101, at art. 15, para. 64 et seq.

110. Para. 1 *OECD Model: Commentary on Article 15* (2017); the BFH has relinquished its former jurisprudence as well: DE: BFH, 5 Oct. 1994, I R 67/93, BStBl. II 1995, 95.

111. Para. 13.1 *OECD Model: Commentary on Article 15* (2017).

112. De Broe, *supra* n. 98, at m. no. 67; NL: HR [Supreme Court], 8 June 2018, 18/00913; Case Law IBFD.

Model has added this replacement approach and follows the opinion that they are taxable in the state in which the employee normally exercised the employment,<sup>113</sup> and thereby fictitiously also connects these days of sickness with the place of work state. This exhibits similarities with the allocation of the taxing rights in the case of severance payments. Those are calculated by reference to the period of past employment and the remuneration earned during that period.<sup>114</sup> However, with regard to the taxation of severance payments, the German BFH<sup>115</sup> and German competent authorities<sup>116</sup> argue that those payments would in principle fall under the scope of article 15(1) of the OECD Model, but are not connected with the former performed work and therefore also taxable in the state of residence. Instead, the German legislator has clarified this issue for cases as from the 2017 assessment period and stipulates that severance payments shall be seen as connected with the former employment activity in this regard.<sup>117</sup>

The ratio of the replacement approach to that of the taxation of severance payments should not be relevant for calculating home office days in light of article 15 of the OECD Model. This approach might fulfil its intent in regular employment situations where the employee has worked only in one state of work or at least has worked predominantly in this state. However, this method can raise concerns in situations of increased mobility,<sup>118</sup> as it can be difficult to reconsider the place the employee would have exercised their employment if several places are involved. Furthermore, it seems to be questionable why a deviation from the principle of “physical presence” as an outflow of the place-of-work principle is necessary. The place of work is the place where the employee is located at the time of being sick or working in the home office.<sup>119</sup> In this case no allocation difficulties arise.<sup>120</sup>

#### 12.4.2. Public measures imposing home office and stranded workers

Next to general considerations of remote work, COVID-19 may have an additional impact on general rules of allocation. Measures such as

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113. Para. 2.14 *OECD Model: Commentary on Article 15* (2017).

114. *Id.*, at paras. 2.8 and 2.14; cf. De Broe, *supra* n. 98, at m. no. 42.

115. Established law practice DE: BFH, 10 June 2015, I R 79/13, IStR 2015, 785.

116. IV B 2 (2018) – S 1300/08/10027, ch. 5.5.5.1.

117. Para. 12, sec. 50 EStG; IV B 2 (2018) – S 1300/08/10027, ch. 5.5.5.1.

118. De Broe, *supra* n. 98 at m. nos 54 and 67.

119. Critical as well *id.*

120. *Id.*, at para. 54 of art. 15.

lockdowns and travel restrictions forced employees to work in the home office in their state of residence or even in a different place. The OECD gave guidance<sup>121</sup> and pointed out that this could lead to involuntary and temporary change of the place where the employment is performed.

If the employee is prevented from returning to their state of residence and works in the state where they are stranded (stranded workers), the income will be taxable in that state as it is in principle taxable in the state of work, according to article 15(1) of the OECD Model. However, if the employee does not have a closer connection with that state, the exemption of article 15(2) of the OECD Model will most likely be applicable, and the income will be taxable in the state of residence exclusively. This exemption applies when the employee was not present in the state of work for more than 183 days, neither was the employer who paid the salary a resident of that state, nor do they have in that state a PE by which the income is borne.<sup>122</sup> If the employee is hindered from returning to their state of residence due to, for example, travel restrictions, according to OECD recommendations, these respective days shall not count in cases of COVID-19, at least if the employee had otherwise qualified for the exemption from article 15(2) of the OECD Model.<sup>123</sup> These concerns are similar to the general concerns explained above.<sup>124</sup> In fact, this is an extension of the “replacement approach”. Public measures hindering employees from performing in the state of work are very similar to cases of sickness, and with regard to COVID-19, quarantine measures are even due to sickness. Consequently, the place of performance would then be the place where the employee exercised the employment had these measures not existed.<sup>125</sup> In contrast, the German fiscal authorities have not yet included this exception within their COVID-19 FAQ.<sup>126</sup>

Furthermore, and especially concerning posted workers, who are individuals sent by the employer to work abroad for a period of time, further issues arise concerning article 4 of the OECD Model. The posted worker will most likely create a residence according to domestic law in both the work and the

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121. *OECD Guidance*, *supra* n. 71, at Box 4.

122. *Id.*, at para. 61.

123. *Id.*, at para: 56 et. seq.

124. *See* 4.2.

125. *Id.*

126. BMF, *FAQ “Corona” (Steuern)*, BMF (21 Mar. 2023), available at [https://www.bundesfinanzministerium.de/Content/DE/Downloads/BMF\\_Schreiben/Internationales\\_Steuerecht/Allgemeine\\_Informationen/2018-05-03-steuerliche-behandlung-arbeitslohn-doppelbesteuerungsabkommen](https://www.bundesfinanzministerium.de/Content/DE/Downloads/BMF_Schreiben/Internationales_Steuerecht/Allgemeine_Informationen/2018-05-03-steuerliche-behandlung-arbeitslohn-doppelbesteuerungsabkommen).

home state. In these cases, article 4(2) of the OECD Model applies.<sup>127</sup> In most cases, the qualification of the posted worker's permanent home, or at least their CVI will not change because of external circumstances preventing the worker from leaving the home state.<sup>128</sup>

### 12.4.3. Continued payment of wages

Employees who did not have the possibility of working remotely yet were still hindered from exercising their work because of COVID-19 preventative measures still received in several cases regular payments, e.g. short-time compensation (*Kurzarbeitergeld*) either from the employer or from government funds.<sup>129</sup> These payments fall within the scope of article 15(1) of the OECD Model, as they qualify as “similar remuneration” and are taxable in the state of work because this is the state where it was reasonable to assume that the employee would have exercised the employment and the state where they used to work before COVID-19.<sup>130</sup> In contrast, Germany has concluded several tax treaties which contain special provisions for payments concerning the social security law of a contracting state.<sup>131</sup> These grant the right of taxation to the funding state.<sup>132</sup> Germany has also completed a consultation agreement with France that gives the right of taxation to the state of residence.<sup>133</sup> According to German national law, those payments are tax-free<sup>134</sup> and are not burdened with a payroll tax.<sup>135</sup> However, they can still be considered for the purposes of determining the progressive income tax rate.<sup>136</sup>

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127. K. Cejic, *New Problems Caused by the COVID-19 Pandemic – Income Taxes and Social Security Contributions (An Overview)*, 61 Eur. Taxn. 5, p. 185 et seq. (2021), Journal Articles & Opinion Pieces IBFD.

128. Id.

129. IStR 2020 735 (741).

130. Para. 2.6. *OECD Model: Commentary on Article 15* (2017); para. 24 *OECD Secretariat analysis of tax treaties and the impact of the COVID-19 crisis* (3 Apr. 2020) [hereinafter *OECD Secretariat Analysis*]; according to sickness benefits DE: BFH, 17 Oct. 2003, I B 98, BeckRS 2003, 25002629.

131. For example art. 17.2 *Ger.-Lux. Income and Capital Tax Treaty; Convention between the Federal Republic of Germany and the Kingdom of Denmark for the Avoidance of Double Taxation and Reciprocal Administrative Assistance with Respect to Taxes on Income, Capital, Business and Land* art. 18, sec. 2 (30 Jan. 1962), Treaties & Models IBFD.

132. IStR 2020, 553 (741).

133. DE: MAP Germany-France, 25 May 2020, BMF, IV B 33, S 1301-FRA/19/10018:007, IStR 2020, 477.

134. Sec. 3, no. 2 EStG.

135. IStR 2020, 553 (741).

136. Sec. 32b, para. 1, sent. 1, no. 1, 5 or 1 and para. 2, no. 1 or 2; IStR 2020, 553 (741).

## 12.5. Article 15(2) and (3) of the OECD Model

### 12.5.1. Impact of mobility of work on article 15(2) of the OECD Model

Article 15(2) lit. a of the OECD Model states that one of the three requirements to gain exemption from the state of work principle is that the recipient of the income derived by the employer stay fewer than 183 days in the state of work. This raises the question of how these days are counted, especially with respect to home office days spent outside the state of work. According to the Commentary on the OECD Model, the “physical presence” test shall apply by counting the days the recipient is literally present in the state of work.<sup>137</sup> The daily duration of the presence is not important, except in cases of transit.<sup>138</sup> The purpose of presence is also not important, and thus any days spent in the state of work will count, and might trigger the 183-day rule.<sup>139</sup> Therefore, days spent in the home office, for example in the state of residence, also do not qualify as days spent in the state of work.<sup>140</sup>

Article 15(2) lit. b of the OECD Model stipulates the second requirement. The remuneration must be paid, or borne by an employer that is not a resident of the state of work. This requires the residence of the employer according to article 15(2) lit. b and article 4 of the OECD Model.<sup>141</sup> Article 4 of the OECD Model refers to domestic law to define residence. If an employer has lost a severe amount of “physical” substance from a certain place, due to all employees working from home, this could create another residence of the employer in another state, e.g. if the place of effective management moved therewith, and just the situs remains in the state of work.<sup>142</sup> If the employer thereby creates a residence in a third state, this would not in principle affect the applicable tax treaty concerning the state of residence and state of work of the employee.<sup>143</sup> However, according to sentence 2 of article 4(1) of the OECD Model, only inasmuch as the employer is still liable to full taxation in the state of work. Otherwise, the employer cannot qualify as a resident.<sup>144</sup> Further issues arise if the employer creates dual residence thereby.

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137. Para. 5 *OECD Model: Commentary on Article 15* (2017).

138. *Id.*, at para. 5.1.

139. *Id.*, at para. 5.

140. Prokisch, *supra* n. 101, at para. 63 of art. 15, DE: MAP Germany-Austria, 18 Apr. 2019, BMF, IV B 3, S 1301-AUT/07/10015:02; Hofmann, IStR-LB 2019, 50.

141. De Broe, *supra* n. 98, at m. no. 244.

142. Cf. sec. 12.2.3.

143. De Broe, *supra* n. 98, at m. no. 250.

144. *Id.*

In these cases, the tiebreaker rule would apply in principle.<sup>145</sup> However, the German BFH has held that article 4(2) and (3) of the OECD Model or similar rules shall not apply for the qualification of the residence of the employer in the sense of article 15 of the OECD Model.<sup>146</sup> Article 4(3) of the OECD Model should simply help to identify the state of work and the state of residence. As article 15 of the OECD Model would constitute the principle of taxation in the state of work, the employee and not the employer would be the taxpayer under this provision. Thus it would be solely necessary to define the state of residence of the employee under the law of the tax treaty. Other scholars have held that this would contradict the wording of the agreement itself as it states in article 4(1) of the OECD Model “residence” for “the purpose of the convention”, and this would rather be a conflict of the state parties who claim to be the state of residence.<sup>147</sup> This argument seems to be in line with the Commentary on the OECD Model which states that the object and purpose of article 15(2) lit. c of the OECD Model is to avoid the source taxation of short-term employments to the extent that the employment income is not allowed as a deductible expense in the state of source, because the employer is not taxable in that state as it is neither a resident nor has a PE.<sup>148</sup> However, the employer is not a resident in the meaning of sentence 2 of article 4(1) of the OECD Model if it is just liable to limited taxation in the state of work. Still, if the employer is liable to full taxation, the employment income is allowed as deductible expense in that state and thereby does not contradict the object and purpose set out in the Commentary on the OECD Model. In these cases, article 4(3) of the OECD Model shall not apply.<sup>149</sup>

The last requirement is stated in article 15(2) lit. c of the OECD Model and states that the remuneration must not be borne by a PE of the employer. Concerns exist that an employee working in a home office could create a PE of the employer.<sup>150</sup> In usual cases where employees may create a PE, the remuneration is also borne by the PE and/or is at least taxable in the state of work.<sup>151</sup> However, if the PE was created by the home office activities of

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145. Cf. sec. 12.2.3.

146. I R 1/06 (2007), BStBl. II 810, IStR 2008, 29; *Ger.-US Income and Capital Tax Treaty* (1989) – tiebreaker rule did not exist and sent. 2 of art. 4 did not exist; same opinion Schoueri, *The Residence of the Employer in the “183-Day Clause” Article 15 of the OECD’s Model Double Taxation Convention*, 21 Intertax 1, p. 23 (1993); dissenting opinion: De Broe, *supra* n. 98, at m. no. 250.

147. De Broe, *supra* n. 98, at m. no. 250, fn. 398.

148. Para. 6.2 *OECD Model: Commentary on Article 15* (2017).

149. Similar approaches NL: HR [Supreme Court], 28 Feb. 2002, BNB2001/295; US: [IRS] 12 July 2004, Rev. Rul. 2004-76, 2004-31 IRB 111.

150. Cf. sec. 12.3. et seq.

151. De Broe, *supra* n. 98, m. no. 295.

the employee, these activities must still go over the threshold of article 5(4) of the OECD Model. Furthermore, the home office must be at the disposal of the employer.<sup>152</sup>

### 12.5.2. Improvement of article 15 of the OECD Model

Based on the above-mentioned concerns, the question arises as to whether the current principles regarding the taxation of individuals are sufficient to deal with an increase in mobility of work. In most cases, the current allocation rules already provide solutions for allocating taxation despite such an increase, though not without an increase of a more fragmented allocation. This can be illustrated by the phenomenon of so-called “digital nomads” or other highly mobile workers. These highly mobile employees may work in several different states in “flex offices” and could be a greater challenge for international taxation.<sup>153</sup> Due to the detailed regulations concerning tiebreaker rules, according to article 4(2) of the OECD Model, it should be possible to determine their state of residence, which is at least the state where they are nationals. However, there are some concerns that they might constitute a PE.<sup>154</sup> Due to the nature of the way they work, digital nomads regularly do not meet the requirements laid down in article 5(1) of the OECD Model (“fixed place of business”). In any event, similarly to employees working from home, digital nomads will mostly not constitute a PE for their respective employers, given the lack of the enterprise’s disposal of the location.<sup>155</sup> Even if exceptionally this may not be the case, the exemption from article 5(4) of the OECD Model would most likely apply.<sup>156</sup> Furthermore, if they do not have a sufficient nexus to the state where they currently exercise work, they are taxable in the state of residence exclusively (articles 15(1) and (2) of the OECD Model). Nonetheless, a highly fragmented tax allocation could arise if these highly mobile workers do not meet all requirements of the exemption from article 15(2) of the OECD Model.

This is similar to the rationale of article 15(3) of the OECD Model. Employees that work abroad on a ship or aircraft that operates in international traffic will be taxable exclusively in the state of residence, except

152. Cf. sec. 12.3.2.

153. S. Bendlinger, *Tax Nexus due to “Digital nomads” and the folly of home office permanent establishments*, 8 *Steuer und Wirtschaft International – Tax and Business Review*, p. 450 (2021).

154. Cf. *id.*, at p. 454 et seq.

155. *Id.*, at p. 461.

156. *Id.*, at p. 462.

when the ship or aircraft is operated solely in the other contracting state. This reduces difficulties in determining the locality of the exercise of the employment, which occurs because of the high mobility of those occupations.<sup>157</sup> This principle may also be applied to the taxation of other employees. Therefore, in order to reduce an over-fragmented allocation, withdrawal could be considered from the requirements stipulated in article 15(2) lit. b and/or c of the OECD Model.<sup>158</sup>

## **12.6. Frontier workers**

### **12.6.1. Frontier worker rules and home office days**

These special allocation rules require a daily return to the state of residence, provided a certain number of “harmful” days (4 to 6 working weeks) is not exceeded.<sup>159</sup> In this regard, home office days are treated variously. While some agreements will not qualify home office days as “harmful” days,<sup>160</sup> other frontier worker rules or MAPs regarding those rules expressly consider home office days as “harmful”<sup>161</sup>. However, most rules require that the employee exercises the employment within the frontier region at a minimum.<sup>162</sup> If the employee exceeds the tolerated number of harmful days, as a consequence, the income is taxable in both countries, split equally.<sup>163</sup> Therefore, these rules are not very flexible with regard to an increase of mobility of work nor, in most cases, an increase in remote work. For this

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157. De Broe, *supra* n. 98, at m. no. 295.

158. Cf. sec. 4.2.

159. *OECD Guidance*, *supra* n. 71, at para. 58; e.g. the frontier worker rule between Germany and Austria will not apply if the employee does not return to the state of residence or works outside of the border zone for more than 45 days (IV B 3 – S 1301-AUT/07/10015-02; BStBl. I 2019, 456); between Germany and France: 45 days (DE: BMF, 3 Apr. 2006 – IV B 6 – S 1301-FRA-26/06; BStBl. I 2006, 304; DE: BFH, 11 Nov. 2009, I R 84/08, BStBl. II 2010, 390); between Germany and Switzerland: 60 days (*Ger.-Switz. Income & Capital Tax Treaty*, BStBl. II 2011, 1092).

160. S. Bruns, *Homeoffice und Kurzarbeit aufgrund der COVID-19-Pandemie – die steuerlichen Auswirkungen auf grenzüberschreitend tätige Arbeitnehmer und die Antwort der Finanzverwaltung*, 9 Internationale Steuer Rundschau 7, p. 228 et seq. (2020); *Fr.-Ger. Income and Capital Tax Treaty* (1959) (BGBl. II 1961, 397), as long as the employee exercises the performance within the frontier region.

161. For example DE: MAP Germany-Austria, 24 Aug. 2000, BMF IV B 3 – S 1301-AUT/07/10015-02; BStBl. I 2019, 456); Bruns, *supra* n. 160, at p. 228 (231).

162. Cf. overview Bourseaux & Sandler, *supra* n. 104, at para. 147.

163. If both countries apply art. 23A *OECD Model* (2017); see Bruns, *supra* n. 160, at p. 231 ff.; Höppner & Schade, *supra* n. 104, at p. 53 et seq.



reason the German fiscal authorities have concluded several agreements for the interpretation of frontier worker rules with neighbouring states.<sup>164</sup>

### 12.6.2. Frontier worker rules and place of residence

Frontier rules are not solely vulnerable with regard to the place of work, which could vary from case to case, but also because residence difficulties could arise from an increase in mobility of work. Most rules require that the employer and at least the employee are resident in the contracting states and also often require that domicile and work place are located in the frontier region.<sup>165</sup> Therefore, the same residence difficulties discussed above could arise,<sup>166</sup> and in a few cases, even more problematically, as the state of residence will lose its exclusive right of taxation and both states will split taxation. However, employees in particular will try to prevent such a situation because, in several instances, they will have relied heavily on the distinct tax allocation.<sup>167</sup> On the other hand, frontier rules deviate from the general place-of-work principle. If states agree bilaterally on this deviation, they should define the requirements either precisely within the wording of the tax treaty or (at least) with the help of MAPs.

### 12.6.3. Future of frontier worker rules

An increase in mobility of work as well as an increase in remote work will have an impact on the application of frontier worker rules due to their constrained wording and drafting. Therefore, a consistent and generous solution for classifying home office days within the scope of frontier worker rules should be arrived at.<sup>168</sup> For example, the frontier rule between France and Germany does not qualify home office days as harmful days, provided the employment is exercised within the frontier region.<sup>169</sup> This rule grants a certain flexibility but preserves the exceptional character of frontier rules contradicting the place-of-work principle. Therefore, frontier rules should not be seen as superfluous rulings, but rather their scope should be slightly adjusted to maintain the appeal for employment.

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164. Cf. *OECD Guidance*, *supra* n. 71, at Box 4.

165. Cf. overview Bourseaux & Sendler, *supra* n. 104.

166. Cf. sec. 2.1.

167. Burns, FR 2021, 1010 (1015).

168. Likewise Bruns, *supra* n. 160, at p. 228.

169. Bourseaux & Sendler, *supra* n. 104; IStR 2020, 735 (739); DE: BFH, 9 Oct. 2014, BFH/NV 2015, 167.

#### 12.6.4. Subsidies cross-border workers

Another concern with regard to frontier workers arises due to subsidies related to COVID-19 and similar measures in general. The OECD addressed the topic of governmental subsidies to keep employees on a company's payroll during the COVID-19 crisis in its analysis, and suggests to attribute those, similarly to termination payments,<sup>170</sup> to the place where the employee would otherwise have worked.<sup>171</sup> However, Moreno raises concerns about the qualification of the OECD and suggests that those payments would be very similar to "non-competition payments", which are attributable to the state of residence.<sup>172</sup> This is because they may have been derived in respect of employment but not derived from employment activities performed before the termination of the employment.<sup>173</sup> This exhibits similarities to the jurisprudence of the German BFH<sup>174</sup> and the approach of the German competent authorities<sup>175</sup> concerning the taxation of severance payments. Both agree that those payments would in principle fall under the scope of article 15(1) of the OECD Model, but also hold that these payments are not connected with the former performed work and are therefore also taxable in the state of residence. In general, this attribution needs to be viewed critically, as most countries do not follow this strict approach, and therefore this may lead to cases of double non-taxation.<sup>176</sup> Simultaneously, frontier worker rules bear an increased risk that the tax allocation of the usual wages and those of subsidies and similar measures could fall apart because of these different approaches of interpretation.<sup>177</sup> Therefore, in cases of prevention measures due to COVID-19, it is advisable to follow the OECD principle, given the extraordinary circumstances, and to ensure a certain coherence.<sup>178</sup> For future cases concerning German practice, it remains to be seen whether the German BFH will deviate from its former jurisprudence due to the clarification of the legislator.<sup>179</sup>

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170. Para. 2.6 *OECD Model: Commentary on Article 15* (2017).

171. *OECD Secretariat Analysis*, *supra* n. 130, at para. 24.

172. A. Báez Moreno, *COVID-19 and Fiscal Policies: Unnecessary and Yet Harmful: Some Critical Remarks to the OECD Note on the Impact of the COVID-19 Crisis on Tax Treaties*, 48 *Intertax* 8/9, p. 827 (2020); cf. para. 2.9 *OECD Model: Commentary on Article 15* (2017).

173. Para. 2.9 *OECD Model: Commentary on Article 15* (2017).

174. Established law practice: DE: BFH, 10 June 2015, I R 79/13, *IStR* 2015, 785.

175. IV B 2 (2018) – S 1300/08/10027, ch. 5.5.5.1.

176. Prokisch, *supra* n. 101, at art. 15, para. 26.

177. *IStR* 2020, 735 (742); e.g. in case of short-term compensation regarding Germany because of clarifying MAPs due to COVID-19 with Belgium, France, Netherlands and tax treaty itself with Austria and Switzerland.

178. Similar Báez Moreno, *supra* n. 172.

179. *See* sec. 4.2.

## **12.7. Mobility of work and the justification and legal Basis of COVID-19-based rules (consultations or mutual agreements)**

### **12.7.1. Fiction of state of activity and PE establishment concerns**

Several countries gave guidance with regard to the difficulties involved in the establishment of PEs concerning the change of residence and taxation of income from employment due to the COVID-19 crisis.<sup>180</sup> Most of the provided guidance adopts the deliberations of the OECD<sup>181</sup> and/or has a clarifying character. For example, the German competent authorities introduced an unbinding note consisting of frequently updated FAQs.<sup>182</sup> Those FAQs contain guidance to the effect that temporary interruptions of construction sites caused by COVID-19 will not lead to a suspension of the deadline of article 5(3) of the OECD Model and the deadline defined in national law.<sup>183</sup>

Furthermore, Germany's competent authorities have concluded consultation agreements with several states which contain a MAP on a temporary and factual fiction that during a time when health authorities give advice to stay at home, cross-border workers who work in home offices are treated as they would have been had they worked in their state of activity.<sup>184</sup> These consultation agreements are based on similar provisions to article 25(3) of the OECD Model incorporated in the respective tax treaties. Regarding Germany, *see* a domestic authorization in section 2, paragraph 2 of the AO.

### **12.7.2. Exceptional circumstances**

This response of the OECD and several states was solely meant to address the exceptional circumstances of the COVID-19 crisis and to avoid double taxation that could occur thereby.<sup>185</sup> Therefore, the reactions partly aimed to eliminate these consequences, for example by the application of factual

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180. Cf. *OECD Guidance*, *supra* n. 71, at Box 1-4.

181. *OECD Secretariat Analysis*, *supra* n. 130.

182. BMF, FAQ "Corona" (*Steuern*), BMF (21 Mar. 2023), available at [https://www.bundesfinanzministerium.de/Content/DE/Downloads/BMF\\_Schreiben/Internationales\\_Steuerrecht/Allgemeine\\_Informationen/2018-05-03-steuerliche-behandlung-arbeitslohn-doppelbesteuerungsabkommen.](https://www.bundesfinanzministerium.de/Content/DE/Downloads/BMF_Schreiben/Internationales_Steuerrecht/Allgemeine_Informationen/2018-05-03-steuerliche-behandlung-arbeitslohn-doppelbesteuerungsabkommen.)

183. *Id.*, at X.1.

184. *OECD Guidance*, *supra* n. 71, at Box 4.

185. Cf. *id.*, at para. 5.

fictions. However, this raises questions and doubts as to whether exceptional circumstances should be factored into the interpretation of tax treaties in general. There is, for example, the matter of whether it is a relevant criterion for tax treaty law that a taxpayer decided voluntarily to work in a certain country or was forced to do so. With the exception of COVID-19 cases, the OECD seems to be reluctant with regard to such an interpretation. For example, concerning the 183-day rule, according to article 15(1) and (2) lit. a of the OECD Model, short breaks on the territory of a contracting state due to strikes or lock-outs will count as days spent in a jurisdiction.<sup>186</sup> Even with regard to the COVID-19 crisis, the OECD takes a reluctant approach, as it states that modifications to article 15(2) of the OECD Model shall only apply if the individual was prevented from traveling either because they were in quarantine or government measures made it impossible to travel. In contrast, a mere recommendation will not be sufficient in this context.<sup>187</sup> Furthermore, the OECD itself has introduced the concept of PoEM within its analysis for considerations of tax treaty application with regard to home office PEs.<sup>188</sup> Moreover, Austria and Ireland have issued guidance that they will provide for force majeure circumstances where an individual is prevented from leaving the country due to COVID-19, especially if this could lead to the establishment of a PE.<sup>189</sup> Admittedly, although this corrective, which finds its origin in civil law concerns, seems to be a suitable solution, it seems unnecessary to apply and transfer this principle to tax treaty law.<sup>190</sup> First, exceptional circumstances and notably a “government’s directive” usually need to be considered within the interpretation of tax allocation, as they impact the conditions of the market,<sup>191</sup> and the main purpose of tax treaties is to prevent double taxation and ensure an adequate allocation in the collateral sense only.<sup>192</sup> Therefore, when exceptional circumstances lead to a tax allocation that was not previously foreseeable, though this allocation does not lead to double taxation, it is questionable whether a transferred corrective is needed.<sup>193</sup> Second, the majority of existing provisions and rules seem already to deal with exceptional circumstances. In the case of issues

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186. De Broe, *supra* n. 98, at m. no. 53.

187. A broader approach that also includes recommendations is applied by the US Internal Revenue Service (cf. <https://www.irs.gov/pub/irs-drop/rp-20-20.pdf>, sec. 2.01).

188. *OECD Secretariat Analysis*, *supra* n. 130, at para. 9.

189. *OECD Guidance*, *supra* n. 71, at Box 3.

190. Cf. S. Rasch, F. Rosenberger & P. Brülisauer, *Auswirkungen dezentraler Homeoffice-Tätigkeiten auf die Betriebsstättenbegründung, Gewinnzuordnung und die Besteuerung der Arbeitnehmer*, 2020 Internationales Steuerrecht Beiheft 1, p. 1 et seq. (2021).

191. *Id.*

192. J. Schönfeld & N. Häck, *Chapter A. III*, in *Schönfeld/Ditz Doppelbesteuerungsabkommen (DBA) - Kommentar, Systematik* para. 1, 12 ff. (2nd ed., Dr Otto Schmidt 2019).

193. Similarly, Rasch, Rosenberger & Brülisauer, *supra* n. 190.

regarding article 15(2) of the OECD Model, a translation of the “replacement approach”<sup>194</sup> will be able to deal with most consequences arising from exceptional circumstances, and with regard to the constitution of a PE, it seems questionable whether the employee’s home office is at the employer’s disposal to a sufficient degree. This is the case particularly where the employee works in the home office solely due to exceptional circumstances.<sup>195</sup> However, the impact of exceptional circumstances on the interpretation of tax treaties should be handled cautiously in every way.

### 12.7.3. Reactions of German BMF

As stated above, Germany has concluded several consultation agreements, such as those with Austria, Belgium, France, Luxembourg, the Netherlands and Switzerland, in order to avoid unforeseeable consequences because of special provisions concerning commuting in tax treaties with these states.<sup>196</sup> These agreements find their legal basis in provisions similar or identical to article 25(3) of the OECD Model and are considered as public national law agreements which bind the negotiating authorities in the first place.<sup>197</sup> Furthermore, German domestic law, particularly because Germany is considered a dualistic state, also requires a sufficient statutory basis for these agreements to bind the courts, while the implementation of article 25(3) of the OECD Model cannot itself serve as a sufficient basis.<sup>198</sup> However, Germany has enacted section 2, paragraph 2 of the AO, which qualifies closed mutual agreements as statutory orders according to domestic law.<sup>199</sup> Therefore, in principle, these mutual agreements would create a certain binding effect.

Nevertheless, two concerns arise in this context. First, the consultation agreements contain MAPs that consider days spent in the home office due to the COVID-19 crisis as days spent in the state where the employee would usually have exercised the employment.<sup>200</sup> The object and purpose of these rulings is comparable with the “replacement approach” applied in

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194. Cf. sec. 13.4.2.

195. See sec. 13.3.2.

196. OECD, *Updated guidance on tax treaties and the impact of the COVID-19 pandemic* Box 4 (21 Nov. 2021).

197. R. Ismer & S. Piotrowski, in *Klaus Vogel on Double Taxation Conventions* para. 92, art. 25 (5th ed., Reimer & Rust 2021).

198. Id., at art. 25, para. 155 et seq.

199. Cf. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 25* para. 53 (21 Nov. 2017), *Treaties & Models IBFD*.

200. Cf. *OECD Guidance*, *supra* n. 71, at Box 4.

accordance with article 15(2) of the OECD Model<sup>201</sup> and deviates from the usual practice of the German BFH, which adheres strictly to the physical presence principle.<sup>202</sup> Furthermore, Austria and Germany, for example, concluded a pre-COVID-19 MAP in which they have agreed that days spent in a home office shall count as harmful days in application of their tax treaty provision concerning frontier workers.<sup>203</sup> This raises concerns with regard to the principle of an authentic interpretation of treaty provisions,<sup>204</sup> particularly under German law. In cases where there are several possibilities of how to interpret a provision, a former MAP creates a major divergence from the interpretation of the treaty at the time of tax treaty conclusion, and according to German jurisprudence, the competent authorities may not simply unilaterally differ (from a domestic law perspective) from this former understanding and practice.<sup>205</sup> Second, German domestic law provides an authorization for the competent authorities to conclude MAPs.<sup>206</sup> Despite this, the German BFH has held that such provision contradicts the principle of legal certainty in the light of German constitutional law.<sup>207</sup> In consequence, the German courts are still not bound by MAPs, especially if they do not simply clarify an agreement.<sup>208</sup> Therefore, in the context of the impact of COVID-19 on tax allocation, the combination of these two aspects creates severe uncertainty concerning the binding effect and legal validity of these agreements under German domestic law.

## **12.8. Future of the mobility of work: A need for adjusting the existing treaty rules?**

There is no doubt that increased mobility of work will have a major impact on the lives of employers and employees alike. On the one hand, COVID-19 may simply have functioned as a catalyst, because the digital working environment evolved in several sectors. On the other, it laid bare the inter-relationships of a more globalized world. At the same time, the effects

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201. Compare De Broe, *supra* n. 98, at para. 53 et seq.

202. DE: BFH, 17 Oct. 2003, I B 98/03, I S 9/03, NV 161 (2004).

203. IV B 3 – S 1301-AUT/07/10015-02; BStBl. I 2018, 456, para. 9.

204. Cf. Schönfeld & Häck, *supra* n. 192, at para. 110.

205. Id.; DE: BFH, 25 Oct. 2006, I R 81/04, BStBl. II 2010, 778.

206. In para. 2, sec. 2 AO (“*Abgabenordnung*”); cf. Ismer & Piotrowski, *supra* n. 197, at paras 92, 25; DE: BFH, 11 Nov. 2009, I R 15/09, BStBl. II 2010, 602; AUT: VwGH [Supreme Administrative Court], 27 Aug. 1991, 4 K 3363/07, EFG 2008, 593.

207. I R 79/13 (2015), BStBl. II 2016, 326; cf. Y. Hohler, C. Laschewski & K. Laschewski, *Die Besteuerung von Abfindungen in Wegzugsfällen*, DStR 40, p. 2321 et seq. (2016).

208. I R 79/13 (2015), BStBl. II 2016, 326; para. 53 *OECD Model: Commentary on Article 25* (2017); Ismer & Piotrowski, *supra* n. 197, at art. 25, para. 92.

digitalization, climate change and further evolution will have on the working environment are unpredictable. The only fairly certain thing is that globalization will remain and with it an increase of mobility of work.

However, whether those radical and comprehensive changes in the world require corresponding changes in the legal world is doubtful. In most cases, existing tax treaty rules still prove to be fit for so-called paradigm shifts in the business world and the changing ways of working, providing the main objective is to avoid double taxation. Besides the very exceptional impact of COVID-19, most of the modern concepts of an increased mobile business environment will not overwhelm the existing tax treaty rules concerning the taxation of individuals with regard to articles 4 and 15 of the OECD Model. This does not mean that no adjustments should be made nor lessons drawn. The place of residence of individuals should still be adequately determinable with the help of article 4(2) of the OECD Model, despite the fact of increased mobility, which coincidentally has the potential to lead to a highly split tax allocation due to the allocation method provided in article 15(1) and (2) of the OECD Model. However, this split tax allocation is not a new phenomenon and is already common in the case of the taxation of sportspersons and artists according to article 17 of the OECD Model. That said, difficulties may still arise in determining the place of performance. In this regard, states should be reluctant to deviate from the physical presence principle and should be wary of allowing legal fictions, if they are not needed.

Concerning an increase in remote working and flex offices, it is important to create a preferably coherent understanding of where the performance is exercised and how these days should be qualified. This is especially important for the application of frontier worker rules. In the light of the changing business environment, these rules are no longer fit for modern purpose. However, some employees are not able to work remotely yet still fall under the scope of these rules. Furthermore, it is doubtful whether working in an office or at a fixed work place will become the exception. However, due to the limited geographical range of application and the strict day limits in the case of non-return to the state of residence, an increase in mobility or the occurrence of unpredicted circumstances may lead to unforeseeable changes of taxation between the respective states. Therefore, the states should stipulate coherent and clear requirements for the application of those rules, notably in relation to home office days.

Furthermore, the OECD, along with many states, has issued short-term guidelines and agreements, etc. in dealing with the outbreak of the

pandemic and the tax-related uncertainties it brought with it. In some cases, those announcements called for disregard of tax treaty rules or fictions. Although it may be tempting to view these measures as irrefutable evidence of the inadequacy of existing treaty law, it is necessary to bear in mind the exceptional character of the COVID-19 outbreak. However, from a German legal perspective, this has additionally highlighted a different concern. Under these extraordinary circumstances, but coincidentally also in a more globalized world, a coherent understanding of the interpretation of tax treaty provisions, at least between the two contracting states, is of the utmost importance. In this regard, MAPs are useful instruments to clarify the understanding of a tax treaty and enhancing ability to react to external circumstances. For this reason, the uncertainty of the binding effect of those agreements with regard to evaluation before a court should be readdressed. In German there is a saying that goes “before the court and on the high sea, one is in God’s hands”.



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## Chapter 13

### The Impact of Tax Treaties on International Mobility of Work in Greece

Christina Dimitropoulou

#### 13.1. Mobility of work and domestic tax law

With the advent of the COVID-19 pandemic, Greece was forced to take specific measures for the protection of public health, including travel restrictions, mandates for home office/teleworking, or home restraints and social distancing, as well as the suspension of employment contracts.<sup>1</sup> Specifically, teleworking in Greece increased exponentially compared to the pre-pandemic period, despite the fact that since 2010, labour laws had already provided for it as an option.<sup>2</sup> However, following the pandemic, teleworking increased to unprecedented levels, and a new regulatory framework has been promulgated by the new Labour Law 4808/2021.<sup>3</sup> The impact of teleworking was not only restricted to Greek tax residents already working for Greek employers and working from home, but also affected non-Greek tax residents who were physically present in Greece during the pandemic, whether voluntarily or not. More specifically, many Greek citizens who were non-tax resident in Greece (expatriates) decided voluntarily to return to Greece and work from there, at least for the duration of the pandemic. Others coincidentally happened to be physically present in Greece when the travel bans were introduced and were therefore stranded in Greece until the travel bans were lifted. Although the strict measures of the pandemic crisis have been lifted in the majority of countries around the world, remote working is here to stay. In view of the above, issues initially raised during the pandemic's period of restrictive measures regarding the tax status of both individuals and legal entities have not unreasonably remained a concern for the future.<sup>4</sup> More importantly, the impact of the abovementioned

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1. J. Rogers-Glabush & T. Morales, *Emergency Tax Measures in Response to the COVID-19 Pandemic*, 60 Eur. Taxn. 7 (2020), Journal Articles & Opinion Pieces IBFD.

2. Teleworking in Greece was traditionally regulated under art. 5 of law L.3846/2010, but before the pandemic outbreak, it remained at low levels.

3. See GR: Labour Law 4808/2021, art. 67, providing for more comprehensive regulation of remote working such as, for example, definitions of teleworking or remote working, employees' entitlements, the right to disconnect, etc.

4. K. Pouliakas, *Working at Home in Greece: Unexplored Potential at Times of Social Distancing?*, in *The Economic Impact of Covid-19 in Greece* pp. 70-128 (V. Monastiriotis

circumstances emerging from the pandemic is being examined in light of the application of tax treaty rules regulating taxing rights on the cross-border income of individuals and legal entities, and the potential changes that might be brought about within the taxing rights of Greece.

In principle, Greece applies worldwide taxation for its tax residents, who are taxed on their worldwide income, irrespective of where that income arose,<sup>5</sup> while non-residents are taxed only on income that is sourced in Greece, including employment income from work that is performed in Greece.<sup>6</sup> The latter is not dependent on the remuneration being paid in Greece, as long as such remuneration is connected to employment services performed in Greece, based on the relevant employment relationship.<sup>7</sup> Despite the above-mentioned rule on worldwide taxation, Greece has recently adopted a special taxation regime that is included in the Income Tax Code (ITC) and which introduces some territorial characteristics with regard to the taxation of the income of just certain categories of individuals.<sup>8</sup> The newly introduced special regime concerns only investors who want to make investments in Greece, and pensioners who will be taxed only on income from Greek sources and property situated in Greece, on condition that they transfer their residence to Greece.<sup>9</sup>

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& P. Katsinas eds., Hellenic Observatory, LSE 2020), suggesting that remote work in Greece should be enhanced and it could extend to 37% of all salaried jobs. *See also* the surveys conducted by the Hellenic Federation of Enterprises, based on which employees were found to generally support the idea of preserving teleworking schemes, although employers are less sanguine. C.A. Ioannou, Y. Sidiropoulos & A. Agnantopoulos, *Telework in Greece during the Covid-19 pandemic: A preliminary review of evidence*, Hellenic Federation of Enterprises (SEV) (June 2020), available at [https://en.sev.org.gr/wp-content/uploads/2020/06/Telework\\_SEV\\_english.pdf](https://en.sev.org.gr/wp-content/uploads/2020/06/Telework_SEV_english.pdf) (accessed 19 May 2022).

5. GR: Income Tax Code, Law 4172/2013, art. 3(1), OJ Folio A, no. 167 of 23 July 2013, Primary Sources IBFD [hereinafter ITC]. *See also* C. Kypris, *Greece - Individual Taxation* sec. 1., Country Tax Guides IBFD (accessed 19 May 2022).

6. Art. 3(2) ITC.

7. Taxation of employment income and the forms of remuneration that qualify as employment income are provided for in art. 12 ITC, while the international aspects of it are governed by the general principle of worldwide taxation, based on which foreign-source employment and pension income earned by Greek residents is included in their taxable income. However, Greece provides a tax credit for tax paid abroad, irrespective of whether a double tax treaty is applicable.

8. Art. 5A ITC, introduced by GR: Law 4646/2019, art. 2, OJ Folio A, no. 201 of 12 Dec. 2019 and art. 5B ITC, introduced by GR: Law 4714/2020, art. 1, OJ Folio A, no. 148 of 31 July 2020.

9. This new regime is mentioned merely to illustrate that it consists of a deviation from the standard principle governing taxation of Greek tax residents, as its scope excludes the tax treatment of foreign-source income of new tax residents transferring their tax residence in Greece under specific conditions. *See, to that effect*, K. Perrou, *Alternative Taxation Regimes for New Tax Residents*, 60 Eur. Taxn. 12 (2020), Journal Articles & Opinion Pieces IBFD.

Based on the general norm, an individual is considered to be a tax resident in Greece if they maintain a permanent residence or habitual abode in Greece, or if their centre of vital interests is in Greece.<sup>10</sup> In addition, an individual who is physically present in Greece for more than 183 days during any 12-month period (cumulatively) is also considered a tax resident in Greece from the first day of their presence in the country.<sup>11</sup> However, individuals who remain in Greece for a period not exceeding 365 days for touristic, health, therapeutic or similar reasons are exempt from the above 183-day rule, and are not considered tax residents.<sup>12</sup>

### 13.1.1. Domestic tax law and residence status of individuals and companies during the pandemic

The Greek ITC rules regarding the tax jurisdiction of Greece, adopted in 2013, are in line with the principles and guidelines of the OECD Model (2005). However, following the spread of the pandemic and the guidelines issued by the OECD as regards the application of the tax treaty rules and countries' tax entitlements with relation to the impact of teleworking on the tax status of cross-border individuals stranded in a country other than their country of residence, and also with relation to legal entities,<sup>13</sup> Greek tax revenue authorities decided to react, issuing some further clarifications/guidance that were included in Circulars 2113/2020 and 2130/2021 of the Greek Independent Authority of Public Revenue (IAPR).<sup>14</sup> In the said circulars, it was highlighted that the periods of 18 March to 15 June 2020 and 9 November 2020 to 14 May 2021 were characterized as periods of "objective inability of movement" with regard to the application of articles 4 and 6 of the Greek ITC, and are therefore<sup>15</sup> not taken into account for the determination of the tax residence of individuals who were non-residents and only present in Greece during that period. However, in the above

10. Art. 4(1) ITC.

11. Id., at art. 4(2).

12. Id.

13. OECD, *Secretariat Analysis of Tax Treaties and the Impact of Covid-19 Crisis* (2020), available at [https://read.oecd-ilibrary.org/view/?ref=127\\_127237-vsdagpp2t3&title=OECD-Secretariat-analysis-of-tax-treaties-and-the-impact-of-the-COVID-19-Crisis](https://read.oecd-ilibrary.org/view/?ref=127_127237-vsdagpp2t3&title=OECD-Secretariat-analysis-of-tax-treaties-and-the-impact-of-the-COVID-19-Crisis) and OECD [hereinafter *OECD Secretariat Analysis*]; and OECD, *Updated Guidance on Tax Treaties and the Impact of the COVID-19 Pandemic* (2021), available at [https://read.oecd-ilibrary.org/view/?ref=1060\\_1060114-o54bvc1ga2&title=Updated-guidance-on-tax-treaties-and-the-impact-of-the-COVID-19-pandemic&\\_\\_cf\\_chl\\_tk=pfqZmvuqIo3i0jpaBosURu0PFK3gOyz3tETq6m4bKC0-1652957412-0-gaNycGzNCX0](https://read.oecd-ilibrary.org/view/?ref=1060_1060114-o54bvc1ga2&title=Updated-guidance-on-tax-treaties-and-the-impact-of-the-COVID-19-pandemic&__cf_chl_tk=pfqZmvuqIo3i0jpaBosURu0PFK3gOyz3tETq6m4bKC0-1652957412-0-gaNycGzNCX0) [hereinafter *OECD Guidance*].

14. GR: Circulars no. E.2113/2020 and E.2130/2021 of the Greek Independent Authority of Public Revenue [IAPR].

15. Regulating tax residency in Greece for individuals and legal entities.

circulars, it was stressed that the assessment of the above would generally be made on a case-by-case basis, and that the individuals concerned had to be prepared to provide evidence showing that they were indeed objectively unable to move to their country of residence during those time periods. Therefore, on examination of the above facts and circumstances, if it can be proved that the employee’s presence in Greece is linked to preventative measures against COVID-19 and that their presence and carrying out of work in Greece is only exceptional,<sup>16</sup> the employee will not be considered to be tax resident in Greece. Table 13.1 illustrates the relevance of the application of Greek tax residence rules with regard to the time periods during which there was an objective inability to travel.

Table 13.1. Tax residency test and time period

| Time periods                                                                 | Relevance of tax residency tests       |
|------------------------------------------------------------------------------|----------------------------------------|
| Up to 17 March 2020<br>16 June 2020 – 8 November 2020<br>15 May 2021 onwards | To be reviewed on a case-by-case basis |
| 18 March 2020 – 15 June 2020<br>9 November 2020 – 14 May 2021                | Disregarded                            |

Given the above, therefore, for Greece to claim taxing rights on an individual’s income, it does matter whether or not that individual was forced to stay in Greece due to the extraordinary circumstances arising from the pandemic. However, this is not the case when restrictive measures have been lifted and remote working circumstances are no longer considered to be “exceptional”. In view of the above, both domestic law and tax residency tests must be re-examined with a view as to whether they are in line with those of the OECD Model and fit for purpose in the current era.

Additionally, in a situation where a person (Greek tax resident) works and stays in another country for a longer period, and one which could likely give rise to tax residence in that other country, there is no risk of an exit tax being triggered in Greece. In July 2020, Greece transposed into its national legislation article 5 of the EU Anti-Tax Avoidance Directive 1 (2016/1164) (ATAD) regarding the imposition of an exit tax by way of article 58 of Law 4714/2020, which had itself been further added to the Greek ITC by the introduction of article 66A, elaborating the exit tax rule. This was the first time that Greece had introduced an exit tax. However, its scope is limited

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16. After examination of the conditions of the exercise of the employment of the individual.

to legal entities, and individuals are therefore not covered.<sup>17</sup> On the other hand, if an individual participates in a Greek company, their transfer of residence may indeed trigger an exit tax to the extent that the participation will constitute a fictitious sale of assets. Moreover, for legal entities to whom such a rule could potentially apply (subject to the rest of its conditions), it is unlikely that an exit tax would have been triggered during the periods when the pandemic-related restrictive measures were in place. For periods extending beyond those qualifying as periods of “objective inability of movement”, exit taxation might be triggered, assuming that the factors giving rise to tax residence of legal entities in Greece are no longer present, and that the company might be regarded as having transferred its residence abroad. The rationale for this transfer cannot be easily ascertained, particularly for the periods during which restrictive measures were in place. In addition, it is not clear, for exit tax purposes, whether such a transfer should automatically be linked with the rationale of avoiding taxes in Greece. This is because such an exit tax regime complements the anti-tax avoidance package of measures that Greece implemented for the purpose of transposing into Greek tax legislation the ATAD.<sup>18</sup> Hence the temporary nature of the transfer of residence seeming to acquire significance in the evaluation of the residence status of both individuals and companies by the Greek tax authorities when claiming taxing rights, which, it is considered, should apply equally for the exit tax liability.<sup>19</sup>

17. See also K. Perrou, *The Implementation of the ATAD in Greece*, 50 Intertax 8&9, p. 625 (2022), arguing that base erosion concerns relating to the transfer of assets or residence of individuals can be addressed only through a GAAR, due to the non-expansion of the exit tax’s scope to individuals.

18. See K. Karakike, *Introduction of Exit Taxation and Hybrid Mismatch Rules in Greece*, 62 Eur. Taxn. 4 (2022), Journal Articles & Opinion Pieces IBFD; and A. Savvaïdou & V. Athanasaki, *Specific Anti-Avoidance Measures in Greece in the Post-BEPS and Post-ATAD Era*, 59 Eur. Taxn. 4 (2019), Journal Articles & Opinion Pieces IBFD.

19. See also J. Schwarz, *European Union: How To Minimize Exit Taxation Of Natural Persons*, Mondaq (19 Aug. 2021), available at <https://www.mondaq.com/tax-authorities/1103314/how-to-minimize-exit-taxation-of-natural-persons-> (accessed 22 May 2022), arguing that “[d]epending on the situation, a temporary move (emphasis added) may be possible. Then income will be taxed in the destination state (the new tax residence), but exit tax may not be triggered in the departure state. To create evidence that the move is not permanent, an apartment can be still available in the departure state, and there also shall be a plausible explanation why the centre of interest remains there”. This view is included in the general context that a change of residence, as such, is not sufficient to consider that the tax allocation has to be re-examined or that an exit tax may be triggered unless all other factors are evaluated. Hence, the temporary nature of the transfer of assets or residence is a presumption indicating that it is not likely to be accompanied by facts that support “true exit”, namely, some substance will still exist in the state of departure. However, substance is still a concept under review in the presence of remote working, leading to further challenges of what constitutes substance and how temporariness is evidenced at the end of the day. The same arguments are expressed by D. Weber, *The Influence of the*

As far as the tax residence of corporations and legal entities is concerned, article 4.3 of the Greek ITC stipulates that a legal entity be considered a tax resident in Greece if: (i) it has been incorporated under Greek law; (ii) its seat has been registered in Greece; or (iii) its place of effective management (PoEM) is in Greece.<sup>20</sup> In addition, article 4.4 of the Greek ITC enumerates the circumstances under which the PoEM of a legal entity is considered to be exercised in Greece. Falling within the above-mentioned categories are cases where the residence of the members of the Board of Directors (BoD), or any other executive management board, is in Greece (defined as physically present in Greece). For the latter, it is sufficient that the exercise of PoEM in Greece be made for any period during the tax year.<sup>21</sup> In cases where the residence of the BoD of a company is no longer in Greece, this may constitute transfer of residence of the legal entity, which is then subject to examination of whether the company still in fact has its PoEM in Greece (after evaluation of all facts related to which, a PoEM may be considered to exist in Greece). When evaluating whether the latter is in fact the case, factors to be examined include: (i) the place of exercising day-to-day management; (ii) the place of making strategic decisions; (iii) the place where the annual general meeting of shareholders or partners is held; (iv) the place where the books and records are kept; and (v) the place where the meetings of the members of the BoD or other executive management board take place.<sup>22</sup> However, based on Circulars E. 2113/2020 and E. 2130/2021

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*COVID-19 Pandemic on the Application of the OECD PPT, GAARs and (Some) SAARs: Lack of Substance for the Protection of Health*, Kluwer International Tax Law Blog (30 Apr. 2020), available at <http://kluwertaxblog.com/2020/04/30/the-influence-of-the-covid-19-pandemic-on-the-application-of-the-oecd-ppt-gaars-and-some-saars-lack-of-substance-for-the-protection-of-health/> (accessed 25 May 2022), positing that the lack of substance due to the restrictions applied for the protection of health are not to give rise to the application of anti-tax avoidance rules (GAARs and SAARs), because the intention of the lack of substance which has been driven by government measures was not for avoiding taxes, but for the protection of public health. There are cases where this may be challenged, as pointed out by Weber, and hard to prove (for example where companies never had substance, pre-COVID-19, in the country examined) and, therefore, this view is also subject to the continuation of the lack of substance in such a way that it would qualify as more permanent.

20. Art. 4(3) ITC.

21. *Id.*, at art. 4(4).

22. *See also Participation in Management of Greek Companies No Reason for Rejection of Change of Tax Residence Request, Supreme Court Decides* (18 Feb. 2021), News IBFD. The Greek Supreme Administrative Court, in its decision with no. 418/2020, decided that the participation of an individual in the management of Greek companies (Greek SA companies) does not as such justify the Greek tax authorities rejecting their request for a change of tax residence abroad, since participation in the management of Greek companies is not in itself an indication that the centre of vital interests of the individual is in Greece. This is due to the interpretation of the respective residence test in combination with the other criteria provided in art. 4 ITC. *See also Company with effective management in Greece*

of the IAPR, if the change of residence of the BoD has been a result of the “exceptional situation” of the pandemic and is therefore of a temporary nature, such a change shall not in itself lead to a change in the tax residence of the legal entity.<sup>23</sup> In all cases, the legal entities must be in a position to prove by any convenient means, such as keeping a record of facts and circumstances, that their presence in a different country was founded on reasons of force majeure. It is also not out of the question that a retroactive change of tax residence may apply,<sup>24</sup> should matters, after an audit, prove to be different than claimed. With regard to the above, there is the question of whether an exit tax would be triggered by virtue of article 66A of the Greek ITC; however, this is not very likely, on the assumption that the facts that may have given rise to a change or transfer of residence are driven by the exceptional circumstances indicated above, in line with the principal position of the Greek tax authorities.<sup>25</sup>

However, it remains to be seen whether such an extraordinary situation falls under the scope of the exit tax rule, given that exit taxation is not explicitly predicated on such a requirement. The only exception from the exit tax in cases of transfer of residence from Greece to another EU Member State or to a third country is when the relevant assets of the company remain effectively connected with the Permanent Establishment (PE) in Greece.<sup>26</sup> For special categories of assets,<sup>27</sup> it is also stipulated that the exit tax rule does not apply if these assets are returned to Greece within 12 months of their exit. In view of the above, it would have to be assessed whether the grounds that make the application of the exit tax rule conditional could be broadly interpreted, for example with regard to a temporary transfer of residence or assets, or one that is driven by exceptional circumstances, and which would fall outside the exit tax’s scope. As argued above, a temporary transfer is not likely to counter all substance requirements giving rise to taxation in

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*not taxable in Netherlands* (23 Feb. 2009), News IBFD (a case where the sole director and shareholder of a company incorporated under Dutch law had moved to Greece and this consisted of a change of the place of PoEM of the company).

23. On another note, the Greek Supreme Administrative Court has recently ruled that a Greek individual who has moved abroad but has been appointed either as the administrator of a single-member private company (IKE in Greek) or participated in the management of a Greek corporation (SA) shall not be treated as a Greek tax resident solely because of their capacity as an administrator or member of the BoD of a Greek company. See GR: Supreme Administrative Court (StE), decision no. 403/20 and 418/20, 5 Feb. 2021.

24. Circular E. 2113/2020 of the IAPR.

25. *Id.*

26. Similarly, Perrou, *supra* n. 17, at p. 625.

27. These are the assets relating to the financing of securities, assets posted as collateral, assets transferred in order to meet prudential capital requirements or for the purpose of liquidity management, as provided also in art. 5(7) ATAD 1.



Greece, although this is something that is being challenged robustly, given current and likely future permanent work patterns. Moreover, although substance evaluation is subject to objective elements, the lack of which may trigger the application of anti-avoidance rules, it should be investigated on a case-by-case basis, since lack of substance may always be justified with valid commercial reasons.<sup>28</sup>

Therefore, on the premise that remote working proliferated during the pandemic and resulted in low substance for companies, this should not a priori mean that the said circumstances should be brought within the scope of domestic GAARs (General Anti-Avoidance Rules) or the tax treaties' PPT (Principle Purpose Test) rule.<sup>29</sup> Nonetheless, it is hard to provide evidence of a company's patterns pre- and post-COVID-19 as a comparative indication that the lack of substance is due to the exceptional circumstances of the pandemic.<sup>30</sup> In the author's view, remote working does not alienate companies' "substance" (this being understood as the company conducting real business activities). The criteria that currently apply for justifying substance are rather formal, albeit objective, for the obvious reason that tax avoidance must be substantiated based on objective factors and not an appraisal of the taxpayers' intentions.<sup>31</sup> Nevertheless, the question should be whether remote working may provide for sufficient substance, and what requirements would then be appropriate to evidence that. In Greece, there are no specific substance requirements for companies other than those provided for in article 4.3 of the ITC regarding the criteria that give rise to the residence of legal entities in Greece. However, Greece has transposed the Parent-Subsidiary Directive and the ATAD GAAR. It has CFC (Controlled Foreign Company) rules in place and has also introduced several SAARs (Specific Anti-Avoidance Rules), all of which provide for some minimum

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28. See Circular GR: E. 2167/13.09.2019 of the IAPR regarding the uniform implementation of anti-avoidance rules that have recently been implemented in Greece by virtue of art. 38 ITC (the Greek GAAR), art. 27 ITC article 27 (SAAR related to tax losses forfeiture) and art. 56 ITC (SAAR regarding corporate restructurings). The general approach of the Greek tax authorities towards the implementation of the above rules is to balance tax avoidance cases with actual business economic activity. For this reason, the above rules should apply exceptionally and only in cases where artificial arrangements aiming at tax avoidance have been detected. The said approach is in line with the case law of the European Court of Justice (ECJ).

29. *OECD Model Tax Convention on Income and on Capital* art. 29(9) (21 Nov. 2017), Treaties & Models IBFD.

30. Compare Weber, *supra* n. 19.

31. See, for example, A. Báez Moreno, *Unnecessary and Yet Harmful: Some Critical Remarks to the OECD Note on the Impact of the Covid-19 Crisis on Tax Treaties*, 48 *Intertax* 8&9, p. 816 (2020), arguing for the objectivity of factors of substance and criticizing the OECD guidance on the residence tests.



substance requirements. The latter include indicatively physical premises, permanent payroll and personnel and assets and operations.<sup>32</sup> Nonetheless, Greek tax authorities have not yet issued any guidance clarifying what further substance requirements are considered relevant, nor whether the existing ones have to be re-examined in view of mobility of work.<sup>33</sup>

Despite substance risks, a person working from a home office in Greece for a foreign corporation may also, under certain conditions, qualify as a permanent establishment (PE) of the foreign entity in Greece. Circulars E. 2113/2020 and 2130/2021 ruled out this possibility for the time period when pandemic-related restrictive measures were in place, even though all situations have yet to be examined and reviewed on a case-by-case basis, in case remote working becomes more permanent. In general, the definition of a PE in Greece is provided in article 5 of the Greek ITC and follows the principles included in the OECD Model and its Commentary.<sup>34</sup> Therefore, a PE is “a fixed place of business through which the business of an enterprise is wholly or partly carried on”, and includes specifically: a place of management, a branch, an office, a factory, a workshop, a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources. A PE may also exist where an employee acts as a dependent agent of the enterprise. Contrary to the time period required in the OECD Model, a construction site PE is deemed to exist in Greece for a period of at least 3 months. Based on Circular E. 2113/2020, the PE risks that could arise from an employee of a non-resident entity working from home in Greece are considered non-existent for the period of 18 March to 15 June 2020. This view follows the OECD Guidance finding a lack of PE in the impermanence of the place of business and in the absence of an explicit requirement by the employer that the employee’s home office be used for rendering the business activities of

32. See, indicatively, M. Stefanakis, *In Review: Corporate Tax Planning Developments in Greece*, Deloitte Legal (11 May 2022), available at <https://www.lexology.com/library/detail.aspx?g=4ee59649-ff08-4f69-87c5-22ff411ed4c5>.

33. See, for example, S. Vanesse & L. Khvat, *How to Manage Substance in a Home Working Environment? How can Taxpayers Seek to Protect their Position?* Deloitte (2022), available at <https://www2.deloitte.com/lu/en/pages/real-estate/articles/how-manage-substance-home-working-environment.html>, suggesting reviewing membership of the BoD and their governing instruments in order to ensure that in the case of lack of physical presence, decisions can still be considered to be executed in the place of their previous residence (Luxembourg in the case at hand) which shall, however, require structural legal changes that will take time, and, as a simpler alternative, they propose amending the governing instruments of the BoD by granting proxies or powers of attorney. A power of attorney may be used to ensure that documentation continues to be validly executed solely or primarily in Luxembourg. These are proposals with a short-term view and do not correspond to the radical changes that might be needed in the event remote working becomes the rule, or at least more permanent, in all countries.

34. See the Explanatory Report in L. 4172/2014 (the Greek ITC).

the corporation. The said criteria, considered to exist by default during the specified time period, will have to be revaluated for the periods preceding or following those when the restrictions applied.

The same holds for agency PE risks, assuming that the employee was concluding contracts in Greece (i.e. their home jurisdiction) on behalf of the employer, since this could not have been the case if there was no habitual exercise of that activity from the employee on behalf of the foreign entity in Greece before the COVID-19 outbreak. Therefore, whether or not this condition is met (and to an appropriate degree) is a result of facts, and should accordingly be assessed as such for the periods not covering the exceptional circumstances of COVID-19. Lastly, the guidance clarified that a construction site PE would not be regarded as ceasing to exist “when work is temporarily interrupted due to COVID-19 restrictions, but the time of such interruption is included in the calculation of time thresholds for construction PE”.

Social security contributions in Greece are levied on the salary income of employees, as well as on benefits in cash or kind granted by the employer to its employees, and are fully deductible for corporate income tax purposes.<sup>35</sup> There is no direct link between social security contributions and tax residency nexus. However, non-resident companies employing Greek employees usually have to register in Greece. This may lead to tax residency in Greece. However, in cases of remote working, this does not happen, as the employee working from a home office in Greece is not officially registered in Greece, which would otherwise give rise to a PE of the foreign entity in Greece, subject to the agency or service PE requirements.

### **13.2. Residence, tiebreaker rules and mobility of work: Individuals and entities**

For the determination of the physical presence of individuals in Greece and the application of the tiebreaker rules in circulars E. 2113/2020 and 2130/2021 during the pandemic, a distinction was made between “coerced” and “voluntary” residence. Specifically, the periods during which restrictive measures and travel bans were in place were not taken into account for the determination of the 183-day rule or whether the individual had their habitual abode in Greece. In cases where Greek individuals might be considered

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35. S. Papademetriou & G. Kerameus, *Greece - Corporate Taxation* sec. 4, Country Tax Guides IBFD (accessed 20 May 2022).

dual residents, having spent time in another country due to the pandemic, it was reiterated that a temporary disruption of an individual's connection with Greece would not be viewed as such so as to alter their tax residence, based on the OECD Model. The position of the Greek IAPR is in perfect alignment with the one included in the OECD note of 2021,<sup>36</sup> according to which it is not likely that an individual has a permanent home available to them in the other country (for the periods marked by the COVID-19 restrictions) unless they are renting a home in that other country while at the same time renting out their permanent home in Greece for a significant amount of time, in which case, they may be considered as a resident of the other country.<sup>37</sup>

It is striking that, as Báez Moreno has correctly pointed out, no reference to the tiebreaker rule of the centre of vital interests is made by either the OECD or the Greek IAPR, who had only been concerned with the permanent home and habitual abode tests for the tax residence of individuals.<sup>38</sup> This is to be expected, to the extent that the centre of vital interests rule implies some permanence, or at least some intention of a permanent stay by the taxpayer (evidenced by objective facts) to the effect that they build their personal or economic relations with one state, which seems to be outside of the scope of the guidance of the OECD.<sup>39</sup> The latter aimed to clearly clarify the tax residence status of individuals during specific time periods, and was in no way intended to disrupt the application of the current tax treaty rules if it was only for a temporary period of time. It is thus justified by the ultimate purpose of preserving the status quo, although such status quo seems to have been equally challenged by the allegedly temporary situation of the COVID-19 restrictions, assuming that the latter generally lasted for at least 2 years with different degrees of severity.

It is also interesting that the centre of vital interests rule is to be found in a particular place in the hierarchy of the tiebreaker rules, which is not to diminish its significance, as it entails a substantive evaluation of the circumstances that could define the residence status of taxpayers. As the Greek Supreme Administrative Court has ruled, the tax authorities bear, in principle, the burden of proof as to whether an individual is a tax resident in Greece by evaluating all facts and circumstances, in particular the existence

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36. Same position is taken by the *OECD Guidance*, *supra* n. 13, at p. 14.

37. *Id.*

38. Báez Moreno, *supra* n. 31, at p. 829.

39. *Id.*, at pp. 827-828, where he mentions that cases of repatriation and especially cases of prolonged repatriation for different reasons can overturn the justifications offered by the OECD, who seemed to push towards a forced interpretation of the tiebreaker rules in order to maintain business as usual.

of a home, the physical presence of the individual and their family members (not only including spouse and children), the place of their business, the place from where the individual manages their property and the place where they establish administrative links with public authorities and bodies (insurance, professional and social), as well as the place of development of political, cultural or other activities.<sup>40</sup> On the other hand, it has been maintained that in the event of a long-held change in tax residence, the burden of proof of the fundamental facts giving rise to such a change lies with the taxpayer, who must provide all the information that they consider crucial to proving their change in tax residence.<sup>41</sup> In a case concerning a Greek individual who used to work with the Greek National Bank and was a tax resident in Greece until 2018, when she moved abroad and took unpaid leave, the Greek tax authorities rejected her application for a change in tax residence for the according tax year by arguing that her centre of vital interests remained at least partially in Greece, due to the fact that she was still typically employed by the Greek National Bank. However, the Supreme Administrative Court ruled that the tax authorities were mistaken, and that the rejection of the individual's application for a change in tax residence should be annulled, as it relied solely on the formal fact that the applicant was in a dependent employment relationship with the Greek National Bank. The tax authorities should have disregarded neither the unpaid leave granted to her until a few years after, nor the actual facts, based upon which the individual was residing and working abroad for more than 183 days during the 2018 calendar year. Thus, the formal requirement of being in a dependent employment relationship was not considered sufficient by the Court to substantiate that her centre of vital interests, and therefore tax residence, was in Greece.<sup>42</sup>

In other cases, when a centre of vital interest cannot be established, tax residence is determined by the place of habitual abode, namely where the individual has spent more time. The Greek tax administration requirement with respect to the determination of habitual abode is broadly in line with the OECD Model,<sup>43</sup> as it is based on the frequency, duration and regularity of stay that is part of the individual's settled routine, although the exceptional circumstances of COVID-19 could not be considered relevant for evaluating said regularity.<sup>44</sup> Therefore, since habitual abode evaluation is not restricted to merely counting days, it cannot be ruled out that the

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40. GR: SE [Supreme Administrative Court], Decisions no. 1212/2019 and 93/2020.

41. GR: SE [Supreme Administrative Court], Decision no. 2105/2018.

42. GR: SE [Supreme Administrative Court], Decision no. 1628/2020.

43. See *OECD Model: Commentary on Article 4* para. 19 (21 Nov. 2017), *Treaties & Models IBFD*.

44. Circular GR: E. 2113/2020 of the IAPR.

individual's routine may be altered during and following the measures of the pandemic, forcing them to adopt a different approach towards the duration of and reasons for their stays in each country.

Under the above view, the distinction between those time periods when objective inability to travel applied and those when that was relatively the case seems to function as an irrefutable assumption of non-tax residence in Greece (at least during the periods when the travel bans applied). However, actual facts could prove that this is not the case, especially if one considers that many taxpayers changed their routine in between the periods when restrictions took place, in anticipation of the measures that the government might adopt next. Therefore, no matter how convenient the above approaches of the OECD and the Greek IAPR may be for the interpretation of the treaty rules in extraordinary circumstances and the need to maintain the status quo, it remains a fact that tax treaties should be interpreted differently, namely in light of the object and purpose of each provision. The above does not negate the policy reasons for which many countries, including Greece, decided to adopt the same stance as the OECD in tax treaty interpretation during the pandemic, in view of the truly extraordinary circumstances, and reserved the right to re-examine this stance, should the actual facts point to a radical change in how tax residence rules should apply in the near future.<sup>45</sup>

As regards individuals teleworking in Greece for a foreign employer, their tax residency, as stated further by Circulars E. 2113/2020 and 2130/2021, shall in principle be determined after taking into account the residency tests provided for in article 4 of the ITC that are in line with article 4 of the OECD Model, and should be examined on a case-by-case basis. Those tests should be interpreted inside and outside of the exceptional circumstances that took place during the above-mentioned periods and that were attributed to any dislocation (of a temporary nature) owing to the pandemic. The criteria upon which the tax residence test evaluation should be based for individuals teleworking in Greece for a foreign employer are: (i) whether there is an office made available by the employer to the employee in the country of departure, but of which the employee cannot make use due to the circumstances; and (ii) whether the employment contract makes explicit reference to the employee providing their services from home compulsorily, or whether this can only happen exceptionally, in which case the employee is not obliged to work from home. It is obvious that the above criteria are set as indications of what could be considered a temporary stay, and whether it

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45. This is actually true for any legal change or the function and role of laws in general. Usually, laws follow societal or economic changes with a view to regulating them, or at least acting in parallel with them, rather than prescribing them.

is justified under the circumstances of COVID-19. It is still not clear what happens in the case of a taxpayer maintaining two offices available for them in both Greece and in another state, but with the employment contract being tacit on this issue. It is also not clear what happens if the individual is of Greek nationality, but works and is resident in another country. For example, what happens if, after COVID-19, they decide to split their time between Greece and the other country, maintaining a home and office in both? In Greece they only have a home office where they reside with their parents when in Greece. In the latter case, it is hard to identify both the centre of their vital interests and their habitual abode, assuming that the stays in both countries are equally lengthy and that both personal and economic ties may bind the taxpayer with both countries. Moreover, monitoring tax residency would be highly burdensome, assuming that tax residence determination continues to rely on physical presence monitoring.<sup>46</sup> To that end, digitalization of tax administration is key in order for tax administrations to be able to effectively track the physical presence of individuals for the purposes of tax residence status.

The Greek tax administration has not yet provided any specific digital tool with which it will be able to monitor tax residence, although significant steps have been taken towards implementing data analysis technologies for e-invoicing purposes.<sup>47</sup> The Ministry of Finance (MoF), together with the IAPR, have recently announced decisions regarding the implementation of e-books and the e-issuance of wholesale and retail sale records (e-invoicing) through licensed providers that would be connected online with the “myDATA platform” of the IAPR, starting from 1 October 2020 onwards (with the indication that the data collection preceding a 9-month period of

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46. There are some views on how technology can help in tracking physical presence for tax residence purposes, assuming that physical presence will continue to be a fundamental nexus for taxation of individuals and also legal entities (based on the PoEM test) by relying for example on geolocation technologies or by integrating risk management analysis by tax administrations based on data collected from various sources and public agencies. See G. Beretta, *Cross-Border Mobility of Individuals and the Lack of Fiscal Policy Coordination Among Jurisdictions (Even) After the BEPS Project*, 47 Intertax 1, p. 111 (2019), Traditional ways based on which to monitor tax residence were based on registered tickets, proof of attendance of meetings, invoices issued for costs for accommodation etc. See, among others, H. Niesten, *Revising the Fiscal and Social Security Landscape of International Teleworkers in the Digital Age*, 49 Intertax 2, p. 129 (2021).

47. See, respectively, GR: Law 4646/2019, Tax Procedures Code (TPC), GR: L.4646/2019 amending GR: L. 4308/2014. Special tax incentives have been also provided for companies to either issue or receive e-invoices through the licensed providers such as a reduction of the statute of limitation by 2 or 1 years or a tax super deduction by 100% of the initial equipment and software purchase as well as the respective e-invoicing issuance expenditure for the first year. See also, Decision A.1024/2020 of the IAPR regarding the possibility of real time transmission of data or, at the latest, within 24 hours from the transaction.

the initial implementation of the platform will be transmitted to the IAPR retroactively).<sup>48</sup> Moreover, a joint ministerial decision was issued to determine the general architecture, interoperability and interconnection requirements of the myDATA platform with the rest of the public information systems.<sup>49</sup> In view of the above, it is not unlikely that the Greek tax administration might take advantage of the above digital tools to track taxpayers' transactions in Greece, and, through analysis thereof, deem a taxpayer to be resident in Greece through a combination of factors (for example, potentially on a transactional tracking basis) that could imply a physical presence in Greece. The above is always subject to data protection regulation rules and the taxpayer being a priori informed on the digital processing of their data.

With regard to the impact of teleworking on the residence of legal entities, it has been clarified that all factors that would give rise to a legal entity's PoEM in Greece will be examined "in light of the exceptional circumstances under which enterprises operate and based on the public health measures taken in response to the COVID-19 pandemic".<sup>50</sup> It is however questionable how the existing tiebreaker rules or the PoEM test would in practice apply if substance is what matters, and such substance is evidenced by the physical presence of the individuals making decisions for the company. Circular E. 2113/2020 clarifies that all factors that could be relevant for the PoEM determination may be impacted as a result of the COVID-19 health emergency. Therefore, the factual indices falling within the individual cases referred to in article 4.4 of the ITC (for example, place of decision-making or daily exercise management, meeting place or residence of the majority of shareholders) are inappropriate and cannot be taken into account, unless we compare the pre- and post-COVID-19 environments in order to identify some patterns.<sup>51</sup> However, this line of reasoning presupposed that all cases had a pre-COVID-19 pattern (which is not true) and that, after the COVID-19 outbreak, remote working cases would reduce to pre-COVID-19 levels. With this view, the existing criteria that had applied up to that point would

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48. See Decision A.1138/2020 of the IAPR, determining the scope and details of the digital transmission of entrepreneurs' data to IAPR. For more on the operational details of the platform, see [www.aade.gr/mydata](http://www.aade.gr/mydata) (accessed 25 May 2022).

49. See GR: Joint Ministerial Decision no. 60967 EΞ 2020.

50. Circular GR: E.2113/2020 of the IAPR.

51. Circular GR: E. 2113/2020, paras 16-17. To be noted that in all tax treaties concluded by Greece, the PoEM is the sole criterion for the determination of the tax residence of legal entities. This has been maintained also following the signature of the MLI by Greece and therefore the new art. 4(3) *OECD Model* (2017) providing for a MAP is not applicable for the determination of the residence of legal entities in the treaties signed by Greece.



have continued to be relevant. Such interpretation lacked foresight and, in any case, has in all likelihood not continued to be relevant for the present.

On the other hand, companies' tax residence was one of the core aspects of the Base Erosion and Profit Shifting (BEPS) Project, which revealed that residence, as such, is inappropriate as a nexus rule for our globalized digital era. Whether remote working is another sign that we should do away with residence nexus entirely, or else find different criteria to deem residence, is still under discussion. For the purposes of this report, it suffices to say that if one were to conclude that, for lack of adequate information needed in order to determine the actual place of effective management, formal tests should prevail (in the name of objectivity) with regard, for example, to place of incorporation or headquarters, this is equally risky in terms of tax planning opportunities. The PoEM concept seems to become even more vague in nature, which makes even more difficult the task of the competent authorities when called upon to decide the tax residence of companies through mutual agreement procedures (MAPs). In the above situations, vagueness would only be compensated for by the tax authorities' discretion.<sup>52</sup>

The determination of the PoEM attracts special attention in the context of article 8(1) of the OECD Model, which gives exclusive taxation on the profits of an enterprise from the operation of ships and aircraft in international traffic to the state where effective management of that enterprise is located.<sup>53</sup> Greece has made a reservation to article 8 of the OECD Model, in view of the importance of shipping for the country,<sup>54</sup> stating that it will retain its freedom of action with regard to the provisions in the convention relating to profits from the operation of ships in international traffic. It is also notable that Greece, in principle, allocates exclusive taxing power to the state of registration of the ship in its treaties, in order to promote the

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52. As of the time of writing this report, there is no information on whether the PoEM has been challenged by tax authorities under an audit or under a MAP discussed with other states, nor to which criteria the Greek tax administration has given emphasis for the PoEM determination.

53. See para. 1 *OECD Model: Commentary on Article 8*. See also L. De Broe, *Income from Employment*, in Klaus Vogel on *Double Taxation Conventions* para. 325 (5th ed., E. Reimer & A. Rust eds, Kluwer 2021), emphasizing the subtle difference between arts. 4(3) and 15(3) *OECD Model*, in that the former is concerned with the place of the entity as such, whereas the latter is concerned with the place of "the enterprise", the difference is that an entity may carry on different enterprises and, therefore the PoEM in art. 4(3) *OECD Model* is concerned with the whole entity's PoEM and tax residence respectively. De Broe argues that for the purposes of *OECD Model: Commentary on Article 8*, it is the PoEM of para. 3 *OECD Model: Commentary on Article 4* that should be taken into account.

54. Para. 35 (Reservations on the Article) *OECD Model: Commentary on Article 8*.



Greek flag. Should a company not be registered in Greece, no exclusive taxation is claimed by Greece. Nonetheless, in a few tax treaties, the PoEM has been chosen as a criterion of residence of the shipping enterprise.<sup>55</sup> For those tax treaties, a risk emerges with respect to the potential loss of residence of shipping enterprises during a pandemic in cases where the PoEM criteria are not met in Greece. However, no particular case has emerged nor guidance been issued by the Greek tax authorities with regard to that matter. Neither do there seem to be any particular issues that the movement of companies to a different state could potentially raise as regards the application of article 16 of the OECD Model relating to the taxation of directors' fees. Interestingly, since this report is not concerned with the de facto exercise of the activities of directors, the tax residence of the company is decisive with regard to taxing rights. Given that the residence of companies determined by the PoEM is often challenged, it follows that the taxation of directors' fees will be accordingly affected. What is interesting, however, in the above context, is that the purpose of this article, which was predicated on the convenience of not having to determine the place of exercise of the activities of directors (as top-level managers of a company who exercise supervising functions), is more in line with current technological developments than is article 15 of the OECD Model.<sup>56</sup> On the other hand, supposing that the right to tax under the above rule is attributed to the place of residence of the company, and given that such residence is further determined by the PoEM of the company, there are inherent difficulties in the application of both articles 15 and 16 of the OECD Model. In Greece currently, the personal tax liability of directors comes up with regard to the remuneration they receive in their capacity as members of the BoD (appointed as statutory directors) in a group company situated in Greece, on the condition that such remuneration is connected with their duties as board members of the Greek entity.<sup>57</sup>

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55. For a detailed analysis, see M. Tegos, *Greece in Taxation of Shipping and Air Transport in Domestic Law, EU Law and Tax Treaties* ch. 16 (G. Maisto ed., IBFD 2017), Books IBFD.

56. For example, see A. Cordewener, *Article 16. Directors' Fees and Remuneration*, in *Klaus Vogel on Double Taxation Conventions* para. 107 (5th ed., E. Reimer & A. Rust eds., Kluwer 2022).

57. See indicatively, KPMG, *Taxation of international executives* (Greece) (Jan. 2021), available at Taxation of International Executives - KPMG Global.

### 13.3. Permanent establishments and mobility of work

The implementation of teleworking measures during the COVID-19 period has exacerbated both the risks of establishing a tax presence in Greece<sup>58</sup> on behalf of individuals working in Greece for a foreign employer and the possibility that the individual's home office may fall under the PE rule.

The criteria for a home office PE follow those of the fixed place of business as found in article 5(1) of the OECD Model, are in line with article 6 of the ITC, and divided between the *permanency* criterion and the criterion that such a PE or home office is *at the disposal* of the enterprise<sup>59</sup> for which the individual renders their services. The above requirements have not, in general, been revised by the Greek tax administration, which simply clarified that the temporary presence of an individual in Greece, by reason of governmental orders imposing employment restrictions in the context of limiting the spread of the COVID-19 pandemic, shall not be taken into account for the existence of a PE.<sup>60</sup> Therefore, according to the Greek tax administration, under the above circumstances, a home office PE does not satisfy the criterion of permanency, but with no further specification offered on how such permanency is to be interpreted.<sup>61</sup> Conversely, if the employer had specifically asked the employee to use their home office for the purpose of rendering the enterprises' business activities, and this had happened on a continuous basis, then a PE would exist in Greece under the second criterion, according to which the home office would be deemed to be *at the disposal* of the enterprise.

In addition, it has been argued that for a home office to be at the disposal of the enterprise, the latter would be required to have specifically requested

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58. This is because teleworking used to apply also before COVID-19, but at lower levels. It is also true that residence risks could also be created for Greek companies whose employees were working from a different country during the pandemic and where such a situation was likely to be continued also after the lifting of the travel restrictions.

59. See, for example, A. Skaar, *Permanent Establishments: Erosion of a Tax Treaty Principle* sec. 14.2 (Kluwer Law International 2020) and para. 18 *OECD Model: Commentary on Article 5* (2017).

60. Circular GR: E. 2130/ 2021 IAPR.

61. *Id.* It was limited to the periods when the restrictive measures applied, as discussed above, and therefore, if the above situation looked to continue also after the lifting of the restrictions, the Greek tax authorities did not rule out the existence of a PE. Thus, the period from 9 Nov. 2020 to 14 May 2021 was not taken into account for the assessment of a PE, while for the time period between 15 June and 9 Nov. 2020, potential PE risks were to be examined on a case-by-case basis. The main concern of that examination would again have been around the permanency criteria, assuming that the relevant time periods still created an uncertainty as to the termination of the health crisis.

that the employee use their home as an office and, by the same token, not have provided the employee with an office in the location of the enterprise. However, Circular E. 2113/2020 mentions that a PE would not exist, even if the company's offices continued to be available for the employees, but access was limited or impossible due to measures for the containment of the COVID-19. In general, for a home office to constitute a PE, the employer must also bear the costs of the equipment necessary for a home office PE, which is an indication that the employer has power over the living quarters of the employee.<sup>62</sup> One would normally agree that the above requirements were, to a large extent, fulfilled during the pandemic, when companies asked their employees to take to their homes any movable equipment that they used in the office, following governmental announcements on quarantine. However, based on the OECD Model, this cannot be interpreted as the company's request per se if it happened as a result of the COVID-19 measures and was a consequence of force majeure.<sup>63</sup> It is questionable, though, whether this interpretation can cover the whole period of the pandemic, let alone also apply in the future – assuming that many companies still apply a special regime regarding how to return to the office, in combination with the proliferation post-COVID-19 of hybrid work patterns. For this reason, it has been further clarified that in the future, following a pandemic, if a business has changed the way it operates and decides to request employees to use their home for rendering business activities, such a home office would be considered to be at the disposal of the enterprise and constitute a PE.<sup>64</sup> Similar arguments are provided by the Greek IAPR as regards the existence of agency PEs, based upon which a PE is deemed not to exist if the employee did not, before the pandemic, habitually conclude contracts on behalf of the foreign employer in Greece. It is again obvious that the term “habitually” is linked with the work patterns that were the norm prior to the pandemic, which is not, in general, a solid criterion for assessing how the term should be interpreted in a more permanent post-pandemic teleworking environment.<sup>65</sup>

As regards the existence of a construction site PE, an exception has been outlined in the IAPR circulars whereby exceptional time periods would not be seen as the cessation of activities and related supervision activities

62. Para. 12 *OECD Model: Commentary on Article 5* (2017).

63. *OECD Secretariat Analysis*, *supra* n. 13, at para. 9 and Circular GR: E. 2113/2020 IAPR.

64. Circular GR: E. 2130/2021, para. 19 IAPR.

65. See also Báez Moreno, *supra* n. 31, at p. 819, mentioning that the agency PE risks for COVID-19 repatriates at least is not likely, but for reasons other than those claimed in the OECD note.

of the relevant installation projects.<sup>66</sup> This is also in line with the OECD's approach.<sup>67</sup> Although one can be sceptical of the impact of the COVID-19 restrictions on the interpretation of the temporary nature of the interruptions, it seems that the object and purpose of the construction site PE rule would still provide for the continuation of the existence of such a PE.

No further guidance is offered by the Greek tax authorities regarding how profits from an office PE would be attributed, considering that few opportunities were given by the IAPR for the existence of such PEs, and that they also reserved the right to revert to a reassessment of the circumstances, should home office PEs continue after the pandemic. In general, however, the Greek ITC follows the single entity approach to PEs on profit distribution, considering that the PE and the non-resident head office are parts of the same legal entity, subject to particular deviations that apply on the above principle with respect to financial transactions. On the other hand, the separate entity approach is also becoming favourable.<sup>68</sup> In general, the transfer pricing provisions included in the ITC are applied in line with the OECD Guidelines.<sup>69</sup> As regards the attribution of profits to PEs, Greece recently started to follow the Authorised OECD Approach (AOA) in its domestic tax law, but the new version of article 7 of the OECD Model is not yet included in its tax treaties. Therefore, in the above cases, the AOA would not apply.<sup>70</sup>

A special regime for digital nomads has been implemented in Greece by virtue of article 11 of Law 4825/2021, providing for a digital nomad visa offered to third-country citizens that reside in Greece and work remotely from Greece.<sup>71</sup> The visa is valid for 12 months, and the applicants may be accompanied by their family members, while also being required to prove that they will provide remote work for employers outside Greece. Moreover, the visa is offered on condition that the digital nomads provide evidence of sufficient financial resources to cover their living expenses in Greece for the length of their stay. The law does not provide for any tax-related

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66. Circular E. 2113/2020 of the IAPR.

67. See also para. 155 *OECD Model: Commentary on Article 5*.

68. S. Papademetriou & G. Kerameus, *Greece - Corporate Taxation* sec. 7.3.3, Country Tax Guides IBFD (accessed 27 May 2022).

69. Art. 50 ITC.

70. See *OECD Transfer Pricing Country Profile: Greece* (Feb. 2022), available at <https://www.oecd.org/tax/transfer-pricing/transfer-pricing-country-profiles.htm> and *OECD - OECD Adds and Updates Transfer Pricing Country Profiles* (28 Feb. 2022), News IBFD (accessed 4 June 2022).

71. GR: Law 4738/2020 (Greek Government Gazette A 207/27.10.2020, art. 11, see translation available at [https://www.workfromcrete.gr/wp-content/uploads/2021/09/WorkfromCrete\\_Greek-National-DN-Visa-Law-4825.2021-Article-11-not-official-translation.pdf](https://www.workfromcrete.gr/wp-content/uploads/2021/09/WorkfromCrete_Greek-National-DN-Visa-Law-4825.2021-Article-11-not-official-translation.pdf)).

implications from the digital nomad visa, nor has any further clarification been issued by the IAPR. It is, however, obvious that such a regime does pose a great risk that the digital nomad end up being considered either as a tax resident in Greece, given that their stay shall exceed the thresholds provided in article 4 ITC, or else of creating a PE for the foreign employer for whom they are working remotely from Greece.<sup>72</sup>

### 13.4. Physical presence according to articles 15(1) and 17 of the OECD Model

The critical factor for taxing employment income in Greece is that the employee is resident in Greece, in which case, their worldwide income is taxed in Greece, including income from employment. Therefore, Greece (as the resident state of the recipient of the employment income) has exclusive taxing rights on that income. In addition, employment income is considered as income from Greek sources if the employment is exercised in Greece.<sup>73</sup> In such cases, Greece, as a source state, shares taxing rights with the resident state of the employee. In the latter case, the critical factor for the taxation of employment income is the place where the employment is exercised following the *lex loci laboris* principle, or the place of work principle, similar to articles 15(1)(a) and (2) of the OECD Model.<sup>74</sup> Such a place of work with regard to private dependent employment is further determined by the physical presence of the employee at the time they carry out the activities for which the remuneration is paid. Therefore, the remuneration paid for labour services exercised in Greece by an employee physically present in Greece is taxed in Greece as Greek-source income, subject to the rest of the requirements set down in article 15(2) of the OECD Model.<sup>75</sup> As far as short-term assignments are concerned, the income earned in respect of

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72. Compare E. Bosinaki, *Greece: Digital Nomad Visa – A Tax Perspective*, International Tax Review (10 Dec. 2021), available at <https://www.internationaltaxreview.com/article/b1vty0g5j6232/greece-digital-nomad-visa-a-tax-perspective>.

73. See art. 5(1)(a) ITC.

74. See para. 1 and 2 *OECD Model: Commentary on Article 15* (2017).

75. These requirements set out in para. 2 *OECD Model: Commentary on Article 15* are cumulative and provide that such remuneration will be taxable in the resident state of the employee unless: (i) the employee is present in the host country for a period or periods not exceeding 183 days in any 12-month period commencing or ending in the taxable year; (ii) the remuneration is paid by or on behalf of an employer who is not a resident of the host country; and (iii) the remuneration is not borne by a PE that the employer has in the host country. The above wording is followed also by the majority of tax treaties concluded by Greece. Therefore, if an employee is not a Greek resident, they may still be taxed in Greece on their employment income if: (i) they are present in Greece for more

employment exercised in Greece (that is, Greek-source income) is also taxable in Greece, irrespective of whether it is remitted in Greece or not.<sup>76</sup>

The three-prong test found in articles 15(1)(a) and (b) and 15(2) of the OECD Model for assigning taxing rights in respect of income from employment has been put under pressure during the COVID-19 pandemic, especially as regards the place of work principle. This was particularly the case for Greek workers stranded abroad who could not travel back to Greece, and also foreign employees who were working remotely from Greece for a foreign employer and for whom, due to the travel restrictions, Greece became de facto their place of work. In such circumstances, it is rightly questionable whether the physical presence proxy upon which taxing rights allocation of employment income is predicated is still fit for purpose, in view of the proliferation of remote working cases.<sup>77</sup> Although the Greek ITC does not explain when it is that work is considered to be “exercised” in one state, Circular E. 2113/2020 reaffirmed that dependent self-employment is provided in the state in which the employee has a physical presence upon performance of the labour services for which the remuneration is paid.<sup>78</sup> This is similar to the interpretation found in the Commentary on the OECD Model as regards the term “employment exercised” proxied by the employee’s physical presence.<sup>79</sup> However, such physical presence seems to

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than 183 days during any 12-month period; (ii) the remuneration is not paid by or on behalf of an employer who is not resident in Greece; and (iii) also if the remuneration is borne/deducted by a PE that the employer has in Greece.

76. KPMG, *Greece – Taxation of international executives* (Jan. 2021), available at <https://assets.kpmg.com/content/dam/kpmg/xx/pdf/2023/01/TIES-Greece.pdf>, discussing also long-term employment situations of non-residents and the relevant requirements. See also P. Pistone, *Article 15: Income from Employment - Global Tax Treaty Commentaries* sec. 2.2.1.1., Global Topics IBFD (accessed 29 March 2022), mentioning that the correct interpretation of the exceptions in art. 15 *OECD Model* implies that none of these may affect the exercise of taxing rights by the residence state regarding the remuneration derived by its residents in respect of an employment. This means that the first exception to the residence taxation of employment income, contained in art. 15(2), may be interpreted as even expanding the scope of art. 15(1) rather than restricting it, hence allowing the residence state to have exclusive taxing rights with respect to short-term employment exercised in the other contracting state.

77. See Pistone, *supra* n. 76, at sec. 3.3.2.2.2. (noting that “equating the source state with the activity state is perhaps no longer suitable to realize its objectives, especially for the types of employment that may be exercised remotely” linking also the said inadequacy with the reasons that advocated the chosen nexus for the taxation of directors’ fees in *OECD Model: Commentary on Article 16* and G. Beretta, “Work on the Move”: *Rethinking Taxation of Labour Income under Tax Treaties*, 5 Intl. Tax Stud. 2 (2022), Journal Articles and Opinion Pieces IBFD.

78. See Circular 2113/2020, para. 37 of the IAPR, reiterating the exceptions under para. 2 *OECD Model: Commentary on Article 15*.

79. Para. 1 *OECD Model: Commentary on Article 5* (2017).

be understood somewhat differently under the general rule and the exceptions provided in article 15(2) of the OECD Model, where the calculation of the days of presence for the 183-days rule is critical.<sup>80</sup> The clarifications provided by the Greek tax authorities in the light of the COVID-19 measures did not mention anything further regarding the taxing rights of Greece in the above scenarios, potentially due to the fact that they already considered that remote working cases would fall under employment activities of a short-term duration (due to the temporary nature of the situation), which would not, in principle, affect current taxing rights allocation and interpretation of article 15 of the OECD Model. Therefore, in the case of a non-Greek tax resident employee, whether or not a home office is the place where the activity is exercised is dependent on whether the employee is physically present in Greece with none of the conditions set out in article 15(2) of the OECD Model fulfilled.

Nevertheless, under the conditions marked by the COVID-19 restrictions, the Greek tax authorities took the position that they did not as such view the place of work as altered, and that in the event of the suspension of employment contracts due to the pandemic, the “cross-border worker” would not be considered as providing dependent work in the source state (although they may receive compensation for it), with the result that they either remain unemployed in that state (i.e. the source state) or return to the state of residence.<sup>81</sup> In order to address such cases, it has been further clarified (in accordance also with the guidelines of the OECD) that compensation shall be equated with the compensation for the termination of employment, which shall fall within the scope of the provisions regarding taxation of employment income and, as such, shall be deemed as arising in the state in which the employee would otherwise have worked (i.e. exercised their employment activities).<sup>82</sup> In the case of cross-border workers, this would be the state in which dependent self-employment was exercised before governmental measures were taken for countering the spread of COVID-19 pandemic, so that the source state’s right to tax is not affected.<sup>83</sup> Subsequently, even if physically present there for the periods during which restrictive measures were in place, stranded workers were not taxed in Greece if, due

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80. Id., at para. 5.

81. The term cross-border worker seems to have been merged here with the term “frontier worker” as it is in the respective OECD Guidance, as can be assumed from the rest of the sentence explaining in principle the frontier worker’s regime. It is however noted that the OECD Guidance and those of the IAPR could apply more generally and cover all cases of cross-border workers with respect to the above subject matter, *see* Báez Moreno, *supra* n. 31, at p. 826.

82. *See* Circular E. 2113/2020, para. 38-39 IAPR.

83. Id.



to the said travel restrictions, they had been prevented from travelling to their residence state.

As of 1 January 2020, Greece introduced special provisions for the taxation of athletes and coaches under certain conditions.<sup>84</sup> Based on the relevant provisions, income earned by professional athletes from sports corporations or recognized sports clubs is taxed at a flat tax rate of 22%, with no further tax liability, on the condition that such income is received either as a lump sum or even in instalments, for either a transfer contract or a renewal of a terminated contract whose amount exceeds EUR 40,000 within the respective tax year. In other cases, the regular progressive income tax scale for employment income applies. With respect to the taxation of artists, income earned from artists resident in Greece is considered income from business activity. No special classification of such income is provided. For those artists and sportspersons who are non tax-resident in Greece, the income they receive from the performance of such activities is nevertheless taxed in Greece if such income “arises” in Greece, i.e. the performance of their services takes place in Greece.<sup>85</sup> Moreover, if the income of artists is received from payments made by legal entities or natural persons who are tax residents of and carry on business activity in Greece, a withholding tax is levied on the payments at the rate of 20%. The artist has the obligation to register with the Greek tax registry and file a tax return, since the above withholding exhausts any further tax liability of the artist for the said income.<sup>86</sup> In contrast, assuming that the beneficiaries of the income are artists and sportspersons who are tax residents of a country with which Greece has concluded a tax treaty, the taxation of their income is subject to the provisions of the respective tax treaty. Specifically, if the remuneration is paid by a foreign tax resident without a PE in Greece, no withholding tax is levied in Greece. Most of the tax treaties signed by Greece follow the OECD Model and therefore article 17 of the OECD Model should be applicable<sup>87</sup> in that case.

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84. See GR: Tax measures for the enhancement of the development of the Greek economy, the implementation into Greek legislation of the E.U. Directives 2017/1852, 2018/822, 2020/876, 2016/1164, 2018/1910 and 2019/475, the contribution of the Greek State to the repayment of loans of affected borrowers from the adverse effects of COVID-19 and other provisions, introducing among others special taxation for pilots and sports coaches (2020), L. 4714/2020.

85. See para. 1(8) art. 5 ITC.

86. See also Circular GR: POL.1120/2014 of the General Secretary of Public Revenues.

87. See, for example, *Convention between the Hellenic Republic and the Kingdom of Spain for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Tax on Income and on Capital*, art. 17 (2000), Treaties & Models IBFD; *Convention between the Kingdom of the Netherlands and the Hellenic Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Tax on Income and on Capital* art. 18 (1981) (as amended through 2006), Treaties & Models



In other treaties, there is a special reference to the taxation of the income of artists and sportspersons in the provision relating to the taxation of employment income, where it provides either for source taxation in the state where such activities are exercised<sup>88</sup> or merely stipulates that such activities are not covered by the provision of the article relating to the taxation of income from employment,<sup>89</sup> which usually provides for residence taxation, subject to exceptions similar to those found in article 15(2) of the OECD Model. However, article 17 of the OECD Model providing for source taxation of the income of artists and sportspersons raises several interpretational issues with respect to how the place of performance is determined, and whether training sessions or rehearsals taking place in a different location count as public performance, for the determination of the source state. Assuming that training and rehearsals form part of the performance of the artists and sportspersons, it is likely that more than one source state may have the right to tax the income from such activities, which creates further issues as regards the apportionment of such income.<sup>90</sup> It is also disputed whether online performance via digital means (livestreaming) qualifies as “public performance” for the purposes of article 17 of the OECD Model, which is supposed to be the core requirement for the activities of entertainers and their taxation under article 17 of the OECD Model.<sup>91</sup>

During the COVID-19 pandemic, most of the personal or professional “activities” of athletes and artists were conducted online, which does not automatically point to a certain source state from where the activity would traditionally be considered as being carried out. That place is also

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IBFD; *Convention between Belgium and Greece for the Avoidance of Double Taxation and the Regulation of certain other Matters with Respect to Taxes on Income* art. 17 (1968), Treaties & Models IBFD.

88. See, for example, *Agreement between the Federal Republic of Germany and the Kingdom of Greece for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital and to the Trade Tax* art. XI(1) (1966), Treaties & Models IBFD (“[n]otwithstanding anything contained in the foregoing provisions income derived by public entertainers, such as theatre, motion picture, radio or television artists, and musicians, and by athletes, from their personal activities as such may be taxed in the Contracting State in which these activities are exercised”).

89. *Convention between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Kingdom of Greece for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*, art. XI(3) (1953), Treaties & Models IBFD.

90. Para. 9.1 *OECD Model: Commentary on Article 17* (2017).

91. A connection with the public is necessary, but an indirect link between income and the performance is sufficient for such income to fall within art. 17 *OECD Model*, as argued by J. Roeleveld & K. Tetlak, see J. Roeleveld & K. Tetlak, *Article 17: Entertainers and Sportspersons/Artistes and Sportspersons - Global Tax Treaty Commentaries*, Global Topics IBFD.

not necessarily the place of residence of the beneficiary of the income received from that activity, since the artist or athlete can livestream the performance from any state, although during the pandemic, this was most likely to be from the resident state.<sup>92</sup> In this situation, it is argued that maybe the market in which the activities are addressed is the source state for the purposes of article 17 of the OECD Model, which is supposed to be justified under the benefit principle.<sup>93</sup>

A different situation would arise if the income from the activities fell under article 15(1) or 15(2) of the OECD Model, and the remuneration was either paid by an employer who had a PE in the source state or else was paid by the state itself. This is a question of the legal relationship between the payer and the recipient of the income from the performance of services.<sup>94</sup> Similar issues are raised with regard to the taxation of influencers and which state has taxing rights over their income from that activity.<sup>95</sup> Greek tax authorities have started to investigate a few Greek celebrities in their capacity as influencers, but no official guidance has yet become publicly available.<sup>96</sup>

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92. See S. Kostikidis, *Influencer Income and Tax Treaties*, 74 Bull. Intl. Taxn. 6 (2020), Journal Articles & Opinion Pieces IBFD.

93. Id., at sec. 2.1.

94. Compare for example the definition of income from employment and pensions provided in art. 12 para. 1 and 2 ITC where the (gross) income from paid work and pensions includes all kinds of income in cash or in kind obtained under existing, past or future employment relationships. For Greek income tax purposes, an employment relationship exists when a natural person provides services in the context of an employment contract, in accordance with labour law on the basis of a contract (oral or written) with which the natural person acquires a relationship of private dependent work with another person who has the right to control an employment relationship exists when a natural person provides services on the basis of a contract, oral or written, with which the natural person acquires a relationship of dependent work with another person, who has the right to define and control the manner, the time and place of performance of the services. Moreover, it is considered that a person is under a dependent employment relationship with one employer if this person provides services to no more than three employers, their remuneration exceeds 75% of the gross income from business activity coming from one of the natural or legal persons or legal entities receiving this person's services and that person does not maintain a professional establishment other than their place of residence. Moreover, in accordance with Circular GR: 1047/2015, it is clarified that with the introduction of the new ITC, in effect from 1 Jan. 2014, most categories of sources of income from independent services were grouped under the general classification of business income (art. 21 ITC). In all cases that fall under the above provisions, a withholding is carried out in accordance with the provisions of art. 60 ITC.

95. Kostikidis, *supra* n. 92, at sec. 2.2. and 2.3., discussing the personal and objective scope of *OECD Model: Commentary on Article 17* and to what extent it covers influencers.

96. See ToBHMA Team, *Tax Evasion – Famous Greek Influencers Under Scrutiny* (15 Aug. 2021), available at <https://www.tovima.gr/2021/08/15/international/tax-evasion-famous-greek-influencers-under-scrutiny/>.

It is, however, expected that, due to domestic legislation, the taxation of influencers' income will likely qualify as business income for domestic tax purposes.

During the pandemic, it is likely that Greek influencers may have offered their services from a state other than Greece, which would normally give that state the right to tax their income. However, given the conventional stance of the Greek tax authorities and the OECD Guidelines relating to the challenge to tax treaty rules during the exceptional circumstances of the pandemic, it is expected that, in practice, the taxation of influencers would not create any problem. For the future, however, the discussion should focus on finding a common interpretation as to which state is the source state for the influencers' income from such activities and also which formula should provide the basis for the income to be apportioned in cases where more source states are entitled to the taxation of that source of income.

### 13.5. Article 15(2) and (3) of the OECD Model

For the purposes of article 15(2)(a) of the OECD Model and specifically the application of the 183-day rule, days spent in a home office are counted from the first day of presence in said home office.<sup>97</sup> With regard to periods excluded from the calculation due to pandemic-related travel bans, *see* section 4 analysis above. Therefore, if a non-resident employee of a foreign company works in a home office in Greece and effectively stays in Greece for more than 183 days within a tax year in the aggregate, their presence in Greece would count from the first day of presence in the home office in Greece, after exclusion of the periods indicated above. This means that the 183-day rule was generously applied during the pandemic. Although in principle 183 days is supposed to set a threshold for the non-taxation of short-term employment in the source state,<sup>98</sup> it has in practice been broadly interpreted in light of the exceptional nature of the COVID-19 pandemic.

In the future, it is expected that the above clause will be interpreted more narrowly and in accordance with the OECD rules and commentaries that distinguish between whether or not the presence of the employee in Greece would exceed 183 days in the aggregate within a tax year (12-month period)

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97. Circular GR: E. 2113/2020 of the IAPR.

98. Para 16.2 *OECD Model: Commentary on Article 15* (2017) and K. Dziurdz, *Article 15 of the OECD Model: The 183-Day Rule and the Meaning of "Borne by a Permanent Establishment"*, 67 Bull. Intl. Taxn. 3, sec. 2 (2013), Journal Articles & Opinion Pieces IBFD.

that either starts or ends in the respective taxable year. Similar to what is provided in the OECD Commentary, the employee's stay in Greece due to work in the home office shall follow a comprehensive approach, according to which all days would count.<sup>99</sup> The second condition of article 15(2)(b) is based on the remuneration of an employee not being taxed in the source state unless such remuneration is paid by or on behalf of an employer who is resident in the source state. The author would argue that due to lack of personnel working on the premises, the substance of the employer should not disqualify the employer from residence status. Neither was suggested during the pandemic period, nor does the author consider that they should be in the future. The above is predicated on the need to identify the relevant substance requirements in the case at hand and interpret them in a way that reflects the current economic model of work, so that remote work for an employer that lacks either a payroll or sufficient premises in Greece shall not by default classify the company as a tax avoider.

The third condition of article 15(2)(c) of the OECD Model, allocating powers of taxation to the source state insofar as the remuneration of the employee is borne by a PE of the employer in the source state, will probably become more relevant in the future to the extent that the home office of the employee in a source state qualifies as a PE of the employer. How the employee's remuneration would be borne by such a PE is, however, open to interpretation. Some indicators of how the expression "borne by" should be interpreted consist of whether, for example, the salary costs are charged on<sup>100</sup> and if in general, the PE as a whole is performing the employer's functions, which requires an evaluation under the arm's length principle.<sup>101</sup> It is difficult to imagine how a home office PE would exercise the employer's functions in order that employee remuneration is borne by that PE.<sup>102</sup> Nonetheless, the factors already taken into account for classifying a home office as a PE (i.e. the requirements of the home office to be "at the disposal" of the employer) may still be relevant in combination with whether the home office can be treated as a separate enterprise. Assuming also that

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99. Para. 5 and 6 *OECD Model: Commentary on Article 15* (2017).

100. *Id.*, at sec. 3.2.1.1.4.

101. Dziurdz, *supra* n. 98, at p. 126 highlighting that the mere deduction of the salary from the employer's expenses is not enough for that remuneration to be borne by the PE of the company in the source state.

102. This is because, the entire terms between employee and employer would need to be revisited in the future and therefore the attribution of income to home office PEs would have to be based on an updated definition of what shall now consist of employer's functions.

the arms' length principle is much challenged in the digital work world,<sup>103</sup> it is not out of the question that article 25(2)(c) of the OECD Model also be brought under a formulary apportionment method of allocation of the income that is attributed to the said PEs. If that is not to happen, a labour factor presence test and its corresponding apportioning of the salary costs may be approaches worth exploring.<sup>104</sup>

With regard to whether the special rule under article 15(3) of the OECD Model could provide an alternative interpretation of the rest of the provisions of article 15 of the OECD Model, in view of the challenges caused by remote working, the author would argue that a sourcing rule based on PoEM is no better than one based on the place of exercise of the activity.<sup>105</sup> In any event, Greece has reserved its right to apply the said rule differently, in view of the importance of shipping for its economy.<sup>106</sup>

From the above, it is obvious that article 15 of the OECD Model has to be re-examined both from the perspective of what are now considered to be employment income and employer,<sup>107</sup> as well as which nexus is appropriate for the taxation of employment income - also taking into account the relevant administrative difficulties source states face in enforcing taxes in the absence of the physical presence of non-residents.<sup>108</sup> As a start, reconsidering physical presence as a criterion for the employment to be exercised in one state would seem plausible.<sup>109</sup> Afterwards, insights could be drawn from other OECD provisions to the extent that they are relevant<sup>110</sup> and also from

103. See also R. Collier, A. Pirlot & J. Vella, *Tax Policy and the COVID-19 Crisis*, 48 Intertax 8&9, sec. 3.1.2, pp. 794-804 (2020).

104. S.V. Kostić, *A Plea for a Workforce Presence PE Concept in a Post-Covid Digitalized World*, 49 Intertax 10, sec. 6 (2021).

105. Likewise, Pistone, *supra* n. 76, at sec. 3.3.3.1., arguing that the criterion of the place of employment is actually reflected and deemed to coincide with that of the PoEM of the enterprise.

106. Para. 20 and 21 *OECD Model: Commentary on Article 15* (2017).

107. Similarly, S.V. Kostić, *In Search of the Digital Nomad – Rethinking the Taxation of Employment Income under Tax Treaties*, 11 World Tax J. 2 (2019), Journal Articles & Papers IBFD.

108. Compare OECD Policy Responses to Coronavirus (COVID-19), *Tax administration: Towards sustainable remote working in a post COVID-19 environment* (19 July 2021), available at <https://www.oecd.org/coronavirus/policy-responses/tax-administration-towards-sustainable-remote-working-in-a-post-covid-19-environment-fdc0844d/>.

109. Also, G. Beretta, "Work on the Move": *Rethinking Taxation of Labour Income under Tax Treaties*, 5 Intl. Tax Stud. 2 (2022), Journal Articles & Opinion Pieces IBFD.

110. For example, *OECD Model Commentary on Article 14*, which still exists in several tax treaties despite being abolished from the OECD Model, or *OECD Model: Commentary on Article 16*.

recent OECD initiatives for the taxation of the digital economy included in the Two Pillars.

### **13.6. Frontier workers**

Greece has not concluded special provisions with its treaty partners regarding the taxation of frontier workers, thus the general provisions of article 15 of the OECD Model would normally apply for cases similar to a frontier worker regime. It is however expected that despite the lack of specific tax rules on frontier workers, hybrid modes of work may well give rise to situations where workers who are tax residents in Greece can be employed by an employer tax resident in a neighbouring country. The latter might accept a Greek resident working from their home office in Greece for a few days per week and the remaining days on the premises of the company in the neighbouring country. To date, this practice has not been common, but such cases can be expected to increase in the near future.<sup>111</sup> Therefore, it would be interesting to see whether a new regime for frontier workers would make sense for Greece in order to maintain its taxing rights over the income of Greek tax resident employees under the described scenario. Although agreement could also be reached via a MAP, a tax treaty negotiation would be preferable.

However, it seems more likely that a potential new interpretation of article 15 of the OECD Model would make the frontier worker regime rather redundant, subject to very specific policy rules that some countries may wish to adopt in light of the economic relations that they have with their neighbouring countries. The author is of the opinion that since Greece has not yet seen any tax or geopolitical reason to introduce a frontier worker regime, it is more likely to embrace any adaptations of article 15 of the OECD Model that may potentially be made in the near future and that would cover such cases.

An interesting issue that has been dealt with in Circular 2113/2020 is how COVID 19-related subsidies for employment qualify for tax purposes and, more importantly, cross-border taxation of employment. The Greek IAPR adopted fully the position of the OECD Guidelines and stated that those payments would be assimilated into payments for the termination of the

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111. OECD, *Implications of Remote Working Adoption on Place Based Policies: A Focus on G7 Countries* (2021), available at <https://www.oecd.org/publications/implications-of-remote-working-adoption-on-place-based-policies-b12f6b85-en.htm>, on the increasing acceptability of hybrid modes of work.

employment.<sup>112</sup> Amongst the measures related to the COVID-19 stimulus package implemented in Greece were subsidies to companies whose operations were temporarily suspended by virtue of a state decision and who were allowed to suspend (partially or fully) personnel employment,<sup>113</sup> VAT reductions, debt payments postponements and interest loan grants.<sup>114</sup> With respect to the special allowances employees received during the COVID-19 period in Greece, no special distinction was made as to whether the beneficiaries were Greek tax residents either before or during COVID-19, nor what would happen if that residence status changed as a result of the ongoing teleworking developments. Circular 2113/2020 seems to imply that in any case of cross-border employment, tax treaty rules apply, and under this scenario, Greece will apply article 15 of the OECD Model, since no frontier-worker regime exists. As to the qualification of the employment subsidies, the author agrees with Moreno that this is a subtle issue and even risks those payments escaping tax treaty coverage.<sup>115</sup>

### **13.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)**

In all the above situations, where working from home challenged the status of tax residence for individuals and legal entities alike, the response of the Greek tax authorities was to apply both domestic and tax treaty rules on residence in a narrow manner, to the degree that no radical changes have been made to the existing tax treaty framework. Applicable as the legal basis for all cases were articles 4 to 6 of the ITC, which were interpreted in light of the relevant rules in the OECD Model (tax residence of individuals and legal entities and the PE rule). The decision to apply rules rather narrowly was based on the assumption that the COVID-19 crisis that gave rise to the change in work patterns would not last long. Moreover, provisions that deem an individual or a legal entity to be a tax resident in one country apply neither in cases of short-term residence, temporary situations, nor even in

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112. See paras 37-38 of Circular GR: E. 2113/2020 of the IAPR.

113. Within the above process, each employee was eligible for a special allowance of EUR 800, while the employer could pay an extra amount to the suspended employees up to their gross remuneration.

114. For an overview see EY, COVID-19: EY Greece Government Support Package. (5 May 2020), available at [https://assets.ey.com/content/dam/ey-sites/ey-com/en\\_gr/topics/tax/covid-19/ey-greece-government-support-package\\_05052020.pdf](https://assets.ey.com/content/dam/ey-sites/ey-com/en_gr/topics/tax/covid-19/ey-greece-government-support-package_05052020.pdf).

115. Báez Moreno, *supra* n. 31, at pp. 826-827.



cases where the de facto change in the tax residence status, compared to the past, was not a result of the taxpayer's willingness, but of governmental decisions. Therefore, tax residency changes were in response to force majeure owing to the health crisis.

As a consequence, the author would argue that the interpretation of the tax treaty rules on residence, as such, is not compatible with the actual object and purpose of the provisions, at least as regards all rules that could give rise to tax residence in one state. However, the tax policy rationale of not going the way of radical reform is justified if the situation does not continue. Of particular concern is the claim on force majeure and its relevance in the interpretation of tax treaties. The concept of force majeure is generally considered as a contractual law doctrine "which anticipates that there may be some sort of event beyond the control of the parties, which inhibits the parties' ability to perform the contract and which justifies modification of their respective obligations as a result".<sup>116</sup> On the other hand, neither is force majeure defined as such in the 1969 Vienna Convention on the Law of Treaties, nor does it exist in the OECD or UN Model as a relevant concept of the interpretation of tax treaties.<sup>117</sup> Nevertheless, it is acknowledged that the doctrine of force majeure forms part of international customary law in relation to the non-performance of international obligations.<sup>118</sup> Furthermore, it is codified in article 23 of the ILC articles on state responsibility, while in the domestic law of many countries, it is recognized as a general principle of law.<sup>119</sup>

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116. See P. Sutton, *COVID-19 and force majeure clauses in intercompany agreements* (19 Apr. 2020), available at <https://lcnllegal.com/covid-19-and-force-majeure-clauses-in-intercompany-agreements/>.

117. See also UN Report by the Secretariat, Committee of Experts on International Cooperation in Tax Matters, *Taxation and Coronavirus Disease (COVID-19): Pandemic and Post-Pandemic Issues*, E/C.18/2022/CRP.8, para 11, available at <https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2022-03/CRP.8%20Taxation%20and%20COVID%2019%20VFinal.pdf>, stating the need to clarify the implications of such a concept on tax treaties' rules implementation.

118. See *Autopista Concesionada de Venezuela, C.A. v. Bolivarian Republic of Venezuela*, ICSID Case no. ARB/00/5, para. 108, Award, 23 Sept. 2003: "[i]t is common ground between the parties that force majeure is a valid excuse for the non-performance of a contractual obligation in both Venezuelan and international law. It is further common ground that the following conditions must be fulfilled for a force majeure excuse: Impossibility, i.e., the force majeure event made performance impossible to achieve, Unforeseeability i.e., the force majeure event was not foreseeable..."

119. See Sutton, *supra* n. 116, at sec. A, arguing that "in many common law jurisdictions, the term 'force majeure' has no defined legal meaning, and the effect of these clauses is largely a matter of contractual interpretation. Other legal systems may have a separate body of law which applies to relieve parties of obligations on the occurrence of unforeseen events, even if no express contractual provision exists".



Tax treaties are public international law treaties, whose interpretation is governed by the general principles in article 31 of the VCLT, which are also considered to be a codification of customary international law, being binding on all nations.<sup>120</sup> It may thus be argued that force majeure could be a condition that falls under articles 31-34 of the VCLT and could prescribe a specific treaty interpretation, should the conditions that gave rise to its application arise, even if not explicitly mentioned therein.<sup>121</sup> Pursuant to article 31 of the VCLT, a treaty must be interpreted “in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose”. Notwithstanding, article 32 provides for additional rules of interpretation based on supplementary materials that are only to be resorted to in case the application of article 31 cannot provide sufficient results, or for confirmation of such results.

As argued, the drafters of the VCLT “intended to adopt a plain meaning approach because they thought this methodology reflected customary practice and would give nations less flexibility to pursue unilateralist interpretations”.<sup>122</sup> Therefore, the VCLT seems to depart from a purely contractual approach in international treaty interpretation and relies upon the parties’ intent only in marginal cases. However, particular intent may be taken into account if it is included in subsequent agreements or practices on behalf of the contracting states that reflect mutual intent and can offer an additional source of interpretation as the case may be.<sup>123</sup> These are, for example, MAPs that are concluded between the competent authorities of two states with regard to the interpretation of a tax treaty provision. Such MAPs should be considered in the same way as if included in the treaty itself.<sup>124</sup> In view of the above, it is correctly argued that “the contractual law principle of force majeure, together with the use of the term “government’s

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120. B.J. Arnold & M.J. McIntyre, *International Tax Primer* pp. 112-1132 (2nd ed., Kluwer Law International 2002).

121. Because the codification of customary international law in the VCLT is not exhaustive, in that it does not seek to codify all existing maxims, but rather to look for a balance among the main schools of international interpretation. See, respectively, M.L. Hallivis Pelayo, *Using the Vienna Convention of the Law of Treaties for Interpreting Tax Treaties*, sec. III, RDTI Atual, Special Edition (2016), available at <https://revista.ibdt.org.br/index.php/RDTIAtual/article/view/2110/1910>.

122. R.M. Kysar, *Interpreting Tax Treaties*, Iowa Law Review (15 May 2016), available at <https://ilr.law.uiowa.edu/print/volume-101-issue-4/interpreting-tax-treaties>.

123. See art. 31(3) VCLT where subsequent agreements between the parties and subsequent practice with respect to the interpretation of the treaty must be taken into account together with the context under art. 31(1) VCLT.

124. See B.J. Arnold, *An Introduction to Tax Treaties* para. 56 (United Nations 2020), available at <https://www.un.org/development/desa/financing/document/introduction-tax-treaties-brian-arnold>.

directives”, was an unnecessary element for tax treaty interpretation, and even a misleading assertion by the OECD”.<sup>125</sup> Therefore, if a government did not unilaterally make the same assumptions as those of the OECD in relation to force majeure, but had instead concluded MAPs with its treaty partners, such MAPs would be part of the context of the relevant tax treaty rules and more consistent with tax treaty interpretation rules. Yet, as far as is known, during the pandemic, Greece did not conclude any MAP with a treaty partner on issues relating to tax treaty rules on residence and taxation of employment income. This was to be expected by the very limited role of MAP practice in Greece, which recently introduced regulatory framework by virtue of secondary legislation.<sup>126</sup>

### **13.8. The future of the mobility of work: A need for adjusting the existing treaty rules?**

In so far as an update of certain tax treaty rules is necessary, in view of increasing mobility of work, see how remarks made in the previous sections regarding ways in which the respective tax treaty rules on residence and taxation of employment income are challenged and in which direction future tax discussions should go<sup>127</sup>. It is beyond doubt that any change on how taxation of work in a globally mobile environment should be approached must be coordinated.<sup>128</sup> However, given the very diverse legal concepts of employment in many tax jurisdictions, and the characterization of income resulting therefrom, this is a challenging task, especially for tax administrations.<sup>129</sup> The author would argue that since the future of work and forms of employment is very dynamic, a harmonized approach on the above

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125. A.A. Skaar, *Permanent Establishment Today: The Ongoing Erosion of a Principle* (15 July 2020), available at <https://www.wolterskluwer.com/en/expert-insights/permanent-establishment-today-the-ongoing-erosion-of-a-principle>.

126. Compare K. Perrou, *Making the Mutual Agreement Procedure More Effective in Greece: A Commentary on the Guidelines for the Conduct of MAPs*, 61 Eur. Taxn. 2/3 (2021), Journal Articles & Opinion Pieces IBFD and N. Kakali, L. Panetsos & E. Vitsa, *The Greek Council of State Rules on the Nature of Mutual Agreement Procedures and Their Relationship with the Judicial Proceedings before Domestic Courts*, 25 Intl. Transfer Pricing J. 5 (2018), Journal Articles & Opinion Pieces IBFD.

127. See secs 13.5, 13.6 and 13.8.

128. See also Niesten, *supra* n. 46, at sec. 6.2. onwards, discussing the importance of tax coordination from the social security law perspective as well as that which is immediately linked with taxed levied on income from employment or business income for independent workers.

129. Compare G. Lockwood & V. Nath, *The Monitoring of Tele-Homeworkers in the UK: Legal and Managerial Implications*, 63 International Journal of Law of Management 4, pp. 396-416 (2021).

concepts is probably the most appropriate solution, with regard to legal certainty and the need to guarantee states' taxing rights on such incomes. Currently, the phenomenon of mobile work has not preoccupied tax authorities from the perspective of the value creation process and how it affects current tax instruments, although part of this discussion is addressed under the tax challenges created overall by the digitalization of the economy. As pointed out in previous sections, compartmentalization of work, and employees being physically present in various places where the employer lacks the current substance requirements would either lead to non-taxation of such income anywhere or to multiple taxation in all the possible source countries involved. In the above cases, attribution of income under the current transfer pricing rules would be problematic. However, introducing a new method of income apportionment would have to be accompanied by a revision of the relevant nexus rules for the taxation of employment income. Under the above scenarios, the author could predict a reform that would be more in favour of a formulaic method of apportionment of income based on a physical presence test that would be facilitated by the use of new technologies.<sup>130</sup>

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130. See, in that respect, Beretta, *supra* n. 46, at sec. 6.



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## Chapter 14

### The Impact of Tax Treaties on International Mobility of Work in India

Shipra Padhi, Abhishek Padwalkar and Siddhesh Rao

#### 14.1. Mobility of work and domestic tax law

##### 14.1.1. Tax residence of individuals under Indian domestic law

In India, the criteria for determining tax residence are largely objective. The general rule is that a person is considered to be “resident in India” if they spend either (i) 182 days or more of the concerned financial year in India or (ii) 60 days of the concerned financial year and a total of 360 days or more of the preceding 4 financial years in India. Certain special rules apply for Indian citizens or persons of Indian origin (PIO) coming to India on a “visit”.<sup>1</sup> There is also a deemed resident concept under section 6(1A) of the Indian Income Tax Act (1961) (ITA) to capture “stateless persons”.<sup>2</sup> The intention behind (ii) appears to be to ensure that resident Indians otherwise subject to worldwide taxation in India are not out of the tax bracket on account of spending a short duration of time (up to 2 years) outside of India. Furthermore, in the case of an Indian citizen who leaves India in any previous year either (i) as a member of the crew of an Indian ship or (ii) for the purposes of employment outside India, such an individual is considered an Indian tax resident only if they had a presence in India of 182 days or more in the preceding year.<sup>3</sup>

Importantly, within the definition of “residence”, there are two relevant aspects: resident ordinarily resident (ROR) and resident not ordinarily resident (RNOR) in India. As an ROR, an individual is subject to worldwide taxation, whereas an RNOR is subject to taxation only on India-sourced income.<sup>4</sup> An ROR must either have (i) been resident in India for at least

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1. IN: The Income Tax Act, 1961, explanation 1(b) to sec. 6(1), Primary Sources IBFD [hereinafter ITA].

2. Sec. 6(1) ITA. It deems Indian citizens not liable to tax in another country as Indian tax residents, but they are given RNOR status.

3. Explanation 1(c) to sec. 6(1) ITA.

4. Sec. 5 ITA.

2 out of the preceding 10 tax years<sup>5</sup> or (ii) stayed in India for an aggregate period of 730 days or more in the preceding 7 tax years.<sup>6</sup> If these criteria are not fulfilled but the residence criterion is fulfilled, an individual is treated as an RNOR. The RNOR provisions appear to offer a transition period to foreigners coming to live in India, so that for at least 2 years they are taxed only on India-sourced income.

A possible reason behind this distinction is to provide a transitional period for foreign nationals coming to India for employment reasons, so that their worldwide income does not become taxable in India from day 1 onwards. The rules of residence are bright-line tests. In the authors' view, considering the current rules of residence in place, it is difficult for persons resident in India to give up their tax residence for 2 years (or more) for reasons other than (i) as a member of a ship or (ii) employment abroad. However, if it can be proved that an Indian citizen has left the country for the purpose of employment, and if in that year that citizen spends less than 182 days in India, such an individual should be considered a non-resident. Conversely, for foreign nationals coming to India, it is not easy to gain tax residence merely by spending a few months in the country.

Since the test of residence is based on a day-count test, it can be concluded that residence-based taxation for workers is triggered when significant time is spent in the country, as a country of residence. For determining the residence of individuals, it is not relevant whether the workplace of such individuals is inside or outside of the country. Therefore, the current residence rules in India are not especially burdensome for individuals opting for a globally mobile job – both in the case of foreign nationals coming into India and that of Indian nationals leaving India for the purpose of employment. However, in future, for the purposes of the relaxed residency rules, questions may arise as to what constitutes “employment”. For instance, the question of whether the work-from-home models, whereby the employee moves from India to a foreign country and continues to work there for an Indian company, constitute employment abroad. In such cases, the tiebreaker rule under tax treaties would take precedence in the case of a dual residence situation. Therefore, in the authors' view, the domestic criteria for residence are sufficiently robust, even when considering globally mobile individuals, as they rely on presence in India.

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5. In India tax year runs from 1 Apr. to 31 Mar.

6. Sec. 6(6) ITA.

### 14.1.2. Special rules for determining residency during COVID-19

Due to COVID-19 measures, a number of individuals were stranded in different parts of the world. On 8 May 2020, the Central Board of Direct Taxes (CBDT), which is the apex of the Indian tax administrative authority, released a circular to clarify the residency status of individuals<sup>7</sup> and provided limited relief to individuals on a visit to India before 22 March 2020. This has been summarised in table 14.1.

Table 14.1. Clarification of residency under section 6 of ITA

| Categories of individuals                                                                                                                                                                                                           | Relief granted                                                                                                                                                              |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Individual who was unable to leave India on or before 31 March 2020                                                                                                                                                                 | Period of stay in India from 22 March 2020 to 31 March 2020 will be excluded for determining the residential status                                                         |
| Individual who has either (i) been quarantined in India due to COVID-19 on or after 1 March 2020 and has departed on an evacuation flight on or before 31 March 2020, or (ii) been unable to leave India on or before 31 March 2020 | Period of stay in India from the beginning of quarantine to the date of departure or 31 March 2020, as the case may be, will be excluded for determining residential status |
| Individual departed on an evacuation flight on or before 31 March 2020                                                                                                                                                              | Period of stay in India from 22 March 2020 to date of departure will be excluded for determining residential status                                                         |

For the financial year 2019/20, CBDT provided limited relaxation to individuals who remained in India on account of the COVID-19 pandemic. However, such relaxation was not extended to financial year 2020/21.<sup>8</sup>

However, the relief provided was marginal and temporary. As COVID-19 cases began to spread rapidly, and the economy and social life remained at a standstill, the Indian government issued a press release<sup>9</sup> which ensured an extension of the relief provided in the circular of the 8 May 2020. However, the CBDT released another circular on 3 March 2021,<sup>10</sup> clarifying that the relaxation in the calculation of the number of days would not be extended to financial year 2020/21.

7. IN: CBDT Circular no. 11 of 8 May 2020.

8. IN: CBDT Circular no. 2 of 3 Mar. 2021.

9. IN: CBDT Press release of 9 May 2020.

10. IN: CBDT Circular No. 2 of 3 Mar. 2021.

If an individual was forced to stay in India due to the non-availability of outbound flights or due to strict lockdown rules, that individual could argue that the stay was involuntary, and the number of days during which they were not allowed to leave the country because of extraneous circumstances should be excluded. In *Suresh Nanda* (2015),<sup>11</sup> the Delhi High Court held that the number of days the authorities wrongly impounded the passport of the taxpayer, making it impossible for him to leave the country, should be excluded from calculating the period of residency under section 6 of the ITA. However, the court remarked that the case should not be treated as a precedent and was applicable only to those particular circumstances. Nonetheless, following a similar argument for situations arising during the COVID-19 pandemic, an individual could rely on the “impossibility of performance”, thereby treating the stay as involuntary. Given the exceptional circumstances caused by the pandemic, courts would be willing to consider the argument if the individual demonstrates that they had no option but to stay in India beyond the intended period. The burden of proof to prove that a person is a non-resident has to be discharged by that person, based on the material on record.<sup>12</sup>

### 14.1.3. Exit taxes in India for individuals

There are no exit taxes in India. However, India has deemed sourcing rules.<sup>13</sup> For instance, income arising to a non-resident “whether directly or indirectly” from “transfer of a capital asset situated in India” is income deemed to accrue or arise in India.<sup>14</sup> Shares of a company are regarded as being situated in India if the share register is situated in India.<sup>15</sup>

Consequently, the transfer of shares of an Indian company by a non-resident is taxed in India under the ITA.<sup>16</sup> Other capital assets, such as immovable property situated in India, are likewise covered under this section.<sup>17</sup> The source rule for shares is also extended to indirect transfers. The transfer of a share of a foreign company which derives its value substantially from assets located in India is also taxable in India.<sup>18</sup> Considering such laws, an exit tax

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11. IN: HC Del., 2015, *CIT vs. Shri Suresh Nanda*, 375 ITR 172.

12. IN: SC, 2015, *Choudhary vs. UOI*, 186 ITR 329.

13. Sec. 9 ITA

14. Sec. 9(1)(i) ITA.

15. IN: HC Bom., 2003, *Pfizer Corporation v. CIT*, 259 ITR 391.

16. The same is subject to treaty relief under sec. 90 ITA.

17. Sec. 9(1)(i) ITA.

18. Explanation 5 to sec. 9(1)(i) ITA.



is not required to trigger tax on alienation of capital assets of an individual, whether resident or non-resident.

#### 14.1.4. The tax residence of a corporation

In India, the residence of a corporation is regarded to be in India if (i) it is an Indian company or (ii) the place of effective management (PoEM) is situated in India.<sup>19</sup> The PoEM is defined as the place in which key management and commercial decisions for the conduct of the company are undertaken.<sup>20</sup> The PoEM analysis has to be carried out on a financial year basis. Furthermore, there is a *de minimus* exception for companies with a turnover or gross receipts of less than INR 500 million.<sup>21</sup> According to the CBDT, the PoEM rules are divided into two parts:<sup>22</sup> (i) active business outside India and (ii) passive business outside India.

A company is deemed to be engaged in active business outside India if it fulfils all three of the following conditions: (i) its passive income is less than 50% of its total income; (ii) its assets situated in India are less than 50% of its total assets; and (iii) the number of employees situated in India or resident in India is less than 50% of the overall number of employees or the payroll incurred on employees situated in India is less than 50% of total payroll expenditure. Thus, the active business (outside India) test is a cumulative set of rules and must be determined according to the average data of the current financial year and 2 years prior to that year. If a company does satisfy these criteria, it is presumed to be non-resident and thus does not have PoEM in India as long as the majority of the board meetings are held outside India. However, if it is established by the facts and circumstances that the powers of management are exercised by a person resident in India, then the PoEM is considered to be in India. Thus, India takes a “substance over form” approach in determining PoEM for companies with active business outside India. A scenario could occur in which the board of directors decides to visit India, becomes stranded due to an extended lockdown and thus holds the majority of their meetings in India. Since there is no relief provided by India in this context, in all probability, the PoEM would be constituted in India. Moreover, if the board of directors merely performs a ministerial act of approval, it remains to be seen whether the people exercising the decisions are indeed located in India.

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19. Sec. 6(3) ITA.

20. Explanation to sec. 6(3) ITA.

21. IN: CBDT Circular no. 8 of 23 Feb. 2017.

22. Id.

On the other hand, companies with passive business outside India would include all companies other than those companies with active business outside India. To determine the PoEM of such companies, a two-step process is adopted. First, the people taking key management and commercial decisions for the company need to be identified. Second, the place where management decisions are being taken needs to be determined. The place where the decisions are implemented is not crucial for determining the PoEM. Thus, for the PoEM to be in India, the board of directors or any persons taking key decisions should make those decisions in India. Importantly, India takes the view that in situations in which board or executive committee meetings are conducted through videoconferencing or teleconferencing, it is the usual place of residence of the executives or directors that should be considered as the place from which decisions are taken, and not the place where the directors or executives are conducting either teleconferences or videoconferences.<sup>23</sup>

If the involuntary stay of the directors or key managerial personnel does give rise to a PoEM of an offshore company in India, the resident company would be subject to other statutory requirements, such as maintenance of accounting books, withholding tax compliance, transfer pricing documentation and applicability of advance tax.

Under section 4 of the ITA, read with section 5, Indian resident companies are taxed on a worldwide basis.

#### **14.1.5. Legal consequences of a change in corporate residence**

When an Indian incorporated company has management or board of directors outside India, it does not change the tax residence of such company since the company continues to be an “Indian company” by virtue of incorporation. On the other hand, when a foreign company is effectively managed from India, it could result in the PoEM of said foreign company being in India, thereby resulting in Indian tax residence and, consequently, worldwide taxation for the company.

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23. Id.

#### 14.1.6. Exit taxes for corporations in India

Given the tax criteria for residence of the companies discussed in section 14.1.4., a situation of migration of an Indian resident company could only occur when a foreign incorporated company managed by Indian persons loses its residence by moving the PoEM of such entity to another country. In such a situation, there is no exit tax under Indian law. Furthermore, a change in the tax residence of a corporation does not generally result in a deemed alienation (or transfer) or consequent capital gains taxes. The reason for this is that, under section 45 of the ITA, in order to trigger a capital gains tax a transfer of a capital asset should be situated in India. Section 2(47) of the ITA provides that transfer includes sale, exchange, relinquishment exchange and extinguishment of interest in a capital asset. As such, a change in tax residence does not result in any “transfer” of a capital asset (i.e., in this case, shares) since the shares of the Indian company do not change hands.

However, in cases in which a migrated corporation holds capital assets situated in India, for instance shares of an Indian company, the alienation of such shares is taxable in India irrespective of the residence of the corporation, although a change of residence in itself is not a taxable event.<sup>24</sup> Such a situation is unlikely, as it is not common for companies to be structured in such a way that their PoEM is situated in India; therefore, the question of migration is not realistic. This is, of course, based on the fact that Indian tax residence is not determined solely on the basis of the PoEM but can also be triggered on account of incorporation in India.

#### 14.1.7. Substance requirements for tax residence in India

There are no substance requirements prescribed for claiming tax residence in India. An Indian incorporated company is regarded as a company resident in India for tax purposes.

#### 14.1.8. Tax consequences of employees working from home

Let us consider two situations:

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24. See sec. 14.1.4. The same consequences apply for all non-residents, i.e. individuals and corporations.

- an Indian-incorporated corporation with Indian resident employees working from home in India or abroad. Such a situation does not result in any change in the tax residence of the Indian resident corporation, as incorporation in India is a sufficient criterion to trigger tax residence in India. Under the Indian Companies Act (2013), a company incorporated in India is required to have a registered office to receive communications addressed to the company. Such an office is required to fall within the jurisdiction of a state-level registrar of companies and would, therefore, need to be located in India;<sup>25</sup> and
- a foreign-incorporated corporation with employees outside India but managed in India. To determine the residence of the corporation, the PoEM test should be considered. The location of the employees is not a relevant factor for this. Instead, the place in which the management takes decisions is relevant. Therefore, if employees (not including directors or key personnel) work from their homes abroad, and the corporation does not have sufficient workforce in India, there are no consequences for the residence of the company under Indian domestic law.

#### 14.1.9. Home office as permanent establishment

Depending on the circumstances, if a person works from home in India for a foreign corporation, that foreign corporation could have a business connection in India.<sup>26</sup> Under Indian law, income accruing or arising through or from any business connection in India is considered to be income “deemed to accrue or arise in India”.<sup>27</sup> The attribution rule provides that in case of a business (other than a digital business) for which not all operations are carried out in India only such part of the income as is reasonably attributable to the Indian operations shall be “deemed to accrue or arise in India”.

The term “business connection” is not defined in the ITA, and the wording has been chosen by the legislature to be of wide import.<sup>28</sup> In *R.D. Aggarwal & Co* (1965),<sup>29</sup> the Supreme Court prescribed that a business connection would presuppose an element of continuity between the business of the non-resident and the activity in India. There should be a “real and intimate” relation in India, through which income must accrue to the non-resident. Specifically, a “business connection” in India includes business activities

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25. IN: The Indian Companies Act, 2013, sec. 7, Primary Sources IBFD.

26. Under Indian law, a business connection is the equivalent of a PE.

27. Sec. 9(1)(i) ITA.

28. IN: All., 1946, *Hira Mills Ltd v. ITO*, 14 ITR 417.

29. IN: SC, 1965, *CIT v. R.D. Aggarwal & Co.*, 56 ITR 20.

carried out in India during which a person acts on behalf of a non-resident and habitually exercises, in India, an authority to conclude contracts on behalf of the non-resident. They may either habitually conclude contracts or play a principal role leading to the conclusion of contracts, and such contracts are (i) in the name of the non-resident, (ii) for the transfer of ownership or licensing or (iii) for the provision of services by the non-resident. Furthermore, a business connection is one through which an agent habitually maintains a stock of goods in India from which they regularly deliver such goods on behalf of a non-resident or through which they regularly secure orders in India mainly or wholly for the non-resident (or its related parties).<sup>30</sup>

In other words, where the non-resident has a dependent agent in India, a business connection is constituted. Moreover, the scope of a dependent agent business connection under Indian domestic law is wider than the scope of a dependent agent permanent establishment (DAPE) under the OECD Model Tax Convention on Income and on Capital (2017) (OECD Model). There is also an exception for independent agents.<sup>31</sup> Lastly, exceptions are provided for cases in which a non-resident engages in the purchase of goods or performance of certain activities, such as filming and the collection of news for agencies in India.<sup>32</sup>

In *Great Lakes Carbon Corporation (No.1)(1993)*,<sup>33</sup> employees of a non-resident company were seconded to India and, during this period, continued to be employed by the non-resident company. In India, these employees worked with the Indian subsidiary for the erection of a plant and related services. The Court held that such employees constituted a business connection of the non-resident in India. Given the wide import of “business connection”, the home office of an employee is likely to breach this test since an employee can be regarded as a dependent agent of a non-resident

30. Sec. 9 ITA.

31. Business activities carried on through a commission agent, broker or any agent with an independent status acting in the ordinary course of their business. However, this exception does not apply if control in terms of shareholding is determined vis-a-vis the independent agent.

32. Explanation 1 to sec. 9(1)(i) ITA. Exceptions include (i) operations confined to the purchase of goods in India for the purposes of export, (ii) the business of running news agencies or publishing papers in which the activities are confined to the collection of news and views in India for transmission out of India, and (iii) in the case of non-residents, non-citizen individuals, firms without a partner who is a citizen or resident of India or corporations without Indian shareholders, operations confined to shooting of cinematographic films in India. Certain other exceptions regarding the display of diamonds are also included.

33. IN: HCJ Cal., 1993, *Great Lakes Carbon Corporation (No.1) v CIT*, 202 ITR 64.

(employer) if (i) they conclude contracts or play a principal role in this, on behalf of their employer, or (ii) there is a continuous business activity of the non-resident carried out in India through the employee.

#### **14.1.10. The alignment of social security laws with tax residence**

The nexus rules under Indian tax law are different from those under employment laws. An “international worker”,<sup>34</sup> in the sense of an Indian employee going to work in a foreign country or an employee other than an Indian citizen working for Indian establishment, is subject to social security laws in India and required either to make payments to provident funds or to abide by compliance requirements.<sup>35</sup> However, an exception is applicable if such an international worker is contributing to a foreign social security programme as per a social security agreement.<sup>36</sup>

### **14.2. Residence, tiebreaker rules and mobility of work: Individuals and entities**

#### **14.2.1. Residence of individuals under a tax treaty**

According to article 4(1) of the tax treaties, in order to determine the residential status of an individual, one has to evaluate whether that person is a resident according to the domestic law. Determining whether a person is a resident under section 6 of the ITA is crucial for the purpose of article 4(1) of a given tax treaty. However, being a resident under domestic law does not automatically fulfil the residency criteria under article 4. An individual must be “liable to tax”, i.e. subject to comprehensive tax in the state. The Supreme Court in the case of *Azadi Bachao Andolan* (2003)<sup>37</sup> pointed out the difference between liable to tax and payment of tax. Liability to tax is a legal situation, whereas payment of tax is a fiscal act. Even if a particular item of income is exempted, the individual would still be considered to be liable to tax. The Finance Act (2021) clarifies this position. Thus, RNOR

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34. IN: Employees’ Provident Fund Scheme, 1952, Rule 83(ja).

35. V. Shroff & S. Saha, *India*, in *International Employment Lawyer: New Ways of Working* p. 3 (Nishith Desai Associates 2022), available at <https://www.nishithdesai.com/Content/document/pdf/Articles/New%20Ways%20of%20Working%20.pdf> (accessed 22 May 2022).

36. IN: Employees’ Provident Fund Scheme, 1952, Rule 83(f).

37. IN: SC, 2003, *UOI v. Azadi Bachao Andolan*, 263 ITR 706.

and deemed residents under section 6 of the ITA would not be residents under the tax treaties because they are taxed only with respect to income accrued in India. Specifically, the last sentence in article 4(1) of the OECD Model (and reflected in most Indian tax treaties) excludes a person liable to tax only in respect of income sourced in that state. Moreover, the concept of deemed residency considers citizenship the main criterion, which cannot be considered a sufficient territorial link to the state.

The two tests for residency mentioned in section 6 of the ITA require the physical presence of an individual in India in the course of a financial year. Once this objective criterion is fulfilled, the purpose of stay is immaterial. Even if a person were compelled to stay in India against their will, they would still satisfy the requirements under section 6 of the ITA, thereby qualifying as a resident even under article 4 of a given tax treaty.<sup>38</sup>

Lastly, if a person stranded in India is a director of a company and fulfils the residency criteria under the relevant tax treaty, the fees received by this person would be taxable in India.

#### 14.2.2. Applicability of the tiebreaker rule (individuals)

There could be scenarios in which a person fulfils the residency criteria under section 6 of the ITA as well as under the domestic law of the other contracting state, thereby triggering residency under article 4(1) in both states. In such cases, the tiebreaker rules under article 4(2) come to the rescue. In its circular of 3 March 2021 (2021 Circular), the Indian government argued that, even if an individual were to become a resident (given that relief was not extended), this would have no untoward effect, as the tiebreaker rules under the relevant treaty would come to the rescue. The tiebreaker rule is explained in the following paragraphs.

*Permanent home:* The first criteria provided by article 4(2) of the OECD Model is that of a permanent home. If an individual has dual residency under article 4(1), they are considered a resident of the state in which they have a permanent home available to them. A permanent home should be available to the individual at all times continuously and not just occasionally for the purpose of a short duration.

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38. See secs. 14.1.1. and 14.1.2. for the determination of residency under domestic law, and specifically the COVID-19-related relaxations in this respect.

*Centre of vital interest:* If an individual has a permanent home in both contracting states, they should be regarded as a resident only in the state in which their “personal and economic relations” are closer. The tax treaties entered into by India do not assist in determining “closer personal and economic relations”. It is a fact-driven exercise. Family and social relations, postal address, place of upbringing, active telephone connection, wishes for burial, etc. could all be considered personal relations, whereas the place of business and profession, income and property, contributions to the pension plan, etc. could be considered economic relations. However, when economic and personal relations are scattered across both contracting states, considerations based on “personal relations” are preferred.<sup>39</sup> Once it is decided that the centre of vital interest lies in a particular jurisdiction, the actual presence in that state is of secondary importance. Thus, if a person is forced to stay in a state against their will and has permanent residence in both contracting states, their centre of vital interest is the place to which they have deeper economic and personal ties.

*Habitual abode:* An individual is said to have habitual abode in the place where they would normally and customarily live. In the case of *M A Rafik* (1995),<sup>40</sup> the Authority for Advance Ruling (AAR) laid down certain criteria for determining the habitual abode of an individual: (i) the place where an individual has their house; (ii) the place where an individual is settled with their family; (iii) the place where they are schooling their children; (iv) the place where they are present year after year for several months; and (v) nationality.

The last criterion of the tiebreaker rule is that of nationality. Nationality also means citizenship.<sup>41</sup> Thus, if an individual is stranded and becomes a resident under section 6 of the ITA, the tiebreaker rules under the relevant tax treaty would extricate the individual from dual residency. However, this imposes an additional burden on the individual to prove that they fall under one of the tiebreaker rules, which in itself is a factual exercise. Moreover, in the absence of a tax treaty, the income of an individual may be doubly taxed.

Thus, if an individual becomes a resident due to an extended involuntary stay in India, the tiebreaker rules under a particular tax treaty would reasonably solve the issue of double residency. However, problems could arise in cases in which there is no tax treaty. It is important for tax authorities to

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39. IN: AAR, 1996, *Rajnikant R Bhatt v. CIT*, 222 ITR 562.

40. IN: AAR 1995, *M.A. Rafik vs. CIT*, 213 ITR 317.

41. Technical explanation to India’s tax treaty with the United States.



take the facts, circumstances and ground reality into consideration while deciding these cases.

### 14.2.3. Residence of corporations under a tax treaty

If a company is classified as a resident under the ITA, then it is considered a resident even for the purposes of a tax treaty. As seen in section 14.1.4., a PoEM is one of the two criteria for determining residency under domestic law. The criteria of PoEM would be applicable also to determine residency under article 4(1).<sup>42</sup>

With respect to article 8, many Indian tax treaties have PoEM criteria for determining the residency of shipping enterprises. However, if the enterprise does not carry on operations in international traffic in a particular year due to unavailability of crew, it would not fulfil one of the criteria mentioned under article 8 and thus not be liable to tax.

### 14.2.4. The applicability of article 4(3) of the pre-2017 OECD Model for companies

In the Indian treaty context, the determination of the residency of a company and the tiebreaker rule under a given treaty are both determined by way of the PoEM. In all likelihood, the determination of the residence of a company would be resolved under article 4(1) itself. However, the other contracting state might interpret the PoEM in a different way. For example, in South Africa, PoEM is considered to be the place where the company is managed on a regular basis by the senior employees and directors implementing major policy decisions and managerial functions. Thus, day-to-day decisions are crucial to determine the PoEM in South Africa. India's tax treaty with South Africa, however, provides for mutual agreement in case the issue is not resolved.

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42. The criteria for determining PoEM under Indian domestic law have been dealt with in detail in sec. 14.1.

### 14.3. Permanent establishments and mobility of work

#### 14.3.1. Home office as “fixed place permanent establishment” / “at the disposal”

Due to the COVID-19 pandemic, many companies allowed their employees to work from home. For some employees of foreign companies stranded in India, working from their homes in India was inevitable due to the extended lockdown and unavailability of regular flights. If an employee carries out the business of a foreign enterprise from their home office in India, fixed place PE issues could ensue. A fixed place PE needs to satisfy two requirements: (i) to be geographically fixed and (ii) at the disposal of the enterprise. The OECD Model mentions that an employee carrying on the business of their employer at their home office is not reason to automatically assume that the location is at the disposal of the enterprise. Cases in which the carrying on of business activities is intermittent or incidental should not give rise to a fixed place PE. On the other hand, if such activities are carried out on a continuous basis and the enterprise requires the employee to do so, PE issues could arise.<sup>43</sup>

To constitute a PE, the existence of a substantial element of an enduring or permanent nature is essential.<sup>44</sup> The Supreme Court, in *Formula One* (2017),<sup>45</sup> laid down three characteristics of a fixed place PE: stability, productivity and independence. It held that a place would be treated at the disposal of the enterprise if the enterprise had the right to use that place and had control over it. The Supreme Court also pointed out that the period for which the place is at the disposal of an enterprise is immaterial and control over the place is what matters. Thus, it is clear that the test of “permanence” would depend on the facts and circumstances of each case and the nature of the business carried on. The Authority for Advance Ruling<sup>46</sup> concluded that a presence of 66 days in a particular place would constitute a fixed place PE. However, given the exceptional nature of the COVID-19 pandemic, the work from home requirement is not necessarily imposed by the enterprise, nor is the home office at the disposal of the employer. The OECD COVID-19 guidance<sup>47</sup> also suggests that individuals teleworking from home, as a public

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43. OECD Model Tax Convention on Income and on Capital: Commentary on Article 5 para. 18 (23 Nov. 2017), Treaties & Models IBFD.

44. IN: AP, 1983, *CIT v. Vishakhapatnam Port Trust*, 144 ITR 146.

45. IN: SC, 2017, *Formula One World Championship Ltd. v. CIT*, 394 ITR 80.

46. IN: AAR, 2012, *Production Resource Group v. CIT*, 1330.

47. OECD, *Updated Guidance on Tax Treaties and the Impact of the COVID-19 Pandemic* (21 Jan. 2021).

health measure imposed or recommended by at least one of the governments of the jurisdictions involved to prevent the spread of the COVID-19, should not create a PE. Although India is not an OECD country, Indian courts have relied on the Commentaries on the OECD Model to interpret cases in the past. Nonetheless, if an employer requires an employee to work from home on a continuous basis, and that employee carries out core business activities that do not fall within the preparatory/auxiliary activities exception, there is a stronger argument to be made in favour of a PE. There could also be a scenario in which the foreign employer provides membership for the employee to work from a shared working space for a considerable amount of time, and the employee carries out activities from that place. In such a case, it can be said that the requirements of permanence and disposal are satisfied. In a similar vein, if the costs of internet, laptops and other amenities required for a workspace are provided by an employer to an employee, a case of “at its disposal” could be made. Reliance can also be drawn from the case law of common law countries, in which there have been instances of the living accommodation, and even hotel accommodation, of a travelling salesperson being considered a permanent establishment.<sup>48,49</sup>

#### 14.3.2. Home office or self-employment as a dependent agent permanent establishment

If a home office does not constitute a fixed place PE due to the non-satisfaction of one or both the criteria required to qualify as such, an employee can still trigger an agency PE in India. If an employee is instrumental in habitually concluding contracts or playing a principal role in concluding contracts solely on behalf of their employer, they may form an agency PE. As in the case of a fixed place PE, it is important for the formation of an agency PE that the activity be carried out on a continuous basis. Thus, if a few contracts are concluded while an employee is stranded in India, said employee would not form an agency PE. Even if the conclusion of contract is habitual during that employee’s limited stay in India, their employer can argue that the stay of the employee was owing to the public health measure imposed by the government. This view is supported by the OECD COVID-19 guidance. However, if the employee continues to negotiate and conclude contracts on behalf of their foreign employer even after the travel restrictions have been

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48. US: 1951, *American Wheelaborator & Equipment Corporation v. MNR*, 51 DTC 285.

49. UK: TCC, 1990, *Joseph Fowler v. MNR*, 90 DTC 1834.

lifted, this could constitute an agency PE, provided the other conditions mentioned therein are fulfilled.

Lastly, self-employment situations in which an individual acts as an independent consultant for a non-resident company should fall within the exception under article 5(6). In *Al Nisr Publishing* (1999),<sup>50</sup> the Authority for Advance Ruling relied on the non-exclusive nature of the Indian agency's activities to conclude that the Indian agent should not constitute an agency PE of the UAE firm. In another case,<sup>51</sup> it was concluded that, if a service provider provided a plethora of services to the same recipient, said service provider could not be treated as an independent agent. Accordingly, the same tests of determining independence could be used even in the case of self-employment situations during a pandemic.

#### 14.3.3. Service permanent establishment in the case of a home office

If a foreign company renders services in India through an employee in India, and that employee exceeds the threshold provided in a particular tax treaty, the company may constitute a service PE in India. In *E-Funds* (2015),<sup>52</sup> the Supreme Court held that if the services rendered by the foreign company in the source state (India) were not provided to clients in that state, there could be a service PE. Thus, it is necessary that services are rendered to clients situated in India. It is also important that such services are rendered to third parties and not to the employer company. The presence of an employee should be for the purpose of rendering such services in India. However, if an employee is stranded in India because of the COVID-19 pandemic and not allowed to leave, it can be argued that this employee is not required to stay in India to render those services, and that their stay in India is solely because of an inability to leave the country. Supposing the employee continues to render services during this involuntary stay in India, it can be argued that the employee intended to travel back but couldn't because of travel restrictions imposed by the government. However, the tax authorities have announced no measures in this regard. Furthermore, in cases in which an employee does not render services to clients (of their employer) in India, their presence should not constitute a service PE merely because they are working from their home in India.

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50. IN: AAR, 1999, *Al Nisr Publishing v. CIT*, 237 ITR 203.

51. IN: AAR, 2005, *Indian JV. Co., In re*, 274 ITR 501.

52. IN: SC, 2015, *ADIT v. E-Funds IT Solutions Inc.*, 6082.

#### 14.3.4. A construction permanent establishment and mobility of work

Under most Indian treaties, building site or construction, installation or assembly projects constitute PEs if they extend past the time threshold of 6 months. A construction PE commences from the date on which the contractor commences preparatory work. Although the duration of 6 months (or any other period according to the relevant tax treaty) should be taken into account for each separate project, India's tax treaties with the China, Denmark, Italy, the United States etc. provide that the time spent on unconnected sites or projects should be considered while determining the PE threshold. A PE ceases to exist when a given project is completed or permanently abandoned.<sup>53</sup> If, due to the COVID-19 pandemic, contractors decide to either abandon a project, the existing PE would cease to exist. If contractors do not fulfil the threshold of 6 months before abandoning a given project, no profits would be attributed to the Indian project, as no PE would have been constituted in the first place. The Commentary on Article 5 of the OECD Model mentions that seasonal and temporary interruptions should be taken into account while determining the period of a construction PE.<sup>54</sup> Even for the interruptions caused by the COVID-19 pandemic, the OECD guidance suggests that the number of days should be taken into account. As the name suggests, seasonal or temporary interruptions do not last long. Nonetheless, it is prudent to take them into consideration, as seasonal and temporary interruptions are a risk which comes with the nature of doing construction business. The uncertain nature of freedom of movement caused by the COVID-19 pandemic cannot be said to be seasonal or temporary. Even in the case that business operations and travel within India had recommenced, the home state of an enterprise might still have been under lockdown, making it difficult to run the construction site in India. The Delhi High Court, in the case of *National Petroleum* (2017),<sup>55</sup> observed that, in the ordinary course of activities, interruptions such as a weekly day off would undoubtedly be included in the duration of the PE. However, in cases in which an interruption exceeds substantial periods, representing cessation of the activities at the site, it would be difficult to accept that the building or project site continues to represent a fixed place of business of an enterprise. If COVID-19 leads to the cessation of activities at the construction site for an extended period, an argument could be made that such a period should not be considered for calculating the number of days. Whether an

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53. IN: HC Del., 2001, *BKI/HAM v.o.f. v. CIT*, 347 ITR 570.

54. Para. 55 *OECD Model: Commentary on Art. 5*.

55. IN: HC Del., 2017, *National Petroleum Construction Company v. DCIT*, ITA 143.

interruption is long or merely temporary would depend on the nature of the activity and the duration of the whole project. However, if the COVID-19 pandemic merely caused a slowdown of a project, this would not constitute an interruption for a long time as the project, though proceeding at a snail's pace, would still have been ongoing. There is no guidance issued by the Indian tax authorities with respect to a construction PE.

#### **14.4. Physical presence according to article 15(1) and (17) of the OECD Model**

##### **14.4.1. Taxation of salary income under article 15(1) of the OECD Model**

Regarding article 15(1), Indian tax treaties have wordings that are identical to that of the OECD Model. A few Indian tax treaties make some additional references to the articles concerning capital gains, artists and sportspersons, pensions, government service entertainers and athletes, professors, teachers and researchers, as well as students, trainees and apprentices.<sup>56</sup>

##### **14.4.2. Determination of “exercise of employment” under article 15(1) of the OECD Model**

Given that article 15(1) of India's tax treaties is generally identical to that of the OECD Model, the term “exercise of employment” is interpreted as per the Commentary on Article 15 of the OECD Model, i.e. the place where the employee is physically present when performing the employment activities. In a case involving India's tax treaty with France, the Indian tax tribunal concluded that remuneration for the period employees visited India for work related to a French employer is not taxable in India under article 15(1) of the treaty.<sup>57</sup> Furthermore, as explained in section 14.2.2., the CBDT has indirectly taken the position that employment is exercised at the location of the employee. However, CBDT circulars are not binding on the taxpayer and can be challenged before courts.<sup>58</sup>

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56. C.S. Mathur, M. Görl & K. Sonntag, *Principles of Model Tax Conventions and International Taxation* p. 683 (LexisNexis 2013).

57. IN: HC Mum., 1979, *Gallotti Raoul v. CIT*, 61 ITD 453.

58. IN: HC Kar., 1998, *East India Hotels Ltd. v. Shekhar Reddy*, 230 ITR 622.

#### 14.4.3. Impact of COVID-19 measures on article 15 of the OECD Model: Exercise of employment by “stranded” employees

The circular of 8 May 2020 does not provide for any specific relief regarding the determination of the exercise of employment by “stranded employees”.<sup>59</sup> However, the 2021 Circular states that, for the financial year 2020/21, the income from the exercise of employment by “stranded” employees would be dealt with after obtaining relevant information from these employees. Any stranded employee facing double taxation may furnish the information in Form NR, as prescribed in the 2021 Circular, making their case. In the case of a dual resident taxpayer, article 4(2) provides the tiebreaker for determining the residential status of the taxpayer.

Although there are no express relaxations, a taxpayer’s argument that the reason for the home office was due to the unavailability of flights and the subsistence of COVID-19 measures could be looked at favourably by the courts, even with respect to the calculation of the day-count test under article 15(2). However, if an employee continues to work from a home office, despite the relaxation of COVID-19-related travel measures, the source state (state of the exercise of employment) will have a right to tax, subject to the fulfilment of the conditions in article 15(2).

#### 14.4.4. The taxation of severance payment in the case of work-from-home employees

Under section 17(3) of the ITA, severance payment received by employees is taxed as “profit in lieu of salary”. No differentiation is made in the domestic law regarding the taxation of severance pay in the case of work-from-home employees and work-from-office employees. However, the same issue regarding “exercise of employment” would be relevant for the taxation of both salaries and severance pay and, in case of severance pay, the exercise of employment should be linked to the presence of the employee at the time of “past employment”. No specific treaty cases on the issue of severance pay have come before Indian courts.

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59. The circular of 8 May 2020 is discussed in detail in section 14.3.

#### 14.4.5. The taxation of artistes and athletes under article 17 of the OECD Model

##### 14.4.5.1. Generally

Modern Indian tax treaties contain the same article 17 as the UN Model Tax Convention. It grants taxation rights to the source state through an “open distributive clause”.<sup>60</sup> Older treaties contain deviating rules concerning activities of entertainers that are subsidized by public funds.<sup>61</sup> There is no significant Indian case law on the scope of article 17. However, while interpreting a domestic tax provision available to artists,<sup>62</sup> Indian courts have differentiated between the terms “artiste” and “artist”, stating that the term “artiste” refers to a professional entertainer, as opposed to an “artist” who is the creator of a work of art.<sup>63</sup> For instance, a fashion designer is an “artist”<sup>64</sup>, whereas a dancer is an “artiste”.<sup>65</sup>

Under domestic law, section 115BBA of the ITA provides for the taxation of income received for a performance in India by an entertainer who is neither a citizen nor resident of India. The term “entertainer” has not been defined and should, therefore, be given a wide meaning to cover income from “any activity which is for the purpose of entertainment”, i.e. all forms of entertainers such as magicians and other live performers.<sup>66</sup> Taking this view further, even online entertainers such as influencers could be covered within the meaning of “entertainer” if their activities can be regarded as entertainment. Similarly, the livestreaming of performances if such performances are performed in India could also be covered.

Accordingly, activities of influencers, such as comics, mimics, dancers and reel makers, could all potentially qualify as “entertainment” under section 115BBA of the ITA. Consequently, a similar interpretation could be taken by courts while interpreting the term “entertainer” under article 17 of the Indian tax treaties. However, the activities of an influencer such as a photographer (which could be interpreted as the activities of an artist) are

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60. C.S. Mathur, M. Görl & K. Sonntag, *Principles of Model Tax Conventions and International Taxation* p. 695 (LexisNexis 2013).

61. Id.

62. Sec. 80RR ITA.

63. IN: HC Mum., 2008, *Harsha Achyut Bhogle v. ITO*, 171 Taxman 108.

64. IN: HC Mum., 2010, *Commissioner of Income-tax v. Tarun R. Tahiliani*, 192 Taxman 231.

65. IN: HC Mum., 2008, *Harsha Achyut Bhogle v. ITO*, 171 Taxman 108, in which an “artist” was distinguished from an “artiste”.

66. S. Iyengar, *Law of Income taxes*, vol. 6, p. 9067 (Bharat Law House 2016).



not included within article 17. Such activities are likely to be taxed under the article on independent personal services (since most Indian tax treaties include this article) or as business profits.<sup>67</sup> Lastly, section 194E of the ITA provides for a withholding tax obligation on any resident or non-resident person who is responsible for payment to a non-resident entertainer.

#### 14.4.5.2. The taxation of artistes and athletes under article 17 of the OECD Model in the case of cancelled events or online events due to ongoing COVID-19

No special guidance has been provided under article 17 of the OECD Model with respect to the taxation of artistes and athletes in either the case of cancelled events or substitute online events taking place as COVID-19 and associated measures continue.

#### 14.4.6. The tax consequences of livestreaming performances

The livestreaming of performances is chargeable to tax as profits and gains from business and profession as per section 28 of the ITA. For individuals livestreaming performances, the income is chargeable as per applicable progressive tax rates. Under the ITA, withholding taxes could also apply to payments made towards the livestreaming of performances. The rate of withholding tax will depend on the nature of the service rendered or the type of transaction entered into. No special guidance has been provided with respect to the tax consequences of livestreaming performances under a given treaty.

#### 14.4.7. The taxation of influencers and the effect of COVID-19 measures on such taxation

Similarly to income derived from the livestreaming of performances, the income earned by influencers is chargeable to income tax as profits and gains from business and profession, as per section 28 of the ITA. For individual influencers, the income is chargeable as per the progressive tax rates applicable to individuals. Under the ITA, withholding taxes could also apply to payments made to influencers. The rate of withholding tax applicable

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67. While the article on independent personal services was deleted from *OECD Model* (2017), it continues to exist in the *UN Model* and has been followed in the most recently concluded tax treaties by India.

will depend on the nature of the service rendered or the type of transaction entered into. For instance, if the influencer falls within the term “entertainer”, taxation and withholding taxes would apply as per section 115BBA of the ITA read with section 194E. Owing to COVID-19 measures, the situs of the performance of influencers may have shifted to India on account of influencers being stranded in India, resulting in an Indian tax liability both under Indian law and article 17 of the relevant tax treaty. No special guidance has been provided with respect to the tax consequences of livestreaming performances under the Indian tax treaties.

From 1 July 2022 onwards, a new provision has been introduced under the ITA whereby perquisites or freebies received by influencers (that exceed approximately EUR 250 in value) would be subject to withholding tax at the rate of 10% in the hands of the person providing such benefit (subject to certain turnover related thresholds) for the exercise of influencer-related activities.<sup>68</sup> Such a withholding tax obligation should also apply to non-resident businesses that are serviced by Indian resident influencers, making it a burdensome compliance requirement for foreign businesses.

Pertinently, under Indian law, there may be withholding tax obligations that apply to even non-residents making payments to an Indian resident or non-residents making casual visits to India. As regards payments to residents, it is of course administratively easier for the tax officer to pursue the resident taxpayer. Nonetheless, in the case of non-withholding, the non-resident payer could be treated as an “assessee in default”. However, such liability is extinguished once correct taxes are paid by the primary taxpayer at the time of the filing of their tax returns and compliance with other conditions.<sup>69</sup>

## **14.5. Article 15(2) and (3) of the OECD Model**

### **14.5.1. The determination of the day-count test for home office**

Apart from the circular of 8 May 2020 discussed in section 14.1.2., the Indian government has provided no clarification on whether the days spent in a home office would be counted for determining tax residency. However, in respect of the day-count test, under article 15(2) of the OECD Model, the tax residency of an individual does not matter. Therefore, the only relevant

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68. Sec. 194R ITA, read with IN: CBDT Circular no. 12 of 2022.

69. Sec. 201 ITA.

criterion is the 183-day test which, as per a literal reading of article 15, should also cover home office days. Of course, wherever applicable, the relief provided in the circular of 8 May 2020 could be utilized, and the argument of “impossibility of performance” can be considered.

#### 14.5.2. The qualification of residence for the employer under article 15(2) of the OECD Model

##### 14.5.2.1. In the case of the loss of substance due to home office

Employees taking key management and commercial decisions from their home office may lead to the home office being deemed a PoEM for the companies employing them, depending on the facts and circumstances of the case. However, the lack of permanency of the activities of such employees, in addition to the home office not being at the disposal of the foreign company,<sup>70</sup> would make the argument for concluding the existence of a PoEM difficult. The Indian government has provided no guidance or clarification in such cases.

##### 14.5.2.2. In the case of the lack of PoEM in the residence state

The term “key management and commercial decisions”, as mentioned in the Indian PoEM rules, has not been defined. It depends on the facts and circumstances of each case and is subjective. Determination of a PoEM has been explained in detail in section 14.1. In the case of a lack of a PoEM in the residence state, article 15(2) of the OECD Model would not apply.

#### 14.5.3. A home office as a permanent establishment under article 15(2) of the OECD Model

A home office may lead to the creation of a fixed place PE, dependent agent PE or service PE under the Indian tax treaties. A fixed place PE may be constituted due to a foreign company’s business being carried out in the source country owing to employees or key management personnel working from their home offices. However, as explained in section 14.5.2.1., the lack

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70. S. Padhi, *COVID-19: Forced Residency and Unintended Tax Consequences in Times of a Lockdown*, Kluwer International Tax Blog (9 Apr. 2020), available at <http://kluwertaxblog.com/2020/04/09/covid-19-forced-residency-and-unintended-tax-consequences-in-times-of-a-lockdown/> (accessed 10 May 2022).

of permanency of activities of such employees, the lack of key management personnel and the home office not being at the disposal of the foreign company<sup>71</sup> would make the argument for concluding a fixed place PE difficult. In the case of *DIT (International Taxation) v. Morgan Stanley & Co* (2007),<sup>72</sup> the Supreme Court laid down the test for determining a PE in the case of deputed employees. The key principles of the test are the responsibility of the foreign company for the work performed by the employee, the presence of said employee on the payroll of the foreign company and the employee's control over their job with the foreign company. This decision may provide a criterion for determining a PE in the case of employees working from a home office in India and may lead to the creation of a PE for the financial year 2020/21. In addition, when such employees or key management personnel conclude or negotiate contracts on behalf of their employer, this may lead to the constitution of DAPE. However, the lack of habituality in concluding such contracts from the home office would make the argument for concluding a DAPE difficult.

There is also a risk of the home office being constituted as a service PE, especially in the case of India's tax treaties with Singapore, the United Kingdom and the United States. These treaties provide an objective threshold of 90 days for providing services that may not take into consideration the challenges raised by the COVID-19 pandemic.<sup>73</sup> The creation of a PE has been discussed in detail in section 14.3.

#### 14.5.4. The impact of COVID-19-related measures

Other than the circulars discussed earlier, the status quo remains, as the Indian government has not provided any changed guidance vis-à-vis conditions prevailing prior to COVID-19.

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71. Id.

72. IN: SC, 2007, *DIT (International Taxation) v. Morgan Stanley & Co.*, 292 ITR 116/182 Taxman 165.

73. S. Padhi, *COVID-19: Forced Residency and Unintended Tax Consequences in Times of a Lockdown*, Kluwer International Tax Blog (9 Apr. 2020), available at <http://kluwertaxblog.com/2020/04/09/covid-19-forced-residency-and-unintended-tax-consequences-in-times-of-a-lockdown/> (accessed 10 May 2022).

#### 14.5.5. Comments and suggestions to improve article 15 of the OECD Model

Similarly to article 5 of the OECD Model, which has been the topic of intense debate with regard to the digital economy, article 15 is not immune to changes happening in the way employees work. The way article 15 has been drafted in the OECD Model relies on the physical presence of individual employees and grants taxation right to the residence state as defined in article 15(1). COVID-19 has accelerated the adoption of digital technologies, and the way in which employees work has undergone radical changes. Many of employees started working from home, or from wherever they were located, with the help of the internet and other online digital tools. The way employees can work remotely without being physically present in the office makes the condition of physical presence for granting taxation right unsuitable for today's times.

Further, for the application of article 15 of the OECD Model, it is crucial to interpret the term “employment” and “employee”, neither of which have been defined in the OECD Model.<sup>74</sup> However, on various occasions, Indian courts have laid down criteria for determining the relationship of employment, namely control and supervision regarding the way work is done, payment of remuneration or wages for such work, and the power to select, suspend or dismiss an employee.<sup>75</sup> This relationship has been changing recently, with much flexibility and discretion left to employees to make their own decisions rather than being under the direct control and supervision of employers. Such a shift in responsibility also requires changes to the old article 15, in order to make it adaptable to the environment in which employees are working today.

### 14.6. Frontier workers

There are no specific rules for the taxation of frontier workers in the Indian tax treaties. This is because there are no agreements between India and its neighbouring countries allowing for cross-border movement of frontier workers in the first place.

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74. S.V. Kostić, *Rethinking Article 15 of the OECD Model in light of Digitalization*, Kluwer International Tax Blog (3 June 2019), available at <http://kluwertaxblog.com/2019/06/03/rethinking-article-15-of-the-oecd-model-in-light-of-digitalization/> (accessed 10 May 2022).

75. V. Dhariwal & P.M. Thakur, *Global Mobility: Taxation Aspects and Controversy*, Taxmann (Dec. 2014).

## **14.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)**

### **14.7.1. Unilateral measures by the Indian government with regard to tax residence and the application of tax treaties**

Under section 90 of the ITA, a taxpayer can elect to be taxed as per the provisions of the Indian law or the relevant tax treaty, whichever is more beneficial. Accordingly, the government can provide tax relief to taxpayers under Indian law. Under Indian law, the government can provide tax relief to relevant taxpayers who may so avail themselves of tax relief, despite the tax treaty not providing such relief.

However, it is not possible for India to *suo moto* change the provisions of a tax treaty, considering that it should be approved by both treaty partners. Nonetheless, India can introduce beneficial provisions under domestic law which will be applicable over the provisions of the tax treaty, if a taxpayer opts for this.

In India, the CBDT can issue orders to subordinate tax authorities for the proper administration of the tax legislation, and such orders are binding on the subordinate authorities.<sup>76</sup> The Supreme Court<sup>77</sup> has held that circulars issued by the CBDT which deviate from the tax legislation but which are beneficial to the taxpayer are binding on the tax authorities. Consequently, the taxpayer has the right to enforce such circulars and get relief regarding these before the court.<sup>78</sup>

To conclude, there is a sufficient legal basis for the issuance of directions or circulars by the tax department, even if such circulars deviate from the provisions of the tax legislation, and a taxpayer can rely on a given circular if that circular is beneficial to them.

In relation to the COVID-19 situation, an individual stranded in India due to the COVID-19 pandemic approached the Supreme Court to seek relief due to the non-relaxation of residency rules despite the pandemic. The Supreme

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76. Sec. 119 ITA.

77. IN: SC, 1965, *Navnit Lal C Javeri v. Sen (KK)*, AAC 56 ITR 913; and IN: SC, 1971, *Ellerman Lines Ltd. v CIT*, 82 ITR 913.

78. S. Iyengar, *Law of Income taxes*, vol. 6, p. 9577 (Bharat Law House 2016).

Court directed the CBDT to consider the case upon that individual making a representation to the CBDT.<sup>79</sup> Subsequently, the CBDT released the 2021 Circular, under which it clarified certain positions on tax treaties. If an individual faces double taxation despite applying for treaty relief, the 2021 Circular provides an opportunity to submit a completed special form (Form NR) containing all relevant information. Form NR requests details such as tax residence, citizenship, day-count in India, total income, arrival and departure date in and from India, and reasons for return (i.e. whether COVID-related or not).

#### 14.7.2. The Indian government's position on employment income under tax treaties

Regarding the article on employment income, the CBDT in the 2021 Circular took the example of India's tax treaty with the United States. In this respect, it reiterated the position under the treaty that the treaty distributes taxation rights between the country of residence (of the employee) and the source country (of exercise of employment). Regarding the COVID-19 situation, the 2021 Circular sets out that the situations in which India has taxing rights are only those in which the employee of a US corporation is stranded in India and (i) performs employment from India, (ii) stays in India for more than 183 days or (iii) has a salary borne by a PE of the US corporation in India. Therefore, through this example, the CBDT has indirectly taken the position that employment is exercised at the location of the employee.<sup>80</sup> The 2021 Circular also refers to the OECD position on the issue that tax treaties contain the necessary provisions to deal with the taxation of employment income in the case of dual residency arising due to COVID-19 situations.

#### 14.7.3. The Indian government's position on the constitution of permanent establishments

The issue of PEs has not been addressed specifically by the Indian government through circulars or instructions.

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79. IN: SC, 2021, *Gaurav Baid v. Union of India*, 136/2021.

80. As mentioned in sec. 14.4.2., CBDT circulars are not binding on taxpayers and can be challenged before the courts.

#### 14.7.4. Consultation agreements

No consultation agreements with other governments have been concluded by India.

#### 14.7.5. Force majeure in tax treaties

Contracts between private parties often contain a specific force majeure clause which leads to either the suspension or frustration of the contract in the case of a force majeure event. Section 32 of the Indian Contract Act (1872) provides that, if a contract is based on the happening of a future event and such event becomes impossible, the contract becomes void. Whether a pandemic would be covered by the force majeure clause in the contract would depend on how the clause is worded. Even in the absence of a specific force majeure clause, section 56 of the Indian Contract Act deals with the frustration of a contract and provides that a contract becomes void, *inter alia*, if it becomes impossible by reason of an event which a promisor could not prevent. Even if the event falls within the ambit of a force majeure, that would not automatically absolve a party from the performance of the contract unless there is a causal link between the non-performance and the force majeure event.<sup>81</sup> While no specific views are expressed by the Indian Government on the application of force majeure on tax treaties, a cross-border commercial contract could be considered a “contract”.<sup>82</sup> If contract law principles are applied, force majeure could also be contemplated within a tax treaty. Having said that, the better view is to regard a tax treaty as an international treaty covered by the Vienna Convention on the Law of Treaties (1969).<sup>83</sup> However, the VCLT contains a narrow impossibility of performance clause and no clear force majeure clause that could potentially cover pandemic-related situations.

As regards force majeure and the impossibility of performance of the taxpayer’s obligations or determination of taxes, the Supreme Court has applied the doctrine of impossibility of performance to hold that the withholder

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81. IN: HC Orissa, 1998, *Sri Ananda Chandra Behera v. Chairman Orissa State Electricity Board*, 85 CLT 79.

82. BL: HL, 1987, *Belgium Government v Postlethwaite et al.*, 2 All ER 985, as mentioned in J. Schwarz, *Schwarz on Tax Treaties* p 108 (6th ed., Wolters Kluwer 2021); and CA: FC, *The Estate of the Late John N. Gladden v. Her Majesty the Queen* (1985) 85 DTC 5188, as mentioned in N. Modi, *The Law and Practice of Tax Treaties: An Indian Perspective* p. 2 (2nd ed., CCH India 2018).

83. P. Hongler, *Justice in International Tax Law: A Normative Review of the International Tax Regime* p. 115 (IBFD 2019), Books IBFD.



cannot be expected to withhold taxes in the past in situations for which the explanation clarifying the charge of tax was introduced retrospectively and not “actually and factually in the statute”.<sup>84</sup> Furthermore, given the case of *Suresh Nanda*, courts may extend the reasoning of impossibility of performance or force majeure even to other tax treaty issues dealing with a home office PE, construction PE, residency, etc. To conclude, it is not uncommon for Indian courts to apply principles such as the impossibility of performance if the situation so demands, even in a tax treaty context. Nonetheless, its usage would depend upon the facts and circumstances of the case.

## **14.8. The future of the mobility of work: A need for adjusting the existing treaty rules?**

### **14.8.1. A change in tax treaty rules in India**

As regards changes in article 4 of the Indian tax treaties on the tax residency of companies, most Indian tax treaties provide for the PoEM rule as a tie-breaker in the case of dual-resident companies. India has not been keen on accepting mutual agreement procedures for the tiebreaker rule for most tax treaties, and it is unlikely that this position will change in future.

As regards changes to the tiebreaker rule for individuals under article 4(3) of the Indian tax treaties, due to growing concerns of determining residence according to concepts such as habitual abode, centre of vital interests etc., it may be useful to move to a day-count model under the tax treaties. For example, residence should be determined based on where an individual spends more than 182 days of a year. A day-count model is also consistent with Indian domestic law, and such harmonization could help to reduce subjectivity and provide tax certainty for the taxpayer.

Regarding article 15, the main concern is whether the exercise of employment by an employee in a source country would result in taxation in that source country, despite the employer being in the resident country. From an Indian perspective, a change in article 15 to make allocation of taxing rights in favour of the resident country is unhelpful and would lead to a loss of tax revenue. As a source country, India would look to protect its taxing rights and resist any such change in the current position. In any event, Indian labour laws are fairly restrictive when it comes to movement of an Indian

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84. IN: SC, 2021, *Engineering Analysis Centre of Excellence Private Limited v. CIT*, 432 ITR 471.

employee to a foreign country, as it requires compliance with Indian labour laws concerning health, safety, flexible work and other such issues.<sup>85</sup>

#### **14.8.2. Rethinking existing tax treaties in the current scenario of mobility of work**

Mobility of work takes the form of permanent immigration in countries in which skilled/unskilled labour is needed or a forced stay is necessary due to situations like the COVID-19 pandemic or other calamities. The uncertainty involved in determining tax residence and potential double taxation due to timing mismatches requires more guidance for interpreting tax treaty rules.

#### **14.8.3. Reasonable interpretation**

Generally, the strict rule of interpretation is used to interpret fiscal statutes. The courts are supposed to give clear and plain meaning to the words of a statute. If the strict interpretation gives rise to discriminatory or absurd interpretations, it is important to understand the intent of the legislature while interpreting a statute.<sup>86</sup> Moreover, the VCLT requires that a treaty should be interpreted in good faith. The Supreme Court, in the case of *J.H. Gotla* (1985),<sup>87</sup> held that, if the literal interpretation of a statutory provision produces a result that the legislature could have never intended, courts may depart from the literal interpretation and produce a rational construction. Thus, in the case of COVID-19, when people were restricted, the courts should apply the principles of good faith and intention of the legislature to determine issues such as residency and PE. However, this would need to be considered on a case-by-case basis in the absence of any clear guidance from the tax authorities. More importantly, in the absence of any COVID-19-related restrictions, a move to home office and remote work models requires that issues relating to the constitution of a PE, residency and the taxation of salary income be addressed. As a source country, India is likely to resist such changes that restrict the source country's taxation rights.

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85. V. Shroff & S. Saha, *India*, in *International Employment Lawyer: New Ways of Working* p. 3 (Nishith Desai Associates 2021), available at <https://www.nishithdesai.com/Content/document/pdf/Articles/New%20Ways%20of%20Working%20.pdf> (accessed 22 May 2022).

86. IN: SC, 1994, *C.W.S. (India) Ltd. v. CIT*, 118 CTR 118.

87. IN: SC, 1985, *CIT v. J. H. Gotla*, 156 ITR 323.

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## Chapter 15

### **The Impact of Tax Treaties on International Mobility of Work in Indonesia<sup>1</sup>**

Atika Ritmelina Marhani, Riyhan Juli Asyir and Yurike Yuki

#### **15.1. Mobility of work and domestic tax law**

##### **15.1.1. Individuals**

The criteria for determining the tax residency of an individual are further clarified by the issuance of the Minister of Finance (MoF) Regulation No. 18/PMK.03/2021 (PMK 18/2021) as the implementing regulations for the tax cluster of the Job Creation Law (also known as the Omnibus Law) that was issued on 2 November 2020.

Previously, an Indonesian citizen would continue to be a tax resident until the citizen passes away or leaves Indonesia permanently. One of the key changes in the Income Tax Law (ITL) is that an Indonesian citizen staying outside Indonesia (not physically present in Indonesia) for more than 183 days in a 12-month period (183-day rule) can now be treated as a non-tax resident if the citizen meets certain requirements.<sup>2</sup>

The tax residence test for an individual is a combination of an objective physical presence test and a subjective “intention to reside” test. Article 2 of the ITL defines a resident individual taxpayer as an individual who resides in Indonesia, is present in Indonesia for a total of more than 183 days in any 12-month period or resides in Indonesia with the intention of staying there.

An individual will be deemed to have the intention to reside in Indonesia if it can be substantiated by the following documents:<sup>3</sup>

- a permanent stay permit;
- a limited stay visa that is valid for more than 183 days;
- a limited stay permit that is valid for more than 183 days;

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1. The content within this chapter is based on information current as of 22 November 2022.

2. ID: *Peraturan Menteri Keuangan Republik Indonesia* [Minister of Finance Republik Indonesia Regulation] No. 18/PMK.03/2021, art. 3.

3. ID: *Peraturan Menteri Keuangan Republik Indonesia* [Minister of Finance Republik Indonesia Regulation] No. 18/PMK.03/2021, art. 2 para. 4.

- a contract or agreement to perform work, business or activities in Indonesia for more than 183 days; or
- other documents that show the intent to reside in Indonesia, such as a rental agreement of more than 183 days or a document indicating the relocation of family members to Indonesia.

Considering this, travel restrictions due to COVID-19 that may lead an individual staying longer than planned (i.e. more than 183 days) could have a detrimental impact on their residence status under the Indonesian tax residence test. However, until now, the government has not provided further clarifications on the impact of the COVID-19 pandemic on a number of matters including the Indonesian tax resident status in situations that may be considered “exceptional circumstances”.

Under MoF Regulation No. 35/PMK.03/2019 (PMK-35/2019), a non-tax resident company may be treated as having a taxable presence if it runs a business or conducts activities in Indonesia through a fixed place of business that is permanent in nature, which can be in the form of:

- a place of management;
- a branch of the company;
- a representative office;
- an office building;
- a factory;
- a workshop;
- a warehouse;
- a room for promotion and selling;
- a mine for extraction of natural resources;
- a mining working area for oil and natural gas;
- a fishery, animal husbandry, agriculture, plantation or forestry location;
- or
- computers, electronic agents or automated equipment owned, leased or used by an electronic transactions provider to conduct business via the Internet.

Furthermore, PMK-35/2019 also states that foreign tax persons may be deemed to have a permanent establishment (PE) in Indonesia, even though they do not have a fixed place of business in Indonesia, if they carry out business or activity in Indonesia through one or more of the following:

- construction, installation or assembly projects in Indonesia;
- the furnishing of services in whatever form by employees or other personnel as long as the services are conducted for more than 60 days within a 12-month period;

- a person or entity acting as a dependent agent; or
- an agent or employee of an insurance company that is not established or domiciled in Indonesia that collects premiums or insures risks in Indonesia.

Consistent with the concept under the OECD and UN Commentaries, domestic regulations on PEs also acknowledge that, under the operation of a tax treaty, a business form that is used by a foreign corporation to carry out only “preparatory or auxiliary” activity in Indonesia will not create a PE. However, in the event that a person performs essential and significant activities for any of the activities mentioned in the preceding list for a foreign corporation and this person works from their home in Indonesia, then this activity may trigger a PE.

### 15.1.2. Entities

Pursuant to article 2 of the ITL, any organization having its establishment in Indonesia, excluding certain government agencies fulfilling specific criteria, is considered to be a tax resident. Pursuant to article 15 of Directorate General of Taxation Regulation No. PER-43/PJ/2011 (PER-43/PJ/2011) of 28 December 2011, a corporate tax resident will be deemed to have its establishment in Indonesia if:

- it is stated in the articles of incorporation that its domicile is in Indonesia;
- its head office, central administration or central financial office is in Indonesia;
- it has a controlling office in Indonesia that undertakes management activities;
- its board meetings in which strategic decisions are made are held in Indonesia; or
- its management board members reside or are domiciled in Indonesia.

If the management board members of a corporation live and work in different countries, then this would not have any legal consequences on the residence status of the corporation as long as it still fulfils other criteria stipulated in article 15 of PER-43/PJ/2011. In other words, it is unlikely that a corporation would lose its residence status in Indonesia even if the management board members of the corporation live and work in another country but its head office or its establishment or registration remains under Indonesian law. Indonesia does not recognize an exit tax in its income tax law. In the event of a tax resident of Indonesia moving out to another country, they have

an obligation to annul their tax identification number, which automatically triggers a tax audit.

### 15.1.3. Social security system

The national social security system that applies in Indonesia is mandatory for every employee or worker who works in Indonesia (except for foreign national who works in Indonesia less than 6 months), and it is divided into two types, namely, BPJS Healthcare (*Kesehatan*) for health insurance and BPJS Employment (*Ketenagakerjaan*) for employment benefits (i.e. workers' accident compensation, old age compensation and pension and death compensation). The contribution to both social security bodies are borne by the employer and employee with portions as stipulated in the relevant regulations. Based on those facts, the social security system in Indonesia is quite aligned with the tax residence nexus according to the income tax law because the conditions to join the social security program are not merely based on citizenship and job status but also on the time test that is also used in determining the tax residency status.

## 15.2. Residence, tiebreaker rules and mobility of work: Individuals and entities

The tiebreaker rules for determining an Indonesian citizen as a foreign tax resident are mentioned in article 3(1)(c) of PMK 18/2021. The first requirement for an Indonesian citizen to be regarded as a non-tax resident is to be residing permanently in a place outside Indonesia that is not temporary (permanent home).

The second requirement is that Indonesian citizens have a place of main or personal activity or economic or social ties abroad (centre of vital interest). Personal attachment can be proven by the presence of the main family residing outside of Indonesia. Economic engagement outside of Indonesia is evidenced by the existence of sources of income from abroad while social engagement is evidenced by membership in recognized religious, educational, social, gym, club or social organizations in the local state government.

The third requirement is that Indonesian citizens undergo daily habits or activities outside of Indonesia (habitual abode). As for Indonesian citizens who wish to become a non-tax resident, they do not need to fulfil all of the

first, second and third requirements in article 3(1)(c) as the requirements are to be fulfilled in stages.

In article 3(2)(a) of PMK 18/2021, it is emphasized that the first requirement, namely, permanent residence outside of Indonesia, is a requirement that must be fulfilled by Indonesian citizens to become a non-tax resident.

If the Indonesian citizen has been outside Indonesia for more than 183 days in 12 months (permanent home), the second and third requirements regarding the main activity centre (centre of vital interest) and place to carry out daily activities (habitual abode) do not need to be fulfilled by the Indonesian citizen as long as the Indonesian citizen is no longer residing in Indonesia.

If it turns out that the Indonesian citizen resides permanently outside Indonesia and also resides in Indonesia, the second requirement regarding the main activity centre (centre of vital interest) must be fulfilled by the Indonesian citizen to become a non-tax resident.

If the first and second conditions are met, then the third requirement regarding places for Indonesian citizens to carry out their daily activities (habitual abode) does not need to be fulfilled.

Furthermore, if an Indonesian citizen resides and has a main activity centre outside Indonesia but also meets the requirements for residence and has a main activity centre in Indonesia, the third requirement regarding a place to practice habits (habitual abode) must be met by the Indonesian citizen before becoming a non-tax resident.

Indonesian tax treaty networks generally follow the concepts of the OECD Model, including article 4(2). According to article 4(2) of the OECD Model, the criteria to resolve a dual-resident issue with the “tiebreaker rule” are as follows:

Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows:

- a) he shall be deemed to be a resident only of the State in which he *has a permanent home* available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his *personal and economic relations* are closer (centre of vital interests);

- b) if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has an *habitual abode*;
- c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a *national*;
- d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by *mutual agreement*. [Emphasis added]

### 15.2.1. Individuals

The COVID-19 travel limits are unlikely to affect the treaty residence status, notably whether a person would gain residence status in the jurisdiction where they temporarily reside due to extraordinary circumstances.<sup>4</sup> Domestic legislation, on the other hand, has provisions that may constitute a foreign person as a resident for tax purposes after spending a particular number of days in a jurisdiction. However, even if the person becomes a resident under such legislation, if there is a tax treaty in effect, the person is unlikely to be a resident of that jurisdiction under the tiebreaker rule of the treaty. In the vast majority of circumstances, such a minor disruption should have no tax effects.

The tiebreaker rule in the applicable treaty is unlikely to change if an individual's temporary presence in a jurisdiction results in them becoming a dual resident as a result of the COVID-19 pandemic given that the tiebreaker rule requires consideration of the factors that shall also be assessed in a "normal" situation. If one of the governments involved in the tax treaty prohibits a person from returning home because of public health measures, this should not affect a person's residence status for purposes of the tax treaty.

This is consistent with what is happening in Indonesia, namely that even though there are exceptional conditions, one of which is the impact of the COVID-19 phenomenon, it does not necessarily affect domestic regulations governing the tax residency status of individuals. In other words, if a person is stuck in Indonesia for more than 183 days due to a travel limitation, the

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4. OECD, *Updated Guidance on Tax Treaties and the Impact of the COVID-19 Pandemic* (21 Jan. 2021), available at <https://www.oecd.org/coronavirus/policy-responses/updated-guidance-on-tax-treaties-and-the-impact-of-the-covid-19-pandemic-df42be07/#section-d1e808> (accessed 22 May 2022).



individual is found to be an individual tax resident in Indonesia according to the Indonesian domestic requirements in article 2(4) of PMK 18/2021.

Moreover, expatriates working in Indonesia must obtain a valid work permit and stay permit. On 15 May 2018, the Directorate General of Taxation (DGT) and the Directorate General of Immigration (DGI) signed a cooperation agreement that provides for the exchange of information, joint intelligence activities, collaboration with law enforcement and training in tax and immigration processes. The agreement states that the DGT will provide the DGI with a taxpayer's identity data, and the DGI will provide the DGT with information regarding passports, transit and visa details and stay permits.

### 15.2.2. Entities

Similarly, COVID-19 travel limits are unlikely to trigger an issue of dual residence (in cases where the change in the place of effective management results in a company being considered a resident of two contracting states simultaneously under their domestic laws). However, even in cases when an entity has dual residence, tax treaties include a tiebreaker rule to ensure that the entity is only resident in one of the contracting states. All relevant circumstances during the pandemic and prior to the pandemic must be taken into consideration when deciding the residence status of the corporation.

Paragraph 24.1 of the Commentary on Article 4 of the OECD Model illustrates the range of factors that the competent authorities are expected to consider in making their determination, including: where the company's board of directors or equivalent body usually meets; where the CEO and other senior executives usually carry out their activities; where the senior day-to-day management of the company is carried out; and where the company's principal place of business is.

Paragraph 149 of the Commentary on Article 29 of the OECD Model explains that the concept of the "place of effective management" was interpreted by some jurisdictions as the place where the most senior person or group of persons (such as a board of directors) made key management and commercial decisions for the company's business. Since the determination of residence status requires a thorough consideration of all of the relevant facts and circumstances, it is unlikely that board members exercising their activities in a state different from the residence state of the corporation will trigger the issue of dual residence.

The articles in the tax treaty in Indonesia still refer to the 2017 versions of the OECD and UN Models. As a result, provisions relating to the definition of “entity” or tiebreaker rules in relation to an “entity” continue to employ the old concept, namely, the “place of effective management”. During the COVID-19 pandemic, Indonesia has not had any specific guidelines for the implementation of tax treaties. However, the DGT issued Circular Letter No. SE-52/PJ/2021 in 2021 concerning general instructions for the interpretation and application of provisions in tax treaties.

According to the circular letter, a person is considered an Indonesian tax resident if, under Indonesian law, that person can be taxed based on domicile, residence, place of establishment, place of management or other similar criteria. In a case where an entity has dual residence, the residency status of the entity is determined by where the place of effective management is located. The domicile of effective management refers to the location where significant management and commercial decisions are made or the location where management makes key decisions. Therefore, the interpretation of fiscal domicile and tiebreaker rules in Indonesia still follows the interpretation of tax treaties in general, and there is no specific guidance relating to the COVID-19 pandemic.

### **15.3. Permanent establishments and mobility of work**

#### **15.3.1. Dependent agent**

Under PMK-35/2019, generally, a person or an entity acting as a dependent agent constitutes a PE if the person or entity is acting for and on behalf of a foreign corporation. The dependent agent is acting for and on behalf of the foreign corporation if it receives instructions for the benefit of the foreign corporation in conducting its business or activities or it does not bear the risk of its business or activities.

Solely receiving instructions from a foreign individual or corporation does not automatically trigger a PE. The dependent agent is also not considered a PE if they only carry out preparatory or auxiliary activities. There is an exception when a business or activity in Indonesia is conducted using an independent agent, broker or intermediary as long as the agent, broker or intermediary is acting in the ordinary course of their business. However, it should be noted that the phrases “authority to conclude contracts” and “maintenance of stock of goods” are not addressed in PMK-35/2019;

accordingly, it is not clear whether PMK-35/2019 broadens the scope of a dependent agent PE.

Under most tax treaties concluded by Indonesia, when a person other than an agent of independent status is acting on behalf of an enterprise and habitually concludes contracts in the name of the enterprise, that enterprise will be deemed to have a PE in that state in respect of any activities that that person undertakes for the enterprise.<sup>5</sup>

### 15.3.2. Services permanent establishment

PMK-35/2019 expands the definition of a services PE that is generally defined as the furnishing of services in whatever form by employees or other personnel for more than 60 days within a 12-month period. Under the regulation, this can apply if:

- the employee is employed by a non-tax resident or is a subcontractor of a non-tax resident;
- the furnishing of the service is performed in Indonesia; and
- the service is rendered to parties within or outside of Indonesia.

There might be a different time frame and covered period of performance of the service's start until its completion in the tax treaty. To conduct a time test based on a tax treaty in a case in which the time period is calculated based on the number of days, a part of a day is calculated as one full day. In a case in which the time period is calculated based on the number of months, a part of a calendar month is calculated as one full month.<sup>6</sup>

### 15.3.3. Digital nomads and remote workers

A digital nomad is a worker with no fixed address who earns money online while travelling, and Indonesia is a popular destination for them. A digital nomad can be categorized as a tax resident as long as they fulfil one of these conditions under article 2 of the ITL: (i) they reside in Indonesia; (ii) they spend time in Indonesia for more than 183 days in a 12-month period; or (iii) within a tax year, they live in Indonesia and intend to reside in Indonesia.

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5. P. Partogi, *Indonesia - Permanent Establishments*, Country Tax Guides IBFD (accessed 30 Apr. 2022).

6. Id.

In imposing tax on income received by a tax resident by crossing the country/tax jurisdiction (international tax aspect), it is important to note that the provisions of the tax treaty as a *lex specialis* of the provisions of the domestic legislation. As an example, the Indonesia-United States tax treaty provides that a person can be designated as a tax resident as long as the person is domiciled in the country concerned by taking into account: (i) ownership of a permanent residence (permanent dwelling place); (ii) a place to carry out daily activities, including personal interest and economic activities (ordinary course of life); and (iii) a place to carry out their habits/hobbies (place of habitual abode). According to this treaty, a digital nomad can be categorized as an Indonesian tax resident as long as the person concerned has a place of residence and/or lives in Indonesia.

Digital nomads working in a flex office are unlikely to trigger a PE because, under the domestic legislation, the provision that the “place of business” is used to run a business or conduct activities will not be met in the event that the foreign individual or foreign entity has limited access to operate such a place of business.<sup>7</sup> Besides a digital nomad, someone who works flexibly in a conventional office is also known as a “remote worker”.

A remote worker is a worker with an ability to work outside of a traditional office.<sup>8</sup> With regard to the determination of an Indonesian tax resident, the applicable remote worker provisions are no different from those for a digital nomad. Therefore, remote workers could meet the criteria as Indonesian tax resident. However, there is a significant difference related to the determination of a PE between a digital nomad and a remote worker that primarily concerns flexible working time and the place of work.

The conclusion on whether there is a PE in Indonesia for the activities of a remote worker is based on the criteria for establishing a PE as stipulated in articles 4(1) and 5 of PMK-35/2019. There are three criteria that must be met, namely, the place of business must be in Indonesia, the place of business must be permanent and the place of business must be used to run a business or carry out activities in Indonesia.

First, a place of business includes any type of place, space or installation, including machinery or equipment, that is used to conduct business or

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7. ID: *Peraturan Menteri Keuangan Republik Indonesia* [Minister of Finance Republik Indonesia Regulation] No. 35/PMK.03/2019 art. 5, para. 5.

8. M. Hansmitt, *Location Independent vs. Remote Worker vs. Digital Nomad?*, Republic of Estonia E-Residency (4 Feb. 2022), available at <https://www.e-resident.gov.ee/blog/posts/location-independent-vs-remote-worker-vs-digital-nomad> (accessed 5 Oct. 2022).

carry out activities. The existence of the fixed place of business is determined without regard to whether the place is owned or rented by the non-tax resident or whether the non-tax resident have legal rights to the place. Therefore, any place used by a remote worker to work can be said to meet the criteria for having a place of business in Indonesia.

Second, the place of business is permanent as long as it is used continuously and located in a certain geographic location. Third, the place of business should be available to be used in a way that gives the non-tax resident unlimited access to conduct business or perform activities. The second and third criteria are the decisive factors for determining whether a remote worker will constitute a PE. Thus, generally, it is possible for a remote worker to constitute a PE in Indonesia with regard to the location-independence level of the remote worker, namely: (i) whether they can continuously work at a place of business located in a geographical location and (ii) whether they have unlimited access to perform activities at the place of business.

For example, if a person works from a coworking space in Indonesia where they pay daily to rent a desk in such a coworking space and there is no specific commitment, then this condition will not constitute a PE in Indonesia. However, if a person works from a coworking space and they pay monthly or annual rent for a desk in such a coworking space, it can be said that they can continuously be in a place in a geographical location and have unlimited access to the use of that place for work so that the conditions in question can form a PE in Indonesia. It should be noted that these two examples are not the only ones that can be used as a benchmark in determining whether a remote worker can be categorized as a PE member for their company in Indonesia. Determining the PE status for the company must be analysed carefully on a case-by-case basis in accordance with the facts and circumstances when analysing the provisions of articles 4 and 5 of PMK-35/2019.

## **15.4. Physical presence according to articles 15(1) and 17 of the OECD Model**

### **15.4.1. Income from employment under article 15(1) of the OECD Model**

A common situation in some jurisdictions is that the worker can choose the location of their home office, which is where they will conduct their activities, whether it is their own home, their parents' home or the home of

a relative. The purpose of the home office is to replace the location where employees would normally perform their duties, which is the employer's office. Thus, work done from home is treated the same as work done directly at the workplace. Furthermore, the activity is always carried out in the state where the home office is located.

This situation is not commonly implemented in Indonesia. The new working from home arrangement has been implemented in Indonesia as a whole for all companies as a result of the COVID-19 prevention measures. However, there are no further regulations issued by the government regarding the "home office" either in general or specifically for taxation purposes in Indonesia.

The principal premise for taxing employment income under the Indonesian tax law regarding this home working arrangement is the principle of resident status, which is identical to article 15(1) of the OECD Model, where this rule allocates taxing rights on income from employment exclusively to the employee's residence state.<sup>9</sup> The determination of tax residency status in Indonesia is detailed in section 15.1., where physical presence is one of the primary determining factors for tax residence in Indonesia. Therefore, determining the employee's residence state is crucial in Indonesian income tax law and when applying article 15 of the OECD Model.

Consider the practical example of an Indonesian tax resident (Mr Candra) who is an employee working in Indonesia. Thus, Indonesia as a domicile country has exclusive taxation rights on such income unless the work is carried out by Mr Candra in a third country; then the income can be taxed in that other country.<sup>10</sup>

Based on this example, it can be stated that income from employment can only be taxed in the country of the tax treaty where the employee becomes an Indonesian tax resident (country of domicile) unless the work is carried out in the other country of the tax treaty (source country). The work is deemed to be carried out at the place where the employee concerned is physically present while carrying out the work for which the income is paid. The country of domicile has the exclusive right to taxation of income from employment if:

- the employee is a tax resident of the country of domicile; and
- the employee performs their work in the country of domicile.

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9. G. Beretta, *Work on the Move: Rethinking Taxation of Labour Income under Tax Treaties*, 5 Intl. Tax Stud. 2, p. 10 (2022), Journal Articles & Opinion Pieces IBFD.

10. ID: *Surat Edaran* [Circular Letter] No. SE-52/PJ/2021.

Nonetheless, the Indonesian income tax law's connecting factor for taxing employment income is broader than article 15 of the OECD Model because, in determining subjective connecting factors, Indonesia not only determines residency status based on the 183-day test but also considers other subjective connecting factors, namely, (i) dwelling place; and (ii) intent to reside in Indonesia (article 2 of the ITL).

#### 15.4.1.1. Severance payment

A severance payment can be interpreted as having two purposes, namely, (i) remuneration for layoffs; or (ii) remuneration for retired older people.<sup>11</sup> If a severance payment is paid to an employee for past employment due to being laid off, the applicable provisions under the OECD Model are articles 15, 16 (for former directors), 19 and 21. However, if the severance payment is paid to older people who are retired from employment, the main tax rights are given to the residence state under article 18 of the OECD Model.

In the discussion here, in the case that employment is exercised partly or totally in a home office in the state of residence (or in the other state), a severance payment is taxed under article 15 when the taxing right is allocated to the residence state. The taxing rights will be allocated to the source state if some requirements are fulfilled. Most Indonesian tax treaties conclude the similar criteria in the provisions stated under article 15 of the OECD Model to determine the allocation of taxing rights between the treaty partners.

In the context of a severance payment in Indonesia, one of the issues that emerged during the COVID-19 crisis was the condition in which employees were temporarily furloughed during the COVID-19 pandemic without being paid a salary.<sup>12</sup> Nonetheless, based on the policies of several companies, employees can still get employee benefits such as health insurance or severance pay when they are temporarily discharged. Employees' income from employee benefits includes income subject to article 21 of the ITL.

Workers who are given severance pay when they are laid off or on temporary leave (without being paid) will be given a tax rate in accordance with the amount of the severance pay. The rate of the tax for severance pay is still the

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11. Darussalam & D. Septriadi, *Perjanjian Penghindaran Pajak Berganda*, pp. 452-453 (DDTC 2017).

12. A. Holandari, *Pajak bagi Karyawan Dicutikan pada Era Covid-19*, Pajakku (15 Apr. 2021) available at <https://www.pajakku.com/read/6078003ceb01ba1922cca7d8/Pajak-bagi-Karyawan-Dicutikan-pada-Era-Covid-19> (accessed 30 Apr. 2022).

same as of 16 November 2009 in article 17(1)(a) of the ITL. Nevertheless, due to the pandemic conditions, the government issued incentives to exempt taxes for those who meet several conditions.

#### 15.4.1.2. The impact of travel restrictions

The pandemic in late February 2020 stranded many workers outside their home and/or work state.<sup>13</sup> In Indonesia, if this condition occurs where they are prevented from returning to their state of residence or to the state where they usually exercise their employment due to travel restrictions, both Indonesian citizens and foreign citizens can be categorized as tax resident as long as they: (i) reside in Indonesia; (ii) spend time in Indonesia for more than 183 days in a 12-month period; or (iii) live in Indonesia within a tax year and intend to reside in Indonesia.

However, after the enactment of the Job Creation Law (since 2 November 2020), the principle of territorial taxation applies on income received or earned by a foreign citizen who qualifies as an Indonesian tax resident as long as the foreign citizen has certain expertise; this is valid for 4 years. This is applied in the same way to digital nomads.<sup>14</sup> Therefore, the territorial principle in question stipulates that taxation is only carried out on income derived from Indonesia.<sup>15</sup> Nevertheless, this provision will be invalid if the person concerned uses the tax treaty provision.

Under other conditions, employees who cannot exercise their employment and, due to travel restrictions or public health measures, must remain in their state of residence (without the ability to work in a home office, e.g. because they typically work in a factory) but continue to receive compensation from their employer or the state are also treated according to the regulations for determining the imposition of individual taxes, which refers to article 2 of the ITL and PMK-18/2021. This is due to the fact that there is no particular regulation related to this situation in Indonesia.

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13. Beretta, *supra* n. 9, at p. 7.

14. M.Y.D. Utama, *Digital Nomad Bebas Pajak di Indonesia? Ini Ketentuannya*, Dirjen Pajak (28 Dec. 2021), available at <https://pajak.go.id/id/artikel/digital-nomad-bebas-pajak-di-indonesia-ini-ketentuannya> (accessed 30 Apr. 2022).

15. A.F. Medina, *Indonesia's Omnibus Law: New Tax Treatment to Support Ease of Doing Business*, ASEAN Briefing (10 Sept. 2021), available at <https://www.aseanbriefing.com/news/indonesia-tax-omnibus-law-exemptions-other-changes/> (accessed 30 Apr. 2022).



#### 15.4.2. Entertainers and sportspersons under article 17(1) of the OECD Model

Under the tax treaties between Indonesia and its treaty partners, similar to the provision related to employment income, the distribution of the allocation of tax rights on income earned by entertainers and sportspersons is given to both states as long as activities are exercised in the source state. However, for the COVID-19 condition, the criterion “as such exercised in the other Contracting State” under article 17(1) of the OECD Model cannot be fulfilled where the personal activities of entertainers and sportspersons are not carried out in other states due to travel restrictions.

The situation will be the same as if they rehearse or train in one state and perform publicly in another state. Both do not meet the conditions of physical presence in the other contracting state. Under these conditions, the tax on the income of entertainers and sportspersons should be allocated under other OECD articles such as article 21 and not under article 17.<sup>16</sup> Thus, the allocation of taxing rights is given to residence states where entertainers and sportspersons have a physical presence in that state.

This can be a consequence for the taxation of employees and artists or athletes if the COVID-19 crisis continues for a longer period. There needs to be a change under article 17 of the OECD Model on the criterion “as such exercised in the other Contracting State”, which is no longer relevant when entertainers can carry out their activities by streaming or for sportspersons to compete in the form of e-sports where there is no physical presence in the other contracting state.<sup>17</sup>

In regard to this specific rule, Indonesia has not further considered the issue. In this case, Indonesia continues to apply the general rule only from the OECD Model for taxing artists and sportspersons even in the COVID-19 crisis. Interestingly, in some Indonesian treaties with treaty partners on provisions relating to entertainers and sportspersons, such income shall, however, be exempt from tax in that state if such activities are supported, wholly or substantially, from the public funds of the government of either contracting state or a local authority or statutory body thereof.

Another example in Indonesia is that the tax provisions for streamers in Indonesia still use the same provisions under individual income tax law,

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16. Id.

17. Id.

namely, Law Number 36 of 2008 article 2(3) concerning the fourth amendment to Law Number 7 of 1983 regarding income tax. In this regard, the basis for collecting taxes on streamers is still not clearly regulated in Indonesia, which is in contrast to the artist tax.

#### 15.4.2.1. Influencers

A taxpayer who works as an influencer is categorized as an artist or art worker such that, when they have a solid income from month to month and year to year, they are required to pay taxes on that income. Using social networks analytics, the DGT monitors the social media accounts of taxpayers.<sup>18</sup> This system not only monitors social media held by influencers, but it also allows the DGT to optimize the DGT enterprise search, which is beneficial for assessing taxpayers and bound entities such as family members, assets owned and firm ownership.<sup>19</sup> Thus, due to pandemic-related restrictions (e.g. on travel), the taxation of influencers is not affected. They will be treated the same as entertainers or sportspersons under article 17 of the OECD Model for cross-border activities.

### 15.5. Article 15(2) and (3) of the OECD Model

Workers may be scattered over the world and choose the best location to work and live if they are no longer required to dwell within a predetermined commuting distance from their usual workplace (habitual abode and familiar workplace). In the second phase of the pandemic, remote working became the “new normal” due to uncertain conditions, and many people relocated out of their homes to accomplish their work remotely.<sup>20</sup>

Referring to domestic regulations in Indonesia that require a time test to determine an individual’s residency status, the calculation of this time test is crucial. In article 2(3) of PMK-18/2021, the calculation of the 183-day test is determined by calculating the length of time an individual has been in Indonesia for a period of 12 months, either continuously or intermittently, with part of the day being counted as 1 day. In this regard, there are

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18. *Pemantau Pajak Selebgram dan Youtubers*, Indopajak.id (8 Jan. 2019) available at <https://indopajak.id/pemantau-pajak-selebgram-dan-youtubers/> (accessed 30 Apr. 2022).

19. M. Wildan, *Dengan Integrasi Data, Ditjen Pajak Dapat Gambaran Tingkah Laku WP*, DDTC News (3 Dec. 2020), available at <https://news.ddtc.co.id/dengan-integrasi-data-ditjen-pajak-dapat-gambaran-tingkah-laku-wp-26058> (accessed 30 Apr. 2022).

20. Beretta, *supra* n. 9, at p. 7.

no specific rules on how home office days are counted in Indonesia. Thus, PMK-18/2021 will be referred to as the general rule.

Departing from the critical issue of the time test, if the COVID-19 condition continues, article 15 of the OECD Model has to be improved in regard to the threshold of the time test itself. If not, this can have an impact for which source country loses its tax allocation rights. One of the alternative ways that can alleviate this is by reducing the threshold.

In this regard, the physical presence of workers determines the location where workers take advantage of public goods provided by the government. Based on these facts, it is reasonable for taxes to be paid where the workers are located, in this case, where the home office is located.

Article 15(3) of the OECD Model follows a different concept for employees working in international traffic. From the authors' point of view, article 15(3) of the OECD Model provides rules that could be discussed as an alternative to article 15(1) and (2) of the OECD Model to determine the allocation of tax rights for workers who work remotely because it is the same as employees working in international traffic that will not stay in a certain state for more than 183 days.

## **15.6. Frontier workers**

Commuting from Indonesia to neighbouring countries (or vice versa) for work is possible with certain immigration conditions. Therefore, the existence of frontier workers is not a new thing for Indonesia or the countries that are members of the Association of Southeast Asian Nations. However, Indonesia does not have a clause related to frontier workers in a tax treaty with signed treaty partners. The thing that needs to be considered when this provision is adopted into Indonesia's tax treaties with treaty partners is the difference between frontier workers and cross-border workers as regulated in article 15 of the OECD Model. Frontier workers also need to be distinguished from employees with a home working arrangement. Thus, particular requirements are needed, such as a requirement stating that the application of these rules requires a daily return to the state of residence (with some exceptions).

Also, for instance, under some conditions, employees commuting to a neighbouring jurisdiction are taxed on their employment income only in their home jurisdiction provided that any employment activity carried out

elsewhere is confined to a maximum specified period (typically ranging from 4 to 6 working weeks).<sup>21</sup>

### **15.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)**

The COVID-19 pandemic has had a significant impact on various aspects of the lives of Indonesian citizens, especially the social and economic aspects. In order to overcome the various negative impacts of the pandemic, the government of the Republic of Indonesia uses various instruments, including fiscal instruments. The years of the pandemic since 2020 have marked the era of reform of Indonesia's tax regulations and policies as indicated by the three amendments in less than 2 years to various laws in the taxation sector. This is Indonesia's largest tax reform since the 1983 tax reform.

The amendment to tax laws and regulations after the emergence of the COVID-19 virus in Indonesia first started on 31 March 2020 with the issuance of Government Regulation in Lieu of Law (Perppu) Number 1 of 2020 concerning State Financial Policies and Financial System Stability for Handling the 2019 Corona Virus Disease (COVID-19) Pandemic and/or in the Context of Dealing with Threats that Endanger the National Economy and/or Financial System Stability.

This Perppu then officially became law on 18 May 2020 because it received full approval from the parliament. This rule regulates four policies in the field of taxation, which include an adjustment to income tax rates for domestic corporate taxpayers and PEs, the tax treatment of trading activities through the electronic system, a time extension for the exercise of rights and fulfilment of tax obligations and granting the authority to the Minister of Finance to provide customs facilities in the form of exemption or relief from import duties for handling emergency conditions as well as recovering and strengthening the national economy.

Furthermore, there are two other important and urgent amendments to the tax law carried out by the government to cope with the economic impact due

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21. OECD, *Updated Guidance on Tax Treaties and The Impact of The COVID-19 Pandemic* (21 Jan. 2021), available at <https://www.oecd.org/coronavirus/policy-responses/updated-guidance-on-tax-treaties-and-the-impact-of-the-covid-19-pandemic-df42be07/#section-d1e808> (accessed 22 May 2022).

to the COVID-19 pandemic, namely, the Job Creation Law (Law Number 11 of 2020) and the Law on the Harmonization of Tax Regulations (Law Number 7 of 2021). Revisions to the provisions of the income tax law in the Job Creation Law regard changes in the definition of tax resident and non-tax resident by clarifying primarily for Indonesian migrant workers working abroad to be classified as non-tax residents in Indonesia, expanding tax exemptions on dividends and reducing the withholding tax rate for interest income for non-tax residents.

As for the Law on the Harmonization of Tax Regulations, the changes that occurred are the conditions for granting in kind that can be financed, non-taxable income on gross turnover of up to IDN 500 million (special regime for small to medium-sized enterprises), rearrangement of depreciation and amortization, the application of 22% corporate income tax starting from the fiscal year 2022 (although, in reality, there is a delay), submission of efforts to prevent tax avoidance by applying methods that are in accordance with international standards (international best practice) and increasing government authority to participate in multilateral agreements.

It can be seen from the explanation of Indonesia's tax reform since 2020 that mobility of work is not an important issue in the provisions of the Indonesian tax laws and regulations. The relevant regulation in the discussion on the mobility of work is related to article 2 of the ITL, which reregulates the determination of individual tax residents using the calculation of the number of days of their presence in Indonesia. It aims to provide legal certainty for individual taxpayers.

In article 2 of the ITL, it is explained that an individual will be designated as an individual tax resident as long as they are in Indonesia for more than 183 days within a 12-month period or 1 tax year in Indonesia and have the intention to reside in Indonesia. This rule applies to both Indonesian citizens and foreign nationals. Furthermore, article 2(3) of the ITL confirms the period of 12 months, which is meant either continuously or intermittently with part of the day counted in full as 1 day. Meanwhile, if an Indonesian citizen is outside Indonesia for more than 183 days within a 12-month period, then they are confirmed as a non-tax resident. However, they must meet five conditions as follows:

- they reside permanently outside Indonesia, and it is not a stopover place;
- they have a main activity centre that shows personal, economic and/or social attachments outside Indonesia, such as family, work and organizations recognized by the local government;

- they have a place to carry out their daily habits or activities outside Indonesia;
- they are a tax resident in another country or jurisdiction; and
- they have completed tax obligations on all income received or earned by Indonesian citizens while being subject to domestic tax.

The fulfilment of all of these requirements is demonstrated by a certificate of an Indonesian citizen completing the qualifications to become a non-tax resident issued by the director general of taxes.

Regarding foreign citizens, if the individual foreign citizen has certain expertise and has become a tax resident, then their income is subject to income tax only on the income received in Indonesia for the first 4 years by submitting an application to the director general of taxes.

The purpose of this regulation is to increase legal certainty, which will ultimately determine the imposition of income tax for Indonesian citizens and foreign nationals. This is considering that, prior to the changes in the Job Creation Law, foreign nationals and Indonesian citizens residing in Indonesia were treated as tax residents who were equally subject to world-wide taxes. This means the same income could be taxed twice and the burden of compliance obligations must be implemented obediently (tax return filing procedure).

In relation to Indonesia's tax treaty networks, it has been agreed that a total of 47 tax treaties would be amended after the government ratified the multilateral instrument on tax treaty (MLI) through Presidential Regulation Number 77 of 2019.<sup>22</sup> However, the amendments to the tax treaty only contain and revise the clauses in the covered tax agreement (CTA) between Indonesia and the tax treaty partner jurisdiction in order to adopt the matching position of substantive clauses in the MLI.<sup>23</sup> There are no provisions regarding the issue of mobility of work.

In addition to the CTA, Indonesia has also amended the tax treaty in the period from 2020 until the time this paper was prepared, namely, only with Singapore on 4 February 2020, which amended matters related to:

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22. DDTC News Editor, *Ada 19 P3B Indonesia yang Direvisi Tahun Ini*, DDTC News (17 Jan. 2020), available at [https://news.ddtc.co.id/ada-19-p3b-indonesia-yang-direvisi-tahun-ini--18439?page\\_y=0](https://news.ddtc.co.id/ada-19-p3b-indonesia-yang-direvisi-tahun-ini--18439?page_y=0) (accessed 22 May 2022).

23. A. Teapriangga, *Begini Posisi Indonesia dalam Multilateral Instrument*, DDTC News (9 Jan. 2020), available at <https://news.ddtc.co.id/begini-posisi-indonesia-dalam-multilateral-instrument-18344> (accessed 22 May 2022).

(i) reducing the tax rate on royalty and branch profit tax; (ii) the abolition of the most favoured nation clause or equal treatment for all members in taxation arrangements for production sharing contracts and contracts of work related to the oil, gas and mining sectors; (iii) more explicit clauses regarding tax avoidance, anti-tax avoidance and evasion and capital gains on asset sales, as well as exchanges of information in accordance with international standards; (iv) interest exemption on interest earned by government institutions of the two countries, including the Sovereign Wealth Fund and its subsidiaries; and (v) the implementation of the exchange of notes related to tax treaties and the elimination of the benefits of the Indonesia-Singapore tax treaty for permanent business entities located in third countries.<sup>24</sup>

Therefore, thus far, there have been no domestic provisions, amendments to tax treaties or revisions to the tax treaty protocols that Indonesia has in relation to the home office either in the context of determining the allocation of taxation for the income of the individual or the creation of a PE. The applicable provisions that remain are the “old regime” as stated in section 15.3.

### **15.8. The future of the mobility of work: A need for adjusting the existing treaty rules?**

Individual income tax is normally owed in the worker’s country of residence in accordance with the applicable rules and tax treaties. However, cross-border employees may be subject to taxation in countries other than their place of residence. Afterward, for enterprises, the concept of a PE can also be affected by the location of effective management activities in order to determine the business profits that are due. These restrictions are often based on an individual’s physical presence in a country.

Individuals who typically work abroad or in a cross-border situation may have performed more telework from a remote location or office space as a result of the precautions adopted by governments in response to COVID-19, while others may have worked from home in their home state on a regular basis. From the standpoint of international taxation, the common rules to identify which country has taxing rights according to tax treaties remain relevant during and after the current economic crisis. This may imply that

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24. Ministry of Finance, *Indonesia-Singapura Perbarui Perjanjian Penghindaran Pajak Berganda (P3B)*, Indonesian Ministry of Finance (5 Feb. 2020), available at <https://www.kemenkeu.go.id/informasi-publik/publikasi/berita-utama/indonesia-singapura-perbarui-perjanjian-penghindar> (accessed 22 May 2022).

the taxing rights could move to the other country as a result of the altered work patterns. However, several nations have taken precautions to avoid certain unfavourable repercussions of the pandemic.

Switzerland, for example, has secured agreements with its neighbouring countries to avoid the possibility of the taxing rights of one country shifting to the other country as a result of home or remote working due to COVID-19. The reason is based on the principle that, when exercising the right of taxation, it is presumed that employees in a lockdown and frontier workers are pursuing their gainful activity in the usual manner, namely, at their previous place of work (treated in the same way as it was prior to the pandemic when the work was typically carried out in the other country).<sup>25</sup> This agreement is also being adopted in the agreements on the taxation regime for remote workers between Belgium, Germany and the Netherlands, in which the measure aims to prevent the employment income of cross-border employees working from home from becoming fully taxable in their state of residence.<sup>26</sup>

As mentioned in section 15.4.1, Indonesia does not have any domestic or international legal basis that governs international mobility of workers due to the COVID-19 pandemic. Indonesia nevertheless has a need to clarify issues related to worker mobility, such as issues regarding home offices, digital nomads, frontier workers and others related to taxes on individuals and the creation of PEs. In this regard, the authors recommend that the Indonesian government should be able to follow the recommendations that have been prepared by the OECD, some of which have been implemented by other jurisdictions.<sup>27</sup>

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25. R. Matteotti, et al., *Switzerland Settles Mutual Agreements for Remote Working*, International Tax Review (11 Feb. 2021), available at <https://www.internationaltaxreview.com/article/b1qhpclz9q3l6g/switzerland-settles-mutual-agreements-for-remote-working> (accessed 22 May 2022).

26. International Organisation of Employers, *Belgium, Germany and Netherlands agreements on taxation regime for remote workers to be extended* (Jan. 2022), available at [https://ioewec.newsletter.ioe-emp.org/industrial-relations-and-labour-law-january-2022/news/article/belgium-germany-and-netherlands-agreements-on-taxation-regime-for-remote-workers-to-be-extended?tx\\_news\\_pi1%5BoverwriteDemand%5D%5Bcategories%5D=57&cHash=33e0cbca7fc311b60540eef10dc70890](https://ioewec.newsletter.ioe-emp.org/industrial-relations-and-labour-law-january-2022/news/article/belgium-germany-and-netherlands-agreements-on-taxation-regime-for-remote-workers-to-be-extended?tx_news_pi1%5BoverwriteDemand%5D%5Bcategories%5D=57&cHash=33e0cbca7fc311b60540eef10dc70890) (accessed 22 May 2022).

27. OECD, *Updated Guidance on Tax Treaties and the Impact of the Covid-19 Pandemic* (21 Jan. 2021), available at <https://www.oecd.org/coronavirus/policy-responses/updated-guidance-on-tax-treaties-and-the-impact-of-the-covid-19-pandemic-df42be07/#section-d1e808> (accessed 22 May 2022).



### **15.8.1. Concerns related to the creation of permanent establishments**

Extraordinary and temporary changes in the place where employees perform their duties, such as working from home, shall not result in the creation of new PEs for the employer because of the COVID-19 phenomenon. Similarly, the temporary completion of contracts in the homes of employees or agents due to the COVID-19 outbreak should not give rise to PEs for enterprises. When construction is momentarily halted, a construction site PE is not considered to cease to exist.

As a public health measure to limit the spread of the COVID-19 virus, however, governments may consider “stopping the clock” when evaluating if the PE level has been met during specified periods when activities are suspended. However, thresholds under domestic law that require a business to register for tax purposes may be lower than those applicable under a tax treaty. Therefore, a business must determine whether all income taxes are covered by the applicable tax treaty in order to avoid potential complications.

### **15.8.2. Concerns related to change of residence**

Due to the COVID-19 pandemic, a transitory shift in the location of board members or other senior executives is an exceptional and temporary circumstance, and such a change should not cause a change in treaty residency. It is improbable that the COVID-19 crisis will result in any modifications to the residence status of an entity under a tax treaty.

### **15.8.3. Concerns related to income from employment**

The first issue concerns the application of taxation on employment income that is received by cross-border workers who cannot perform their work due to restrictions. When an employee residing in one jurisdiction and formerly employed in another jurisdiction receives a COVID-19-related government subsidy from the work jurisdiction in order to continue the employment relationship, the payment is attributable to the work jurisdiction for income tax purposes.

The second issue concerns the applicability of taxation on a worker who is stranded in a jurisdiction where they are not a resident but have previously

exercised employment. For the purposes of the 183-day test in article 15(2) (a) of the OECD Model, it would be acceptable for a jurisdiction to overlook the additional days spent in that jurisdiction under certain conditions. However, some jurisdictions may take a different approach or may have given special instructions detailing their strategy in such situations. In this circumstance, taxpayers should contact their local tax office.

The third issue concerns the applicability of taxation on a worker who works remotely from a jurisdiction for an employer who is resident in another jurisdiction. Changes in the jurisdiction in which an employee exercises their employment can affect the taxation of their income. In the other jurisdiction, new taxing rights over the employee's income may arise, and these new taxing rights may displace existing taxing rights. As payroll taxes are frequently withheld at source, resolving the change will incur administrative and compliance expenditures for both the company and employee. Therefore, it is crucial to provide administrative relief to reduce the high additional compliance burden.

#### 15.8.4. Other concerns

The authors understand that the COVID-19 pandemic can be said to be slowing down with the number of active daily cases decreasing every day. Currently, many countries have lifted various restrictions related to COVID-19. Indonesia itself recently lifted restrictions on the use of masks in open spaces. On this basis, at first glance, it seems that tax measures related to COVID-19 as discussed in this chapter no longer seem important.

However, the recommendation to reorganize the mobility of work due to the COVID-19 crisis is still very relevant with at least two main considerations. The first consideration is the fact that the World Health Organization (WHO) has not yet lifted the COVID-19 global pandemic status. Following the steps of the WHO, Indonesia and various countries around the world have not revoked the status of the COVID-19 pandemic and are still imposing various restrictions, although they are not as strict as before. The second consideration is the fact that the world is growing because of globalization and technological advances that require tax regulations that also adapt to the times. The recommendations in this chapter are sourced from the OECD report which, in fact, will remain relevant even if the COVID-19 pandemic has ended.

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## Chapter 16

### **The Impact of Tax Treaties on International Mobility of Work in Israel**

Tamir Shanani

#### **16.1. Mobility of work and domestic tax law**

##### **16.1.1. Acquisition and abandonment of fiscal residency for individuals**

The COVID-19 epidemic broke out in Israel during February 2020. A month after, the Israeli government decided to close Israel's borders to the entry of foreigners (who wanted to enter for touristic purposes) and to significantly restrict the entry of foreigners to the country. However, such limitations were one-sided, and the ability of foreign citizens who resided/stayed in Israel to exit the country was almost uninterrupted throughout the entire two-and-a-half-year period. Similarly, Israeli citizens who resided overseas when the global pandemic broke out and wanted to enter the country were able to do so fairly freely – even during the three national lockdowns that were imposed on March 2020, September 2020 and January 2021, each lasting several weeks. In December 2020, the Israeli government embarked on a national vaccination campaign to vaccinate its adult population. The national vaccination was a major success, and within several weeks, the state of Israel had the highest vaccinated population per capita in the world, which led to a drop in severe COVID-19 cases and also attracted Israeli citizens who resided abroad to return to Israel, get the vaccine and spend some time in Israel (mainly voluntarily). Clearly, the global pandemic had an unprecedented impact on the Israeli economy. Despite an increase in public funding, the high-tech sector – which had become a dominant element even before COVID-19 – continued to flourish, undeterred by the extraordinary conditions due to COVID-19 when employees were forced to work remotely. It seems that the virtual economy is set to become part of our lives.

To better understand the consequences of individual taxpayers' acquisition/abandonment of their Israeli tax residency, it is important to understand grounds under which the state of Israel taxes income and gains. The Israeli Income Tax Ordinance (ITO) originally followed territorial principles (with

minor exceptions) under which Israeli income tax liability was levied on income earned, produced or remitted in Israel,<sup>1</sup> whereas income generated, produced or remitted abroad was exempted. The ITO did not include any source rules, and even though generally foreign-source income was not subject to Israeli tax – in limited scenarios, it was – and the ITO allowed to credit these foreign taxes to eliminate/reduce double taxation. Section 1 of the ITO originally defined fiscal residency for individuals based on one's physical presence in Israel. It also stated that periods of temporary absences from Israel would be ignored. This definition was very equivocal and forced the Israeli Tax Authorities (ITA), and later the Courts, to interpret it and adopted the “centre of life/living” criterion (the “Centre of life”) to interpret it.<sup>2</sup> The centre of life criterion is the closest concept (yet not identical) to the domiciliary approach practiced in many legal systems. In general, domiciliary – for fiscal purposes – is commonly established in the state where the taxpayer either has their permanent home or the strongest connections. The centre of life criterion in this context also resembles one of the tiebreaker rules in article 4 of the tax treaties, which is used to determine residency when the taxpayer is considered to have multiple residencies. It is based on factual analysis which tries to determine in which of the states the taxpayer has the strongest attachment, with those relations justifying that state's right to tax.<sup>3</sup>

Unfortunately, it is not always easy (or even possible) to determine a taxpayer's centre of life since, in most cases, individuals have numerous attachments, and the judicial ruling needs to determine – of these attachments – which state has the strongest ties. Over the years, the courts based their residency determination by evaluating the following non-exclusive list of factors: place of house; family home; furnishings; rented/owned apartments; passport; place where the taxpayer was born and raised; place where children were born or the place where children or spouse reside; place where other family members reside; place where spouse seeks employment; professional licenses or any other memberships; language skills; identity of the employer; employment agreement (temporary relocation or indefinite

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1. Secs. 2 and 89 of IL: Income Tax Ordinance (1961) (prior to ITO (Amendment 132) of 2002) [hereinafter ITO].

2. The concept of residency was not that significant under the territorial approach and, therefore, the tax law of 1941 did not even include any definition for “residency”; the tax ordinance of 1947 codified an indeterminate definition that focused on the taxpayer's physical presence in Israel. Based on this definition, an individual who resided in Israel was considered a resident. *See* IL: District Court, 27 Dec. 1995, No. 300/91, *Raz vs Tel-Aviv 1 Assessment Office*.

3. Art. 4 *OECD Model Tax Convention on Income and on Capital* (27 Nov. 2017), *Treaties & Models IBFD*.

agreement); driver's license; health insurance; personal belongings, such as car; retirement plans; bank accounts and so forth.<sup>4</sup> However, since there are so many different factors, determining residency is highly complicated.

In 2002, the Israeli income tax system underwent a significant reform<sup>5</sup> and, after more than five decades, it departed from a broadly defined territorial approach to a residence-based worldwide income taxation. The income tax reform, among other things, amended the definition of "fiscal residency for individuals" and codified the previous judicial test which adopted the centre of life criterion. Furthermore, the definition incorporated two alternative rebuttable presumptions based on physical presence. According to these presumptions, to the extent that an individual meets one of the two physical presence tests – namely (i) 183 days in a calendar year; or (ii) 30 days in the calendar year, plus 425 in the current year plus the two previous calendar years – the person is presumed to be an Israeli resident for tax purposes and subject to tax on their worldwide income. However, since these presumptions are rebuttable, the taxpayer can argue that the purpose of the visit was transitory with no intention to establish a home in Israel.<sup>6</sup>

The Ministry of Finance issued regulations which set a list of instances that classify taxpayers as non-Israeli residents despite their presence in Israel. The regulations listed several exceptions to the aforementioned physical presence test, including (i) foreign diplomats, foreign clergymen, foreign journalists and foreign athletes; (ii) non-Israelis who come to serve in the army and foreign students; (iii) foreign teachers/lecturers/researchers who come to teach/research; and (iv) patients who come to get medical treatment in hospitals. None of these categories will establish Israeli residency during the relevant time period stipulated in the regulations.<sup>7</sup> Furthermore, over the years, the ITA and the Israeli courts also opined/ruled on a case-by-case basis and expanded the circumstances according to which temporary stays/absences in/from Israel would not result in acquisition/abandonment of Israeli residency. Examples include individuals who travel to Israel to

4. IL: ITA, *The Internal Guidelines of The ITA's interpretation of the ITO* (2022).

5. IL: ITA, The Public Commission for the Reform of Income Tax (2000); and IL: ITO, Amendment 132 of 2002.

6. Two years ago, the director of the ITA appointed a special committee that was asked to present recommendations to required amendments to strengthen the rules regarding international taxation, and their recommendations proposed incorporating irrebuttable presumptions which would provide more certainty. See Public Committee, *Report of the Committee on International Tax Reform* (2021). This report will not discuss the proposed changes as it is unclear if these changes will indeed be legislated.

7. IL: Income tax regulations (determination of individuals classified as Israeli residents and determination of individuals classified as non-residents) of 2006.

take care of relatives who were hospitalized; individuals who travel to Israel to participate in familial celebrations (e.g. marriages, births, funerals etc.); or individuals who travel to Israel to get special health treatments (such as assisted reproductive technological treatment) and so forth.<sup>8</sup>

However, the ITA did not issue specific guidelines as to the acquisition/abandonment of fiscal residency or any other guidelines in light of the special circumstances that were imposed due to the COVID-19 pandemic. The state of Israel was one of the first states that purchased vaccinations and offered to vaccinate its entire population. At the beginning of the pandemic, tens of thousands of former Israeli-born individuals (who maintained their Israeli citizenship but abandoned their Israeli fiscal residency) travelled to Israel to get vaccinated, many of whom chose to voluntarily extend their stay for various reasons.<sup>9</sup> Therefore, the ITA's approach was that most of the people who came to Israel did it intentionally and that their main reason to extend their stay in Israel was not because of travel restrictions (as the travel restrictions imposed by the government were relatively short in time) and they could have left the state within the "60-day period", which is generally used by the ITA as the maximum presence period for disregarding one's presence in Israel before acquiring fiscal residency.<sup>10</sup>

Accordingly, the ITA did not tone down the tax rules despite the COVID-19 restrictions.<sup>11</sup> Furthermore, in most cases, there was no need to adopt special rules because Israel had already adopted favourable rules available for newcomers and Israelis who return to live in Israel after a 10-year period or 6-year period (10-year veterans and returning residents, respectively). For example, the ITO offers newcomers and 10-year veterans to elect not to be treated as Israeli residents during their first year in Israel (also referred to as "adaptation year").<sup>12</sup> These rules also exempt them from being taxed in Israel on their foreign-source income, and they are further not required to report these foreign income/gains during a 10-year period starting from the

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8. ITA Circular 1/2012 Determination of Fiscal Residency Abandonment and Acquisition (2012).

9. Those who decided to extend their stay in Israel did so for several reasons, namely cost of living is cheaper in comparison to the countries from which they came; health conditions; ability to get help from Israeli relatives in childcare when schools were closed and so forth. For this reason, the ITA did not issue general guidelines and stated that each case will be examined independently based on each case's facts and circumstances.

10. ITA: Private letter ruling 62/2006 Residency Determination (2007); and ITA: Private letter ruling 63/2006 Residency Determination (2007).

11. Conversely, there can be situations where taxpayers are classified as non-residents and face a reduced risk of double taxation (or taxation at all).

12. Sec. 14(a)(1) ITO.

date they (re)acquired their Israeli residency for tax purposes. In addition, returning residents are offered more limited tax breaks, which exempt them from certain types of foreign passive income/gains during a 5-year/10-year period. Accordingly, these favourable tax rules eliminate almost all negative consequences that were potentially caused by COVID-19 restrictions, and the only individuals who may still need some clearer guidance from the ITA are those Israelis who left Israel but have not abandoned their Israeli residency and remained its resident.<sup>13</sup>

While the income tax rebuttable presumptions for acquiring Israeli residency based on day-count presence in Israel were not toned down, it seems that the rules for abandoning Israeli residency are more flexible, and absences of up to 3 years generally do not sever one's Israeli residency for tax purposes.<sup>14</sup> Moreover, for longer absences, the ITO states specifically that Israeli taxpayers who have been asked to relocate by the state of Israel (including by the Israeli government, authority, agency, national agency national foundation and so forth) will retain their Israeli residency regardless of the length of their mission abroad. Furthermore, in recent cases, the Israeli courts ruled that regardless of the period one spends abroad (irrespective of visits to Israel), to the extent that one did not acquire a foreign (non-Israeli) residency throughout such period, then abandoning Israeli residency for income tax purposes is more complicated. The Israeli courts essentially ruled that customarily one cannot abandon Israeli residency before acquiring non-Israeli residency in a foreign country where a person resides and has established a fiscal permanent status.<sup>15</sup>

### 16.1.2. Acquisition and abandonment of fiscal residency for enterprises

The ITO defines “corporate residency” based on two criteria,<sup>16</sup> namely (i) a test that is more formal, which examines the state of incorporation; and

13. Secs. 14 and 97 of ITO.

14. ITA: Private letter ruling 63/2006 Residency Determination; ITA: Private letter ruling 1/2012 Residency Determination (2012); and ITA: Private letter ruling 4387/2013 Residency Determination (2013).

15. IL: Supreme Court, 9 Oct. 2018, No. 476/17, *Amit vs Tel-Aviv 4 Assessment Office*; and IL: Tel Aviv District Court, 10 Apr. 2019, No. 6418-02-16, *Refaeli vs. Kfar Saba Tax Assessment Office*.

16. Prior to the international tax reform of 2002, corporations were considered Israeli residents when either of the following criteria was met: (i) the corporation was registered in Israel and the majority of its activities were in Israel; or (ii) the management and control of the corporation were undertaken from within Israel.

(ii) a test that is more substantive, which examines the state/states in which the control and management of the enterprise are undertaken. Accordingly, if the answer to one of the two tests is Israel, then the enterprise should be classified as an Israeli resident for tax purposes.

The ITO does not specify how to determine corporate residency when different board members live and work in different countries. However, based on three leading court appeals,<sup>17</sup> it seems that the courts try to understand to what extent such board members are independent and able to make decisions that steer the wheels of the enterprise. Note that the board members' residency for tax purposes is of less importance, and the test attempts to understand the place from which the managerial decisions and duties are being carried on. The courts interpreted the term "management and control" as the place where the strategical managerial decisions – and not to the day-to-day managerial decisions – are taken.<sup>18</sup>

Lastly, neither the ITO nor the Israeli courts were required to determine whether multiple residency is possible (when the board members of the enterprise live and work in different countries and exercise their managerial duties within and outside of Israel) and how the domestic tax rules would be combined with the tax rules of the other relevant contracting states that treat the enterprise as its resident using the applicable tax treaties (if existing). However, based on the ITA's position, it seems that special attention will be given to the powers of the Israeli board members and whether any of them have special veto power, including the managerial roles of the Israeli shareholders or any other managerial functions that are carried on from Israel.<sup>19</sup>

Under both the Companies Law of 1999 and the ITO, a corporation is not required to maintain (own or lease) a workplace, meaning that a company's operations can be conducted from various places, including from employees' home offices. However, for determining the income tax implications (including corporate fiscal residency) and if and where permanent establishments (PEs) exist, the location of the company's working premises

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17. IL: District Court, 22 July 2008, No. 1090/06, *Yanko Weiss v. Holon Tax Assessment officer (Yanko Weiss)*; IL: Supreme Court, 14 July 2014, No. 3102/12, *Niago v. Kfar Saba Tax Assessment officer*; and IL: Supreme Court, 1 Nov. 2018, No. 1609/16, *Shay Zamarot (Oranit) Ltd vs Director of Petah-Tikva VAT*. In all cases, the courts found that since the management and control was undertaken in Israel, the corporations should be classified as Israeli residents.

18. Id.

19. ITA Circular 4/2002 Determining Factors regarding the Management & Control Test No. 4/2004.



(and lack of) and the existence of employment/service relations and the places from which such services are performed are all taken into account by the ITA and the courts.<sup>20</sup> It seems that the time has come to rethink how virtual reality (not necessarily in the context of the pandemic) should impact the way corporate residency and PEs are viewed.

### 16.1.3. The implications upon constituting permanent establishment

The ITO does not limit its right to tax business income that foreign (non-Israeli) residents generate in general, as it did not codify the concept of a PE. However, Israel signed 60 tax treaties (mostly based on the OECD Model) and, as such, while the presence of a foreign enterprise that is resident of a contracting state would not be taxed as long as it does not constitute a PE, the presence of other foreign enterprises (that are residents in states that do not have a bilateral treaty with Israel) may subject them to tax in Israel. Under the current tax treaty rules, which will be examined in detail in section 16.3. of this report, the global pandemic may have indeed caused non-Israeli taxpayers who extended their stay in Israel voluntarily/inadvertently to constitute a PE – through paid-in personnel or service providers, even if their services were performed from their “home offices” and not from the enterprises’ offices or workplaces. Nonetheless, it seems that this concern is more theoretical as the ITA have limited resources to enforce these rules, and unless the foreign entities actively reached out to the ITA and report such activity, the enforcement of the rules *de jure* is doubtful.

### 16.1.4. Fiscal residency for social security purposes

The Israel Social Security Law of 1995 classifies Israeli residents for social security purposes based on the centre of life criterion. However, since the income tax laws and social security laws have different ends, the ITA and social security authorities occasionally interpret it differently, and similarly, the district courts (that rule tax cases) and labour courts (that rule social security cases) occasionally interpret fiscal residency differently. According to section 76 of the Social Security Law of 1995, an Israeli insured (resident) may relocate abroad and can still be considered an Israeli resident for social security purposes during a 5-year period. Another difference between the social security rules and the income tax rules is that the individual can

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20. See Niago (2014); and see also Yanko Weiss (2008).

actively reach out to the social security authorities and abandon their residency for social security purposes on the date they depart from Israel, whereas the ability to sever fiscal residency for tax purposes is much more complex and cannot be determined on the date of departure.

## **16.2. Residence, tiebreaker rules and mobility of work: Individuals and entities**

### **16.2.1. Physical presence in Israel and abroad**

As previously mentioned, Israel signed 60 bilateral tax treaties, most of which were signed/re-signed during the past two decades, based on the OECD Model. Since the application of bilateral tax treaties comes into play only when the individual is classified as resident by both contracting states – and since Israel offers generous tax breaks for newcomers and 10-year veterans for a 10-year period – it seems that, for treaty purposes, these two categories of taxpayers will probably be classified as non-Israeli residents as long as they are solely subject to Israeli source income and not their worldwide income.<sup>21</sup>

As indicated previously, the presence of an individual in Israel (even above 183 days) will not necessarily establish Israeli centre of life (residency) for income tax purposes<sup>22</sup> (and vice versa) regarding one's absences.<sup>23</sup> Also, fiscal residency for Israeli tax purposes is based on the centre of life criterion, which requires a case-by-case factual analysis and considers three of the four treaty tiebreakers rules. The Israeli courts interpreted the term "centre of life" using both subjective and objective tests and determined that the acquisition of an Israeli residency, as well as the abandonment of such residency, takes a while – usually months and possibly even 3-4 years.<sup>24</sup> Accordingly, a taxpayer who leaves Israel for a period that does not exceed 3 years will find it difficult to sever their Israeli residency. Moreover, a taxpayer who resides in Israel for several weeks a year (not more than 60 days, regardless of travel restrictions imposed by the government) will probably

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21. Art. 4(1), second sentence *OECD Model* (2017). See K. Vogel, *Klaus Vogel on Double Taxation Conventions* pp. 251-256 (vol. 1, E. Reimer & A. Rust eds., Kluwer 2015).

22. IL: Supreme Court, 12 Sept. 2017, No. 4946/16, *Saad vs Ashkelon Assessment Office*.

23. IL: Supreme Court, 22 July 2017, No. 3328/15, *Ploni vs Ashkelon Assessment Office*.

24. IL: Supreme Court, 29 Dec. 2005, No. 477/02, *Aryeh Gonen vs Haifa Tax Assessment Office*; and id. Please note that once residency abandonment is determined, then the date may go back to several months after the physical departure or a year after.

not acquire Israeli residency, and without such Israeli residency, the application of the OECD Model will not come into play.<sup>25</sup>

Pursuant to recent court cases, it seems that the interpretation of “fiscal residency” for tax purposes does not focus solely on the affinity one has with the state of Israel. To the extent that one has affinity to Israel and other states, in order to determine residency, a comparison will be made between the connections one has with the two or more states; the state that has the strongest relations to the taxpayer will be considered the resident country. The Israeli courts ruled that, at least for Israeli-born individuals, abandonment of Israeli residency will be more complicated but can generally be achieved if the taxpayer proves that he acquired non-Israeli residency, files tax returns in the country where he relocated to as its resident and pays income taxes there.<sup>26</sup>

Accordingly, it seems that a highly mobile lifestyle does not necessarily sever one’s Israeli residency, in that abandonment of one’s residency or acquisition of one’s residency will be determined based on the external actions one makes in order to change one’s “domicile”. For taxpayers who tend to travel frequently, more attention will be given to the place where one’s spouse, children and other close relatives reside, as well as to the question whether they have acquired permanent status and foreign fiscal residency there.<sup>27</sup>

### 16.2.2. Limited liability to tax and the application of article 4(1) of the OECD Model

As indicated earlier, the state of Israel offers generous income tax holidays to 10-year veterans, newcomers and returning residents. Under these tax holidays, newcomers and 10-year veterans are not taxed on their worldwide income for a 10-year period. Even though the ITA’s position is that these populations should qualify as Israeli residents – as they maintain a single habitual abode in Israel – it seems that under article 4(1) of the OECD

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25. To the extent that the taxpayer decides to extend their stay in Israel regardless of the travel restrictions (for instance, for recreational purposes; or since the risk of getting infected in Israel is lower because a higher percentage of the population was vaccinated; or to reduce the cost of living expenses, as their employer closed the workplace premises and employees were expected to work from home), such presence may result in a change of one’s residency and may lead to the acquisition of Israeli residency.

26. *Amit vs Tel-Aviv* (2018); and *Refaeli vs. Kfar Saba* (2019).

27. IL: District Court, 24 Mar. 2021, No. 41182-01-19, *Lederman vs Tel-Aviv 5 Assessment Office*.

Model, because they are not subject to comprehensive tax, they would not establish Israeli residence for treaty purposes.<sup>28</sup> Accordingly, at least with respect to newcomers and 10-year veterans, it seems that even if either dual or multiple residency is determined, such determination will not cause double taxation since they are taxed in Israel on their Israeli source income, and any other state of residence will be expected to provide them with a tax relief (generally credit for foreign taxes paid).

### 16.2.3. Corporate residency

As to corporate residency, the state of Israel defines residency of corporations based on the state in which the enterprise was incorporated or based on the state from which management and control was undertaken. Consequently, the residency of the board members of the corporations is irrelevant in determining its residency, whereas the place in which the managerial decisions have been taken is of extreme importance. As such, Israeli corporate residency can be acquired when the corporation is managed and controlled from Israel, regardless of the place such corporation was incorporated.<sup>29</sup>

While the place of incorporation test was almost unaffected by any COVID-19 restrictions or global mobility changes, the management and control test was much more vulnerable to the special conditions that existed and – as a result – corporate residency determination for tax purposes became even more challenging. As indicated earlier, the ITA did not issue any specific guidelines that deal with the COVID-19 special circumstances. This disregard may be explained by the fact that the ITO already disregards managerial duties performed in Israel by newcomers or 10-year veterans during their first 10 years in Israel. However, to the extent that Israeli residents or former Israeli residents (who abandoned their Israeli residency less than 10 years before) exercise managerial duties while staying in Israel (either on a voluntary basis or because they were forced to stay there due to COVID-19 travel restrictions), the corporation may be classified as Israeli resident and, upon their departure from Israel, an exit tax may be triggered.<sup>30</sup>

As to the question of multiple corporate residencies, as indicated previously, section 1 of the ITO disregards the managerial contribution of newcomers

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28. Vogel, *supra* n. 21.

29. Sec. 1 ITO.

30. Sec. 100A ITO, which imposes exit tax upon expatriation/abandonment of Israeli residency.

and 10-year veterans during their first 10 years in Israel. This relief diminishes the potential for multiple corporate residencies significantly, and it seems that even though no specific guidelines were issued by the ITA regarding COVID-19 implications, it is less likely that a foreign company would be deemed to acquire Israeli residency solely because one or more of its board members were forced to stay in Israel. However, such situation may be viewed by the ITA as constituting a PE in Israel.

### **16.3. Permanent establishments and mobility of work**

#### **16.3.1. Presence of a foreign enterprise in Israel due to travel restrictions**

The ITO gives right to tax whatever income is generated in Israel (Israeli-source income/gain), whether by Israeli residents or non-Israeli residents. However, as part of Israel's undertaking in its treaty network with 60 contracting states, it was willing to disregard business activities conducted by foreign enterprises as long as this presence in Israel did not constitute a PE. Under article 5 of the OECD Model, presence of a foreign enterprise constitutes a PE if the foreign enterprise maintains a fixed place of business through which the business of the enterprise is wholly or partly carried on. Article 5 of the OECD Model also recognizes a PE when the foreign enterprise engages the services of a local independent agent that is acting on behalf of the enterprise and that habitually exercises the authority to bind the enterprise.

As discussed previously, the COVID-19 pandemic imposed travel restrictions on many individuals who were forced to stay in foreign countries during their temporary visits in places where they do not ordinarily reside. These travel limitations could have inadvertently constituted PEs in many countries only because of that and, as such, for tax purposes, many states were willing to ignore activities performed during certain periods in which special conditions/restrictions existed. Israel did not issue any such guidelines.<sup>31</sup>

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31. Despite OECD, *OECD Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis* paras. 8-12 (3 Apr. 2020), available at [https://read.oecd-ilibrary.org/view/?ref=127\\_127237-vsdagpp2t3&title=OECD-Secretariat-analysis-of-tax-treaties-and-the-impact-of-the-COVID-19-Crisis](https://read.oecd-ilibrary.org/view/?ref=127_127237-vsdagpp2t3&title=OECD-Secretariat-analysis-of-tax-treaties-and-the-impact-of-the-COVID-19-Crisis) (accessed 13 Mar. 2024) [hereinafter OECD Guidance].

### 16.3.2. Physical presence due to travel restrictions

Since the term “place of business” is not defined in the OECD Model, it seems that the ITA’s position is that a “place of business” of a foreign enterprise also exists where no formal workplace is available for carrying on the business. This criterion may be satisfied simply by having a certain amount of space available (whether owned, rented by the enterprise or by its employees/service providers, including through their home offices),<sup>32</sup> which may well be regarded as constituting a location at the disposal of the enterprise (as long as the additional facts and circumstances of the case support such conclusion).

For example, based on a private letter ruling issued by the ITA in 2012, services rendered from a home office to a foreign enterprise constituted a PE even when the employee had no connections with the enterprise’s Israeli customers and the foreign enterprise had no additional operations in Israel. These factors impact the determination of whether a PE was constituted, as well as the revenue allocation methodology that should be adopted between the PE and the foreign enterprise, as discussed in section 16.3.4.<sup>33</sup>

Based on ITA publications, it seems that the following criteria impact the decision of whether the foreign enterprise establishes a PE in Israel: (i) the length (duration) of stay in Israel;<sup>34</sup> (ii) the nature and reasons of their arrival to Israel and for not departing as planned;<sup>35</sup> (iii) the nature of the services they provide and the taxpayer’s seniority and status;<sup>36</sup> (iv) whether the foreign enterprise carries on a business in Israel;<sup>37</sup> and (v) to whom the services are rendered.<sup>38</sup> However, since the ITA did not tone down the tax rules (at least formally), the pandemic may have constituted inadvertent PEs. Nonetheless, it is unclear to what extent these enterprises actually filed tax reports and paid their taxes due and, if not, whether the ITA can audit and enforce it. Similarly, the ITA may well determine that when a taxpayer is present for an extensive period in Israel and carries on a significant part of the business activities from their “home office”, such activity may constitute

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32. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 5* para. 18 (23 Nov. 2017), Treaties & Models IBFD.

33. ITA: Private letter ruling 253/12 Existence of a PE due to employment from home office (2012).

34. ITA: Private letter Ruling 2519/17 Residency Determination regarding Employees’ Relocation (2017).

35. *Lederman vs Tel-Aviv* (2021).

36. ITA: Private letter ruling 36/2008 The establishment of a PE (2008).

37. *Id.*

38. *Id.*

a PE even when these activities were performed inadvertently due to traveling restrictions or even because of special conditions.<sup>39</sup>

### 16.3.3. Digital nomads

In the past two decades, more individuals – especially those employed in the high-tech industry – “challenged” their employers and asked to work remotely while travelling around the world and making their personal, travel and adventure dreams come true. Employers understood that sometimes the ability to retain valuable employees comes with a price and were willing to pay it. While up until several years ago, remote employment relations were relatively uncommon (and digital nomads were mainly sole proprietorship), after the global pandemic dissemination, many employers decided to close their workplaces (voluntarily) and ordered their employees to continue working remotely.

This phenomenon did not challenge the Israeli tax rules or practice since, as indicated previously, non-Israeli residents who spend up to 60 days a year in Israel (and up to 183 days for certain employees) would generally not be considered Israeli residents, and even if they are residents of a state that does not have a bilateral treaty with Israel, most likely they will not be taxed in Israel. Accordingly, both short and transitory stays in Israel would probably not constitute a PE, nor would they subject the taxpayer to tax in Israel. On the other hand, when the presence of digital nomads becomes longer, such presence would subject the employee to tax and may constitute a PE.<sup>40</sup> Similarly, Israeli nomads who left Israel and move from one place to another, but do not acquire a foreign fiscal residency during their voyage, would still be considered Israeli residents and are taxed in Israel on a worldwide basis.<sup>41</sup> While Israeli residents who are asked to relocate and work overseas are entitled to certain cost-of-living deductions (that cover most of their living expenses overseas), such favourable deductions are generally unavailable for nomads.<sup>42</sup>

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39. Id.

40. ITA: Private letter ruling 62/2006 Residency Determination (2007); and ITA: Private Letter Ruling 6830/2017 Determining the Rules for non-Israeli residents who relocate to Israel while Maintaining Relations with Their Original Resident Country (2017).

41. *Amit vs Tel-Aviv* (20018).

42. Sec. 17 ITO; and IL: Income tax regulations (determination of individuals classified as Israeli residents and determination of individuals classified as non-residents) of 2006.

#### 16.3.4. Revenue allocations

Assuming that the presence of a foreign individual (whether an employee, any other paid-in personnel or independent agent) who performs services constitutes a PE, a question arises as to the profit allocation methodologies between the PE and the foreign enterprise. The first publication on this subject was issued by the ITA in 2006. This publication chose to allocate revenues/profits between the foreign enterprise and a local PE based on the cost-plus method.<sup>43</sup> A decade after, the ITA issued a circular stating that the revenue allocation methodology in such cases should follow the Authorised OECD Approach, which allocates profits in accordance with the contribution of the people and the functions performed within and outside of the PE locally and overseas.

The ITA would first identify the significant people who are involved in the profit generating process, and their functions and contribution to the profit process would be extrapolated based on the arm's length principle. The ITA stated that this method is only applicable in cases where the foreign enterprise is a resident of a contracting state with which Israel signed a tax treaty.<sup>44</sup>

The ITA circular also stated that – with respect to states that did not have an income tax treaty with Israel, and whose resident enterprises carried on businesses in Israel through their employees, other paid-in personnel or independent agents – the revenue allocation would follow the FAR methodology, which allocates the revenues based on the following three criteria: functions, assets and risks within and outside of the PE locally and overseas.<sup>45</sup>

### **16.4. Physical presence according to articles 15(1) and 17 of the OECD Model**

Article 15 of the OECD Model allocates taxation rights exclusively to the state of residence of the employee unless the employment is exercised in the other contracting state for a period exceeding 183 days within a 12-month period. Even though no specific guidelines were issued, it seems that the

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43. ITA: Private letter ruling 36/2008 The establishment of a PE.

44. ITA: ITA Circular 4/2016 Tax Implications Regarding Local Operation of Foreign Corporations - Permanent Establishment (2016).

45. Id.



tax implications are unchanged, whether such services are performed from the enterprise's work premises, the employee's home office or elsewhere. Accordingly, in this context, it is of limited importance whether the home office was imposed by government measures or not. Even though no explicit guidelines were issued by the ITA, it seems likely that, theoretically, if an employee were forced to extend their stay in Israel for more than 183 days, the ITA may be willing to disregard this presence and income, as long as travel restrictions are still in effect. However, as indicated earlier, the travel restrictions in Israel were relatively short and the ITA's position was that they had limited impact.

The Israeli courts ruled that employees are generally taxed on a cash-receipt basis (while self-employers are entitled to choose whether to report on an accrual basis or a cash-receipt basis).<sup>46</sup> As such, severance paid to an employee for prior foreign-source employment services could, in certain scenarios, be taxable in Israel if the employee had acquired an Israeli residency (excluding newcomers and 10-year veterans). This rule applies not only to salaries but also to additional types of compensation, including allowances, grants and other subsidies (whether paid by the employers or by their residence state, but excluding many of the social security subsidies).

As previously indicated, based on the Israeli court rulings, it seems unlikely that when foreign employees and, in particular, athletes, artists or other public figures (under article 17 of the OECD Model) are forced to extend their stay in Israel due to travel restrictions – preventing performance, services or activities abroad – such forced presence would either change their residency or subject them to tax in Israel.<sup>47</sup> No less challenging are also the rules that should apply to irregular compensation and payments that are paid for past/future periods or periods during which the employee relocated and changed residency. These types of remuneration require additional thinking to solve “tax accidents” that are caused because of timing differences, as employees are subject to a cash-receipt basis.

Lastly, the existing source rules that apply to situations in which services are rendered via live-stream from Israel to an audience residing abroad (including performances of artists and activities by athletes) follow the place from which the services are performed/rendered or to the place from which

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46. IL: Supreme Court, 13 Nov. 1986, No. 9/85, *Income Tax Commissioner vs Bar Ze'ev*.

47. *Amit vs Tel-Aviv* (2018).

the services should have been rendered originally.<sup>48</sup> It seems that the time has come to rethink the source rules for situations where technology has significantly changed the economic reality, especially as it relates to remote economic relations. While customarily services were generally rendered in proximity to the customer, nowadays the location from which such services are rendered is less important, meaning that such change may indeed require revision.

## **16.5. Article 15(2) and (3) of the OECD Model**

According to article 15 of the OECD Model, employment services performed in Israel are exempt if the employees' presence in Israel does not exceed 183 days within a 12-month period. This favourable tax treatment is only available for states that signed a bilateral tax treaty with Israel and are otherwise taxable, and could constitute a PE (even if performed from the employee's/agent's home office).

As indicated previously, the ITA did not issue any specific guidelines after the dissemination of the COVID-19 pandemic. Accordingly, each day spent in Israel would be counted for income tax purposes. However, Israeli residency (centre of life) is determined based on an analysis of the facts and circumstances and, similarly, the determination of existence of a PE, meaning that physical presence does not suffice. Additionally, travel restrictions or any other restrictions/special conditions (i.e. medical conditions/limitations) are also considered in determining the Israeli income tax implications, both at the corporate/PE level and the employee/agent level. In our context, the ITA's approach was that the COVID-19 restrictions had limited impact for most of the non-Israeli taxpayers who stayed in Israel between 2020 and 2021. This resulted in many non-Israeli taxpayers staying in Israel and extending their stay beyond the restrictions imposed by the government (voluntarily) and, similarly, many employers closed their workspaces or requested their employees to work remotely, regardless of governmental restrictions.<sup>49</sup>

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48. IL: District Court, 5 Aug. 2021, No. 26539-10-19, *Rubén Rayos vs Haifa Tax Assessment Office*. The case deals with compensation paid to a foreign football player whose employment relations with the Israeli football team were ended, and he was compensated for the difference between the salary he received in the new football team and the salary he was promised by the Israeli team.

49. Despite the OECD Guidance, *supra* n. 31.

## 16.6. Frontier workers

The state of Israel has four neighbouring countries, namely Lebanon, Syria, Jordan and Egypt. Even though Israel signed peace treaties with Egypt in 1979 and Jordan in 1994, the economic relations between Israel and the two countries have not developed fully and, as such, it is very uncommon for Israeli residents to commute daily across Israeli borders.<sup>50</sup> However, the state of Israel seeks to increase its labour power and, thus, issues working permits to tens of thousands of foreign workers in various industries every year. The foreign workers (legal and illegal) represent approximately 5% of the working population. However, almost all do not acquire Israeli residency even if they stay many years, as their presence is viewed as transitory.<sup>51</sup>

Approximately one-fourth of the foreign workers are considered “frontier workers”.<sup>52</sup> These workers generally live in Gaza or Jericho and travel daily from their homes to the Israeli employment sites (mainly in construction but also agriculture), and at the end of their working day, they head back home. Even though Israel did not sign a bilateral tax treaty with the Palestinian Authority, it signed the Gaza-Jericho Agreement in 1994 and incorporated an annex on economic relations (generally referred as “the Paris Protocol”).<sup>53</sup> According to the Paris Protocol, Israel would “tax” Palestinians who enter Israel to work but remit most of these tax revenues to the Palestinian Authority (keeps 25% as overhead reimbursement), despite the workers physically performing work in Israel (Israeli-source income). While the waiver granted by the state of Israel to the Palestinian Authority does not necessarily represent the optimal revenue allocation arrangement in the context of frontier workers, it should be read in the context of a peace normalization agreement.

50. There are approximately 1,500 Jordanian workers who are employed in tourism in Eilat (mainly working for Israeli hotels). These employees used to commute on a daily basis; however, subject to COVID-19 restrictions, they were asked to stay in Israel in the hotels and subject to government resolution. Despite this change, these workers were still exempt in Israel altogether.

51. *Saad vs Askelon* (2017); and IL: District Court, 27 Nov. 2008, No. 1061/07, *Telrom Human Resources Ltd vs Tel-Aviv 5 Assessment Office*.

52. K. LaOved, *Conquering Labor - Employment of Palestinian Workers in Israel* (Kav Laover 2018), available at <https://kavlaoved.org.il/> (9B%D7%99%D7%91%D7%95%D7%A9-%D7%94%D7%A2%D7%91%D7%95%D7%93%D7%94-%D7%94%D7%A2%D7%A1%D7%A7%D7%AA-%D7%A4%D7%9C%D7%A1%D7%98%D7%99%D7%A0%D7%99%D7%9D-%D7%91%D7%99%D7%A9%D7%A8%D7%90%D7%9C/ (accessed 24 Mar. 2024).

53. Annex IV Protocol on Economic Relations between the Government of the State of Israel and the P.L.O., representing the Palestinian people (29 Apr. 1994).

## **16.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)**

The ITA did not issue any specific guidelines during COVID-19, nor did it tone down the tax rules or provide any tax relief in consideration of the extraordinary conditions that were imposed by the government/employers. However, it seems that governments, as the sovereigns, may decide to either exercise their taxing powers or refrain from exercising their powers. As such, it seems that taking unilaterally favourable measures is indeed within each state's authority and does not contradict any of its treaty undertakings. For example, the state of Israel has exercised such authority when it decided to encourage immigration and extended favourable tax treatment to newcomers and former Israeli residents in order to incentivize them to return and establish their homes in Israel.

Indeed, the bilateral tax treaty network that a country signed and is obligated to sign does not compel the country to exercise its right to tax. While decades ago, the main concern that governments, practitioners and taxpayers raised was the need to avoid double taxation and double non-taxation was not viewed as harmful, the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI)<sup>54</sup> makes it clear that double non-taxation is no less detrimental. As such, it seems that under part III of the MLI, eliminating double non-taxation anticipates coordinated measures between contracting states. However, even in the absence of such coordination, it seems appropriate to adopt a minimal standard that would require governments that wish to unilaterally adopt tax breaks or any other temporary reliefs to notify their "treaty partners" of such measures. This approach is in line with the MLI's declaration that the application of tax treaties should not create opportunities for non-taxation or reduced taxation through tax evasion or avoidance and that any changes should be adopted in a synchronized and efficient manner across the treaty network.

## **16.8. The future of the mobility of work: A need for adjusting the existing treaty rules?**

The principal view for many years has been that physical capital is much more mobile than human capital. However, through the past few years of

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54. *OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (7 June 2017), Treaties & Models IBFD.

technological and communicational developments, the mobility of work has increased significantly – undermining, to a certain extent, our way of thinking. The author would, therefore, recommend revisiting some of the existing perceptions/rules which were adopted in a different economic reality and will present several examples and possible solutions.

First, the traditional thought of services has been that they are performed in physical proximity to the recipient and, as such, the source rules adopted for such services prioritized the place where such services were rendered. Nowadays, thanks to technological change, it is relatively easy to perform services remotely, and the time has come to revisit the existing “binary” source rule and possibly adopt rules that would allocate the profit between the relevant states of the service providers and recipients. It also seems that special source rules may be adopted to live-stream activities. Second, it seems that the profit allocation methodologies should be updated to consider the new virtual reality that enables new players and new functions take part in the profit-generating process. Similarly, it also seems that the concept of PEs should be revisited. Due to technological breakthroughs, more players manage to participate in the profit-generating activities of an enterprise than in the past, and it is easier and less costly to allocate revenues between the relevant states based on the different players that contribute. Accordingly, it is recommended to make sure that even remote presence of foreign enterprises would constitute a PE after a certain period and, even more so, to the extent that the foreign enterprise reached a minimal turnover.

Lastly, and as indicated previously, it seems that the new economic reality poses greater challenges on the ability to enforce tax rules that rely heavily on the physical dimension. Thus, it is recommended to insert an additional anti-avoidance measure in article 4(1) of the OECD Model. Currently, article 4(1) of the OECD Model requires that the taxpayer be taxed on a comprehensive basis in determining residency for treaty purposes. It is recommended to state that being liable to tax means not only that the taxpayer is taxed on a worldwide basis but also that the taxpayer does not receive special significant reduced tax rates that are unavailable for everyone else. In such cases, it is recommended that residency of that state for treaty purposes should not be applicable. This concept is, in some ways, in line with article 29(8) of the OECD Model and with the preamble to the MLI, according to which the tax treaty network should not create opportunities for non-taxation or reduced taxation.



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## Chapter 17

### The Impact of Tax Treaties on International Mobility of Work in Italy

Mario Tenore

#### 17.1. Mobility of work and domestic tax law

##### 17.1.1. Mobility and its consequences on individuals' taxation.

According to article 2(2) of Presidential Decree 22 December 1986, no. 917 (Italian Tax Code, ITC),<sup>1</sup> an individual is regarded as an Italian tax resident if at least one of the following conditions is met for most of the tax period (i.e. more than 183 days): (i) they are registered in the resident population registry (*anagrafe della popolazione residente*);<sup>2</sup> (ii) they have their domicile in Italy for civil law purposes (i.e. “the place in which a person established the main seat of his business and interest”); or (iii) they have their residence in Italy for civil law purposes (i.e. “the place in which a person has his habitual abode”).<sup>3</sup>

If either condition is fulfilled (for most of the tax year), the individual is deemed to be a tax resident of Italy for the entire fiscal year (which coincides with the calendar year, 1 January to 31 December). Alternatively, if none of the three conditions is met for most of the tax period, the individual is regarded as a non-tax resident for the whole period.<sup>4</sup>

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1. IT: Presidential Decree No. 917 of Dec. 22, 1986 [hereinafter ITC].

2. The Registry of Italians Residing Abroad (AIRE) is regulated by Law 470 of 27 October 1988 and by Presidential Decree 323 of 6 September 1989. As indicated by some authors “registration in the AIRE cannot be considered an absolute presumption of non-residence, since it could be proven that the person has kept their civil residence and/or domicile in Italy for most part of the fiscal year”. See IT: Cass. [Supreme Court (Tax Division)], 15 Mar. 2013, 6598; and G. Melis, *Tax Residence of Individuals in the Italian Direct Tax System: Some Reflections about the Relationship between Tax Law and Civil Law in Building Global International Tax Law: Essays in Honour of Guglielmo Maisto*, ch. 17 (P. Pistone ed., IBFD 2022), Books IBFD (accessed 12 Oct. 2022).

3. Melis, id.; and G. Melis, *La nozione di residenza fiscale delle persone fisiche nell'ordinamento tributario italiano*, 6 Rassegna tributaria, p. 1034 et seq. (1995).

4. G. Melis, *Trasferimento della residenza fiscale ed imposizione sui redditi* (Giuffrè Editore 2009); and S. Dorigo, *Chapter 16 – Italy*, in *Residence of Individuals under Tax Treaties and EC Law* (G. Maisto ed., IBFD 2010), Books IBFD. See also Melis, *supra*

Italian tax legislation does not entail the so-called split-year rule<sup>5</sup> for transfers during the year, which has been acknowledged by Italian tax authorities only in presence of a specific treaty expressly providing for the split of the tax period.<sup>6</sup> No exit tax applies upon outbound transfers unless the individual is acting in a business capacity.<sup>7</sup>

With the exception of the requirement based on registration in the resident population registry, which is a purely formal requirement, the other two tests used to ascertain tax residence under domestic law are fact-related, in particular:

- the concept of “domicile” relates to the centre of business and interest irrespective of the physical presence of the individual. The Italian Supreme Court (*Suprema Corte di Cassazione*) has repeatedly held that the domicile of a person is where both (i) economic relationships and (ii) personal, moral or family connections are situated.<sup>8</sup> According to

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n. 3. According to the latter author, “The three conditions mentioned in article 2(2) are, in a legal sense, alternative rather than concurrent: in the case that one of them occurs for the most part of the fiscal year, the individual will be deemed as resident in Italy, and, as a consequence, their worldwide income will be subject to tax for the whole of the relevant fiscal year. This means, for example, that an individual settling their habitual abode in Italy from 1 April to 31 December will also be taxed on their income, wherever earned, between 1 January and 31 March of the same fiscal year unless a tax treaty provides a part-year residence”.

5. Thus, if an individual moves to Italy during the first half of a given year for income tax purposes, they would be regarded as a tax resident in the same (and for the entire) year in which the transfer occurs. Alternatively, if an individual moves to Italy during the second half of the year, they shall become an Italian tax resident only from the subsequent tax period (if they meet the requirements).

6. E.g., Protocol of the Germany-Italy Income and Capital Tax Treaty, art. 3 (18 Oct. 1989), Treaties & Models IBFD according to which “If an individual is deemed a resident of a Contracting State in the sense of Article 4 for only part of the year and a resident of the other Contracting State for the remainder of that year (change of residence), his tax liability in the first-mentioned State, as far as it is determined by his residence, shall cease at the end of the day on which the change of residence takes place. His tax liability in the other State, as far as it is determined by his residence, shall begin on the day following that of the change of residence”. See also Italy-Switzerland Income and Capital Tax Treaty (9 Mar. 1976), Treaties & Models IBFD. The fact that “split year clauses” provided by tax treaties have to be considered an exception has been confirmed by the Italian Tax Authority in Ruling no. 171 of 2020 and in Resolution 471 of 2008.

7. In such case, exit tax shall be applicable with regard to their business assets.

8. IT: Cass. [Supreme Court (Tax Division)], 9 May 1956, 1530; IT: Cass. [Supreme Court (Tax Division)], 12 Feb. 1973, 435; and IT: Cass. [Supreme Court (Tax Division)], 5 May 1980, 2936, according to which the phrase “relates to the generality of an individual’s interests, not only the economic, but also the moral, social and familiar ones”. See IT: Cass. [Supreme Court (Tax Division)], 1 July 2021, 18702; IT: Cass. [Supreme Court (Tax Division)], 8 of October 2020, 21969; and IT: Cass. [Supreme Court (Tax Division)], 16 of July 2020, 15174.



- the most recent case law of the Italian Supreme Court, economic relations should generally prevail over personal and family ties;<sup>9</sup> and
- the concept of “residence” refers to the habitual abode of the individual, thus requiring a link with a specific location in the Italian territory. In this respect, in principle, reference is made to (i) the factual habitualness and, to a lesser extent, (ii) the subjective intention to use that location on a habitual basis.<sup>10</sup>

The Supreme Court and the tax authorities have generally taken a substantial (as opposed to formal) approach when assessing the tax residence of individuals. The absence of physical presence in Italy is not conclusive per se as an individual may qualify as a tax resident even if they spent less than 183 days in the Italian territory. Physical presence is one of the elements that is considered by the Italian tax authorities and case law as an indicator of the tax residence status of an individual. In addition to physical presence, other relevant indicators are taken into account in the overall assessment of tax residence, e.g. the existence of bank accounts or the participation in associations.<sup>11</sup>

As a final remark, article 2(2bis) of the ITC sets forth a rebuttable presumption of Italian tax residence that applies to Italian nationals that transfer their tax residence to certain states listed in the Decree of 4 May 1999 of the Minister of Finance as subsequently amended and extended (this list includes Monaco and Switzerland). The provision entails the inversion of the burden of proof so that the taxpayer that transfers their tax residence abroad is considered a tax resident in Italy by presumption of law. The presumption can be rebutted, and the taxpayer can provide contrary proof that no residence criteria is satisfied for most of the year.

9. IT: Cass. [Supreme Court] n. 15314, 10 March 2021; IT: Cass. [Supreme Court (Tax Division)], 31 March 2015, 6501; IT: Cass. [Supreme Court (Tax Division)], 15 July 2017, 45752; IT: Cass. [Supreme Court (Tax Division)], 25 June 2018, 32992; and IT: Cass. [Supreme Court (Tax Division)], 18 November 2011, n. 24246. See, for example, M. Gusmeroli, *Italian Domicile and Centre of Vital Interests: An Emigrant's Nightmare, an Immigrant's Dream*, 49 Eur. Taxn. 1 (2009), Journals IBFD; and G. Beretta, *Tax Residence of Individuals in Italy: The Determination of the Notion of Centre of Vital Interests*, 55 Eur. Taxn. 8 (2015), Journals IBFD.

10. In particular, the habitualness does not necessarily entail the duration of the use of the property or the frequency of the physical presence. An abode can also be used non-continuously or in separate periods of time (or can even not be used at all for a certain period of time) if it is understood that the individual intends to come back to use it in the future and continues to regard it as their habitual abode (see Ruling no. 458 of 7 July 2021).

11. See also IT: Cass. [Supreme Court], 21 July 2020, 29095; and IT: Cass. [Supreme Court], 8 October 2020, 21969.

## 17.1.2. Mobility and its consequences on corporate taxation.

### 17.1.2.1. Tax residence of corporations.

According to article 73(3) of the ITC, in the version applicable as from 2024, persons other than individuals are considered resident in Italy for income tax purposes if, for most of each taxable period, one of the following requirements is met: (i) they have a legal seat in the Italian territory, i.e. the place indicated in the company's by-laws; or (ii) their place of effective management or day-to-day management is in Italy.<sup>12</sup> The “place of effective management” is defined as the place of the continuous and coordinated taking of strategic decisions concerning the company or entity as a whole, while “day-to-day management” means the place of continuous and coordinated performance of day-to-day management acts concerning the company or entity as a whole.

Article 73(5-bis) of the ITC introduces a deeming residence criterion according to which a company is deemed to have its place of management if it holds a controlling shareholding in at least one resident company and either of the following conditions is met: (i) the company is controlled by persons that are resident of Italy; or (ii) the majority of the members of the board of directors is composed of persons that are residents of Italy. The presumption entailed in the deeming residence criterion is rebuttable if the

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12. See M. Tenore, *Chapter 17 Italy in Residence of Companies under Tax Treaties and EC Law* (G. Maisto ed., IBFD 2009), Books IBFD (accessed 12 Oct. 2022). The place of management is therefore the place where the decisions concerning the activities of the company are made. See M. Antonini, *Note critiche sulla presunzione in tema di residenza fiscale di società ed enti introdotta dal DL 4 Luglio 2006*, n. 223, *Rivista di Diritto Tributario*, part IV, p. 195 (2007); R. Schiavolin, *Aspetti sistematici della norma*, in *La presunzione di residenza delle società estero vestite*, p. 35 (E. Bagarotto ed., Cedam [2008]). It is doubtful whether such decisions should be intended as being related to the day-to-day activities or, conversely, whether they refer to the formulation of the main management guidelines or of the company's strategies. According to some authors, the first solution should be endorsed in light of the observation in the OECD Model Tax Convention on Income and on Capital: Commentary on Article 4 (23 Nov. 2017), *Treaties & Models* IBFD, where it is stated that “[...] the place where the main and substantial activity of the entity is carried on is also to be taken into account when determining the place of effective management”. However, some authors correctly noted that, if one follows such line of reasoning, the reference to the place of management would overlap with the reference to the main object of the activity contained in art. 73, para. 3 of Presidential Decree 917/1986. See also G. Bizioli, *The Evolution of the Concept of the Place of Management in Italian Case Law and Legislation: Interaction with Tax Treaties and EC Law*, 48 *Eur. Taxn.* 10, p. 528 (2008).

company is able to provide contrary evidence that the place of management is located outside of Italy.<sup>13</sup>

The mobility of individuals may have consequences on the residence of the corporation with respect to the requirement of the place of effective management or day-to management.<sup>14</sup> The assessment of the location of the place of the effective management (broadly similar to the OECD notion of the place of effective management) is a question of fact. The place of management tends to be the place from where the company's directors manage the company, i.e. the place where the key decisions necessary for the conduct of the business are in substance made. The directors' residence is often considered to be another important element to be taken into account when determining the company's place of management. In addition, if the management and control functions of the company are carried out by individuals other than the directors, then the place where these individuals make the key decisions would become relevant.

It follows that the transfer to Italy of the tax residence of directors (or key shareholders) of a foreign entity may also determine an attraction of the entity's tax residence to Italy. While being resident of Italy and physically present in the Italian territory, the director may carry out relevant managerial functions that can trigger the existence of the place of effective management in the Italian territory (such as participating in the meetings of the board of directors or receiving and investigating the accounts concerning the management of the company). Similar concerns arise if an individual who is the (direct or indirect) main shareholder of a company transfers their tax residence to Italy and, while tax resident of Italy, engages in any management activities (such as contacting the directors in order to discuss the company's investments or performance). Also, in such cases, the risk arises that the place of effective management of the company was transferred to the Italian territory and the company could be considered tax resident in Italy by virtue of the place of management situated on the Italian territory according to article 73(3) of the ITC.

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13. G. Melis, *La residenza fiscale dei soggetti IRES e l'inversione dell'onere della probatorio di cui all'art. 73, commi 5-bis e 5-ter*, Diritto e pratica tributaria internazionale 3, p. 782 (2007).

14. The mobility of employees would be unlikely to impact the main business purpose, which is considered to be located on the basis of the company's overall activity including the day-to-day operations (not only the highest management functions under the place of management criterion). Should the company's overall activity be performed in different states, the application of the "main" purpose criterion requires ascertaining whether the activity performed in Italy prevails over the activity carried on in a foreign state.

According to article 166-bis of the ITC in which an entity becomes an Italian tax resident, if the transfer is from an EU Member State or a state that allows an adequate exchange of information,<sup>15</sup> the entity is allowed to step up the value of its assets at their market value. Vice versa, if a transfer is from a state that does not belong to the EU or does not allow an adequate exchange of information with Italy, the step up is subject to an advance ruling with the Italian tax authorities. In the absence of such a ruling, the tax basis is determined in accordance with (i) the lower of the acquisition cost, the book value or the market value for assets; and (ii) the higher of the acquisition cost, the book value or the market value for liabilities.

Lastly, Italian tax authorities have taken the position in the framework of the Italian flat tax regime laid down in article 24-bis of the ITC<sup>16</sup> that when a director relocates to Italy to benefit from that regime:

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15. White-listed jurisdictions are listed in the Decree n. 239 of 1° April 1996.

16. For an analysis of the regime, see M. De Vita, *Flat Tax for “New Residents”*: A Comparison between the Italian and Portuguese Regimes, 60 Eur. Taxn. 10 (2020), Journal Articles & Opinion Pieces IBFD (accessed 12 Oct. 2022); G. Beretta, *From Worldwide to Territorial Taxation: Is Italy Now an Attractive Destination for Migrating Individuals?*, 71 Bull. Intl. Taxn. 8 (2017), Journal Articles & Opinion Pieces IBFD; and P. Mastellone & G. Giovannelli, *Recent Competitive Tax and Immigration Measures are Turning Italy into an “El Dorado” for Foreign Investors, Workers and HNWIs*, 49 Intertax 8/9 (2017). In essence, the flat tax regime, also known as the so-called “Paperoni”, intends to encourage – on an optional basis – the transfer of tax residence to Italy by “high net worth individuals” with the aim of encouraging their investments in Italy. As acknowledged by the Italian Revenue Agency, the regime is inspired by similar tax regimes available in other jurisdictions (e.g. Portugal or the United Kingdom). The regime is available to taxpayers of any nationality who transfer their residence to Italy from abroad and who have been resident abroad for at least nine tax periods in the 10-year period preceding the acquisition of Italian residence.

The regime does not require a minimum number of days of presence of the taxpayer in an Italian territory. Income from foreign sources is subject on a yearly basis to a fixed substitute tax of EUR 100,000, which applies in lieu of the personal income tax and related surcharges (reduced to EUR 25,000 if the option is extended to the taxpayer’s family members). By way of example, foreign source income includes dividends paid by foreign companies, income from employment if related to work performed outside the territory of the state (including stock options) or remuneration received as a director in foreign companies (even if related to interposed companies). On the other hand, capital gains realized in the first 5 years of application of the regime and deriving from the sale of qualifying shareholdings in foreign companies (e.g. for unlisted companies, shareholdings exceeding 25% of the capital or conferring at least 20% of the voting rights) are excluded from the application of the flat tax. Such capital gains are subject to the ordinary 26% tax. With respect to assets held abroad, the regime also provides significant advantages, namely, the exemption from wealth tax on foreign real estate (IVIE), wealth tax on foreign financial assets (IVAFE) and from the tax reporting obligations. Finally, for assets held abroad, the regime also entails an exemption from an inheritance and gift tax. The regime has a non-renewable maximum duration of fifteen tax periods. In the event of revocation or withdrawal in advance of the termination, the taxpayer is precluded from exercising a

[...] the particular subjective condition of the natural person who has opted for the substitute tax regime makes the attraction in Italy of the tax residence of a foreign entity, pursuant to article 73 of the TUIR, irrelevant for tax purposes, where the same was based solely on the relationship with the taxpayer who benefits from the substitute tax. This is because the regime referred to in Article 24-bis of the TUIR is not interested in the events relating to the operating entity located abroad where the income is intended to be produced, including those relating to management by the new resident.

This statement, however, should be read in the context of the special tax regime that applies at an individual level and should not be regarded as general.

In the opposite scenario, i.e. if the directors leave the Italian territory, it is very unlikely that a corporation may cease to qualify as tax resident for domestic purposes if it maintains its legal seat or main business object in Italy. Nonetheless, exit tax would apply (article 166 of ITC) if no permanent establishment (PE) remains in Italy.

#### 17.1.2.2. Permanent establishments and mobility of work

If a person works from a home office or a flex office located in the Italian territory, the issue that arises is whether such a place may constitute a PE for the foreign employer and therefore trigger taxation for the corporation.

In Circular Letter no. 33/E of 28 December 2020, Italian tax authorities clarified in the framework of the regime for inbound workers (the so-called *regime degli impatriati*)<sup>17</sup> that the presence in the Italian territory of a worker who relocated to Italy could create a PE of the foreign employer pursuant

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second option in order to fall in the scope of the favourable regime a second time. Finally, the taxpayer is entitled to file an advance ruling request with respect to the confirmation of the subjective requirements regarding the tax residence as well as other aspects related to the application of the regime such as the confirmation of the foreign source of an item of income or the interposed nature of a corporate vehicle owned or attributable to the taxpayer. The submission of a ruling request that must be accompanied by adequate supporting documentation is strongly recommended as it places the taxpayer in a position of greater legal certainty with respect to future tax audits. Finally, as clarified by the revenue agency, access to the regime following the transfer of residence in Italy should not affect the foreign residence of corporate vehicles in which the taxpayer holds a capital participation or is a director.

17. For an analysis of the regime, see S. Serbini & E. Battiloro, *Recent Legislation on the Tax Regime Applicable to Inbound Workers, Qualified Lecturers and Researchers*, 59 Eur. Taxn. 10 (2019), Journal Articles & Opinion Pieces IBFD (accessed 12 Oct. 2022).

to article 162 of the ITC and the relevant tax treaty.<sup>18</sup> However, Italian tax authorities did not specify the conditions and circumstances under which a PE could be deemed to exist; therefore, the statement remains rather vague.

With the exception of this position, Italian tax authorities have not addressed the issue as to whether working from a flex office or a home office could constitute a PE.

According to the author, working from a flex office or a home office could, in principle, give rise to a material PE according to article 162(1) of the ITC, which, similar to article 5(1) of the 2017 OECD Model provides that “[...] the term ‘permanent establishment’ means a fixed place of business through which the business of an enterprise is wholly or partly carried on in the territory of the State”.

However, assessing whether a home office can constitute a PE depends on a multitude of factors.<sup>19</sup> It is submitted that, in order for the home office or flex office to constitute a PE, the place must have a certain degree of permanency (both physically and temporally) and must be at the disposal of the foreign enterprise, which should wholly or partly carry out the business through the place concerned.<sup>20</sup>

Depending on the facts and the actual activity carried out in the Italian territory, working from a home office or a flex office could also give rise to the so-called agency PE according to article 162(6) of the ITC, which is largely in line with article 5(5) of the OECD Model.

According to article 162(6) of the ITC, a non-resident entity is deemed to have a PE in Italy if:

[...] a person acts in the territory of the State on behalf of a non-resident enterprise and habitually concludes or acts for the purposes of the conclusion of contracts without material modifications by such enterprise and these contracts

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18. Italian tax authorities further clarified that the regime for inbound workers does not apply to business income attributable to the PE of the non-resident company (i.e. foreign employer) that will therefore be subject to ordinary taxation.

19. A. Báez Moreno, *Unnecessary and Yet Harmful: Some Critical Remarks to the OECD Note on the Impact of the COVID-19 Crisis on Tax Treaties*, 48 Intertax 8/9, p. 818 (2020).

20. For a thorough analysis of art. 162 ITC, see T. Galluccio, *Chapter 17: Italy in New Trends in the Definition of Permanent Establishment* (G. Maisto ed., IBFD 2019), Books IBFD (accessed 12 Oct. 2022). See, inter alia, also the guidance issued by Italian Tax Authorities in the Circular Letter no. 26/E of 7 Aug. 2014, para. 4.1.; Circular Letter no. 12/E of 3 May 2013; and Resolution no. 119 of 28 May 2007.

are either in the name of such enterprise or for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or for the provision of services by that enterprise.<sup>21</sup>

It shall therefore be important to evaluate whether the employee performs these activities in a “habitual” way. In this respect, the requirement of habituality should not be found insofar as an employee or an agent carries on activity in Italy working at home because of an extraordinary event or public health restrictions. However, Italian tax authorities have not yet issued guidance or specifically endorsed such a conclusion.

According to article 162(7) of the ITC, an exception to the agency PE clause is found, namely:

Paragraph 6 shall not apply where the person, acting in the territory of the State on behalf of a non-resident enterprise, carries on its business as an independent agent and acts for the enterprise in the ordinary course of that business. Where, however, a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, that person shall not be considered to be an independent agent, within the meaning of this paragraph, with respect to any such enterprise.

According to the provision, an agent shall be considered independent and will not trigger the existence of an agency PE. It specifies that a person who operates exclusively or almost exclusively on behalf of one or more closely related enterprises shall not be considered an independent agent.

In light of the previously mentioned rules, it shall be important to evaluate whether the employee performs these activities in a “habitual” way. In this

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21. However, art. 162(7) ITC, which is consistent with art. 5(6) of the OECD Model, provides an exception when the person acting in Italy on behalf of a foreign enterprise carries on their own business in Italy as an independent agent and acts for the enterprise in the ordinary course of that business. In addition, art. 162(7-bis) contains an anti-fragmentation rule that, when a person acts exclusively or almost exclusively on behalf of one or more enterprises to which they are closely related, that person will not be considered to be an independent agent with respect to any such enterprise.

For the purposes of identifying an independent agent, a person is considered closely related to an enterprise if, based on all of the relevant facts and circumstances, one controls the other or both are under common control of a third person or enterprise. In any event, the requisite degree of control will exist when: (i) one person or enterprise directly or indirectly possesses more than 50% of the beneficial interest in the other or, in the case of a company, more than 50% of the aggregate vote and value of the issued and outstanding share capital; or (ii) another person directly or indirectly possesses more than 50% of the beneficial interests in both persons or enterprises or, in the case of a company, more than 50% of the aggregate vote and value of the share capital in both companies.

respect, the requirement of habituality should not be fulfilled insofar as an employee or an agent carries on activity in Italy working at home because of an extraordinary event or public health restrictions. However, Italian tax authorities have not yet issued guidance or specifically endorsed such a conclusion.

This being said, despite that the considerations mentioned previously regard the application and interpretation of Italian domestic tax rules, the same issue concerning the existence of a PE should also be addressed against the background of article 5 of the OECD Model, which is generally followed by Italian tax treaties.

### 17.1.3. Mobility and its consequences on social security.

The Italian pension system is based on the so-called principle of “territoriality”.<sup>22</sup> According to such principle, social security contributions are due in the case that working activity is carried out in the Italian territory. It is immaterial whether the activity is carried out remotely and/or for the benefit of foreign employers who do not have any presence in the territory.

Exceptions to this rule are based on the notion of “temporary secondment” or of the posting of foreign workers in Italy, which is regulated by bilateral agreements and/or under Social Security Regulation (2004/883) on the coordination of social security systems and later amendments.<sup>23</sup> Under article 12(1) of this regulation, for example, an employee who pursues an activity as an employed person in an EU Member State on behalf of an employer that normally carries out its activities there and who is posted by that employer to another member state to perform work on that employer’s behalf shall continue to be subject to the legislation of the first member state provided that the anticipated duration of such work does not exceed 24 months and that they are not sent to replace another posted person.

In addition, under article 13(1) of Social Security Regulation (2004/883), an employee who normally pursues an activity as an employed person in two or more member states shall be subject to the legislation of the member state of residence if they pursue a substantial part of their activity in that member state.

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22. See Law Decree no. 1827 of 4 October 1935, art. 37.

23. Regulation (EC) No 883/2004 of The European Parliament and of The Council of 29 April 2004 OJ L 166, 30 Apr. 2004, p.1.



Article 14 of Social Security Implementing Regulation (2009/987) defines “substantial” as a share of the working time and/or wages of at least 25%. Where the substantial part of the activity is carried out is determined on the basis of a forecast for the next 12 months. Alternatively, i.e. if they do not pursue a substantial part of their activity in the member state of residence, the employee can be subject to the legislation of the member state in which the registered office or place of business of the undertaking or employer is situated.

Other than the exceptions mentioned previously that are limited to a “temporary secondment” or to cases when the employee normally pursues an activity as an employed person in two or more member states, the territoriality principle applies with the consequence that the employee is subject to social security contribution in Italy if the activity is carried out remotely on a stable basis from the Italian territory (regardless of the fact that the activity would be carried out for the benefit of a foreign employer). In light of this, if the employee temporarily and unexpectedly works from home for several weeks or months (e.g. following the COVID-19 measures), according to article 13(1) of Social Security Regulation (2004/883) laying down the multi-state workers’ rule, the employee should be covered by the social security in the residence state (rather than the country where their employer is established). This should apply regardless of the fact that the employee is working at home in accordance with their company’s policy, governmental recommendations or mandatory restraints.

## **17.2. Residence, tiebreaker rules and mobility of work: Individuals and entities**

With respect to the definition of “residence”, Italian tax treaties generally follow the OECD Model. In the case of a dual-residence conflict, that person’s place of residence for the purposes of the tiebreaker included in the applicable treaty is unlikely to change given that the tiebreaker provision requires a consideration of factors that shall also be assessed in a more normal period. Therefore, special considerations should apply if the presence in Italy is due to an exceptional force majeure such as COVID-19, at least until the public health restrictions are lifted.

On 3 December 2020, the Ministry of Economy and Finance (MEF) replied to parliamentary question no. 5-04654, regarding the tax resident status of Italian workers resident abroad who, due to the COVID-19 emergency,

returned to Italy on a temporary basis and ultimately remained in the Italian territory for a long period due to COVID-19 restrictions.

The MEF recognized that the OECD recommendations should be taken into account, despite the fact that Italy had concluded administrative agreements with Austria, France and Switzerland.<sup>24</sup> Therefore, for example, the circumstance for which an individual who is not a resident for tax purposes in Italy has been forced to extend their period of stay in Italy due to the extraordinary and exceptional circumstance of the pandemic regardless of their intention should be considered in order to establish for that person a change of residence for the purposes of the treaty (with particular reference to the criterion mentioned previously of “habitual residence”).

However, in ruling no. 458 of 7 July 2021, Italian tax authorities took a narrower approach compared to the MEF’s position and clarified that the OECD Guidance should be relevant solely in the framework of the administrative agreements mentioned previously based on the reciprocity principle. At present, therefore, the OECD Guidance does not have general relevance for the purpose of interpretation and application of Italian tax treaties except for the cases covered by ad hoc administrative agreements. Ruling no. 458 of 7 July 2021 dealt with employees hired with an Italian contract and seconded to subsidiaries resident in China who returned to Italy following the outbreak of the COVID-19 pandemic. Italian tax authorities clarified that the employees could be considered tax resident in Italy according to the domestic rules, as they could be considered to have their domicile in the Italian territory for most of the tax period. Should a conflict of residence with the foreign state arise, this would have to be resolved according to an applicable tax treaty. The Italian tax authorities noted that, if a person has a permanent home in both states, the conflict of residence is usually resolved based on the treaty tiebreaker criterion of “habitual residence”.

With specific reference to the criterion of “habitual residence”, Italian tax authorities referred to paragraph 19 of the Commentary to Article 4 of the OECD Model. According to this paragraph, however, the habitual abode of a person is where the individual lives habitually in the sense of being

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24. See OECD, *OECD Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis* (3 Apr. 2020), available at <https://www.oecd.org/coronavirus/policy-responses/oecd-secretariat-analysis-of-tax-treaties-and-the-impact-of-the-covid-19-crisis-947dcb01/> (accessed 25 Feb. 2022). On this second document, see OECD, *OECD Updated Guidance on Tax Treaties and the Impact of the COVID-19 Pandemic* (21 Jan. 2021), available at <https://www.oecd.org/coronavirus/policy-responses/updated-guidance-on-tax-treaties-and-the-impact-of-the-covid-19-pandemic-df42be07/>.

For a thorough comment on the OECD note, see Báez Moreno, *supra* n. 19.

customarily or usually present without considering restrictions imposed as a public health measure. The test will not be satisfied by simply determining in which of the two contracting jurisdictions the individual has spent more days during that period.<sup>25</sup>

With regard to the dual residence conflicts involving corporate entities, in 2000, Italy submitted an observation in the Commentary on Article 4 of the OECD Model<sup>26</sup> holding the view that “the place where the main and substantial activity of the entity is carried on is to be taken into account when determining the place of effective management of a person other than an individual”. The place where the main and substantial activity of the entity is carried on corresponded to another criterion employed under domestic law for the purpose of establishing domestic tax residence (the criterion of the “*oggetto principale*”). The criterion of the *oggetto principale* was dropped by the legislator at the end of 2023 and replaced by the criterion of the day-to-day management (referring to the place where the day-to-day management of the entity as a whole is mostly carried out). It could still play a role to assess the taxing rights based on residence criteria.

### 17.3. Permanent establishments and mobility of work

In respect of the definition of a PE, most of the Italian tax treaties follow article 5 of the OECD Model (1963) even when they were signed after the publication of a later version of the model. The principles elaborated by the Supreme Court (since the case *Philip Morris* (1997) onwards) have played a fundamental role in the interpretation of treaty provisions.<sup>27</sup>

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25. Italian tax authorities also made reference to the OECD Guidance on the notion of “habitual abode”, which refers to the frequency, duration and regularity of stays that are part of the settled routine of an individual’s life and are therefore more than transient. The days spent in a person’s previous home jurisdiction because of travel restrictions imposed as a public health measure by one of the governments of the countries involved should not result in a change to the person’s habitual abode. The determination of habitual abode must cover a sufficient length of time for it to be possible to ascertain the frequency, duration and regularity of stays that are part of the settled routine of the individual’s life.

26. Para. 25 *OECD Model: Commentary on Article 4*, which was deleted in the 2017 Commentary, as a consequence of the change to art. 4(3) OECD Model.

27. The principles developed in that case law are reflected in an observation that Italy recorded in the Commentary on Article 5 of the OECD Model, after which the Commentary had been amended to reject the interpretation of “permanent establishment” provided by the Italian Supreme Court. According to that observation: “Italy wishes to clarify that, with respect to paragraphs 97, 116, 117 and 118, its jurisprudence is not to be ignored in the interpretation of cases falling in the above paragraphs”.

With regard to a home office, the author is of the opinion that, in conformity with paragraph 18 of the Commentary on Article 5 of the OECD Model, no PE should exist even though part of the business of an enterprise may be carried on at a location such as an individual's home office. Such a conclusion has not been official endorsed by the Italian tax authorities although it is consistent with OECD recommendations.<sup>28</sup>

It is submitted that – based on the case law on the definition of PE – if remote working is a consequence of a public health measure or restriction imposed at the governmental level, the home office or flex office should not create a fixed place of business PE for the business or employer. If an individual continues to work from home after the cessation of the public health measures imposed or recommended by the government, the home office may be considered to have a certain degree of permanence. A close examination of the facts and circumstances will be required to determine whether the home office is at the disposal of the enterprise following this permanent change to the individual's working arrangements.

The question may also arise whether the activities of an individual temporarily working from home for a non-resident employer could give rise to a

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28. According to the OECD recommendations, the home office cannot be considered at the disposal of that enterprise simply because that location is used by an individual (e.g. an employee) who works for the enterprise. A fortiori, the carrying on by the employee of an intermittent business activity at home does not make that home a place at the disposal of the enterprise. According to para. 18 of the Commentary on Article 5 of the OECD Model, the home office can be considered at the disposal of the foreign enterprise when a home office (being a temporary dwelling or a place of residence) 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 (e.g. by not providing an office to an employee in circumstances where the nature of the employment clearly requires an office). However, according to the Commentary on Article 15, para. 19, if a worker performs most of their work from their home situated in one jurisdiction rather than from the office made available to them in the other jurisdiction, it should not be considered that the home is at the disposal of the enterprise either because the enterprise did not require that the home be used for its business activities or because such an activity lacks a sufficient degree of permanency or continuity. As noted in the Commentary on Article 5 of the OECD Model, para. 98, the extent and frequency of activity necessary to treat an agent as acting "habitually" depends on the nature of the contracts and the business of the enterprise.

In that respect, the same sort of factors considered in the Commentary on Article 5 of the OECD Model, paras. 28 to 30, would be relevant. For example, those paragraphs, among other things, note that while the practices followed by member countries have not been consistent insofar as time requirements are concerned, experience has shown that PEs normally have not been considered to exist in situations where a business had been carried on in a country through a place of business that was maintained for less than 6 months (conversely, practice shows that there were many cases when a PE has been considered to exist where the place of business was maintained for a period longer than 6 months).

dependent agent PE.<sup>29</sup> Under article 5(5) of the OECD Model, the activities of a dependent agent such as an employee will create a PE for an enterprise if the employee habitually concludes contracts in the Italian territory on behalf of the enterprise. In line with the OECD recommendations, the agent's activity in a jurisdiction should not be regarded as "habitual" if they have exceptionally begun working at home in that jurisdiction as a public health measure imposed or recommended by at least one of the governments of the jurisdictions involved to prevent the spread of the COVID-19 virus. Therefore, this would not constitute a dependent agent PE provided the person does not continue those activities after the public health measures cease to apply.<sup>30</sup> A different approach may be appropriate, however, if the employee was already habitually concluding contracts on behalf of an enterprise in their home jurisdiction before the COVID-19 pandemic. Likewise, if the employee continues to work from home for a non-resident employer after the COVID-19 pandemic on a habitual basis and continues to conclude contracts on behalf of the enterprise, the employee could be considered to habitually conclude contracts on behalf of the enterprise.

#### **17.4. Physical presence according to articles 15(1) and 17 of the OECD Model**

Most Italian tax treaties largely follow article 15 of the OECD Model (2017). The identification of the place of the activity state is therefore a crucial element in the application of the provision. The place of physical presence of the recipient of the income is decisive in order to determine the place in which the activities are materially carried out. Italian tax authorities have recently issued a number of rulings in which they have addressed and clarified the relevance of physical presence, excluding the possibility of a departure from this principle.

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29. For a thorough analysis, see S.V. Kostić, *A Plea for a Workforce Presence PE Concept in a Post-Covid Digitalized World*, 40 Intertax 10, p. 758 and ff. (2021).

30. Para. 33.1 OECD Model: Commentary on Article 5 (2014) provides that the requirement that an agent must "habitually" exercise authority to conclude contracts means that the presence that an enterprise maintains in a jurisdiction should be more than merely transitory if the enterprise is to be regarded as maintaining a PE and thus a taxable presence in that jurisdiction.

Similarly, para. 98 OECD Model: Commentary on Article 5 (2017) explains that the presence that an enterprise maintains in a jurisdiction should be more than merely transitory if the enterprise is to be regarded as maintaining a PE in that jurisdiction under article 5(5).

While most of these rulings concerned domestic tax regimes, the principles elaborated therein have also been reiterated in the context of the employment income article contained in Italian tax treaties.

A number of rulings concerned the application of the old regime for impatriate workers (article 16(1)) of Legislative Decree no. 147/2015), which provided a partial exemption of the income if derived from activities predominantly carried out in the Italian territory under certain conditions<sup>31</sup>.

Ruling no. 596 of 16 September 2021 addressed the case of a taxpayer, an Italian citizen, who intended to return to Italy to continue working remotely for a US company. The taxpayer requested, among other things, clarification regarding the application of a special regime for income derived from Italian activities despite that the income was paid by a foreign employer. Italian tax authorities recalled that the special regime does not require the worker to be employed by an Italian company. Therefore, employees who keep an employment relationship with a foreign employer and who relocate to Italy may apply the regime insofar as the activity is physically exercised in the Italian territory.

Ruling no. 55 of 31 January 2022 addressed the case of a taxpayer, an Italian citizen, who was a tax resident in an EU country since 2018. The facts are similar to the previous ruling, and the Italian tax authorities confirmed that the application of the regime only requires the performance of an activity in the Italian territory regardless of the residence of the employer. Therefore, Italian employment activities carried out in Italy in a “smart working” mode can benefit from the special regime.

Other rulings concerned the application of the so-called regime of conventional remuneration for employees working abroad.<sup>32</sup> For example, in ruling no. 590 of 15 September 2021, the Italian tax authorities dealt with the case of an executive who, while remaining tax resident in Italy, was expected to be seconded from an Italian company (employer) to its German subsidiary for the period from 1 April 2021 to 31 March 2023. While seconded in

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31. As from 1<sup>st</sup> January 2024, the regime has been replaced and a new impatriate regime has entered into force according to art. 5 of Legislative Decree n. 209 of 27 December 2023.

32. According to art. 51, para. 8-bis of the ITC, the taxable income is determined on the basis of the conventional remunerations insofar as Italian resident individuals carry out a working activity abroad on an ongoing basis and as the exclusive object of the employment relationship for a period of more than 183 days over a 12-month period. The amount of conventional remunerations is set by 31 January of each year and is determined with reference, and in any case to an extent not less than the minimum remuneration provided by the national collective agreements for the category grouped by homogeneous sectors.

Germany, the executive maintained the work relationship with the Italian company and carried out the working activity remotely from the Italian territory. The Italian tax authorities noted that, with particular reference to the requirement of staying in the foreign state for a period exceeding 183 days, the criterion adopted by the legislator for the application of domestic rules governing the taxation of employment income relies on the physical presence of the employee in the state where the work is carried out (*see* Circular 207/2000 and Circular 17/2017). Accordingly, Italian tax authorities denied the application of the regime of conventional remuneration in the case at stake arguing on the basis of the failure by the executive to carry out the activity in the territory of the foreign state (physical presence test).<sup>33</sup>

More importantly, Italian tax authorities have also addressed the relevance of physical presence in a treaty context with regard to the application of the employment income article. In ruling no. 458 of 7 July 2021, Italian tax authorities dealt with a case regarding employees who were hired with an Italian contract and seconded to subsidiaries resident in China who returned to Italy following the outbreak of the COVID-19 pandemic. During their stay in Italy, the concerned individuals continued to work remotely (i.e. in smart working) on behalf of the Chinese posting companies. The secondment of the workers in China from a contractual and *de facto* point of view did not change from either an individual point of view or from the point of view of the intercompany agreement under which the cost of the posted employees was charged by the Italian company to the Chinese company.

The Italian tax authorities clarified that, for persons who carry out employment activities remotely in another state due to mobility restrictions, the rules on the territoriality of employment income are linked to physical presence in that state both at the domestic level (*see* article 23(c)(1)(l)(c) of the ITC) and at the tax treaty level (article 15(1) and (2) of the China (People's Rep.)-Italy Income and Capital Tax Treaty (2019)). Italian tax authorities pointed out that the OECD Guidance applies only with regard to tax treaties for which Italy concluded an administrative agreement. According to the Italian tax authorities, the OECD Guidance applies to interpret the provisions contained in article 15 of the OECD Model concluded by Italy with Austria, France and Switzerland (*see* section 17.7.). With such neighbouring countries, under conditions of reciprocity, the criterion of "virtual" presence applies in lieu of the criterion of physical presence in line with the OECD recommendation. Italian tax authorities concluded that the principles of

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33. In the same vein, *see also* ruling 345 of 17 May 2021 and ruling 458/2021 of 7 July 2021.

those agreements cannot have effects vis-à-vis other states with which Italy has entered into a tax treaty and confirmed such a position in a number of rulings.

Ruling no. 621 of 23 September 2021 addressed the case of an Italian resident taxpayer, a Dutch national, who has been working in Italy for an Italian company since 2019. During 2020, due to COVID-19, the taxpayer worked remotely from the Netherlands for more than 184 days where his family was located. In the case of smart working, in line with what has been clarified in previous rulings no. 590/2021 and no. 596/2021, Italian tax authorities clarified that the place of performance must be understood as the place where the employee is physically present when they perform their activity. Moreover, Italian tax authorities concluded that, if the income was taxable in the Netherlands according to the relevant tax treaty, the taxpayer could benefit from the tax credit provided by article 165 of the TUIR (according to the treaty obligations laid down in article 24(4) of the tax treaty between Italy and the Netherlands).

Ruling no. 626 of 27 September 2021 addressed the case of an Italian taxpayer who was resident in Luxembourg and employed by a Luxembourgish company. Due to the pandemic, the taxpayer relocated to Italy to work remotely in March 2020. In the case at hand, as the employment activity carried out in Italy exceeded a period of 183 days, Italian tax authorities concluded that, pursuant to article 23 of the TUIR and article 15 of the Italy-Luxembourg Income and Capital Tax Treaty (1981), the income was taxable in Italy (as the state where the activity is performed). Accordingly, Luxembourg (as the state of residence) was obligated to eliminate double taxation credit pursuant to article 24 of the tax treaty.

Although Italian tax authorities have not addressed the issue, it is submitted that the criterion of physical presence should also apply to article 17 of the OECD Model, which deals with income of entertainers and sportspersons. In this respect, the first question to address is where artists and athletes should be taxable according to article 17 of the OECD Model if they rehearse or train in one state and perform publicly in another state. Ruling no. 354/2020 gave some clarification in this respect. According to the facts of the case, two musicians (tax residents of Germany and Switzerland, respectively) were engaged by an Italian foundation to perform in two concerts organized outside the Italian territory. The musicians were entitled to receive a remuneration in connection with the participation in the concerts; however, no remuneration was due in case of cancellation of the concerts (e.g. in the event of force majeure). The musicians were obligated to carry



out all preparatory activities (including concert rehearsals) in Italy (subject to the guidelines provided by the foundation regarding the place and the time of the rehearsals). Neither a specific remuneration nor a reimbursement of the related expenses was provided in the contracts with regard to the rehearsals. The Italian tax authorities took the view that the income paid to the musicians was to be regarded as income from an artistic performance carried out entirely outside the Italian territory regardless of the days of presence in Italy for concert rehearsals as such a performance is not subject to Italian taxation in the hands of the non-resident taxpayers. The Italian tax authorities upheld such a conclusion, pointing out that rehearsals carried out in Italy (i) had a purely preparatory function vis-à-vis the main performance, i.e. the concert exhibition, and hence it was not possible to regard them as separate activities; and (ii) were not specifically remunerated (as also confirmed by the fact that the musicians were not entitled to any payment in the case of cancellation of the concerts).

Finally, in the case of live streaming or online events, it is submitted that the place of physical presence is still to be regarded as the relevant criterion both at domestic and tax treaty levels despite the fact that this sourcing criterion (and the outcome thereof) may appear unsatisfactory in light of the developing of digital entertainment where the interaction between the entertainer and the audience may well be achieved remotely as in the case of live events.

Under article 17 of the OECD Model, however, this is not a relevant element, and one must look exclusively at where the activity is carried out.<sup>34</sup> Therefore, physical presence in the state where the entertaining activity takes place is irrelevant.

However, alternative criteria could be considered, particularly in light of the development of digital entertainment, e.g. e-sports and online gaming.<sup>35</sup> In such cases, it could be argued that a more appropriate connecting factor could be the residence of the organizer of the event or tournament that is the payer of the prize money by applying an analogy with the sourcing criterion

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34. A. Cordewener, *Tax Treaty Issues Related to Qualification, Allocation and Apportionment of Income Derived by Entertainers and Sportspersons in Taxation of Entertainers and Sportspersons Performing Abroad*, p. 115 (G. Maisto ed., IBFD 2016); J. Roeleveld & K. Tetlak, *Article 17: Entertainers and Sportspersons - Global Tax Treaty Commentaries – Global Topics - 3. Source State Taxing Rights*, p. 9 (IBFD 2016) Global Topics IBFD.

35. M. Tenore, *Esports and tax, how the OECD Model Tax Convention applies to player's income*, LawInSport (2020), available at <https://www.lawinsport.com/topics/item/esports-and-tax-how-the-oecd-model-tax-convention-applies-to-players-income> (accessed 7 Apr. 2021).

entailed for directors' remuneration in article 16 of the OECD Model.<sup>36</sup> The commentary to the provision justifies the use of the residence of the payer, pointing out that "it can be difficult to identify where the services are rendered" so that "the provision considers the services rendered in the country of residence of the company" (*see* Commentary on Article 16 of the OECD Model, paragraph 1). The application of a similar sourcing criterion would ensure that income is taxed at least once and would avoid (double) non-taxation if the e-gamer resides in a state characterized by zero or very low taxation with the consequence that the provision would be ineffective with respect to the rationale that has underlined the introduction of article 17 of the OECD Model.

The solution mentioned previously (residence of the payer as an alternative to physical presence), however, is not in line with the current wording of article 17, which unequivocally relies on the criterion of the physical exercise of an entertaining activity in the other contracting state. Therefore, turning to the example of e-sports or online gaming, e-sport players participating in an online tournament connecting from their homes are exclusively taxable in the state of physical presence, which could coincide with the state of residence. By contrast, in the case of offline e-sports tournaments, the income will be taxable in the state where the tournament takes place (source state), following the place of physical presence in the exercise of the entertaining activity.

### 17.5. Article 15(2) and (3) of the OECD Model

Italian tax treaties include an article 15(2) that is similar to the corresponding provision of the OECD Model. Accordingly, employment income is taxable in the state of the activity if: (i) the 183-day threshold is exceeded; or (ii) the remuneration is paid by or on behalf of an employer who is not a resident of that other state; and (iii) the remuneration is borne by an Italian PE.

The computation of the 183-day threshold includes exclusively the days of physical presence. According to Circular no. 201/E of 17 August 1996, this

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36. M. Tenore, *E-sport: l'applicazione dell'articolo 17 Modello OCSE ai redditi conseguiti dagli e-gamer*, rivista telematica di diritto tributario, Rivista Telematica di Diritto Tributario (31 May 2021), available at <https://www.rivistadirittotributario.it/wp-content/uploads/2021/05/Tenore.pdf> (accessed 25 March 2024).

is the method for calculating the number of days an individual is deemed to be physically present in the work state.

With regard to the residence of the employer, in the event that the Italian employer changes its residence due to the fact that the board members relocate outside of the Italian territory to work from a foreign jurisdiction, the following consequences may arise for the employees: (i) they shall continue to be subject to personal income tax in Italy if resident therein (being subject to worldwide taxation); (ii) if not resident in Italy, they shall continue to be subject to personal income tax in Italy if the work activity is carried out in the Italian territory for more than 183 days;<sup>37</sup> or (iii) in all cases, if the remuneration is borne by an Italian PE of the employer that, in the meantime, had ceased to be Italian tax resident. In the latter case, the existence of an Italian PE of the non-resident employer could also be a consequence of work activities remotely carried out in Italy by the employees who are present in the Italian territory.

## 17.6. Frontier workers

Certain Italian tax treaties include special provisions dealing with income of frontier workers.<sup>38</sup>

For example, according to article 15(4) of the Italy-Switzerland Income and Capital Tax Treaty (1976), the employment income earned by cross-border workers is subject to exclusive taxation in the state where the work is carried out by reference to the agreement of 3 October 1974.<sup>39</sup> The 1974 Swiss-

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37. P. Arginelli & M. Tenore, *Italy - Global Tax Treaty Commentaries – Country Policy & Practice*, sec. 16 Country Tax Guides (accessed 30 Apr. 2022). Certain tax treaties (such as with Ivory Coast, Morocco) make reference to a calendar year rather than to a fiscal year in article 15(2). Certain tax treaties include the days of normal interruptions of work in the computation of the 183-day threshold in article 15(2). The tax treaty with Mexico refers to 120 days rather than 183 days.

38. E.g. *It.-Switz. Income and Capital Tax Treaty* (1976), Treaties & Models IBFD; *Austria-It. Income and Capital Tax Treaty* (1981), Treaties & Models IBFD; and *Fr.-It. Income and Capital Tax Treaty* (1989), Treaties & Models IBFD.

39. According to Art. 15.4: “The taxation of employment income derived by frontier workers shall be determined in accordance with the Swiss-Italian Agreement of 3 October 1974, relating to the taxation of frontier workers and financial compensation for Italian frontier municipalities, of which articles 1 to 5 shall be deemed to form an integral part of this Convention”.

Italian Agreement indeed grants exclusive taxing rights to Switzerland as the source jurisdiction.<sup>40</sup>

As noted by some commentators, the 1974 Swiss-Italian Agreement does not contain a definition of “cross-border worker” nor a time-period where cross-border workers can derogate to the daily back home requirement.<sup>41</sup> Based on Italian parliamentary reports, a frontier worker under the 1974 Agreement is “the worker who works in Switzerland, but which, at the end of the workday, comes back to his/her home in Italy”. The notion of frontier workers contained in the 1974 Swiss-Italian Agreement applies to workers who return home daily and reside in an Italian municipality within 20 kilometres from the border. Based on this meaning of frontier workers, those who were forced to remain in either the source or residence state could not qualify as cross-border workers. Therefore, article 15(1) of the Italy-Switzerland Income and Capital Tax Treaty (1976) would apply instead.

On 23 December 2020, Switzerland and Italy signed a new treaty on cross-border workers as well as a protocol amending the existing tax treaty. The new agreement replaces the 1974 Swiss-Italian Agreement and entered into force on 17 July 2023 and will be effective as from 1 January 2024.<sup>42</sup> The 2020 Swiss-Italian Agreement applies to new frontier workers, i.e. those who will start working in Switzerland in the cantons of Graubünden, Ticino and Valais after the agreement enters into force. Income of the new frontier workers may be taxed in both states as follows:

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40. Though, it is provided that, at the end of each fiscal year, Canton Ticino (with Canton Graubünden and Canton Valais) must pay a compensation fee (38.8% of the gross amount of taxes collected) to the Italian municipalities located within 20 kilometres of the Swiss border.

41. F. Amadeo, *Frontier Workers and Remote Working: A Swiss-Italian Tax Perspective*, Kluwer International Tax Blog (28 Jan. 2022), available at <http://kluwertaxblog.com/2022/01/28/frontier-workers-and-remote-working-a-swiss-italian-tax-perspective/> (accessed 25 March 2024).

42. In order to avoid any abuse of the regime, there is now a clearer definition of a cross-border worker: An individual, tax resident in a municipality, whose territory is located, totally or partially, in the area of 20 kilometres from the border with the other contracting state who (i) carries out an employed activity in the border area of the other contracting state for a resident employer, PE or fixed base of that other state; and (ii) returns, in principle, on a daily basis to their principal place of residence in the municipality as stated at point (i). It has been established that the contracting state in which the employee’s activity is carried out will annually provide the state of residence in an electronic format (by 20 March of the year following the fiscal year of reference) the information relevant for the purposes of taxation of the cross-border worker (e.g. personal identification data, amount of gross remuneration received, mandatory social security contribution paid, the amount of tax withholdings applied, etc.).

- Switzerland (considered as the state of source) may apply a withholding tax that cannot exceed 80% of the withholding tax that would otherwise normally be payable; and
- Italy (considered the state of tax residence) taxes the income of the worker and eliminates double taxation.<sup>43</sup>

The 2020 Swiss-Italian Agreement does not address the tax treatment of frontier workers who work from their home office.<sup>44</sup> However, the agreement contains an exemption threshold. In particular, Switzerland and Italy agreed on a 45-day period during which the cross-border worker may derogate to the daily return requirement although for “work reasons only”. The carve-out is unclear as it is difficult to draw the line between work reasons and other reasons. Moreover, the carve-out allows the worker to remain in the source state only (and eventually in a third country) but should not apply to a case where the employee works from their “home office” situated in the state of residence.

In addition, the annex to the agreement contains a clause stipulating that Switzerland and Italy would frequently monitor the remote working evolution and, if needed, an amendment to the agreement would be discussed. In June 2020, Italy and Switzerland signed an administrative agreement in line with the OECD recommendations published in April 2020 (*see* section 17.7. for further details).

Article 15(4) of the Austria-Italy Income and Capital Tax Treaty (1981) contains special rules dealing with frontier workers. According to the provision, an individual who has their residence in a contracting state near the frontier, has their place of employment also near the frontier in the other contracting state and usually goes to work there shall be taxed with respect to their income from employment only in the state of which they are a tax resident. The two countries concluded a mutual agreement to address the application of this provision (*see* section 17.7. for further details).

Finally, article 15(4) of the France-Italy Income and Capital Tax Treaty (1989) also deals with taxation of frontier workers. According to the provision, employment income of persons living in the frontier zone of one of the states and working in the frontier zone of the other state shall be taxable

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43. There are transitional rules for persons who work or have worked in the cantons of Graubünden, Ticino or Valais between 31 December 2018 and the date of entry into force of the new agreement who will remain taxed exclusively in Switzerland.

44. Amaddeo, *supra* n. 41.

only in the state of which such a person is tax resident.<sup>45</sup> The two countries concluded a mutual agreement to address the application of this provision (*see* section 17.7. for further details).

Finally, the tax treaty with San Marino (ratified by Law no. 88 of 19 July 2013) contains a specific provision in the protocol that deals with frontier workers (paragraph 4 of the additional protocol to the agreement). The additional protocol establishes that income earned by frontier workers is taxable in both jurisdictions. So far, Italy and San Marino have not concluded a mutual agreement to address the application of the provision (*see* section 17.7.).

### **17.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)**

Italy concluded three mutual administrative agreements with Austria, France and Switzerland respectively. The agreements took into account the nature of COVID-19 as a one-off pandemic of an extraordinary nature and requiring the implementation of measures, also extraordinary, that are binding on individuals who are typically cross-border workers. The agreements also recognize the existence of governmental health regulations that restrict physical travel to the state where the employment is exercised, and employees may be instructed to exercise it from their state of residence on a full or part-time basis.

The agreement with Switzerland clarifies the tax treatment of the employment income earned by cross-border workers during the COVID-19 pandemic. Italy and Switzerland have agreed on an exceptional and temporary basis that:

- when a worker who is resident in one state (e.g. Italy) necessarily had to work in the state of residence (e.g. Italy) due to the restrictive measures adopted against the spread of COVID-19, the worker is still considered to be a frontier worker, and their activity is considered as if it were carried out in the other state (e.g. Switzerland). Accordingly, income derived from the work carried out in the state of residence

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45. Art. 9 of the protocol clarifies that “frontier zones shall be understood to mean those areas in Italy and those departments in France which are adjacent to the border”. Ruling no. 433 of 2019 pointed out that the status of a frontier worker requires a person to have a home in a French department bordering Italy and to carry out their work in an Italian region bordering France (such as Liguria).

- (e.g. Italy) continues to be taxed exclusively in the state where the work should have been carried out (e.g. Switzerland); and
- for the purpose of application of the Italy-Switzerland Income and Capital Tax Treaty (1976), workers residing in a state (e.g. Italy) who could not return to their state of residence on a daily basis due to the restrictive measures adopted against the spread of COVID-19 and therefore had to work for several consecutive days in the other state (e.g. Switzerland) must continue to be considered “cross-border workers”.

The temporary agreement applies for purposes of the application of article 15(1) and (4) of the Italy-Switzerland Income and Capital Tax Treaty (1976) and article 1 of the Italy-Switzerland Agreement on the Taxation of Frontier Workers and the Financial Compensation for Italian Frontier Municipalities of 3 October 1974.

The temporary agreement that initially applied from 24 February 2020 to 30 June 2020 was tacitly renewed and remained in force throughout the emergency status, i.e. until 31 March 2022. In a joint statement issued on 22 July 2022, the Swiss and the Italian authorities agreed to consult by the end of October 2022 in order to assess the existence of the conditions underlying the agreement.

The agreement concluded with Austria addressed the interpretation and application of article 15(4) of the Austria-Italy Income and Capital Tax Treaty (1981). Both contracting states have agreed that taxpayers usually commuting to their place of work but currently working in a home office due to the prevention of the spread of COVID-19 shall still be taxed as frontier workers under article 15(4) of the tax treaty. To the author’s knowledge, the agreement terminated its effect on 30 June 2022.

Finally, the agreement with France, concluded pursuant to article 26(2) of the tax treaty between France and Italy,<sup>46</sup> addressed the application of art-

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46. Given the measures taken in response to the COVID-19 pandemic and to prevent its propagation, the competent authorities of France and Italy have concluded a mutual agreement, respectively, on 16 July 2020 and 23 July 2020 regarding the provisions applicable to incomes referred to in paras. 1 and 4 of art. 15 of the OECD Model. The mutual agreement applies until 31 March 2022. In the case of tacit renewal, the competent authorities of Italy and France will assess the evolution of the COVID-19 pandemic and may decide by mutual agreement on a possible new extension of the mutual agreement past 30 June 2022. The application of this agreement will be extended by tacit renewal for a 3-month period, i.e. until 30 June 2022, unless terminated by written notification by one of the competent authorities at least 1 week before 31 March 2022.

icle 15(1) and (4) of the tax treaty. Interestingly, this agreement applies also to workers who are not frontier workers.

Exceptionally and provisionally, the two states agreed that, due to the measures to prevent the spread of COVID-19, the days worked in the state of residence at home on behalf of an employer located in the other contracting state shall be deemed as days worked in the state in which the individual, in the absence of such measures, would have exercised their employment for which salaries, wages and other similar remuneration (“income”) are received.

The agreement applies to individuals resident in a contracting state who were, before the COVID-19 situation, habitually exercising their employment in the other state and who, since the entry into effect of the agreement, continue to exercise it but from their state of residence and derive income from this other state, whether it is on a full or part-time basis, and only if the other state effectively taxes the incomes mentioned previously. It has been clarified that the agreement does not apply to income derived by individuals resident in a contracting state in relation with days worked at home or in a third state that were already agreed with the employer before the implementation of the measures to prevent the spread of COVID-19. Interestingly, the agreement contains an opting-out clause. Should a taxpayer not want to benefit from the agreement, they may notify the tax administration of their state of residence of their situation and their intention to waive the application of this agreement concerning the income earned from days worked at home. The agreement also dictates certain procedural rules. In particular, the taxpayer must keep at the disposal of the administration a certificate from their employer indicating the number of days worked at home due to governmental health instructions for which they derived income. The agreement initially applied until 31 August 2020 and, to the author’s knowledge, it was not extended.

### **17.8. The future of the mobility of work: A need for adjusting the existing treaty rules?**

The world after COVID-19 embraces a different paradigm whereby the global mobility of individuals is the most characteristic feature. The new paradigm raises doubts as to whether the tax rules existing both at domestic and international level should be reconsidered.



COVID-19 accelerated a slowly developing trend, and one of the key issues that came to bear in the wake of the pandemic was remote working and the limited physical presence of an employee in the jurisdiction other than the state of residence.

In parallel, the pandemic also boosted the development of digitization, which made possible hybrid and working models that are more flexible, which partly, if not fully, replaced the traditional work carried out in person.<sup>47</sup> In the new paradigm, people may choose to work from where they want and, therefore, it can be wondered whether and to what extent the criterion of the physical presence of a worker should still be the sole criterion underlying the taxation of employment income.

At present, Italian tax authorities have constantly reiterated the relevance of physical presence for purposes of applying domestic tax regimes as well as the employment income article included in tax treaties concluded by Italy. Italian tax authorities have clarified that the OECD Guidance does not have general relevance in the absence of a specific administrative agreement as is the case of the agreements concluded by Italy with Austria, France and Switzerland.

These are the only cases where, considering reciprocity, derogations to the principle of physical presence may be accepted. Such derogations, however, have a very narrow scope as – with the exception of the agreement concluded with France – the mutual agreements concluded with Austria and Switzerland only address the application of specific provisions contained in tax treaties regarding taxation of frontier workers. Therefore, the principles elaborated in the agreements do not have a general relevance for the application of the employment income article in its entirety.

Alternative solutions could be found but would clearly call upon a change in the current treaties. In this respect, the solution would require reducing the relevance of the principle of physical presence. According to a first solution advocated by Pistone, the place of exercise of the employment should be determined by reference to the ordinary place of work of the employee, thus reducing the exposure to double taxation for several cases of remote working.<sup>48</sup> It has been submitted that this goal could best be achieved with

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47. R. de la Feria & G. Maffini, *The Impact of Digitalisation on Personal Income Taxes*, British Tax Review 2, pp. 154-168 (2021).

48. P. Pistone, *The Faltering Legitimacy of the Place of Physical Presence as a Tax Nexus for Active Income in Building Global International Tax Law: Essays in Honour of Guglielmo Maisto*, ch. 8 (P. Pistone ed., IBFD 2022), Books IBFD.

an amendment to the OECD Commentary on Article 15 that could expressly mention the ordinary place of work as relevant criterion for the identification of the place of exercise of the employment. An option could also be to limit the scope of this clarification only to mobile workers by using the following formulation:

For employees entitled to work remotely in part or full, the place of exercise of the employment will be deemed to be the one where they ordinarily conduct their activity. If such activity is conducted in the State of residence of the employee, Article 15 (1) will be interpreted as attributing exclusive taxing jurisdiction to such country.

The author has also proposed that the deduction of the salary from the profits of the employer without a corresponding taxation of the salary would reduce the amount of tax collected for the state of the employer. This reduction is to the advantage of the state of residence of the remote worker who has the exclusive right to tax income from employment, thus without the obligation to give relief for double taxation.

According to Pistone, a perfect balance can be re-established insofar as the state of residence of the remote worker is not entitled to get additional taxing rights on the income attributable to the PE of the employer that could arise due to the presence of the remote worker. The state of residence of the employer could have exclusive taxing rights on the profits of the employer to which the work conducted by the remote worker has contributed. However, the author concludes that the solution could raise legal uncertainties, and advocating the introduction of clarifications and exemplifications in the Commentaries would be highly advisable.

A possible (second) solution could be to stick to physical presence (hence maintaining the current wording of article 15 of the OECD Model) while lowering the threshold of 183 days currently contained in article 15(2) of the OECD Model. In such a case, despite the limited presence in the state of the activity, the state could still impose a tax on the employment income of the employee resident in the other contracting state. However, according to this solution, the state of the activity would not be allowed to tax the income in the case that the employee works remotely from the state of residence on an exclusive basis.

Alternatively, an additional (third) solution would be the sharing of the state revenues as already happens for frontier workers. In the latter case, the state of residence of the employee could waive part of its revenues, which could be remitted to the state of residence of the employer if the employment

activity is carried out remotely from the former jurisdiction. Such a sharing mechanism could therefore apply also if the employment activity is carried out remotely and, therefore, the employee is not physically resident in the other contracting state where the employer is tax resident and the activity would have been exercised if not carried out remotely.

Similarly, the need for a change in the sourcing criterion arises with regard to article 17 of the OECD Model in line with new forms of digital entertainment. As discussed with regard to e-sports, income earned by e-gamers who participate in online competitions for which physical presence is not required is taxable exclusively in the e-gamer's country of residence on the assumption that the e-gamer connects from that state to the gaming platform virtually. It might therefore be asked whether the logic behind article 17 of the OECD Model, which attaches importance to the place where the activity of entertainment is performed, can be considered adequate with respect to digital entertainment. The example of e-sports (which is part of the digital entertainment sector) reveals the inadequacy of the current provisions.



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## Chapter 18

### The Impact of Tax Treaties on International Mobility of Work in Kenya

Ruth Wamuyu Maina and Joy Waruguru Ndubai

#### 18.1. Mobility of work and domestic tax law

Like many other countries around the world, the government of Kenya (GoK) responded to the COVID-19 pandemic by introducing several restrictions to minimize the spread of the virus, including restricting the movement of persons.<sup>1</sup> By way of the Public Health (COVID-19 Restriction of Movement of Persons and Related Measures) Rules of 2020,<sup>2</sup> the GoK constrained the movement of persons by road, rail and air unless for permitted reasons<sup>3</sup> and introduced directives for organizations and business entities.<sup>4</sup> In response to this, the Federation of Kenyan Employers (FKE), the Central Organization of Trade Unions and the Ministry of Labour and Social Protection established a memorandum of understanding (MoU) to support workers and employers through the pandemic.<sup>5</sup> The MoU committed to “take the necessary steps to ensure the workers are not exposed to the pandemic” and required migrant workers to adhere to all measures introduced by the GoK.<sup>6</sup> A further advisory issued by the FKE urged its members to comply with the GoK directives including through “keeping the workplace and employees safe, providing safety gear, working from home and reducing travel”.<sup>7</sup>

The extension of the restrictions to migrants affected employees of foreign companies by requiring them to work remotely from Kenya, raising

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1. KE: The Public Health (COVID-19 Restriction of Movement of Persons and Related Measures) Rules, 2020, as conferred by sec. 36 of KE: Public Health Act, Legal Notice No.50 (Legislative Supplement No.27), 6 Apr. 2020.

2. Id.

3. Id., at sec. 4.

4. Id., at sec. 6.

5. KE: Memorandum of Understanding between the Tripartite Social Partners – Ministry of Labour and Social Protection, Central Organization of Trade Unions (COTU(K)) and Federation of Kenya Employers (FKE), 2020.

6. Id.

7. International Labour Organization, *The Federation of Kenya Employers Interventions during Covid-19* (10 July 2020), available at [https://www.ilo.org/global/docs/WCMS\\_750842/lang--en/index.htm](https://www.ilo.org/global/docs/WCMS_750842/lang--en/index.htm) (accessed 5 May 2022).

concerns about the tax implications including the potential for the creation of permanent establishments (PEs) and individual residence.<sup>8</sup> The restrictions imposed by governments during the height of the pandemic also led to Kenyan residents working remotely from foreign countries. Section 2 of the Income Tax Act, chapter 470 of the Laws of Kenya (ITA), defines a resident as an individual who either:

- has a permanent home in Kenya and was present in Kenya for any period in any particular year of income under consideration; or
- has no permanent home but;
  - was present in Kenya for a period or period amounting in the aggregate to 183 days or more in that year of income; or
  - was present in Kenya in that year of income and in each of the two preceding years of income for periods averaging more than 122 days in each year of income.

Section 3 of the ITA further provides that “income tax shall be charged for each year of income upon all the income of a person, whether resident or non-resident which accrued in or was derived from Kenya”. As a result, any income with its source in Kenya will be subject to tax in Kenya. This establishes a territorial system for income earned by individuals, with the exception of employment income.

Further, section 3 differentiates between the types of income (including gains of profits from any business, any employment or services rendered) and any right granted to any other person for use or occupation of property.<sup>9</sup> Other categories of income include dividends or interest; pension, charges or annuity; amounts deemed to be the income of any person under the ITA; capital gains; net gains from the disposal of interest in a person if the interest derives 20% or more of its value, directly or indirectly, from immovable property in Kenya; and natural resource income.

The provision on income from employment stipulates that an amount paid to any of the following categories shall be deemed to have accrued in or been derived from Kenya:<sup>10</sup>

- a person who is (or was at the time of the employment or when the services were rendered) a resident person in respect of any employment or services rendered in or outside Kenya; or

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8. WTS Global, *Kenya: Virtual Work – Tax considerations of the new normal* (11 Feb. 2021), available at <https://wts.com/global/publishing-article/20210211-global-mobility-kenya~publishing-article?language=en> (accessed 5 May 2022).

9. KE: Income Tax Act, sec. 3(2)(a) [hereinafter ITA].

10. Sec. 5(1) ITA.

- a non-resident person in respect of any employment with or services rendered to an employer who is resident in Kenya or the PE of an employer who is not resident.

The implication of this provision for an individual who is tax resident in Kenya is that they will be subject to income tax on their global income from employment or services rendered. The tax residency of an individual is essential to this determination. As a result, regardless of the higher degree of mobility of work, individuals that qualify as residents will be subject to the provisions on income from employment or services rendered.

At the height of the pandemic, when foreigners visiting Kenya were barred from travel due to the restrictions, the effect of section 2's (ITA) definition of an individual resident would have led to the creation of tax residence in the country under two circumstances, namely (i) foreigners who may have found themselves present in Kenya for 183 days in a year of income; and (ii) foreigners who were present in Kenya for 122 days in each of the two preceding years of income and in the year of income under consideration. This would create a residency conflict with the other jurisdiction where they are considered resident. Similarly, Kenyans barred from travelling home from a foreign country could trigger residence in that other jurisdiction, depending on the rules of the country.

While the government introduced a fiscal stimulus, as well as a temporary reduction of the employment income tax (pay-as-you-earn),<sup>11</sup> it did not provide guidance for the treatment of individuals facing dual tax residency challenges because of the travel restrictions. In addition, in the event where an individual considered tax resident in Kenya leaves the country, then no exit tax applies and their tax liability will be determined based only on their presence in Kenya in a specific year of income.

The current rules regarding the tax residency of individuals are clear but can be considered rigid where restrictions arise, and policymakers should provide exceptions for such situations. However, as the increasing trend of mobility of work continues to give rise to remote workers, digital nomads and more, there is a need to explore whether specific rules applicable to such situations will be required.

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11. EY, *Kenyan Government issues public notice on expected resumption of pre-COVID tax rates* (7 Dec. 2020), available at [https://www.ey.com/en\\_gl/tax-alerts/kenyan-government-issues-public-notice-on-expected-resumption-of-pre-covid-tax-rates](https://www.ey.com/en_gl/tax-alerts/kenyan-government-issues-public-notice-on-expected-resumption-of-pre-covid-tax-rates) (accessed 5 May 2022).

Concerning business income, section 4(a) of the ITA establishes that “where a business is carried on or exercised partly within and partly outside Kenya by a resident person, the whole of the gains or profits from such business shall be deemed to have accrued in or to have been derived from Kenya”.<sup>12</sup> A business will be considered resident in Kenya if, in accordance with section 2 of the ITA, either (i) the body is a company incorporated under a law of Kenya; (ii) the management and control of the affairs of the body was exercised in Kenya in a particular year of income under consideration; or (iii) the body has been declared by the Minister to be resident in Kenya for any year of income.

The ITA does not provide any definition or test for the exercise of management and control, and no Kenyan court has dealt with the issue.<sup>13</sup> Within its tax treaty network, Kenya has taken a varied approach by relying on either the OECD Model<sup>14</sup> or the UN Model,<sup>15</sup> with some exceptions.<sup>16</sup> Most notably, Kenya has often included the place of incorporation, the place of effective management and the place of management. The broad approach taken within tax treaties indicates that the principal concern is with the substance of the management operations of a company and the prevention of the abuse of the concept of residence.

The impact of the definition of “residence” as the “management and control of the affairs of the body” means that if an individual who exercises management and control of the business in a foreign jurisdiction establishes tax residency in Kenya and makes key decisions, there is a possibility that the company could be considered tax resident in the country. As a result, “the trading profits derived from or accrued in Kenya may be taxable at the

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12. Sec. 4(a) ITA.

13. A. Mathini, *COVID-19: Impact on tax residency and permanent establishment status in Kenya* (15 June 2020), available at <https://www.bowmanslaw.com/insights/tax/covid-19-impact-on-tax-residency-and-permanent-establishment-status-in-kenya/> (accessed 6 May 2022).

14. See for instance *Convention between the Government of the Republic of Kenya and the Government of the French Republic for the Avoidance of Double Taxation and the Prevention of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* (2011), Treaties & Models IBFD.

15. See for instance *Agreement between the Government of the State of Kuwait and the Government of the Republic of Kenya for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital* (2014), Treaties & Models IBFD.

16. Art. 4(1) of *Convention between the Government of the Republic of Kenya and the Government of the Republic of Korea for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* (2018), Treaties & Models IBFD: “domicile, residence, place of head or main office, place of incorporation, place of effective management or any other criterion of a similar nature”.



resident corporation tax rate – income that would otherwise not have been subject to Kenyan income tax”.<sup>17</sup> However, no cases have arisen so far. Any movement of the management board of a company between Kenya and another jurisdiction would only raise tax-related concerns if they were to establish tax residency themselves by triggering either the 183-day or 122-day rules. No exit taxes would arise. So far, the question of the availability of a workplace has not raised any concerns, particularly since the domestic rule for determining residence is concerned with either incorporation or management and control.

The ability for employees or even contractors of a foreign company to work from home in Kenya may raise some concerns with respect to PEs. According to section 2 of the ITA, a PE includes a fixed place of business through which the business is wholly or partly carried on and includes a place of management. It may also include:<sup>18</sup>

- the provision of services, including consultancy services, by a person through employees or other personnel engaged for that purpose, but only where the services or connected business in Kenya continue for a period or periods exceeding in aggregate 91 days in any 12-month period in the year of income under consideration; or
- a dependent agent of a person who acts on their behalf in respect of any activities which that person undertakes in Kenya, including habitually concluding contracts or fulfilling the principal role leading to the conclusion of contracts provided that they are routinely concluded without material modification.

These provisions establish the possibility for the creation of a PE in Kenya by way of either the place of management, consultancy services provided by the employee or other personnel or the dependent agent, giving rise to a tax liability. If government restrictions lead an individual to trigger the timing requirements of any of the above-mentioned rules, any income or profits accrued in or derived from Kenya will be subject to corporate income tax at the non-resident rate.<sup>19</sup> In the context of remote work, businesses would need to be most concerned about the provision of services provided by employees or other personnel working from home for a foreign corporation in Kenya, if the activities are in connection to its business in the country.

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17. Mathini, *supra* n. 13.

18. Sec. 2 ITA.

19. Sec. 34 and the Third Schedule ITA.

## 18.2. Residence, tiebreaker rules and mobility of work: Individuals and entities

The current criteria for the determination of tax residence at the domestic level certainly raise concerns for remote work and, more so, for those without a choice (such as where government restrictions arise). Similarly, the higher degree of mobility of work carries implications for treaty residence provisions. Since Kenya does not presently have a tax treaty policy, in order to determine the approach to the determination of residence for a business, this section relies on the broad approach taken in the country's tax treaty network. As highlighted in section 18.1., Kenya commonly applies either the place of management or the place of effective management as one of the criteria for determining the residence of a company. The tiebreaker test used to determine the tax residency of a company is the place of effective management.

The OECD has already recognized the challenges that the pandemic-related restrictions gave rise to by potentially changing the place of effective management "as a result of a relocation, or inability to travel, of board members or other senior executives".<sup>20</sup> However, "a temporary change in location of board members or other senior executives is an extraordinary and temporary situation due to the COVID-19 pandemic and such change of location should not trigger a change in treaty residence".<sup>21</sup> Indeed, even within the domestic context, the timing rules would need to be triggered to establish a presence, and no such cases have arisen in Kenya yet.

Where the possibility of dual residency arises within a treaty, the tiebreaker rule will be applied. The facts or circumstances will be relevant and the Commentary on Article 4(3) of the OECD Model (2017) recognizes that:

Competent authorities having to apply paragraph 3 would be expected to take account of various factors, such as where the meetings of the person's board of directors or equivalent body are usually held, where the chief executive officer and other senior executives usually carry on their activities, where the senior day to day management of the person is carried on, where the person's headquarters are located, which country's laws govern the legal status of the person, where its accounting records are kept, whether determining that the

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20. OECD, *OECD Policy Responses to Coronavirus (COVID-19) – Updated guidance on tax treaties and the impact of the COVID-19 pandemic* (21 Jan. 2021), available at <https://www.oecd.org/coronavirus/policy-responses/updated-guidance-on-tax-treaties-and-the-impact-of-the-covid-19-pandemic-df42be07/#section-d1e46> (accessed 5 May 2022) [hereinafter OECD Guidance].

21. Id.

legal person is a resident of one of the Contracting States but not of the other for the purpose of the Convention would carry the risk of an improper use of the provisions of the Convention etc.<sup>22</sup>

The competent authority should then take into consideration a range of factors.<sup>23</sup> A number of Kenya's tax treaties apply the 2017 version of article 4(3). This provision identifies that the competent authorities of the contracting states should resolve the residence conflict by way of mutual agreement, having regard to the place of effective management and other relevant factors.

In some of its tax treaties, Kenya has adopted the pre-2017 OECD Model tiebreaker rule, which relies only on the place of effective management.<sup>24</sup> According to the OECD, in applying this provision, "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".<sup>25</sup> As a result, "an entity's place of residence under the tiebreaker provision ... is unlikely to be impacted by the fact that the individuals participating in the management and decision-making of an entity cannot travel as a public health measure imposed or recommended by at least one of the governments of the jurisdictions involved".<sup>26</sup> The situation may, however, be different if the stay in Kenya is voluntary. Indeed, in such instances, the review of the facts and circumstances may lead to a shift of the place of management; however, no guidance has been provided by Kenya regarding this issue. The question of substance where no workplace exists has also not been dealt with.

In the unlikely event that dual residency of an individual arises due to increased mobility of work and the application of the tiebreaker rule under article 4(2)<sup>27</sup> does not lead to one resident jurisdiction, Kenya generally resorts to mutual agreement between the competent authorities of the contracting states. No special interpretation has arisen. The OECD has already evaluated the implications of the extraordinary pandemic restrictions and

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22. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 3* para. 24.1 (23 Nov. 2017), Treaties & Models IBFD.

23. OECD Guidance, *supra* n. 20.

24. See for instance *Convention between the Government of the Republic of Kenya and the Government of the French Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* (2011), Treaties & Models IBFD.

25. OECD Guidance, *supra* n. 20.

26. *Id.*

27. Art. 4(2) *OECD Model* (2017).

established that “tax administrations and competent authorities will have to consider a period where public health measures imposed or recommended by the government do not apply when assessing a person’s resident status”.<sup>28</sup> Therefore, tax authorities are expected to only apply the rules under normal circumstances and “dislocation because a person cannot travel back to their home jurisdiction due to a public health measure of one of the governments of the jurisdictions involved should not by itself impact the person’s residence status”.<sup>29</sup> Where voluntary remote work is concerned, it is likely that dual residency situations would need to be resolved by mutual agreement between the competent authorities.

The tracking of the movement of individuals, their presence in a jurisdiction and their tax residence is not easy – particularly for tax authorities that are already capacity constrained. Authorities are reliant on individuals to make self-declarations if they qualify as tax resident. If an individual qualifies as a tax resident, the individual will need to register for a personal identification number (PIN). Section 8 of the Tax Procedures Act (No.9 of 2015) requires that “a person who has accrued a tax liability or who expects to accrue a tax liability under the Income Tax Act” shall apply to be a registered taxpayer. No challenges have arisen in the context of article 4(3) on distributive rules like article 8 or 16, where a corporation may move to a different residence state.

### **18.3. Permanent establishments and mobility of work**

The definition of a PE contained in Kenya’s domestic tax law is also included in a number of its tax treaties.<sup>30</sup> The OECD guidance concerning the possible creation of PEs indicates that:

The exceptional and temporary change of the location where employees exercise their employment because of the COVID-19 pandemic, such as working from home, should not create new PEs for the employer. Similarly, the temporary conclusion of contracts in the home of employees or agents because of the COVID-19 pandemic should not create PEs for the businesses [...] However,

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28. OECD Guidance, *supra* n. 20.

29. *Id.*

30. See for example *Agreement between the Government of the Republic of Kenya and the Government of Islamic Republic of Iran for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital* (2018), Treaties & Models IBFD.

thresholds under domestic law (including state/provincial legislation) that require a business to register for tax purposes may be lower than those applicable under a tax treaty.<sup>31</sup>

Kenya has largely followed this approach in practice, and there have been no cases of a PE arising or tax residence triggered by the restrictions. However, no guidance has been published regarding (i) the circumstances under which a home office may constitute a fixed place of business for treaty purposes; (ii) if a self-employed person may trigger a dependent agent PE; (iii) if a digital nomad may establish a PE through a flex office; or (iv) the impact that the mobility of work may have on PEs in general.

Kenyan domestic law, as highlighted previously, includes a lower threshold of 91 days applicable to the furnishing of services by employees and other personnel. The provision on service PEs is not included in all tax treaties, particularly those signed with OECD member countries, and where it is included, the threshold varies between 90 days<sup>32</sup> and 183 days.<sup>33</sup> In the tax treaty between Kenya and Iran, the 183 days will be a period or periods aggregating more than 183 days within any 12-month period.<sup>34</sup> The same language is adopted in the tax treaty between Kenya and India but with a threshold of 90 days. The low threshold of 90 days may have implications for home office, however no guidance has been provided by Kenya.

#### **18.4. Physical presence according to articles 15(1) and 17 of the OECD Model**

As mentioned in section 18.2., Kenya presently does not have a tax treaty policy. Moreover, no guidance has been provided with respect to the treatment of a home office, except where the company is resident; the status of employees who cannot exercise their employment or are stranded; and the tax treatment of artists, athletes or influencers. Generally, Kenya follows the wording of article 15(1) of the OECD Model. However, as highlighted

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31. OECD Guidance, *supra* n. 20.

32. See for instance *Agreement between the Government of the Republic of Kenya and the Government of the Republic of India for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* (2016), Treaties & Models IBFD.

33. See for instance *Agreement between the Government of the Republic of Kenya and the Government of Islamic Republic of Iran for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital* (2018), Treaties & Models IBFD.

34. Art. 5(3)(b) *id.*

in section 18.1., the connecting factor for taxing employment income under domestic tax law provides a broader definition than the OECD. Kenyan domestic tax law gives rise to worldwide taxation of the employment income of residents of Kenya and a right to tax employment income of a non-resident, if a resident company or PE present in Kenya hires them. No further guidance is available concerning the treatment of a home office.

## **18.5. Article 15(2) and (3) of the OECD Model**

Kenya's bilateral treaties all have provisions on the taxation of employment income.<sup>35</sup> The country relies on a mix of the OECD and UN Models in the drafting of its bilateral tax treaties.<sup>36</sup> There is no national tax treaty policy to guide interpretation of bilateral treaties. However, the Kenyan courts have emphasized the importance of the Commentaries, stating that they serve as “international best practice [and] guide the interpretation of laws and regulate international business transactions”.<sup>37</sup> In *Unilever Kenya Ltd v Commissioner of Income Tax*,<sup>38</sup> the High Court further stressed the importance of relying on international set best practices:

We cannot overlook or side-line what has come out of the wisdom of tax payers and tax collectors in other countries. And especially because of the absence of any such guidelines in Kenya, we must look elsewhere [...] The ways of doing modern business have changed very substantially in the last 20 years or so and *it would be fool-hardy for any court to disregard internationally accepted principles of business as long as these do not conflict with our own laws. To do otherwise would be highly short-sighted.*<sup>39</sup> [Emphasis added.]

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35. Kenya currently has treaties with the following countries: Zambia, Canada, Denmark, Seychelles, Norway, the United Kingdom, the United Arab Emirates, Sweden, Germany, South Africa, France, Iran, India, South Korea and Qatar.

36. The wording used in art. 15 of *United Nations Model Double Taxation Convention between Developed and Developing Countries* (1 Jan. 2021), Treaties & Models IBFD, largely reflects the wording used in the *OECD Model* (2017) with the only exceptions to this being the title of the article, where the *UN Model* retains “Income from Dependent Personal Services” and reference to a “fixed base” under art. 15(2)(c). See P. Pistone, *Article 15: Income from Employment - Global Tax Treaty Commentaries*, Global Topics IBFD, for further analysis on these differences.

37. KE: HC, 10 Dec. 2021, Income Tax Appeal 8 of 2017, *Seven Seas Technologies Limited v Commissioner of Domestic Taxes*, [2021] KEHC 358 (KLR), para. 79, available at <http://kenyalaw.org/caselaw/cases/view/225266/> (accessed 5 May 2022).

38. KE: HC, 17 Sept. 2003, *Unilever Kenya Ltd v Commissioner of Income Tax*, [2005] eKLR, available at <http://kenyalaw.org/caselaw/cases/view/12804> (accessed 5 May 2022).

39. Id.

Therefore, absent a specific tax treaty policy in Kenya, the tax administration relies on the OECD and UN Model Commentaries and guidelines in its interpretation of its bilateral tax treaties.<sup>40</sup> The general rule under article 15(1) is that income from employment is taxable in the residence state, unless the employment is exercised in the work state. If so, such income will be taxable in the work state.

As an exception to the general rule, the resident state retains its taxing rights over employment income if the following conditions are satisfied:

- the recipient of the remuneration is present in the [work] state for a period or periods not exceeding in the aggregate 183 days in any 12-month period commencing or ending in the fiscal year concerned;
- the remuneration is paid by or on behalf of an employer who is not resident of the [work] state; and
- the remuneration is not borne by a PE or a fixed base which the employer has in the [work] state.<sup>41</sup>

In addition, the resident state would retain taxing rights over the employment income of its residents who are “[members] of the regular complement of a ship or aircraft, that is exercised aboard a ship or aircraft operated in international traffic, other than aboard a ship or aircraft operated solely within the [work state]”.<sup>42</sup> Therefore, crews on ships or aircrafts that operate in international traffic are only taxable in their respective residence states.<sup>43</sup> However, this does not apply to crews on ships or aircrafts that operate exclusively in a source state.<sup>44</sup>

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40. In KE: TAT, 1 Apr. 2021, Appeal No. 199 of 2020, *McKinsey & Company Inc. Africa Proprietary Ltd v Commissioner of Legal Services and Border Control*, the Tax Appeals Tribunal found that the *Kenya-S. Afr. Income Tax Treaty* (2010) follows both UN and OECD Models and, therefore, held that commentaries on both models can be relied on in interpreting the tax treaty. This ruling may raise questions in the future for the interpretation of other tax treaties that also rely on both Models, introducing the possibility of both the taxpayers and the tax administrations seeking to rely on the most beneficial commentary. Further clarity will likely be sought in the future.

41. Art. 15(2) *OECD Model* (2017).

42. Art. 15(3) *id.*

43. Para. 9 *OECD Model: Commentary on Article 15* (2017).

44. Para. 9.1 *id.*

### 18.5.1. Interpretation of article 15(2)

#### 18.5.1.1. Physical presence

Based on the treaty, the physical presence test could be for a period of 183 days in the taxable year concerned or in any 12-month period commencing or ending in the taxable year concerned.<sup>45</sup> The former reflects the wording used in the draft 1963 and 1977 versions of the OECD Model.<sup>46</sup> In this case, competent authorities would compute 183 days of physical presence in the fiscal year under review.<sup>47</sup> The Model was amended on 23 July 1994 to prevent “difficulties where the fiscal years of the contracting state did not coincide”.<sup>48</sup> Previously, this had opened up opportunities for tax planning structures that ensured employees remained just below 183 days (5.5 months) in each year without triggering tax liabilities in the work state.<sup>49</sup> Following the amendment in 1994, all “possible periods of twelve consecutive months must be considered even though they overlap”.<sup>50</sup> The “fiscal year concerned” refers to the fiscal year of the work state.<sup>51</sup>

The two approaches lead to differing results, which raises questions as to which version of the Commentary will be relied on for interpretation of this provision. The OECD Council recommends that tax administrations rely on the newest Commentary when “applying and interpreting the provisions of their bilateral tax conventions that are based on these articles”.<sup>52</sup> However, the Council clarifies that, though the newer commentaries can be used, this should only be the case where the commentaries merely clarify

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45. Bilateral tax treaties with Zambia, Canada, Denmark, Seychelles, Norway, the United Kingdom, the United Arab Emirates, Sweden and Germany make reference to 183 days in the fiscal year concerned, while the treaties with South Africa, France, Iran, Korea and Qatar make reference to any 12-month period commencing or ending in the taxable year concerned.

46. Para. 4 *OECD Model: Commentary on Article 15* (2017).

47. *OECD Model Tax Convention on Income and Capital: Commentary on Article 15(2)* para. 3 (11 Apr. 1977), *Treaties & Models IBFD*.

48. Para. 4 *OECD Model: Commentary on Article 15* (2017).

49. *Id.*

50. *Id.*

51. Para 4.1 *OECD Model: Commentary on Article 15* (2017): “Assume, for example, that the fiscal year of State S runs from 1 January to 31 December and that a resident of State R is present and performs employment services in State S between 1 August 00 and 28 February 01. For the purposes of subparagraph 2 a), any twelve month period that begins between 1 January and 31 December 00 or ends between 1 January and 31 December 01 and that includes any part of the period of employment services would be relevant”.

52. OECD, *Recommendation of the Council concerning the Model Tax Convention on Income and on Capital*, OECD/LEGAL/0292 (OECD 2021).



the provisions of the old treaty and not where the substance of the two versions of the tax treaties are different.<sup>53</sup>

Though this report does not seek to go further into the debate on static versus dynamic interpretation of tax treaties, these arguments are a useful background to understand the reasoning behind the use of different commentaries when considering the 12-month period under review. Therefore, the Kenyan treaties that have relied on the 1977 Commentary would rely on the 1977 Commentary definition of 183 days in the fiscal year concerned, while the bilateral treaties that have the amended wording would rely on the newest commentaries that make reference to a 12-month period commencing or ending in the taxable year concerned. It is not clear whether the Kenya Revenue Authority has tackled the question of the use of different commentaries for the application of article 15(2)(a), but based on international best practice, it is likely that the tax administration will rely on different commentaries for this specific provision.

Kenya does not have domestic law guidance on the treatment of employees working from home. However, the Employment Act requires all employment contracts to provide specific details on the place of work, the address of the employer and whether an employee is required or permitted to work from various places.<sup>54</sup> Employers that are party to employment contracts subject to Kenyan law would, therefore, be free to consider their individual policies on home office. In addition, nothing in the law requires different treatment for employees working from home offices. Such contracts would, therefore, be subject to the same provisions as those that work from the office.

Following the guidance under paragraph 5 of the Commentary on Article 15 of the OECD Model (2017), computing the 183 days is based on the “days of physical presence” method. This includes all days the individual is physically present in the country and includes days of transit, weekends, short

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53. Introduction, pp. I-13- I-14 *OECD Model: Commentary* (2017). For a deeper delve into the questions of whether the use of the newest versions of the commentary is in line with the intentions of the drafters of the bilateral treaties, see M. Lang & F. Brugger, *The Role of the OECD Commentary in Tax Treaty Interpretation*, 23 *Australian Tax Forum* (2008); D. Ward, *The Role of Commentaries on the OECD Model in the Tax Treaty Interpretation Process*, 60 *Bulletin Tax Treaty Monitor* 3 (2006); E. Marteen, *The Role of Commentaries on the OECD Model in the Tax Treaty Interpretation Process – Response to David Ward*, 60 *Bulletin Tax Treaty Monitor* 3 (2006); and J. Bossuyt, *The Legal Status of Extrinsic Instruments for the Interpretation of Tax Treaties* (IBFD 2022), Books IBFD.

54. KE: Employment Act No 11 of 2007, sec. 10(3)(d).

breaks, sick days,<sup>55</sup> public holidays and half days. Consequently, the days an employee works from their home office while in Kenya would be considered in the computation.

#### 18.5.1.2. Residency and PE status of the employer

The term “employer” is not defined in the bilateral treaties. Where the term is undefined in the treaty, article 3(2) states that the word shall have the meaning under the domestic law of the state seeking to enforce the treaty, unless the context otherwise requires.<sup>56</sup> Article 31 of the Vienna Convention on the Law of Treaties requires states to interpret any undefined terms “in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose”.<sup>57</sup>

Under Kenyan labour laws, an employer is defined as “any person, public body, firm, corporation or company, who or which has entered into a contract of service to employ any individual and includes the agent, foreman, manager or factor of such person, public body, firm, corporation or company”.<sup>58</sup> Where an employer is identified, their residency is determined based on the provisions of domestic law.<sup>59</sup> If after applying domestic law, the employer is dual resident, the tiebreaker rule under article 4(3) is applicable.<sup>60</sup> A work

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55. Para. 5 *OECD Model: Commentary on Article 15* (2017): “Days of sickness are included in computing 183 days unless they prevent the employee from leaving and he would have otherwise qualified for the exemption.”

56. Para. 13.1 *OECD Model: Commentary on Article 3* (2017) states that reference can be made to both tax and non-tax law domestic law for the definition.

57. *UN Vienna Convention on the Law of Treaties* (23 May 1969), Treaties & Models IBFD.

58. Sec. 2 Employment Act 2007. *See also* paras. 8-8.28 *OECD Model: Commentary on Article 15* (2017), which give guidelines on instances where the work state may reject the application of para. 2 in abusive cases and if, under its domestic laws, the services rendered to a local enterprise by an individual that has a formal employment contract with a non-resident are rendered in an employment relationship. For this purpose, when considering the application of para. 2, special consideration should be given to the employment contract and determination made on who the actual employer is and their residency.

59. Art. 4(1) *OECD Model* (2017).

60. The tiebreaker rules in the Kenyan bilateral tax treaties vary. For treaties with the following countries, the tiebreaker rule relied on is the place of effective management: Denmark, France, Germany, Iran, South Korea, Norway, Qatar, Seychelles, South Africa, Sweden, the United Kingdom and India (if the place of effective management cannot be determined for the Indian tax treaty, the competent authorities are required to come to a mutual agreement). The treaty with Canada uses the nationality test as the tiebreaker rule, while the Zambian treaty uses the place of management and control.

state would have taxing rights over a non-resident's employment income if it is determined that an employer is a resident.<sup>61</sup>

If the employer is not a resident of the work state, the work state may have taxing rights if they operate in the state through a PE.<sup>62</sup> A PE may be established either through a fixed place of business, dependent agents or provision of services.<sup>63</sup> If the employee remains in the work state for a period less than 183 days and the employer is not a resident of the work state – nor do they have a PE in the state – paragraph 2 would prohibit the work state from taxing the employment income. However, if any of the conditions are not satisfied, the work state may tax the employment income.

### 18.5.2. The impact of COVID-19

In the first phase of the pandemic, many workers were stranded outside their resident and/or work states and were forced to start working remotely.<sup>64</sup> In the second phase of the pandemic, employees began purposely moving to different locations to do their work on a remote basis.<sup>65</sup> This “new normal” raises questions on the application of article 15(2) that are discussed in sections 18.5.2.1.-18.5.2.3.

#### 18.5.2.1. 183-days rule

A change in the location of work has consequences on the computation of the 183 days. The OECD publication considers the implementation of article 15(2) in light of the OECD guidelines and gives the following guidance:<sup>66</sup>

61. Art. 15(2)(b) *OECD Model* (2017).

62. Art. 15(2)(c) *id.*

63. Art. 5 *OECD Model* (2017) does not provide for service PEs, but this is present in art. 5(3)(b) *UN Model* (2021). Treaties with Iran, Seychelles, South Africa and India have provisions for the establishment of a PE through furnishing of services (including consultancy services), through employees where the services continue for a period of either 183 or 90 days, depending on the treaty, in any 12-month period.

64. G. Beretta, *Work on the Move: Rethinking Taxation of Labour Income under Tax Treaties*, 5 Intl. Tax Stud. 2 (2022), Journal Articles & Opinion Pieces IBFD.

65. *Id.* See also <https://iamailen.com/digital-nomad-visa-countries/> (accessed 5 May 2022), which provides a list of countries offering digital nomad visas that have become increasingly popular in the post-pandemic era.

66. OECD Guidance, *supra* n. 20.

- Situation 1: if an employee is a resident of one state but exercises employment in the work state and, due to COVID-19 travel restrictions, they have been unable to travel back to the work state, any subsidy from the work state will be taxable in the work state.<sup>67</sup>
- Situation 2: if an employee is a resident in one state and exercises work in another state but is stranded in the other state as a result of COVID-19 restrictions, and would otherwise have left to prevent taxation, the guidance recommends disregarding days spent in the work state.<sup>68</sup> In this case, the work state would forego its taxing right. However, this recommendation may not cover employees who failed to travel based on travel recommendations.<sup>69</sup>
- Situation 3: if the work state loses its taxing right, this would raise administrative and compliance difficulties for employers and employees. The employers may have withholding tax obligations without any legal basis, while the employee may have additional compliance obligations in their residence state. Such situations call for coordination among states to resolve the difficulties faced by the employer and employee.<sup>70</sup>

The guidelines highlight the difficulties raised because of changes in the location of exercise of employment.<sup>71</sup> While these tackle the temporary changes, mobility of work is expected to increase in the post-pandemic era whereby improved technology has not only increased the connection of devices to employers' networks but also increased the number of jobs that require less physical activity, allowing for greater mobility.<sup>72</sup> Article 15(2) of the OECD Model (2017) was devised at a time when physical presence was the most reliable way of establishing a connection with a state.<sup>73</sup> However, this may no longer be the case.

Kenya has not provided guidance on the impact of COVID-19 on the application of article 15(2), but the tax administration has taken note of the

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67. Id., at paras. 49-52.

68. Id., at paras. 53-56. Countries have adopted varying approaches to the taxation of employment income under art. 15, with some countries exempting days employees are stuck in the work state as a consequence of restrictions and reliance on force majeure rules.

69. Id.

70. OECD Guidance, *supra* n. 20, at para. 63.

71. Id., at para. 64.

72. H. Niesten, *Revising the Fiscal and Social Security Landscape of International Teleworkers in the Digital Age*, 49 Intertax 2 (2021).

73. Beretta, *supra* n. 64.

future of work,<sup>74</sup> which may be indicative of ongoing debate on the topic. However, until such guidance is provided, non-residents who find themselves exercising work in Kenya may meet the 183-day requirement, giving Kenya the taxing rights over the employment income earned from the employment services carried on in Kenya. In addition, the Kenya Revenue Authority would be required to give double taxation relief to its residents who meet the 183-days rule in a work state, with which it has an existing bilateral tax treaty for taxes incurred in the work state.

#### 18.5.2.2. Establishment of a PE

The establishment of a PE may change the allocation of taxing rights under article 15(2) of the OECD Model (2017). If an employee is a resident in one state but exercises employment in another state (the work state), the latter may tax the individual's employment if the remuneration is borne by a PE of the employer in the work state.<sup>75</sup> Therefore, one should consider whether an employee working from home in the work state would form a PE for a foreign employer.

In its guidelines on tax treaties and the impact of the COVID-19 pandemic, the OECD considered whether employees working from home in countries other than those that they work in (as a result of travel restrictions) would establish a PE for their employers in the second country.<sup>76</sup> The guidance concluded that the “exceptional and temporary change of the location of employees exercise their employment because of the Covid-19 crisis”<sup>77</sup> would not create a PE for the employer. This principle was extended to employees who would temporarily conclude contracts.

While these guidelines and the respective regulations may be applicable during the pandemic period, changes to the work locations of

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74. See Kenya Revenue Authority, *Impact of COVID-19 on the Future of Work* (7 Sept. 2020), available at <https://www.kra.go.ke/news-center/blog/933-impact-of-covid-19-on-the-future-of-work> (accessed 10 May 2022) [hereinafter KRA Future of Work Brief]; and Kenya Revenue Authority, *Adopting Kenyan Tax Administration to COVID-19 Crisis* (2020), available at <https://www.kra.go.ke/images/publications/Policy-Brief---Adopting-Kenyan-Tax-Administration-to-COVID-19-Crisis.pdf> (accessed 20 May 2022) [hereinafter KRA Adapting to COVID-19 Brief].

75. Art. 15(2)(c) *OECD Model* (2017).

76. Para. 18 *OECD Model: Commentary on Article 5* (2017) states that a home office constitutes a fixed PE if “it is used on a continuous basis for carrying on business activities for [the company] and it is clear from the facts and circumstances that the [company] has required the individual to use that location to carry on the [company’s] business”.

77. OECD Guidance, *supra* n. 20.

the management team may no longer be considered “exceptional and temporary”.<sup>78</sup> Consideration would now need to be given to whether the home office can be considered at the disposal of the employer.<sup>79</sup> However, at the moment, Kenya has not issued any guidance on the application of the treaty rules in light of continued work from home. Until such guidance is issued, employees working from home in Kenya may establish a PE in Kenya if the use of the office is no longer temporary, the said activities are integral to the business and the employee was required to carry on the business in said location.

Employees who habitually conclude contracts on behalf of an employer may also establish an agency PE in Kenya. For treaties with provisions on service PEs, the employees furnishing services in Kenya who are here for a period above the threshold may establish a PE in Kenya. However, the UN Model Commentary has yet to provide guidance on how the 183 or 90-day thresholds would be calculated.<sup>80</sup>

### 18.5.2.3. Company residency

Company residency may give rise to change in the allocation of taxing rights under article 15(2). If an employee is a resident in one state but exercises employment in another state (work state), the work state may tax the income from employment if the employer is a resident of the work state.<sup>81</sup>

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78. Beretta, *supra* n. 64.

79. According to para. 12 *OECD Model: Commentary on Article 15* (2017), determination of whether a place is at the disposal of the employer will be dependent on the effective power to use that location, the extent of the presence of the enterprise at that location and nature of activities performed there (auxiliary activities are not likely to establish a PE). See J. Schwarz, *Lockdown and Tax Treaty Issues*, Kluwer International Tax Blog (6 Apr. 2020), available at <http://kluwertaxblog.com/2020/04/06/lockdown-and-tax-treaty-issues/> (accessed 20 May 2022), which discusses cases decided on the establishment of a PE through a home office. See also OECD Guidance, *supra* n. 20, at para. 15: “If an individual continues to work from home after the cessation of the public health measures imposed or recommended by government, the home office may be considered to have certain degree of permanence. However, that change alone will not necessarily result in the home office giving rise to a fixed place of business PE. A further examination of the facts and circumstances will be required to determine whether the home office is now at the disposal of the enterprise following this permanent change to the individual’s working arrangements.” [Emphasis added.]

80. Committee of Experts on International Cooperation in Tax Matters, *Tax and Coronavirus Disease (Covid-19): Pandemic and Post Pandemic Issues*, E/C.18/2022/CRP.8 (2022), available at <https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2022-03/CRP.8%20Taxation%20and%20COVID%2019%20VFinal.pdf> (accessed 13 May 2022).

81. Art. 15(2)(b) *OECD Model* (2017).

Under article 4(1) of the OECD Model (2017), residency of a company is determined by reference to the domestic law of the state seeking to enforce the treaty.<sup>82</sup> If the company is resident in two states, the treaties provide a tiebreaker rule.

With the exception of Canada and Zambia, treaties entered into by Kenya rely on the place of effective management to determine the residency of a company.<sup>83</sup> As a result of the pandemic, board members or other senior executives may be unable to travel, and there is a risk that the place of effective management will be changed.<sup>84</sup> However, the OECD guidelines provide that this is “extraordinary and temporary” and should not create changes to PE status.<sup>85</sup> Kenya has not issued any guidance on the application of these rules in the pandemic era.

Until such guidance is issued, if the employer (a Kenyan resident company) loses its residence in Kenya because of the change of location of key management, Kenya may lose the taxing right over employment income paid to non-residents employed by such companies, unless either of the other two conditions is satisfied. Kenya may also gain taxing rights over employment income paid to non-residents by foreign companies that trigger residency in Kenya because of the relocation of effective management to Kenya.

## 18.6. Frontier workers

Kenya does not have specific provisions on frontier workers in its bilateral treaties, nor does it have guidance on the treatment of frontier workers. However, it is worth noting that the Treaty for the Establishment of the East African Community (EAC Treaty) commits member states, including

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82. According to sec. 2 ITA, a company is resident if it is incorporated in Kenya; the management and control of its affairs is carried out in Kenya; or it has been declared resident by the Minister.

83. Para. 24 *OECD Model: Commentary on Article 4* (2017) defines “place of effective management” as the “place where key management and commercial decisions that are necessary for the conduct of the business as a whole are in the substance made. An entity may have more than one place of management, but can only have one place of effective management”. In determining the place of effective management, the competent authorities do not just rely on the location of directors but must also consider all facts and circumstances. *See also* Technical Advisory Group on Monitoring the Application of Existing Treaty Norms for the Taxation of Business Profits, *The Impact of the Communications Revolution on the Application of the Place of Effective Management as a Tie Breaker Rule* (2001), available at <https://www.oecd.org/ctp/treaties/1923328.pdf> (accessed 5 May 2023).

84. OECD Guidance, *supra* n. 20, at para. 28.

85. *Id.*, at para. 29.

Kenya, to adopting measures necessary “to achieve the free movement of persons, labour and services and to ensure the enjoyment of the right of establishment and residence of their citizens within the community”.<sup>86</sup> The EAC Treaty further commits to “free movement workers, who are citizens of the other partner states, within their territories”.<sup>87</sup> The East African Community Common Market (Free Movement of Workers) Regulations Annex II provides more details on the regulations associated with free movement of workers. Though the rules exist and the possibility of having frontier workers within the Community does seem possible, the EAC Treaty does not have any guidelines or regulations on the treatment of frontier workers.

In addition, with the signing of the Africa Continental Free Trade Agreement, the African Union also adopted the Protocol Relating to the Free Movement of Persons, Right of Residence and Right of Establishment.<sup>88</sup> The Protocol preserves the free movement of workers across member states;<sup>89</sup> however, similar to the EAC Treaty, there are no specific regulations regarding frontier workers.

### **18.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)**

Kenya has not provided any guidance on the mobility of work or entered into mutual agreements with countries on the application of treaty laws in the pandemic period. The issues of the establishment of a PE for a foreign company; residency of the employee during the pandemic; and taxation of employment income are yet to be practically tackled by the tax administration. However, given the court’s reliance on OECD guidance in previous cases,<sup>90</sup> it is likely that OECD guidelines on the treatment of remote work may be relied on when the tax administration tackles these issues.

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86. *Treaty for the Establishment of the East African Community* art. 104 (1999), available at <https://www.eacj.org/wp-content/uploads/2012/08/EACJ-Treaty.pdf> (accessed 5 May 2023).

87. *Protocol on the Establishment of the East African Community Common Market* art. 10 (2009), available at <https://www.unhcr.org/4d5259759.pdf> (accessed 5 May 2023).

88. Available at [https://au.int/sites/default/files/treaties/36403-treaty-protocol\\_on\\_free\\_movement\\_of\\_persons\\_in\\_africa\\_e.pdf](https://au.int/sites/default/files/treaties/36403-treaty-protocol_on_free_movement_of_persons_in_africa_e.pdf) (accessed 5 May 2023).

89. Art. 14 *id.*

90. *See Unilever Kenya Ltd.* (2005).



## 18.8. The future of the mobility of work: A need for adjusting the existing treaty rules?

OECD guidelines state that temporary changes in the physical location of employees and/or management of a company occasioned by COVID-19 restrictions would not change the residency and PE status of an employer.<sup>91</sup> However, the reality of increased mobility following the pandemic raises interpretation issues and requires governments to consider whether rules based on physical presence are still fit for purpose.<sup>92</sup>

The pandemic has not only changed the kind of work being done but has also impacted “where and how this work is performed”.<sup>93</sup> Importantly, there has been an increase in remote work options since “physical proximity is no longer a constraint”.<sup>94</sup> Kenya has seen a large proportion of its workforce work from home and an increase in business transactions through digital platforms.<sup>95</sup> In the long term, it is expected that employees will continue to split their time between working from home and the office.<sup>96</sup> The pandemic also served as a “technological equalizer”,<sup>97</sup> forcing employees who were not technologically savvy to adapt and embrace working virtually.<sup>98</sup>

Arguably, as we continue to see an increase in the mobility of workers, it does seem that the physical presence criterion – currently used to establish a connection with the work state – may no longer be appropriate for the “work from anywhere” reality of the post-pandemic world.<sup>99</sup> The global reality requires countries to “enhance the effectiveness, flexibility and future

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91. OECD Guidance, *supra* n. 20.

92. Pistone, *supra* n. 36.

93. International Labour Organisation, *World Employment and Social Outlook: Trends 2022* (2022), available at [https://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/--publ/documents/publication/wcms\\_834081.pdf](https://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/--publ/documents/publication/wcms_834081.pdf) (accessed 10 May 2022).

94. *Id.* See also International Organisation for Migration, *Labour Mobility and Skills in Response Recovery and post Covid-19 Pandemic* (2021), available at [https://www.iom.int/sites/g/files/tmzbd1486/files/documents/policy\\_brief\\_labour\\_mobility\\_and\\_skills\\_in\\_covid\\_time\\_final\\_final\\_0.pdf](https://www.iom.int/sites/g/files/tmzbd1486/files/documents/policy_brief_labour_mobility_and_skills_in_covid_time_final_final_0.pdf) (accessed 1 May 2022) [hereinafter IOM Policy Brief]. The brief discusses the role of COVID-19 in accelerating automation, digitalization, e-commerce and remote work. The effects of the accelerated growth in this area are expected to redefine the nature of labour migration and mobility for years to come.

95. KRA Adapting to COVID-19 Brief, *supra* n. 74. See also P. Muindi, *How to Effect a Hybrid Working Model* (17 May 2022), available at <https://www.standardmedia.co.ke/business/enterprise/article/2001445700/how-to-effect-a-hybrid-working-model> (accessed 1 May 2022).

96. KRA Future of Work Brief, *supra* n. 74.

97. *Id.*

98. *Id.*

99. Beretta, *supra* n. 64.

orientation of national labour mobility policies and regulations”.<sup>100</sup> Kenya has yet to tackle these questions, but the global and domestic trends indicate that this might be an area that will need to be addressed in the coming future.

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100. IOM Policy Brief, *supra* n. 94.

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## Chapter 19

### The Impact of Tax Treaties on International Mobility of Work in Liechtenstein

Patrick Knörzer

#### 19.1. Mobility of work and domestic tax law

##### 19.1.1. Individuals

Resident employees are subject to worldwide taxation in Liechtenstein and have to file a tax return. If they work for a Liechtenstein resident employer or if a foreign employer has a permanent establishment (PE) in Liechtenstein, the employer has to make a payroll tax deduction. If working days of the employee were (partially) spent abroad, the legal consequences depend on the respective tax treaty.

Non-resident employees are only taxable in Liechtenstein when the work is performed domestically.<sup>1</sup> It does not matter if these persons are employed in the public or in the private sector. Public servants of the state of Liechtenstein or its municipalities must always be assessed in those cases in which Liechtenstein has the exclusive right to tax their income on the basis of a tax treaty.<sup>2</sup> Similarly, employees with limited tax liability must file a tax return if their annual salary is at least CHF 200,000,<sup>3</sup> with the exception of frontier workers from Austria and Switzerland.<sup>4</sup>

Liechtenstein resident employers make a payroll tax deduction on the salaries they pay out; otherwise, the employee has to pay the tax himself. Special rules for frontier workers are applicable for Austrian and Swiss resident employees (*see* section 19.6.). With regard to the COVID-19 pandemic, the Liechtenstein legislator did not distinguish whether the employee was forced to spend more or less time in Liechtenstein due to travel restrictions or restrictions on the use of the office or did so voluntarily.

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1. Art. 6(5)(c) of LI: Law of 23 September 2010 on National and Municipal Taxes, Liechtenstein Federal Gazette 2010 no. 340, last amended 1 January 2024 [hereinafter Liechtenstein Tax Act].

2. Art. 23(2)(b) *id.*

3. Art. 23(2)(c) *id.*

4. For details, *see* Liechtenstein Fiscal Authority, Information letter on withholding tax on income from employment and substitute income (wage tax) of January 2022.

Work that is done abroad does not cause a limited tax liability in Liechtenstein, even if it is performed for a Liechtenstein resident employer. If a non-resident employee works in a home office abroad, the part of his salary attributable to this work is not taxable in Liechtenstein. In order to get a relief from the payroll deduction, the employee can prove that he has spent only part of his working days in Liechtenstein, and the tax deduction is adjusted accordingly. Alternatively, the employee can file for a full tax assessment and make the same adjustment.

### 19.1.2. Legal persons

Legal persons are considered to be resident in Liechtenstein if their registered seat (as provided for in their statutes, articles of associations, etc.) or place of effective management is within Liechtenstein.<sup>5</sup> As a consequence, mobile board members could have some influence on the taxation of the corporation. If the management board members of a corporation live and work in different countries, this could move the place of effective management to Liechtenstein, which leads to an unlimited corporate income taxation. Board members who change their residence from Liechtenstein to one or more other countries could trigger an exit taxation of the corporation under Liechtenstein tax law<sup>6</sup> if the place of effective management is relocated at that same time. It should be noted, however, that the residence of the board members is not decisive for the exit taxation but rather the place where the strategic and operative decisions for the corporation are made. Vice versa, if the place of effective management is transferred to Liechtenstein, this results in an unlimited corporate income tax liability in Liechtenstein and a step-up is granted in the company's assets.

### 19.1.3. Social security

As an EEA state, Liechtenstein has implemented the social security directives which are applicable in the EEA. Generally, the treatment of mobile employees under social security law is not aligned with the tax residence nexus in Liechtenstein. If frontier workers spend more than 25% of their working time in their home office in their residence state, they are no longer covered by statutory social security in their state of employment – but rather

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5. Art. 44 Liechtenstein Tax Act.

6. For details, see art. 51 id.

in their country of residence – according to EEA directives.<sup>7</sup> However, this rule has been suspended until 30 June 2023 as a result of the COVID-19 pandemic.

From 1 July 2023, new rules apply to employees working at home in cross-border situations within the EEA. If an employee works less than 50% of the agreed working time in the state of his or her residence, the social security legislation of the state in which the employer has its place of business or registered office may remain applicable.<sup>8</sup>

## **19.2. Residence, tiebreaker rules and mobility of work: Individuals and entities**

### **19.2.1. Residence of individuals**

Tracking of residence is a major task for tax administrations when an individual splits their time between mobile work and remaining in their home country. However, this problem already exists under current law. The place where the work is performed is only a subordinate criterion when determining the residence state under article 4(2) of the OECD Model. It is questionable whether additional home office time strengthens the importance of the permanent home available or the habitual residence.

In practice, for tracking residence, the law on foreigners is very helpful when it comes to determining the unlimited tax liability of an individual. If a person has a right of residence in Liechtenstein, this is accompanied by unlimited income and wealth tax liability. When a person receives a residence permit, he must register with the respective municipality. Based on this registration, he is registered with the tax administration at the same time. The only exception is a “small” residence permit for a maximum of 180 days,<sup>9</sup> which only leads to a limited tax liability in Liechtenstein.

For non-resident employees, certain foreign law provisions also need to be taken into consideration. Within the first 10 days after starting work, cross-border commuters must register with the Foreigners and Passport Office in

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7. Regulation (EC) No 883/2004 of the European Parliament and of the Council of 29 April 2004 on the coordination of social security system.

8. For details, *see* Framework Agreement on the application of Article 16(1) of Regulation (EC) No. 883/2004 in cases of habitual cross-border telework and Guidance Note on telework applicable from 1 July 2023.

9. So-called Approval by letter (*Bewilligung in Briefform*).

Liechtenstein (APA) and apply for a cross-border commuter permit (GMB), which entitles the holder to work in Liechtenstein. Frequently, the application is made by the employer in advance.

There is no legal basis that makes a difference whether an employee is forced to spend more time in his residence state or in another country (e.g. due to travel restrictions during a pandemic) or whether the stay in a certain country is on a voluntary basis. Neither the domestic law nor the tax treaties of Liechtenstein contain a force majeure clause for this case. The only regulation that takes into account the inaccessibility of the workplace due to the pandemic is the mutual agreement with Switzerland (*see* section 19.7.).

### 19.2.2. Residence of legal entities

An entity is resident in domestic tax law if its legal seat or place of effective management is in Liechtenstein. The term “place of effective management” means the place where the effective management of the entity is located. A shift of the state where the key management and commercial decisions are made may lead to a loss of taxation right and, consequently, trigger an exit taxation. Especially in the case of Liechtenstein, such a scenario is usually not intended by the corporation.

According to the OECD Model (2017) tiebreaker rule, competent tax authorities deal with the dual residence issue on a case-by-case basis by mutual agreement. This determination will take into consideration all the facts and circumstances of the case, including travel restrictions to board meetings. However, most Liechtenstein tax treaties include the pre-2017 version of article 4(3) of the OECD Model. Under this rule, the relocation of board members to another country may change the state of residence of the respective entity. This causes implications for the taxation not only of the company itself but also its employees, including the board members.<sup>10</sup>

Liechtenstein corporations regularly use mobile workers. Even before the pandemic, desk sharing was taking place in some industries. If a corporation no longer has sufficient workplaces for all its employees, it does not automatically lead to a violation of the substance requirements from a tax treaty perspective. An issue with the substance criteria so that the corporation might even lose its tax treaty entitlement can only be assumed in extreme

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10. *See* para. 24.1 of *OECD Model Tax Convention on Income and on Capital: Commentary on Article 4* (23 Nov. 2017), Treaties & Models IBFD [hereinafter *OECD Model: Commentary on Article 4*].

cases, for example, if all employees are working from home. However, this seems to be rather unfeasible and unlikely to happen in practice.

For international shipping companies, according to domestic Liechtenstein tax law, an activity as an employed person is deemed to be performed in Liechtenstein if it is performed on board a sea-going vessel or an aircraft operated in international traffic, or on board a vessel operating on inland waterways, if the effective place of management of the operating undertaking is located in Liechtenstein.<sup>11</sup> As a consequence, under domestic law, the movement of the effective management to another state affects the taxation of not only the shipping company but also its non-resident employees. For the shipping company, under article 8 of the OECD Model, the taxing right can move to another resident state, which would trigger an exit taxation in Liechtenstein.

### 19.3. Permanent establishments and mobility of work

In Liechtenstein, there is as yet no administrative practice or court ruling on either the circumstances under which a home office constitutes a PE within the meaning of the tax treaty or on whether changes in working practices due to the COVID-19 pandemic can lead to the establishment of a PE. In its tax law, Liechtenstein generally follows the OECD concept of permanent establishments.<sup>12</sup> A home office can only constitute a PE under very narrow preconditions.

In most cases, a home office is not “at the disposal” of the enterprise. Usually, the employer is not entitled to come to the home of the employee unless he is invited. In such case, the disposal of the employer does not appear to exist. Secondly, the OECD interpretation of the scope of a PE states that a fixed establishment cannot be merely temporary but must have a certain degree of permanence. This is not the case, for example, if the COVID measures only apply for a certain period of time and the home office is only used during the pandemic. In this context, it is not yet clear which duration Liechtenstein intends to apply to home offices. It is possible that the duration for construction sites laid down either in national tax law (6 months)<sup>13</sup> or in the tax treaty will be applied by analogy. Likewise,

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11. Art. 6(5)(c) Liechtenstein Tax Act.

12. Art. 2(1)(a) id.

13. Art. 2(1)(a), no. 9 id.

Liechtenstein tax law does not specify the required number of days per week or per month that constitute a home office as a PE.

According to their administrative practice, some states do not want to consider a home office as a PE if it did not exist before the pandemic.<sup>14</sup> In the author's view, this approach can only provide a short-term solution, if any. Some employment contracts or agency contracts that are connected to home office were only established during or after the pandemic; this administrative practice then fails completely. Another point to deliberate is that the work performed in home offices could be of an auxiliary or preparatory nature under article 5(4) of the OECD Model and, therefore, does not lead to a PE. This can be especially true for activities in connection with construction sites. Additionally, the accommodation of the employee may be located in the same state as the enterprise. For example, in the case of employees resident in Switzerland who stay overnight in Liechtenstein during the week, the question of whether the home office constitutes a PE of the employer is irrelevant.

However, if the home office work wholly replaces the workspace in an office over a certain amount of time, it can be seen as a fixed business.<sup>15</sup> Furthermore, if the employer does not provide any working space at his premises and has the authority to dispose of the home office, there can be a PE. In this case, from the very beginning, it is planned that the services of the employee will be provided exclusively in his private home. Liechtenstein domestic tax law does not contain a service PE. Provisions of service PEs are only included in a few tax treaties.<sup>16</sup> Therefore, a home office also cannot constitute a service PE under Liechtenstein tax law. In general, Liechtenstein is rather cautious about giving a home office the quality of a PE.

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14. OECD, *Updated guidance on tax treaties and the impact of the COVID-19 pandemic* (OECD 2021).

15. OECD, *Interpretation and Application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention: Public Discussion Draft* ch. 4 (OECD 2021-2022).

16. Tax treaties with Lithuania, Hongkong, Singapore, Czech Republic and Uruguay.



## 19.4. Physical presence according to articles 15(1) and 17 of the OECD Model

### 19.4.1. Place of work

In Liechtenstein, the connecting factor for taxing employment income under domestic law is no broader than the definition under article 15 of the OECD MC. According to domestic tax law,<sup>17</sup> the work must be exercised in Liechtenstein in order to tax a non-resident employee; it does not matter if the work is done for a Liechtenstein resident or a foreign resident employer. In particular, the taxation in Liechtenstein is not linked to the place where a foreign activity is utilized. The mere provision of services does not lead to a limited tax liability of the employee just because they are provided to an employer resident in Liechtenstein.

A severance payment is considered a substitute for income. According to article 15(1) of the respective tax treaty, home office severance payments are taxed proportionately according to where the active activity was carried out. The place-of-work principle also applies to compensation payments, for instance, to short-time compensation payments which are paid by the state if the employment contract was continued with a lower level of employment due to the pandemic. Exceptions in connection with the COVID-19 pandemic have been agreed with Switzerland (*see* section 19.7.).

### 19.4.2. Entertainers and sportspersons

Entertainers and sportspersons under article 17(1) of the OECD Model are taxed where the activities as such are exercised. If they rehearse or train in one state and perform publicly in another state, the rehearsal or training leads to a splitting of the taxation between the two states if the time spent on rehearsal or training is compensated.<sup>18</sup> Team athletes are generally taxed as employees and receive income from employment.

The only professional sports club resident in Liechtenstein, the soccer club FC Vaduz, is in a unique situation regarding physical presence. Whereas half of the matches and most of the practice take place in Liechtenstein, the other half of the matches (the away matches) are played in Switzerland, as the FC Vaduz is participating in the Swiss soccer league. A considerable proportion

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17. Art. 6(5)(c) Liechtenstein Tax Act.

18. Para. 9.1 *OECD Model: Commentary on Article 17*.

of the players are resident in Switzerland and, therefore, have to commute daily to Liechtenstein. The situation is similar to that of AS Monaco, which is part of the French League.

According to article 17(1) of the tax treaty between Liechtenstein and Switzerland, the taxation of sportspersons corresponds to the wording of the OECD Model. This treaty provision is interpreted in a way that the matches of the national championships are crucial, and matches in European club competitions (such as the UEFA Champions League) are generally irrelevant. It is hard to even imagine players of the top European teams being subject to tax for parts of their income all over Europe, never mind being almost inadministrable. Decisive for the physical presence of the player is the national league, which normally is a purely domestic championship where all the matches are played within the same country – with the exception of the FC Vaduz (and the AS Monaco).

At the end of August 2020, Liechtenstein and Switzerland concluded a mutual agreement procedure, which regulates the taxation of the income of players of FC Vaduz resident in Switzerland within the meaning of article 17(1) of the tax treaty.<sup>19</sup> With regard to players of FC Vaduz resident in Switzerland, it can be assumed that half of their activities are carried out in Liechtenstein and each state taxes half of the income. The FC Vaduz players are free to provide evidence of an actual country-based allocation of their activities that deviates from this presumption.

## **19.5. Article 15(2) and (3) of the OECD Model**

### **19.5.1. 183-days rule**

Liechtenstein has agreed to the 183-days rule of article 15(2)(a) of the OECD Model in all its tax treaties. The Liechtenstein Fiscal Authority did not issue any further guidance on the impact of home office days for the 183-day test so far. The reason might be that the problem of employees becoming stranded in Liechtenstein did not occur during the pandemic, as the borders to the neighbouring countries have always been open for workers (not always for tourists).

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19. Mutual agreement between the competent authorities of Liechtenstein and Switzerland concerning the treatment of income of Swiss-resident players of the FC Vaduz according to the tax treaty of 10 July 2015.

However, the Liechtenstein government issued a general recommendation to use home office where it is possible, which some companies turned into an internal home office obligation. Even if this has meant that the number of working days spent in Liechtenstein by foreign workers has fallen below 183 days, it should be borne in mind that the employer is still resident in Liechtenstein. It seems extremely unlikely that the expansion of home office could lead to the loss of residency of the employer company, especially since hardly all employees are in the home office at the same time. In particular, those employees who have an individual office due to their position in the internal company hierarchy have used home office significantly less due to the lower risk of contagion.

For the lack of a legal basis that allows for a distinction, it generally does not make a difference whether the home office is imposed or recommended by the government in line with public health measures in domestic Liechtenstein law and under most Liechtenstein treaties. Special rules for employees are included in the special agreements with Austria and Switzerland (*see* section 19.7.). For the determination of the economic employer in the sense of article 15(2) of the OECD Model, it also has to be considered who controls and has responsibility for the place at which the work is performed.<sup>20</sup> In case of home office, there is less substance as the employer does not dispose over the workplace.

### 19.5.2. Article 15(3) as a possible alternative?

According to article 15(3) of the OECD Model (2017), the concept for employees working in international traffic provides that such remuneration shall be taxable only in the residence state of the employee. The place of work no longer plays a role in taxation. Before 2017, the OECD Model attributed the exclusive right to tax profits to the residence state of the enterprise or to the state in which the place of effective management of the enterprise is situated. The justification of both rules lies, above all, in the fact that in international traffic, the place of work cannot be assigned precisely to one state. Since this justification does not exist outside international traffic, it is questionable whether article 15(3) can act as an alternative to article 15(1) and (2) of the OECD Model. Besides, a sole link to the residence state of the employer could lead to arbitrary results. The place of taxation can be changed by establishing an employment relationship with a foreign company but continuing to perform the work in the home country.

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20. *See* para. 8.14 *OECD Model: Commentary on Article 15*.

## **19.6. Frontier workers**

### **19.6.1. Austria**

#### **19.6.1.1. Basic rule**

Unsurprisingly, having borders to two states, Liechtenstein has concluded two tax treaties that contain provisions for frontier workers, namely with Austria and Switzerland. There has been a frontier worker rule in the tax treaty between Liechtenstein and Austria for more than half a century. Under the current tax treaty, there is a split taxing right. The state of employment may levy a withholding tax of a maximum of 4%, which is creditable in the residence state. Generally, the related administrative practice is mainly based on information issued by the Austrian tax authorities to the taxpayers.

#### **19.6.1.2. Proximity to the border**

The tax treaty with Austria does not contain any further specifications with regard to the characteristics of a residence close to the border and a place of work close to the border, which are required for the classification of frontier workers. The Austrian tax authorities are of the opinion that all places of work are still to be considered close to the border if – taking into account modern transport conditions – it is possible to travel to the place of work from the home on a daily basis, based on a reasonable travel time. In other words, if no secondary residence is maintained in Liechtenstein (e.g. subletting a room or premises in a staff home) and if, therefore, a return to the Austrian residence on working days actually takes place, the frontier worker status is to be affirmed. According to the Austrian Ministry of Finance, the status as frontier worker even exists if the distance between the Austrian residence in Tarrenz/Tyrol and the workplace at a company in Vaduz is 150 kilometres by rail or 125 kilometres by road for a shareholder-manager with residence in Götzis and place of work in Zurich. Even these longer distances leave no doubt that the primary frontier worker requirement of returning to the Austrian residence on each working day is actually fulfilled.<sup>21</sup>

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21. See Austrian Ministry of Finance of 12.03.1996, B 13/5-IV/4/96, EAS 839 and of 03.09.1996, EAS 936, G 108/1-IV/4/96.

### 19.6.1.3. Home office days

Spending a lot of time in the home office in the residence state could lead to a loss of the frontier worker status under the tax treaty. This would be the case if the home office were so extensive that it could no longer be considered an activity of a frontier worker because the employee no longer commutes regularly enough.

Under Austrian administrative practice,<sup>22</sup> it is possible to split the calendar year into two parts if the home office activities are only exercised during part of the year. This administrative practice could also be applied to stricter COVID-19 measures imposed in winter. In that case, the employee is taxed according to article 15(1) of the respective tax treaty in winter and as a frontier worker in summer. However, if the home office is maintained throughout the year, this possible solution fails.

The percentage of home office days that makes the frontier worker status disappear has not been agreed between Liechtenstein and Austria. On the basis of a mutual agreement to the tax treaty between Austria and Germany, in the case of a year-long employment with a company close to the border, the employee is either classified as a frontier worker for the whole year or not at all – depending on whether the criteria are met. However, the Austrian Ministry of Finance explicitly does not want to apply this rule in the Austrian-Liechtenstein context.<sup>23</sup> The reasons for this can most likely be seen in the different provisions in the Austro-German and Austro-Liechtenstein treaty.

In practice, Austria seems to want to extend the status of frontier worker as much as possible. However, it has to be noted that the classification as a frontier worker of an Austrian resident employee working in Liechtenstein does not make much difference to the total amount of taxes to be paid in most cases. Employees with frontier worker status and non-frontier workers who are treated according to article 15(1) of the treaty are both taxed according to the income tax rates of Austria as their residence state. Therefore, there is no agreed solution to many questions, such as the distance to the home between Liechtenstein and Austria.

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22. Austrian Ministry of Finance, EAS 2158 as well as EAS 1940 und EAS 880; comp. Austrian Fiscal Court of 16 May 2008, RV/0065-F/08.

23. Austrian Ministry of Finance, EAS 3361 of 05.06.2015, BMF-010221/0139-VI/8/2015; *see* EAS 2158 of 14.10.2002, B 441/1-IV/4/02.

#### 19.6.1.4. Activities in third countries

It is also possible that part of the activity of a frontier worker takes place in a third country, be it due to secondments and business trips or if another workplace is available in a third country. According to the Austrian tax authorities, the frontier worker status is not lost if the employee is sent on business trips to third countries by his Austrian employer up to about 40% of his working days, provided that on the days on which no business trip takes place, there is a daily commute between the place of residence in Liechtenstein and the place of work in Austria.<sup>24</sup> Negotiations with Liechtenstein on this issue have not yet taken place. In relation to Liechtenstein, it therefore seems justifiable that a person only has frontier worker status for part of the year or for several parts of the year,<sup>25</sup> as long as the activities performed in third countries do not reach such an extent that the commuting is insignificant due to the clear predominance of the work exercised outside the border zone.<sup>26</sup> In this sense, the frontier worker status is maintained if business trips are undertaken in Austria up to a maximum of 10 days per year.<sup>27</sup>

#### 19.6.2. Switzerland

##### 19.6.2.1. Genesis of the frontier worker rule

The taxation of frontier workers from Switzerland has a long tradition in Liechtenstein. However, the direction of commuting of these frontier workers is rather one-sided: most of them are resident persons in Switzerland working for Liechtenstein-resident employers, whereas only few persons are resident in Liechtenstein and working for Swiss employers. As long as a tax treaty between Liechtenstein and Switzerland has existed, it has contained a frontier worker rule. The first tax treaty was signed in 1995,<sup>28</sup> and the current treaty that replaced the old one was concluded in 2015.<sup>29</sup>

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24. Austrian Ministry of Finance, EAS 3361 of 05.06.2015, BMF-010221/0139-VI/8/2015.

25. Cf. EAS 2158 and, *mutatis mutandis*, EAS 1940 and EAS 880; also Austrian Fiscal Court of 16 May 2008, RV/0065-F/08.

26. Cf. Austrian Fiscal Court of 16 May 2008, RV/0065-F/08.

27. Austrian Ministry of Finance, EAS 3361 of 05.06.2015, BMF-010221/0139-VI/8/2015.

28. Agreement of 22 June 1995 between the Swiss Confederation and the Principality of Liechtenstein on various tax matters; *see also* the message of the Swiss Federal Council of 25 October 1995 on the treaty (BB1 1995 IV 1633).

29. Convention of 10 July 2015 between the Principality of Liechtenstein and the Swiss Confederation for the Avoidance of Double Taxation with respect to taxes on income and on capital.

Under both treaties, only the residence state may tax the income of frontier workers.

The new frontier worker rule, effective from 2017, is highly complex in terms of its scope. Even during the process of concluding the tax treaty, there were discussions in both countries at a political level about the scope of the taxation of frontier workers. In Switzerland, the parliament feared the wishes for a revision of the agreement from Liechtenstein and, therefore, demanded from the Federal Council that the taxation of frontier workers be retained by the residence state in the tax treaty to be negotiated.<sup>30</sup> In its final version, after several rounds of negotiations, some suggestions from the German-Swiss double taxation agreement were adopted in the treaty text. In contrast to the frontier worker rule in the tax treaty with Austria, a very sophisticated administrative practice has been developed for the Liechtenstein-Swiss treaty.

#### 19.6.2.2. Taxation of frontier workers and other employees

Frontier workers from Switzerland are not liable to pay tax in Liechtenstein on their income from employment in Liechtenstein they are liable to pay tax exclusively in Switzerland. In this case, the Liechtenstein-resident employers apply the tax treaty directly in order to prevent time-consuming and administratively costly refund procedures as far as possible. Hence, the Liechtenstein-resident employer does not have to make any tax deduction in these cases.

It is the responsibility of the employer to question the employee about his frontier worker status. For this purpose, he must check the domicile of the employee (principal tax domicile; centre of vital interests). Suitable proof of residence is a current official certificate of residence from the competent tax authority, which the employer is obliged to submit once for newly hired employees with a residential address in Switzerland after they take up their position. The employee is obliged to inform the employer of any changes in residence. If the employer has concrete indications of a change in residence, in particular if the employee informs the employer of a change of address, the employer is obliged to request a new, up-to-date certificate of residency from the employee.

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30. See Motion no. 12.3046 by Walter Müller, as amended by the Council of States (*Ständerat*) on 10 September 2013.

Article 15(1) of the tax treaty, which follows the OECD Model, is applicable to the taxation of non-frontier workers. Accordingly, the state of employment has the right of taxation for those working days on which the activity is carried out there. If, on the other hand, the activity is performed outside this state, the residence state has the right of taxation.

### 19.6.2.3. Frontier worker status

According to article 15(4) of the tax treaty, income from employment of persons who are resident in one contracting state and have their place of work in the other state and who, as a rule, travel each working day from their place of residence to their place of work (frontier workers) may be taxed only in the contracting state in which they are resident. The protocol clarifies that the term “place of work” means the place where the person is incorporated in the business of his employer. The term “residence” means the place where the person has his principal tax domicile. A maximum distance between principal tax domicile and place of work has neither been defined in the treaty nor in the protocol.

The frontier worker status does not apply if, for professional reasons, the person does not return to his place of residence for more than 45 working days in a calendar year after the end of work. The frontier worker rule is clarified by a mutual agreement between Liechtenstein and Switzerland.<sup>31</sup> The number of working days is calculated on the basis of 240 working days per year. In order to determine the number of working days in Liechtenstein, those working days that were exercised outside Liechtenstein must be deducted. If, for example, the work is performed outside Liechtenstein in 50 days, Liechtenstein has the right of taxation for 190 out of a total of 240 working days, in other words, 79 days. Seventeen percent of the income is taxable in Liechtenstein, and the rest in Switzerland.<sup>32</sup>

The calculation of the working days outside Liechtenstein can, in principle, be made on the basis of the list of non-return days, taking into account whether the work on the arrival/departure day was mainly carried out within or outside Liechtenstein. The taxpayer may, alternatively, keep a calendar to

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31. Mutual agreement between the competent authorities of Liechtenstein and Switzerland concerning the application of art. 15 paragraph 4 of the tax treaty of 10 July 2015.

32. Liechtenstein Fiscal Authority, Information letter about the taxation of frontier workers and non-frontier workers according to the tax treaty Liechtenstein-Switzerland of January 2022, para. 24 cont.



prove his Liechtenstein and foreign working days. In this case – in deviation from the formula – the actual working days are taken into account.

In order to determine the status of a non-frontier worker for persons who do not return to their place of residence in Switzerland for work-related reasons on more than 45 working days in a calendar year, the number of non-return days must be determined. Non-return days are those working days in which the employee does not return to his place of residence (principal tax domicile) for professional reasons.

Only working days that are agreed in the respective employment contracts qualify as non-return days. Saturdays, Sundays and public holidays only count as working days if work has been arranged on these days or if they are business travel days. In principle, working days exist as long as the employment contract lasts and either a salary or a (taxable) benefit from the employer or a substitute benefit is paid to the employee. This applies to prolonged illness (daily sickness benefit) as well as to military service, for which the employee receives compensation, and to maternity leave. In the case of unpaid leave, however, there are no working days on the grounds that no remuneration is paid here.<sup>33</sup>

If the employment lasts less than 1 year, the non-return days are calculated proportionately (3.75 non-return days per month). Likewise, if the employment is part-time and the work is not performed every working day, the non-return days are calculated on a pro rata basis. In the event of a change of employer within the same country, the counting of non-return days continues for the year.<sup>34</sup>

#### 19.6.2.4. Professional reasons for the non-return

The non-return must be due to professional reasons. In the following circumstances, professional reasons for non-return are to be assumed (exemplary list) if the employee's overnight stay is made in a hotel or a secondary residence near the place of work and also the return to the place of residence by the means of transport normally used exceeds a travelling time of 45 minutes.

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33. Liechtenstein Fiscal Authority, Information letter about the taxation of frontier workers and non-frontier workers according to the tax treaty Liechtenstein-Switzerland of January 2022, para. 11 cont.

34. Id., at para. 15.

If the travel time between the place of residence and place of work is 45 minutes or less, the professional reason for the non-return shall be justified. Specifically, it is possible to consider overnight stays as work related in cases of high workloads where normal working hours are significantly exceeded. Business meals can be considered as justification for a professional reason for non-return. Professional reasons for non-return are presumed if the overnight stay of the employee takes place in the vicinity of the place of work by an employee on call (on-call duty), provided that the readiness would not be guaranteed when the employee returned to his residence. Professional reasons also exist in the case of an overnight stay of the employee during further training, if the employer pays the overnight costs.

#### 19.6.2.5. Impact of home office days

In principle, days on which the employee does not cross the border because he has the opportunity to pursue his work at home are also days of non-return. Nevertheless, it has been explicitly stipulated between Liechtenstein and Switzerland that working days on which the employee works at his place of residence (home office days) do not count as non-return days.<sup>35</sup> The crucial number of more than 45 non-return days also applies if regular home office work has been agreed, for instance if the employment contract stipulates work at the place of residence, even if the period in which the non-return days can be attained is reduced due to the home office period.

An extension of home office days can lead to the loss of frontier worker status for another reason, namely if the employee thereby no longer regularly commutes to his residence. Unfortunately, there is no agreement as to the extent of home office working above which the employee is no longer taxed as a frontier worker. According to a decision of the Swiss Federal Supreme Court concerning the old tax treaty,<sup>36</sup> the concept of a frontier worker does not require that the employee returns to his place of residence every working day without exception. A regular return is sufficient. The court has ruled that an employee who commutes to his place of work 60% of the working days and works 40% at his place of residence is still to be considered a frontier worker.

The reasoning of the court is somewhat surprising. If the Liechtenstein-resident employee had worked 100% from his home office in Liechtenstein

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35. Mutual agreement between the competent authorities of Liechtenstein and Switzerland concerning the application of art. 15 paragraph 4 of the tax treaty of 10 July 2015, ch. 2.

36. Swiss Supreme Federal Court of 1 October 2009, 2C\_215/2009.

for the Swiss employer or if he had commuted daily 100% of the working days (with two border crossings on each working day), Liechtenstein would have full taxation right under both constellations. It would not be compatible with the meaning and purpose of the tax treaty if Liechtenstein's full right to taxation were to change as soon as the work models are "mixed" and consist of 40% home office and 60% daily commuting.

It is doubtful whether this reasoning is convincing, as the court argues with two constellations that are not the subject of the decision. Based on the nature of the reasoning of the court, it can be concluded that the Federal Supreme Court is not trying to see 40% of home office working days as permissible for frontier workers. Therefore, the question of the exact extent of home office that is still permissible for frontier workers remains unresolved.

Another interesting issue is "home" work that is exercised not at the main residence but at the secondary residence of the employee. The secondary residence must be near the place of work and can be located on either side of the border. It must be used for more than 45 days of the year to avoid the frontier worker status. Consequently, home office days that are spent in the secondary residence are equivalent to non-return days.

#### 19.6.2.6. Collection of income tax

The collection of income tax shows the problems that can arise because of the uncertain number of home office days that will be spent in the coming year. If it is already clear at the beginning of the year, with a high degree of probability, that an employee will not fulfil the frontier worker status (e.g. due to exceeding 45 non-return days for professional reasons), the Liechtenstein-resident employer can already deduct the withholding tax at the beginning of the year, after consultation with the employee. Otherwise, the employer can deduct tax at source from the monthly salary payments from that date onwards, after consulting the employee.<sup>37</sup>

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37. Liechtenstein Fiscal Authority, Information letter about the taxation of frontier workers and non-frontier workers according to the tax treaty Liechtenstein-Switzerland of January 2022, para. 27 cont.

## **19.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)**

### **19.7.1. Austria**

Liechtenstein and Austria have refrained from concluding a mutual agreement for frontier workers with regard to COVID-19. According to article 15(4) of the tax treaty between Liechtenstein and Austria, persons who are resident in a contracting state near the border and have their place of work in the other state near the border and who commute from their place of residence “as a rule on every working day” are considered frontier workers. It was informally agreed between Liechtenstein and Austria that persons who were previously classified as frontier workers because they commuted “as a rule every working day”, but who now work in their home offices in order to contain the further spread of COVID-19 (among other things, on the basis of the recommendations issued by the respective governments), do not lose their frontier worker status as a result. This is because “as a rule” the affected workers travel from their place of residence across the border to their place of work, and the special situation caused by the COVID-19 pandemic shall not change this. However, a certain period of COVID-19 measures has not been defined.

### **19.7.2. Switzerland**

In October 2020, the competent authorities of Liechtenstein and Switzerland concluded a mutual agreement to clarify the implications for frontier workers from the COVID-19 pandemic.<sup>38</sup> This mutual agreement with Switzerland was effective from 11 March 2020 and has been terminated since the end of March 2022.<sup>39</sup> As a consequence, the rules described in this section are only applicable for the taxable years 2020, 2021 and 2022.

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38. Mutual agreement on the Convention of 10 July 2015 between the Principality of Liechtenstein and the Swiss Confederation for the Avoidance of Double Taxation with respect to taxes on income and on capital concerning the tax treatment of wages and state support payments to employed persons during the measures to combat the COVID-19 pandemic.

39. Liechtenstein Fiscal Authority, Newsletter 01/2022 of 3 March 2022.

#### 19.7.2.1. Definition of “COVID-19 measures”

For the mutual agreement with Switzerland, the concept of so-called “COVID-19 measures” is crucial. COVID-19 measures are, in particular, those which, in order to combat the COVID-19 pandemic, impose restrictions or conditions on operational procedures, access to the place of work or the return to the place of residence, for example, the use of public transport, including corresponding recommendations. These measures may be imposed by a state, its local authorities or by the employer, or may also apply by agreement with the employer.<sup>40</sup> Employer measures may include special arrangements for risk groups, rotation of workers, restrictions on access to office premises and restrictions on travel. The overall picture is decisive for the existence of measures and also for the discontinuation of measures.

The period of time during which an employee is affected by measures related to the COVID-19 pandemic must be confirmed by the employer in writing, with reference to the measure applicable in each case. In this way, such proof is, in principle, only to be issued for potential non-frontier workers. The confirmation may be issued for individual employees, groups of employees or all employees who are affected by the respective COVID-19 measures issued.

#### 19.7.2.2. Reduction of the 45 days

Determining the threshold of 45 non-return days for the question of whether or not a person is a frontier worker should, according to the mutual agreement, take into account the measures to combat the COVID-19 pandemic. The threshold is reduced aliquot for the period of application of COVID-19 measures, namely by 45/365 (366 for the year 2020), respectively for the remaining period of the calendar year. The period during which an employee is affected by the measures is not taken into account in order to determine the frontier worker status. During this period, working days on which the worker does not actually return to the place of residence are thus ignored.<sup>41</sup>

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40. Para. 1(1) of the Mutual Agreement on the Convention of 10 July 2015 between the Principality of Liechtenstein and the Swiss Confederation for the Avoidance of Double Taxation with respect to taxes on income and on capital concerning the tax treatment of wages and state support payments to employed persons during the measures to combat the COVID-19 pandemic.

41. Id., at para. 1(3).

### 19.7.2.3. Fiction of daily commuting

If, due to measures taken in connection with the COVID-19 pandemic, an employee is no longer able to commute daily from his place of residence to his place of work (place of incorporation in the employer's business), the fiction is established that he has nevertheless commuted. This fiction also applies in the case of the employee having to stop work due to the pandemic if there is a continued payment of wages.<sup>42</sup> The fiction does not apply to working days that would have been spent at the place of residence anyway or would have been work-free irrespective of measures imposed in connection with the COVID-19 pandemic (for example, home office on the basis of an employment contract provision irrespective of COVID-19).<sup>43</sup>

### 19.7.2.4. Fiction of working in the state in which the work is normally exercised

If an employee is considered *not* to be a frontier worker, working days which are spent in the residence state only due to measures in connection with the COVID-19 pandemic shall – for the purposes of determining the apportionment key – be deemed to be working days spent in the contracting state in which the place of work (place of integration into the enterprise of the employer) would have been located if the measures had not been taken (source state). This fiction does not apply to working days that would have been spent in the residence state independently of these measures or would not have been worked for other reasons, for example, home office based on an employment contract regulation independent of COVID-19. As a consequence of the fiction, the salary attributable to the days worked in the country of residence because of the pandemic is taxable in the source state. The fiction of working in the source state occurs only if the worker proves that wages attributable to days worked in the residence state are actually taxed by the source state to avoid any double non-taxation.<sup>44</sup>

Short-time compensation paid by a contracting state for lost hours of work or similar remuneration hours or similar compensation paid by the state as a result of the measures to combat the COVID-19 pandemic are to be qualified as remuneration for employment within the meaning of article 15 of the tax treaty and, for tax purposes, are to be treated in the same way as

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42. Id., at para. 1(1).

43. Id., at paras. (1) and (2).

44. Id., at para. 2(2).

regular wages.<sup>45</sup> For periods in which a non-frontier worker did not carry out any work but still received remuneration, the taxation of this remuneration is based – subject to special circumstances – on the places where the work was carried out in the same period of 2019.

## **19.8. The future of the mobility of work: A need for adjusting the existing treaty rules?**

During the COVID-19 pandemic, the use of home office increased rapidly, even though the Liechtenstein borders to Austria and Switzerland were never fully closed for frontier workers and the restrictions imposed due to the pandemic in Liechtenstein were rather light, compared to other countries. Home office use is likely to remain at a higher level after the pandemic than before. Due to increased home office activity by employees, Liechtenstein employers run the risk of establishing a PE of the company abroad through the home office activity. Liechtenstein-resident companies would then be liable to tax abroad because of the respective PE.<sup>46</sup> In this case, not insignificant tax substrate would go abroad, not to mention the compliance costs of the companies abroad and possible transfer pricing disputes. Besides, fewer employees working in Liechtenstein means less used infrastructure for the state and municipalities. Restaurants and shops, which are visited mainly at lunchtime, would suffer a massive loss of income if the foreign workers were increasingly absent. This could even lead to tax losses and business closures, which already occurred due to the COVID-19 pandemic.

From a tax policy perspective, Liechtenstein wants to ensure that value creation and, thus, taxation take place within the country. However, if employees are not physically working in Liechtenstein, it is hardly possible to justify to foreign countries that the value creation has taken place in Liechtenstein and that Liechtenstein is allowed to tax the profits generated by the companies. Nevertheless, also in Liechtenstein, the desire for working more home office days is increasing, especially among executives.

Liechtenstein is one of the very few countries in Europe with more employees than inhabitants. Since 2007, there are fewer workers with a residence in Liechtenstein than workers with a foreign residence. The number

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45. Id., at para. 3.

46. Liechtenstein Government, Small inquiry (*Kleine Anfrage*) of 6 April 2022, Insurance subordination of frontier workers in home office.

of non-resident employees of Liechtenstein enterprises has been slowly but constantly growing during the last years and amounted to more than 24,000 or 57% of all employees at the end of 2022. More than 95% of them have their domicile either in Austria or Switzerland.<sup>47</sup> Therefore, the taxation of employment income of frontier workers is of utmost importance for Liechtenstein.

One must concede that frontier worker rules in a tax treaty are difficult to administer in many cases. Furthermore, if the status as a frontier worker is lost because of too many days in home office, the treaty rules lead to an abrupt change in taxation when the taxation based on the place of work principle is applied. In contrast, if a treaty does not contain a frontier worker rule, but the employee is taxed based on his place of work, additional home office days cause a sliding shift in taxation rights towards the residence state.

Internationally, there are no uniform regulations on the taxation of frontier workers. A frontier worker rule in a tax treaty takes into account the specific situation and is normally the result of a negotiation process between two neighbouring countries with considerable economic ties. Therefore, it does not seem feasible to draft an international model of a frontier worker treaty provision that fits all countries. Rather, the open issues should be resolved in the bilateral relationship between the neighbouring states.

For the employee, the current provisions of tax treaties based on the place of work principle often mean that records must be kept of where the work is performed. Employers have frequently been unable or unwilling to record the place of work of their employees. Due to the increase in home offices, the enforcement of the place-of-work principle has become much more complex and burdensome for the tax administrations.

Finally, it should be emphasized that Liechtenstein has refrained from including provisions that are based on the duration of the COVID-19 pandemic in its national tax law. In the course of the practical application of the COVID-19-related provisions, strong ambiguities have become apparent – especially since the duration and the measures to combat COVID-19 may differ among states and companies. In particular, “freezing” pre-pandemic fiscal situations is problematic. In addition, it should be considered that lighter COVID-19 measures may remain for some time. Therefore, the provisions for taxation of home-based work should continue to evolve, regardless of the effects of COVID-19.

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47. See Liechtenstein Statistics Authority, Statistical Yearbook 2024, p. 131.



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## Chapter 20

### **The Impact of Tax Treaties on International Mobility of Work in Moldova**

Andrian Candu

#### **20.1. Mobility of work and domestic tax law**

##### **20.1.1. Work mobility – a global phenomenon**

It is indeed accepted by all that the COVID-19 pandemic significantly changed and challenged our lives. It changed people's lifestyle, economic and business models and behaviour. It also changed the employment relationship, mentality and attitude of employees and the policies of corporations. The social and economic shock brought by the COVID-19 pandemic put everyone in the position to rethink and redesign the notions and perceptions about work and employment occupations, the future of the labour market and, of course, the impact of the tax rules. The measures and actions taken by governments against the COVID-19 pandemic had a negative impact on labour by triggering an unprecedented fall in employment and hours worked. Based on the OECD Economic Outlook and data provided by the International Labor Organization (ILO) in its paper prepared at the request of G20 Leaders:<sup>1</sup>

Between December 2019 (a peak in activity prior to the crisis) and April 2020 (the crisis trough in most countries), these declines ranged from nearly 40% in Mexico to around 8-9% in Japan and Korea. On average, the steep fall in the number of people working which occurred as countries sought to contain the COVID-19 pandemic was 14 times the total decline experienced from the peak to trough – over a much longer period – during the Global Financial Crisis.

The fall in total hours of work captures both the change in the number of people at work but also any reduction in working hours per week for those workers still at work. As such, the fall in total hours gives an idea of the total impact of the pandemic on employment. Total hours worked fell by more than the decline in the number of employed persons at work in most countries, ranging

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1. ILO & OECD, *The impact of the COVID-19 pandemic on jobs and incomes in G20 economies*, ILO-OECD paper prepared at request of G20 Leaders, Saudi Arabia's G20 Presidency (2020).

from a staggering 46% in Mexico to a still substantial decline of around 10% in Australia. The fall was considerably greater on average (more than six times) than the decline that occurred during the Global Financial Crisis.

Globally, projections by the ILO suggest that working hours may have declined by 14% between the fourth quarter of 2019 and the second quarter of 2020. This amounts to approximately 4 00 million full-time jobs, assuming a 48-hour working week. For G20 economies, total hours of work are also projected to have declined by 14% or the equivalent of 265 million full-time jobs.

#### *Working from home (teleworking) and flexibility*

One of the most significant changes that has occurred as a result of the COVID-19 pandemic has been the shift of many employees to work-from-home arrangements across occupations, thus working remotely. While telecommuting has been possible for many years, remote work during the pandemic was supported by rapid deployment of new digital solutions such as video conferences, document-sharing tools and expansion of cloud-based computing capacity. Countries quickly designated essential workers who had to be on-site and told everyone else to stay home. That experience proved some of the benefits of remote work including greater flexibility for workers and more efficiency for businesses. In order to promote a rapid move to telework for all operations that allowed it, countries took a series of measures to simplify its use including financial and non-financial support to companies. Italy, for example, simplified the procedure by allowing companies and employees to arrange teleworking without a prior agreement with trade unions, without a written agreement and at the employees' place of choice, while Russia introduced amendments to its labour code on teleworking. Other countries, such as Japan and South Korea, offered a subsidy towards the cost of introducing flexible work arrangements.

The COVID-19 pandemic had another impact on work and labour relationships. Many would consider that the old way of working is history as the “flexibility culture” takes hold. “Flexibility” is the word often heard, as well as that “flexibility is the way forward”. Employees want flexibility in where, when and how they work. “The people who are satisfied that their organization does a good job providing work flexibility in terms of time and location”, says Justin Black, head of people science at LinkedIn, “are 2.6 times more likely to be happy working at their company and 2.1 times

more likely to recommend that others work at their employer”.<sup>2</sup> Flexibility, indeed, is becoming a key value proposition for employers. Based on the survey undertaken by LinkedIn, there was more than an 83% increase in job posts mentioning flexibility since 2019 and more than 343% more mentions of flexibility in company posts since 2019.

## 20.1.2. Mobility and COVID-19 impact on Moldova

### *Before pandemic – general background*

Migration is one of the most important challenges for the Republic of Moldova. It has a significant social and economic impact. Based on relevant data, the Republic of Moldova has one of the highest rates of migration in the world. At the beginning of 2020, the Republic of Moldova had more than 1.15 million Moldovans living abroad from a total population of less than 4 million, which is more than 29% of the total population. The migration started at the beginning of the 1990s after the collapse of the Soviet Union and continued in different stages and waves with acceleration in 2000 and 2015.<sup>3</sup>

The background and motivations behind the migration are similar to those in other countries and specifically the lack of work opportunities and professional growth, low salaries and lack of prospects. The migration was facilitated also due to a significant number of the Moldovans holding Romanian citizenship (approximately 1 million people) and the freedom to travel to EU countries that was granted in 2014 by the European Union.

The main reason for migration is work migration. The estimation made by the International Organization for Migration (IOM) states that at least 25% of the Moldovan population resides abroad. Additionally, if adding around 350,000 Moldovans who are seasonal migrants with a short work residence abroad, it may be stated that the total migration flow has more than one third of the population. The migration destinations are quite broad, but the

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2. LinkedIn, *Global Talent Trends* (2022), available at [https://business.linkedin.com/content/dam/me/business/en-us/talent-solutions-lodestone/body/pdf/global\\_talent\\_trends\\_2022.pdf](https://business.linkedin.com/content/dam/me/business/en-us/talent-solutions-lodestone/body/pdf/global_talent_trends_2022.pdf).

3. UN Department for Economic and Social Affairs, *World Population Prospects 2022*, available at <https://population.un.org/wpp/>; United Nation, Population Division, *International Migrant Stock*, available at <https://www.un.org/development/desa/pd/content/international-migrant-stock>; and World Bank, *Global Development Indicators* (2019), available at <https://databank.worldbank.org/source/world-development-indicators>

five top destination countries are Italy (18.3%), Russia (15.3%), Germany (12.9%), France (10.7%) and the United Kingdom (10.5%).

*The impact of the COVID-19 pandemic on migration*

The COVID-19 pandemic did not have any significant impact on migration flow. The initial estimations were that the pandemic would force many Moldovans to return back to the Republic of Moldova, but statistical data did not show any significant changes. Comparing with previous periods, in the period between March and September of 2020, there were 300,000 less Moldovans returning back to the country. The majority of those who returned came back after first wave of the pandemic. Based on the analysis and survey conducted, the majority of the Moldovans who came back during the pandemic stated different reasons other than COVID-19. More than 36.5% cited family issues, around 21.9% mentioned the expiration of their residency status and 12.5% vacation. It could then be concluded that only one third of those who returned home during the pandemic came back because of COVID-19.<sup>4</sup>

*The impact of the COVID-19 pandemic on the labour market*

Certainly, the COVID-19 pandemic had a negative impact on the labour regime and the conditions for Moldovans residing abroad or in the Republic of Moldova. Due to the lockdown, many Moldovans lost their jobs, were forced to take leave or faced a reduction of their wages (*see* figure 20.1.). In Moldova, COVID-19 also had a significant impact on labour conditions. To adjust the work conditions, also by imposing different restrictions, the Moldovan authorities presented the proposal to amend the law by providing the possibility to work from home (telework). Thus, the labour code was amended in May 2020 by introducing the notions of home work or telework.

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4. International Organization for Migration, *Social and Economic Impact of the COVID-19 Pandemic on Moldovan Migrants and their families* (2021) available at [https://moldova.iom.int/sites/g/files/tmzbd11626/files/documents/Raport%2520Covid\\_FINAL.pdf](https://moldova.iom.int/sites/g/files/tmzbd11626/files/documents/Raport%2520Covid_FINAL.pdf).

Figure 20.1. The impact of the COVID-19 pandemic on the labour market in Moldova and abroad for Moldovans



### 20.1.3. Tax residency in Moldova and other tax rules

As mentioned in section 20.1.1., the COVID-19 pandemic had a significant impact of the labour market and especially on the mobility of work. Many people were forced to stay home, and others could not travel back to their countries and were thus forced to work from abroad, or, vice-versa, they were forced to work from their own countries but for foreign entities located abroad. For a better understanding the impact of the Moldovan tax rules on the mobility of work phenomenon, the criteria for tax residency and the most important tax rules for individuals and for legal entities will be clarified in the following sections.

#### 20.1.3.1. Tax residency for individuals

According to Moldovan tax legislation, as a general rule, tax residents are liable to income tax on their worldwide income, whereas tax non-residents are liable to income tax only on their Moldovan-sourced income. An individual's obligation to pay Moldovan income tax is determined through their tax residence status. A resident is defined as an individual who either:

- has their domicile in Moldova (based on a valid Moldovan identity card); or
- spends more than 183 days in Moldova in the fiscal year concerned.

If the individual does not fulfil any of these criteria or has a valid residence certificate issued on the basis of applicable tax treaties, they shall be deemed as being a tax non-resident. An individual's obligation to pay Moldovan

income tax is determined through their residence status as well as the types of income obtained.

#### **20.1.3.2. The application of double tax treaties**

The Moldovan tax law expressly provides that the tax treaties prevail over domestic tax law. The only exceptions are cases where the domestic regime provides for more favourable tax rates; in such circumstances, the domestic rates apply. For the application of a tax treaty, the individual has to present their certificate of fiscal residency prior to the payment of income. There are currently more than 50 tax treaties concluded and in force that may provide for a more or less favourable tax regime. Moldovan tax authorities and taxpayers have to use commentaries to the OECD Model to clarify tax issues related to the applicability of tax treaties. Individuals are allowed to credit their foreign income tax paid against their Moldovan tax liabilities (an official confirmation issued by the relevant foreign tax authority is required) but only within the limits of the tax rate that would be applicable in Moldova on tax due for the year concerned.

#### **20.1.3.3. The impact of the pandemic and mobility of work for individuals on their tax residence status**

As the rule of 183 days is important for an individual to be considered as the tax resident and to consequently become liable for income tax worldwide, the challenges triggered by work mobility because of the COVID-19 pandemic also had a potential impact and could eventually change the tax regime. For example, take a Moldovan citizen living abroad who is a tax resident in countries like Italy, Romania, Russia or Germany (called the host country). They are employed by and working for a foreign corporation (also resident in one of those countries) but came to Moldova temporarily on vacation before the pandemic.

While being in Moldova for vacation, the Moldovan authorities impose lockdown and restrictions to travel. The borders are closed, and there are also flight restrictions. The lockdown with other restrictions will be longer than 183 days, and thus the Moldovan citizen becomes a tax resident of Moldova. During this entire period of time, the Moldovan individual was working from home for their employer abroad. Based on this scenario, the following questions or issues may be raised:

- is this a “special and extraordinary circumstance/force-majeure” because of the COVID-19 pandemic, thereby triggering the change of the tax residence status?
- is the salary earned for the work performed physically in Moldova (but not related to Moldova) via a home office that is paid by a non-Moldovan employer considered as Moldovan-sourced income and consequently taxed in Moldova?
- is another income (dividends, royalties, interests, etc.) taxed in Moldova based on tax residency and a worldwide taxation regime? and
- will the foreign corporation (non-Moldovan employer) create a permanent establishment (PE) in Moldova through their employee and thus trigger taxation in Moldova?

These are only a few of the questions raised by the challenges triggered by the pandemic. The answers may be found in either the domestic tax legislation or by applying the tax treaties in place. This report will consequently treat all of these issues in the following sections. In the meantime, some of the answers, briefly, are the following.

*Tax residency* – it is clear that based on the Moldova legislation, because of the period exceeding 183 days, the individual in this discussion would become a tax resident in Moldova. Currently, the law does not make any exception to either a voluntary stay or the one forced by circumstances. Unfortunately, the Moldovan authorities did not come with any guidance or amendments to the legislation to regulate or provide for the consequence of the special circumstance. The one derived from the COVID-19 pandemic can indeed be considered as a force majeure. Of course, the tax treaty in place may treat their residency differently. The tax treaties concluded by Moldova follow the OECD Model that is based on article 4 and focuses on “a permanent home available, place of their centre of vital interests, habitual abode, or nationality”.

Unlike Moldova, the authorities from other countries came up with special treatment, amending their legislation or approving guidance with the scope to clarify and regulate the tax regime due to the COVID-19 crisis. For example, Australia approved guidance providing that, if a person that is not an Australian tax resident is located in Australia temporarily for few weeks or months because of COVID-19, this person will not become an Australian resident for tax purposes. Another example is Ireland, which approved a decision stating that if an individual is prevented from leaving Ireland on their intended day of departure because of extraordinary natural occurrences, this is a force majeure case.

*The salary/wages paid by a non-Moldovan employer for an activity not related to Moldova* – based on Moldovan tax law and on the scenario in this contribution, it is considered that the income is not taxed in Moldova because it is not related to Moldova although it was received by a Moldovan citizen who was forced by circumstances to become a tax resident. However, of course, such a rule also has exceptions. One of the exceptions is related to wages received from a non-Moldovan resident who is acting in Moldova through a PE. This topic will be described and explained in detail in sections 20.1.3.4. and 20.3.

*Income other than salary* – due to Moldovan tax residency and because of the taxation of the worldwide regime, any other income like dividends, interests, capital gains, etc. will be levied and taxed in Moldova, but a favourable withholding tax (WHT) rate will be applicable taking into account a relevant tax treaty.

#### 20.1.3.4. Residency for corporations

According to Moldovan tax law, a tax resident is a legal entity organized or managed in Moldova or that has its main place of business in Moldova. Practically, based on different sources of interpretation, tax residency is determined by the place of incorporation.

*Permanent establishments (PEs)* – there will be more focus on PEs in other chapters and sections within this report and specifically with the application of the provisions of article 5 from tax treaties. Based on Moldovan tax law, a PE is a fixed place of business through which a non-resident company wholly or partially carries out entrepreneurial activity in the territory of Moldova either directly or through a dependent agent. Taking into account the scenario described and domestic Moldovan tax law, the activity performed by the Moldovan individual in the Republic of Moldova will not trigger a PE. This is because the non-Moldovan employer (i.e. the foreign company) does not have any intention of having entrepreneurial activity in the Republic of Moldova, which is a condition required by the Moldovan law.

#### 20.1.3.5. Social security law and impact

As a general rule, even if not clearly stipulated by the law, there is an opinion that salary income received from a non-Moldovan employer is not subject to Moldovan social security contributions. Social security contributions



paid abroad are not considered deductible for income tax purposes. Salary income received from a Moldovan employer for work performed outside Moldova is subject to Moldovan social security contributions unless specifically provided otherwise by applicable social security agreements.

## **20.2. Residence, tiebreaker rules and mobility of work: Individuals and entities**

This section will treat specific tax rules under different scenarios of work mobility, taking into account the domestic Moldovan tax legislation, the provisions of the tax treaties concluded by Moldova with a few countries (where there is a flow of migration and work mobility) and the provisions and commentaries to the OECD Model. The residence and the tiebreaker rules for both individuals and entities will be first.

### **20.2.1. Tax residence – individuals**

As mentioned in section 20.1.3.1., according to the Moldovan tax legislation, the residence is determined based on either the domicile in Moldova or the period exceeding 183 days for a specific fiscal year. By “domicile”, the Moldovan legislation means a registered residency. This is the address that is provided in the internal identification document, which normally is an identification card. For getting such a “registration”, a “permanent place (home)” should be available based on either a property title (ownership) or a legal title to use the space (rent, lease, etc.) but for a longer period of time.

The notion of “domicile” provided by the Moldovan tax law is subject to a registration procedure and generally follows the same qualification and interpretation given by the OECD Model and the majority of tax treaties concluded by the Republic of Moldova. This regards the definition of “domicile” provided by article 4(1) of the OECD Model. Of course, if there are cases where an individual has a “long attachment” of domicile for two or more countries and thus has double residency, then the provisions of paragraph 2, called tiebreaker rules, will be applicable. First, it regards a “permanent home available”, then the place of “his personal and economic relations (centre of vital interests)”, then “habitual abode” and, finally, “the nationality”. These rules are provided based on the OECD Model and also by the tax treaties concluded with Romania (from 1995), Russian (1996), Italy (2002) and other countries.

### 20.2.2. Impact on “residence” of work mobility

There is no doubt that the mobility of work has an impact on tax residence but is subject to some conditions in specific circumstances assuming that an individual “was caught” being in Moldova because of the restrictions (a lockdown), and this is due to the COVID-19 pandemic. An example is a Romanian citizen, a tax resident in Romania, who is travelling to Moldova on a business trip and, while being in Moldova, they are “forced” to stay longer. The first rule provided by the Moldovan tax law related to domicile and also provided by article 4 of the tax treaty concluded between Moldova and Romania will not be applicable for the following reasons:

- they do not have a domicile in Moldova as they would not have a long stay/use title for a location to be used. Most probably, for the beginning, they would stay in the hotel and afterwards would execute a rent agreement for a short stay; and
- as they were on a business trip to Moldova, it is assumed that they did not have a permanent home available, and their place of personal and economic interest was/is in Romania.

However, because they stay longer than 183 days, although without domicile, the Moldovan authorities may qualify them as a tax resident in Moldova. In this situation, because of the double residence, the tax treaty concluded between Moldova and Romania will be applicable and specifically article 4(2), which provides tiebreaker tests (permanent home, centre of vital interest, place of habitual abode and nationality).

Another example has the same circumstances but is related to a Moldovan citizen who left Moldova a long time ago and is now living and working in Italy, which is their current home country. This Moldovan individual returns to Moldova because of the COVID-19 pandemic. In this scenario, most likely either because of their previous domicile in Moldova (many Moldovans still have an ID with their registered domicile) or because of the long stay of more than 183 days, the individual would become a tax resident in accordance with the Moldovan tax law.

However, even in this specific case, this individual becomes a Moldovan tax resident under domestic rules. If the tax treaty with Italy is to be applicable, then the person would not become a resident of Moldova due to their “temporary dislocation” and applying the tiebreaker rules provided by article 4(2) of the treaty. All of these, of course, are subject to the conditions that the Moldovan individual, in this particular case, has a very close relationship with Italy by having an “available permanent home”. If

it is considered that they have permanent home in both countries, i.e. both Moldova and Italy, then, of course, the second rule is applicable related to their centre of vital interest (personal and economic). If that is not working either, then a “habitual abode ” is to be applicable.

### 20.2.3. Tax residence – the enterprises/entities

According to the provision of article 5 of the Moldovan tax code, a legal entity/corporation is a tax resident in Moldova if that entity is “organized or managed in the Republic of Moldova, or if the main place of business/activity is in the Republic of Moldova”. Based on the majority of sources of interpretations, a legal entity is considered to be a tax resident in Moldova for any of the following reasons:

- because the place of incorporation/registration of the company is in Moldova;
- because the “place of management” is in Moldova; or
- because the “main place of activity” is in Moldova.

As was mentioned in the commentaries to the provisions of article 4(3) of the OECD Model, the cases of dual residency for companies are very rare. However, still, in rare cases, the company may be subject to tax as a resident in more than one state “if, for instance, one State attaches importance to the registration and the other State to the place of effective management. So, in the case of companies also, special rules as to the preference must be established”.<sup>5</sup>

To clarify this subject, both versions of the OECD Model before 2017 and the 2017 version must be taken into account. The OECD Model before 2017 came initially with provisions of paragraph 3 focusing on a tiebreaker clause related to the place of effective management. “In 2017, however, the Committee on Fiscal Affairs [...] concluded that a better solution to the issues of dual residence of entities other than individuals was to deal with such situations on a case-by-case basis.”<sup>6</sup>

Therefore, the current version of the OECD Model and its commentaries provide that countries should resolve the cases of dual residence by mutual agreement, applying paragraph 3. Various factors should be taken into account such as where the meetings of board of directors or equivalent

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5. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 4*, para. 21 (23 Nov. 2017), Treaties & Models IBFD.

6. Para. 23 *OECD Model: Commentary on Article 4*.

body are *usually* held, where the chief executive officer and other senior executives *usually* carry on their activities, where the senior day-to-day management is carried on, where the headquarters are located, etc.

As mentioned previously, cases of dual residence for companies should be very rare. Nevertheless, one can still take some examples of cases where, because of the COVID-19 pandemic or other work mobility factors, there are changes to the “place of effective management”. Assume in the first scenario that board members decide *voluntarily* to move to another country. Also, the chief executive officers are relocating, and most of the activity will be performed remotely as it was decided to have a flexible regime. Based on the OECD Model and its commentaries pre-2017, the place of effective management is the key answer. However, the substance criteria must still be taken into account and assessed if this “change” does not have a real intention to change the tax residency and thus have an improper use of the convention or an abuse of a tax treaty.

If taking into account the 2017 version of the OECD Model and its commentaries, then the state authorities seeking the mutual agreement would have to take into account various factors, as mentioned previously (e.g. voluntary or forced relocation of “place of effective management”). Nevertheless, in another scenario, one can assume that changes to the places of board meetings or the place where activity by the top executives is carried on are not voluntary but “forced” by the COVID-19 pandemic. The answer to this scenario came from and by the OECD Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis. In the analysis, the OECD Secretariat states that, indeed, the COVID-19 pandemic “may raise concerns about a potential change in the ‘place of effective management’ of a company as a result of a relocation, or inability to travel, of chief executive officers or other senior executives”.<sup>7</sup>

The OECD Secretariat considers in its analysis that, most probably, the COVID-19 pandemic will not create any changes to residence status under a tax treaty, and this is because of the extraordinary and temporary situation due to COVID-19. Moreover, it must be taken into account that, in both versions of the OECD Model (pre-2017 and 2017), all relevant facts and circumstances should be analysed to determine “usual” and “ordinary”

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7. OECD, *OECD Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis* (3 Apr. 2020), available at [https://read.oecd-ilibrary.org/view/?ref=127\\_127237-vsdagpp2t3&title=OECD-Secretariat-analysis-of-tax-treaties-and-the-impact-of-the-COVID-19-Crisis](https://read.oecd-ilibrary.org/view/?ref=127_127237-vsdagpp2t3&title=OECD-Secretariat-analysis-of-tax-treaties-and-the-impact-of-the-COVID-19-Crisis).

places of effective management, as it was underlined previously, and not only “exceptional and temporary periods such as COVID-19 crisis”.

Interesting examples were given by the OECD Secretariat about countries taking decisions and issuing guidance in this respect. For example, Ireland’s authorities issued guidance based on which it is “to disregard the presence of an individual in Ireland – and where relevant, in another jurisdiction - for a company in relation to which the individual is a *director*, if such presence is shown to result from travel restrictions related to COVID-19”.

Another issue that might be of interest to analyse related to the impact of work mobility is not only about the change in the place of management, voluntary or forced, and thus the triggered risk of dual residency. It is also about the *substance requirements* to be met by companies in order to benefit from the tax treaty. Assume a scenario that, due to the COVID-19 crisis or because of the flexibility in the work regime, the majority of employees will work from home. The question is, will the company in this case still meet the substance requirements? Will this trigger the risk of losing the treaty entitlement and thus being in the situation of a tax treaty limitation of benefits (LOB) clause to be applicable? It is indeed true that, since the OECD presented the action plan on base erosion and profit shifting (BEPS), the importance of the topic of “substance” has significantly increased. The goal of BEPS is to prevent the granting of treaty benefits in the case of companies that are set up only to enjoy the benefits of tax treaties. To achieve this, it is possible by addressing different subjects, such as:

- substance requirements under tax treaties;
- anti-abuse measures in domestic legislation and in tax treaties; and
- controlled foreign company (CFC) rules, etc.

It is important to state that, in the Republic of Moldova, there are no substance requirements provided by law nor any CFC rules. However, coming back to the example given previously, based on jurisprudence and the tax practices, in order to assess the substance criteria, it is not enough to take into account only one that relates to the employees’ place of the activity.

For example, on 22 December 2021, the European Commission published a proposal for a new directive setting up the rules to prevent the use of so-called shell entities for tax purposes.<sup>8</sup> The new rules should be implemented into national legislation by 30 June 2023 and should come into effect on

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8. Proposal for a Council Directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU (COM/2021) 565 final (2021), available at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52021PC0565>.

1 January 2024. Based on the proposal, some entities that are considered entities at risk would have to have a new reporting obligation towards tax authorities in their country of residence if three criteria are met simultaneously, namely:

- more than 75% of the revenue accruing in the preceding 2 tax years is “relevant income”. This mainly includes passive income deriving from dividends, interests, royalties, certain leases, insurance, etc.;
- more than 60% of income is earned or paid out via cross-border transactions or more than 60% of the assets from which relevant income is derived was located abroad in the preceding 2 tax years; and
- the administration of day-to-day operations and decision-making was outsourced in the preceding 2 tax years.

According to the proposal, the entities that meet some of the criteria, and not all three of them, are not affected by the directive. Also, some other entities are considered low-risk, such as listed entities, regulated financial entities and entities with at least five full-time employees carrying out activities generating the relevant income.

The high-risk entities will have to report in their annual tax returns if and how they meet the following three minimum substance requirements:

- the entity has its own premises in the EU Member State or premises for its exclusive use;
- the entity has at least one active bank account in the European Union; and
- one or more directors take decisions or the majority of qualified full-time employees are residents for tax purposes in the Member State of the entity.

As can be seen, the minimal substance requirements are more complex and wider in approach than being limited only to a situation where employees work from home or work remotely.

### **20.3. Permanent establishments and mobility of work**

Another issue that is related to and raised by mobility of work that may be voluntary or forced by circumstances (the COVID-19 crisis) is the PE. As mentioned in section 20.1.3.4., based on Moldova tax law, a PE is a fixed place of business through which a non-resident company wholly or partially carries out entrepreneurial activity in the territory of Moldova either directly or through a dependent agent. More or less, the Moldovan tax law definition

and interpretation of the PE follows the same rules as provided by the OECD Model and its commentaries. The mobility of work, and specifically the impact of the COVID-19 circumstances on PEs were not commented on, amended or adjusted by the Moldovan authorities. However, this aspect was carefully analysed by the OECD Secretariat, in its *Analysis of Tax Treaties and the Impact of the COVID-19 crisis*.<sup>9</sup> As it is mentioned by the OECD Secretariat, “some business may be concerned that their employees dislocated to countries other than the country in which they regularly work, and that working from their homes during the COVID-19 crisis, will create a ‘permanent establishment’ (PE) for them in those countries, which would trigger new filing requirements and tax obligations”.

Further on, the OECD Secretariat explains that the COVID-19 crisis most likely will not create any risks of qualification or determination to a PE because of the exceptional and temporary change of the location where employees exercise their employment (e.g. working from home). Moreover, “a construction site PE would not be regarded as ceasing to exist when work is temporarily interrupted”.

The case of “home office/telework” is treated by both the OECD Secretariat in its analysis and also within the Commentary on Article 5 of the OECD Model. In order to better understand the issue and also assess any risk, the criteria and the characteristic of the PE must also be taken into consideration, which is about the degree of permanency and being at the disposal of the company.

Assume that an employee is performing their duties in a home office because of the restrictions imposed by the local authorities due to the COVID-19 pandemic. In this specific case, the home office is imposed by the authorities, and it is not decided by the company or their employee. Moreover, the fact that activity is performed temporarily and intermittently from the individual’s home office means that it is lacking the degree of permanency. At the same time, in this specific scenario, the home office of the employee is not at the disposal of the company, which means that the enterprise does not have any access or control over the home office.

However, take into account another scenario, and specifically one where the home office is not imposed based on some restrictions or by a government

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9. OECD, *OECD Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis* (3 Apr. 2020), available at [https://read.oecd-ilibrary.org/view/?ref=127\\_127237-vsdagpp2t3&title=OECD-Secretariat-analysis-of-tax-treaties-and-the-impact-of-the-COVID-19-Crisis](https://read.oecd-ilibrary.org/view/?ref=127_127237-vsdagpp2t3&title=OECD-Secretariat-analysis-of-tax-treaties-and-the-impact-of-the-COVID-19-Crisis).

decision that can be qualified as extraordinary circumstances and a force majeure case but on a voluntary basis due to a flexible regime and a different style of work. In this specific case, important facts (some) to take into account might be the following:

- irrespective of the home office, is there still an office available for the employee that is duly controlled and paid for by the company? and
- is the employee compensated, directly or indirectly, for the costs incurred by the home office (internet and other utility bills, equipment or furniture being paid, totally or partially, rent, etc.)?

In other words, if there is not any office available and the employee performs their duties on a permanent basis at their home, there is a high risk that this will trigger the creation of a PE. Moreover, if the company has “control over” the home office by participating directly or indirectly in the maintenance – this fact will definitely bring more arguments for the existence of a PE. In other words, for assessing the risk, it is very important to take into account and assess all data and facts and corroborate with the Commentary to Article 5 of the OECD Model.

#### **20.4. Physical presence according to articles 15(1) and 17 of the OECD Model**

For treating the subject related to the taxation of salaries/wages under the provision of article 15 of the OECD Model that refers to income from employment, this report will first have a look at the regulations provided by Moldovan tax legislation. Like the provisions of the article 15(1) of the OECD Model, the Moldovan legislation provides the same rule, the main one, that salaries, wages, and other similar remuneration derived by a resident of Moldova, which refers to employment, shall be taxable in Moldova if the activity is performed in Moldova.

Moreover, the Moldovan tax legislation also provides that the income received by a resident of Moldova from the sources derived out of Moldova that are paid by a non-resident shall also be taxed in Moldova if the activity is performed in Moldova (the mechanism will be via a PE). As for non-residents, the provisions of article 70 of the Moldovan Tax Code divide the income into two categories, i.e. the income derived from Moldova paid by the entities or sources located in Moldova and those from non-residents or sources outside of Moldova.



For example, for a non-resident who receives salary or any other remuneration as a board member from a Moldovan resident entity, irrespective of where the activity is performed, the income will be taxed in Moldova. This provision is similar to the one provided by article 16 of the OECD Model, which refers to the taxation of a director's fees. So, as a general rule, either under Moldovan law or under article 15(1) of the OECD Model, the income deriving from employment is taxed in the country where the employment is actually exercised. Usually, the employment is exercised in the place where the employee is physically present during the activities for which the salary is paid, which means the place of their residency. So, generally, "the place of performance/activity" is the important one.

This rule, as it is mentioned by the provisions of the OECD Model and its commentaries, also has some exceptions, and these are related to the crews of ships or aircrafts operated in international traffic, pensions and remuneration received by members of a board of directors. For the crew, the taxation would be in the country of residence irrespective of the place of performance (article 15(3) of the OECD Model). For the members of the board, the taxation will be the place where the company resides, irrespective of the place of activity and performance (article 16).

For taxation of employment income, as mentioned in the OECD Model commentaries, the physical place of the employee is important, which is, of course, the place of their activity and performance but not the place where the activities are sourced "merely because the results of this work were exploited in that other state", where the employer company is located.<sup>10</sup>

However, how about a different aspect related to the mobility or work or mobility of performance/activity in this specific case? The author mentioned that the rule is to take into account the place of the activity related to employment, and this can also be a country other than the country of residence. What about a situation where the work is performed in the home office and the home office is placed in the country of residence or, on the contrary, where the company providing employment is located (in the state of source)?

As mentioned in section 20.3., also discussing and analysing the concept of a "home office" versus a PE, the answer depends very much on the "degree of permanency", if this is a "forced and/or imposed" solution, and which

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10. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 15*, para. 1.1 (23 Nov. 2017), Treaties & Models IBFD.

character it has – an exceptional one or ordinary? If the home office is imposed by the authorities and has a temporary and extraordinary character, based on the other examples and cases approved by different countries as well as according to the OECD Secretariat analysis, such cases are seen and considered as “force majeure” and should either be disregarded or shall not have any impact. If the restrictions are imposed by the authorities, then it would be reasonable to consider that the employee is still exercising their activity in the previous states of the activity although working from a home office, for example, in the residence state.

Another issue is related to the payment itself. The OECD Model mentions salaries, wages and other similar remuneration. If the salary itself does not really raise any issues, as it is generally accepted that it is directly related to the employment activity, how about, for instance, the remuneration paid after the termination of the employment? In this regard, the OECD Model states that any such remuneration “(e.g. a salary or bonus for the last period of work, or commissions for sale made during that period) will be considered to be derived from the State in which relevant employment activities were exercised”.<sup>11</sup>

What about a severance payment? Based on paragraph 2.7 of the commentaries, a severance payment is duly linked to the last 12 months of employment (in most cases). Therefore, it should be allocated on a prorated basis to where the employment was exercised during that specific period.<sup>12</sup>

Another important aspect regarding the physical presence is also about the taxation of the income derived by the entertainers and sportspersons provided by article 17 of the OECD Model. Based on article 17, the income derived by an entertainer or sportsperson that is received directly or accrued by another person (a company called a “star company” or via an orchestra, etc.) is taxed in the country where the activity is exercised (place of performance). This rule also refers to activities that are directly or indirectly linked to the main activity, referring to training, rehearsing or traveling to or between the places of performance. The taxation will be imposed by each country where the performance takes place using the proportion-determination formula because the activity may be exercised in different countries or, for example, the performance is exercised in one country but training/rehearsing is in another country.

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11. Para 2.4. *OECD Model: Commentary on Article 15.*

12. Para. 2.7. *OECD Model: Commentary to Article 15.*

## 20.5. Article 15(2) and (3) of the OECD Model

Article 15(2) of the OECD Model provides an exception from the rule provided by article 15(1). For a better understanding of the subject, the author would rather give an example that may be very relevant for Moldova and its neighbour country, Romania, as there are many practical cases like this. Of course, this example will take into account the provisions of the tax treaty concluded between Moldova and Romania. As it was mentioned in section 20.4., in accordance with article 15(1), the income derived by a resident of Moldova based on the employment relationship may be taxed in Romania if the employment activity is performed in Romania, and this is because the “physical presence” is important and thus the place where the activity is actually performed. However, article 15(2) lays out the exception. It provides that the income (from employment) derived by a resident of Moldova in respect of employment exercised in Romania shall be taxable only in Moldova, if:

- the recipient is present in Romania for a period or periods not exceeding a total of 183 days in any period of 12 months;
- remuneration is paid by or on behalf of an employer that is not resident of Romania; and
- remuneration is not borne by a PE or a fixed base that the employer has in Romania.

All three conditions provided by article 15(2) in the context of work mobility, due to the COVID-19 pandemic or not, may raise certain issues and interpretations. Assume that, before the COVID-19 crisis, a Moldovan citizen and resident of Moldova (due to their domicile) was exercising their employment activity in Romania, and their income was taxed in Romania (place of their physical presence and of their activity) because all three conditions were not met and thus paragraph 2 was not applicable. The Moldovan resident was restricted from traveling because of the COVID-19 crisis, and they are performing their activity using a home office from Moldova for a period longer than 183 days.

As mentioned in sections 20.1.3.3. and 20.3., the Moldovan authorities did not offer any domestic regulations to give solutions or answers from a tax point of view to situations in which restrictions imposed by the government (lockdowns or travel limitations) could trigger tax consequences. Therefore, the author takes into account the OECD Secretariat analysis.<sup>13</sup> Based on the

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13. OECD, *OECD Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis* (3 Apr. 2020), available at [https://read.oecd-ilibrary.org/view/?ref=127\\_127237-vsdaqpp2t3&title=OECD-Secretariat-analysis-of-tax-treaties-and-the-impact-of-the-COVID-19-Crisis](https://read.oecd-ilibrary.org/view/?ref=127_127237-vsdaqpp2t3&title=OECD-Secretariat-analysis-of-tax-treaties-and-the-impact-of-the-COVID-19-Crisis).

analysis, the COVID-19 crisis should be seen and accepted as an extraordinary and exceptional situation and a “force majeure”. Therefore, such a circumstance should not trigger any change in the residency status or any change in the employment relationship related to the place of activity. The countries should deem the place and the entire exercise as the one that it was before the crisis. This means that, in this specific example, both Moldova and Romania should consider that the employment exercise is still performed in Romania because of an exceptional situation.

Of course, the impact would be different if the circumstance is not imposed by the COVID-19 crisis but the home office is a voluntary one and it is accepted by the employer (located in Romania). In this specific situation, if the Moldovan employee is exercising their activity for a period longer than 183 days by using the home office located in Moldova, then paragraph 2 is applicable, and the income derived from this employment is going to be taxed in Moldova.

The second condition will now be examined, which is related to the employer and also the context of the mobility of work. Assume that, before the pandemic, the employer was considered to be a resident of Romania in accordance with domestic tax legislation but also in accordance with the tax treaties. The income derived by the Moldovan employee was taxed in Romania because of that and also in corroboration with other circumstances (the period of 183 days). Due to the COVID-19 crisis, all employees are working from home and thus in the position of “lacking substance”. Moreover, the directors are also working from home (abroad) and thus there is a risk of changes in the “place of effective management” and, because of that, the entity might not be a resident of Romania any longer.

These specific circumstances were explained and treated accordingly in section 20.2.3. of this report. As it was mentioned, if these circumstances are imposed by the COVID-19 crisis, this is something exceptional; it is considered a force majeure case, and no changes will be triggered. Also, all of the scenarios shall be examined case-by-case in order to identify if there is a degree of permanency of the home office. Also, it is to find whether there is still an office available and paid by the entity. To be in compliance with the “substance requirements”, it is not only about the office but also the change of the “effective place of management” (for more details, *see* section 20.2.3.).

## 20.6. Frontier workers

Another aspect in consideration of work mobility is the frontier workers.

Unfortunately, the Republic of Moldova does not have any special rules or regulations in its domestic legislation referring to frontier workers. There is a treaty in place between Moldova and Romania (concluded in 2009) related to small border traffic, which provides the rules and regulations on different administrative issues such as documents (special permits), setting up areas (30 km), etc. Although there is a tax treaty in place between Moldova and Romania, this tax treaty does not provide any special provisions on frontier workers (compared to other tax treaties concluded by other countries). Consequently, in such a case, the provisions of article 15 of the tax treaty should be applicable.

The COVID-19 crisis did not raise any questions for the Moldovan authorities to deal with the frontier workers and the tax consequences triggered by the crisis. Unlike the Moldovan case, for the frontier worker environment and framework, and specifically the consequences and impact of the COVID-19 crisis on it, many other countries, members of the European Union and also the European Commission took into consideration these issues and approved some solutions or interpretations. To understand the importance of the framework related to frontier workers, it is important to know the scale and numbers. The number of frontier workers continued to increase during the last period of time. For example, the number of frontier workers in Germany almost tripled from 2010 to 2019 from approximately 66,000 workers to 190,000.

Generally, the cross-border workers may be subject to income tax in two countries, i.e. the country where the activity is performed (the source country) and the country of residence. To avoid double taxation, the tax treaty will be applicable by applying article 15(1) of the OECD Model or the exceptions provided by article 15(2). However, what about the impact of the COVID-19 crisis when cross-border workers perform their employment duties via a home office/teleworking? Of course, the timing is important in this case and also other circumstances related to the application of article 15 as it was described in sections 20.4. and 20.5. of this report.

Generally speaking, based on the effects of article 15(2) of the OECD Model, cross-border workers would be subject to tax in the source state where the usual place of activity is and also subject to taxation in the residence state of (because of the home office). To avoid tax consequences due

to the COVID-19 crisis, many EU Member States agreed on some temporary measures specifically related to a home office in the case of cross-border workers. Many countries concluded a memorandum of understanding introducing provisions that the days spent in a home-office would be deemed, for purposes of the application of tax treaties, as working days spent at the usual place of the activity in another country. And this is because the cross-border workers were in the impossible situation of carrying out their work as usual and at the usual place of the activity. Such conventions were signed, for example, by Luxembourg with its neighbouring countries. However, this is not enough, as the COVID-19 crisis will be over, sooner or later, and it is therefore necessary to find permanent solutions at the level of countries but also at the level of the OECD and European Union.

## **20.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)**

Within this report, it was mentioned and examples were given that many countries were taking different decisions to accommodate and find solutions for the tax consequences triggered by the COVID-19 crisis. The decisions took into account that the COVID-19 pandemic is an extraordinary event and a force majeure case and, as such, should be treated accordingly also with extraordinary measures and solutions. Those solutions or measures were taken by countries or by multilateral international organizations like the OECD and the European Union.

As stated in sections 20.1.3.3. and 20.2.3., there are few examples:

For example, Ireland's Revenue has issued guidance to disregard the presence of an individual in Ireland – and where relevant, in another jurisdiction – for corporate income tax purposes *for a company in relation to which the individual is an employee, director, service provider or agent, if such presence is shown to result from travel restrictions related to COVID-19*.<sup>14</sup>

Another example relates to the tax residency of individuals. Some countries issued guidance and administrative relief on domestic and tax treaty determinations of the residence status of an individual. For example, the United Kingdom issued guidance on whether days spent in the United Kingdom can be disregarded for the purpose of determining residency due to exceptional

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14. Id.

circumstances.<sup>15</sup> As mentioned in the preceding example, Ireland’s guidance provides for “force majeure” circumstances for which an individual is prevented from leaving Ireland on their intended day of departure because of extraordinary natural occurrences.<sup>16</sup>

Another example that has also been mentioned a few times within the current report is the OECD Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis.<sup>17</sup> In this context, the question is whether there are any legal grounds for the countries to take such decisions and thus “deviate” from ordinary domestic legislation, jurisprudence and tax treaties. The deviations and adjustments (*how* and *when*) conducted within the domestic legislation due to COVID-19 as an extraordinary and “force majeure” circumstance are provided by national legislation, special law, the civil code (for a continental system), tax legislation, etc.

However, regarding treaties and particularly tax treaties, the provisions of the Vienna Convention on the Law of Treaties (VCLT) and the 2001 Articles on State Responsibility (UN International Law Commission (ILC))<sup>18</sup> are relevant. Of course, the fundamental principle of the VCLT is *pacta sunt servanda* (provided by article 26 of the VCLT), based on which “[e]very treaty in force is binding upon the parties to it and must be performed by them in good faith”. Nevertheless, this fundamental rule has exceptions and limits related to the fundamental change of circumstances (article 62 of the VCLT), supervening impossibility of performance (article 61 of the VCLT), necessity (article 25 of the ILC Articles) and force majeure (article 23 of the ILC).

As a conclusion and in answer to the question related to the legal grounds, the answer is “yes”, there are legal grounds provided by domestic legislation and also at the international level related to international agreements.

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15. HM Revenue & Customs, Residence, Domicile and Remittance Basis Manual – HMRC internal manual, GOV.UK (2016), available at RDRM13200 - Residence: The SRT: Annex B: Contents - HMRC internal manual - GOV.UK ([www.gov.uk](http://www.gov.uk)).

16. <https://www.revenue.ie/en/covid-19-information/employer-reporting-filing-obligations/temporary-concessionary-measures-2020-only/residence-rules.aspx>.

17. OECD, *OECD Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis* (3 Apr. 2020), available at [https://read.oecd-ilibrary.org/view/?ref=127\\_127237-vsdagpp2t3&title=OECD-Secretariat-analysis-of-tax-treaties-and-the-impact-of-the-COVID-19-Crisis](https://read.oecd-ilibrary.org/view/?ref=127_127237-vsdagpp2t3&title=OECD-Secretariat-analysis-of-tax-treaties-and-the-impact-of-the-COVID-19-Crisis).

18. International Law Commission, *International Law Commission Report, A/56/10* (Aug. 2001), available at <https://casebook.icrc.org/case-study/international-law-commission-articles-state-responsibility>.

## **20.8. The future of the mobility of work: A need for adjusting the existing treaty rules?**

During the analysis made while working on and writing this report, this author can conclude that the state authorities of a few countries paid enough attention to the tax consequences deriving from the COVID-19 crisis. Unfortunately, Moldova did not. During the COVID-19 crisis, the Moldovan authorities came up with only a few amendments and initiatives to support businesses and individuals and those initiatives mainly related to the medical field. Only one amendment related to the mobility of work was introduced and that is the amendment to the labour code that introduced the notion of “home office/working remotely”. Unfortunately, no tax implications were analysed, and no initiatives or new interpretations were raised because of the COVID-19 crisis or post-crisis.

As was also mentioned in section 20.1.1., the COVID-19 crisis had a huge impact on everyone’s lives, the working environment and the use of technologies, etc. All of these created a new approach for the work/employment relationship, with some industries being dominated by flexibility and the home office (e.g. IT). In other words, there is still a presence of a high degree of mobility.

Therefore, countries and international organizations (e.g. the OECD, UN, European Union, etc.) should pay more attention to some of the tax issues deriving from the mobility of work. This concerns home offices, flexible programs and remote activity in different countries. Some of the tax issues that were raised in this report should definitely find a better and more comprehensive interpretation on the level of tax treaties regarding article 4 (residency), article 5 (permanent establishments), article 15 (income from employment), article 16 (directors’ fees) and others.

Although the OECD has tried and managed to come up with interpretations for specific cases and consequences of the COVID-19 crisis, it is still necessary to discuss and provide more solutions within the OECD Model and its commentaries. It is also necessary to design and approve the force majeure clauses within tax treaties to be able to have exceptions in the future or to have domestic rules prevailing over tax treaties in such cases. Definitely, there is still plenty of space and a need for improvement and for adjustments in order to comply with the new trends and approaches related to mobility of work.



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## Chapter 21

### The Impact of Tax Treaties on International Mobility of Work in the Netherlands

Raymond Adema and Irene Burgers

#### 21.1. Mobility of work and domestic tax law

##### 21.1.1. Introduction

This section offers an overview of Dutch national tax law that is relevant for the mobility of work. Prior to COVID-19, in 2018, more than 41,000 frontier workers living in Belgium and 43,000 living in Germany worked in the Netherlands, a country in the north-west of Europe with 17.5 million inhabitants (as of 2022). In 2018, 9,000 persons resident in the Netherlands commuted for work on a daily basis to Germany, and 12,000 to Belgium.<sup>1</sup> Mobility of work is not limited to frontier workers. Labour migrants, for example, are frequently called on for temporary work in the Netherlands in the agricultural sector, abattoirs and distribution centres, as well as with regard to the building of substantial or specialized works such as power plants, offshore wind farms and other infrastructural projects. Moreover, in 2018, the Netherlands had an average of 383,000 international knowledge workers, which is equivalent to 4.2% of the Dutch labour force.<sup>2</sup> More recent numbers were not available at the time of writing (October 2022). The available numbers, however, emphasize that mobility of work is quite relevant for the Netherlands.

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1. A. Leeuw, *Meer grenspendelaars land in dan uit* [More frontier workers in country than out], Binnenlands Bestuur (12 Nov. 2020), available at <https://www.binnenlandsbestuur.nl/financien/meer-grenspendelaars-vanuit-belgie-duitsland-naar-nederland-dan-andersom> (accessed 30 Sept. 2022).

2. Dutch Central Agency for Statistics (CBS), *Relatively few international knowledge workers in the Netherlands*, Statistics Netherlands (10 Feb. 2020), available at <https://www.cbs.nl/en-gb/news/2020/07/relatively-few-international-knowledge-workers-in-the-netherlands> (accessed 30 Sept. 2022). “Knowledge workers” are defined by CBS as all highly educated persons who live in one country (sometimes for many years) but were born in another country.

### 21.1.2. Residence of individuals

Individuals that are resident in the Netherlands are taxable on their worldwide income. For income tax purposes, residency is determined on the basis of “facts and circumstances”. The residence of an individual person is dependent on the existence of “a lasting bond of a personal nature between that person and the Netherlands”.<sup>3</sup> This bond does not need to be stronger than that with another country.<sup>4</sup> The following factors – that may not necessarily point in the same direction – may be relevant for the determination of whether a lasting bond with the Netherlands (still) exists:<sup>5,6</sup>

- the presence of a family, and whether that family has followed the individual to a country (i.e. to the Netherlands or another country);
- the disposal of a dwelling in a country;
- (de)registration in the local population register;
- taking up employment in a country;
- the desire to stay for a longer period in a country of destination;
- the availability of financial ties (e.g. bank accounts, securities, and other assets); and
- nationality.

It follows that an individual who works and therefore stays in another country for a longer period may, in certain circumstances, no longer be considered a resident in the Netherlands.<sup>7</sup> However, an exception applies for a person with Dutch nationality who is employed by the Dutch state and posted to perform activities in the territory of another sovereign power either (i) as a member of the diplomatic, permanent or consular representative of the Kingdom of the Netherlands abroad<sup>8</sup> or (ii) within the scope of a non-tax treaty to which the Kingdom of the Netherlands is a party (e.g. UN peacekeeping missions). Such a person is always considered to be residing in the Netherlands. The same applies to a person who ceases living in the Netherlands but will be living in the Netherlands again within

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3. NL: HR [Supreme Court], 24 Feb. 1954, ECLI:NL:HR:1954:AY2814, BNB 1954/112.

4. NL: HR [Supreme Court], 22 Dec. 1971, ECLI:NL:HR:1971:AX4909, BNB 1973/120.

5. For references to case law, see I.J.J. Burgers et al., *Wegwijs Internationaal en Europees Belastingrecht* [A Roadmap to International and European Tax Law] para. 4.2.4.1 (Sdu 2022).

6. Pötgens points out that, nowadays, most discussions with regard to the residency of individual persons are related to employees who are posted abroad temporarily. See F.P.G. Pötgens, *Cursus Belastingrecht* [Course on Tax Law] IBR.3.2.4.B.c2 (Wolters Kluwer, loose leaf).

7. In such a case, exit taxes may apply to entrepreneurs and individuals holding a substantial interest in a company.

8. NL: Wet Inkomstenbelasting [Income Tax Act], 2001, art. 2.2(2) (amended 2021), Primary Sources IBFD [hereinafter ITA 2001].

1 year, without having lived in another sovereign power or on Bonaire, Sint Eustatius or Saba (the BES Islands) in the meantime. Such a person is deemed to be residing in the Netherlands during their absence.<sup>9</sup> In exceptional cases, a person may not have a lasting bond with the Netherlands or another state. Consequently, such a person does not, from a Dutch tax perspective, have a residency in that other state. If such a person is a member of the (flight or cabin) crew of a sea vessel or an aircraft with a homeport in the Netherlands, that person is considered to reside in the Netherlands.<sup>10</sup>

### 21.1.3. Residence of legal persons

Corporate bodies as defined in article 2(1) of the Corporate Income Tax Act (1969) (CITA 1969)<sup>11</sup> that are resident in the Netherlands are taxable on their worldwide income. A corporate body – e.g. a public or limited liability company or an actively engaged<sup>12</sup> association/foundation – is a tax resident in the Netherlands if it is incorporated under Dutch tax law (article 2(5) of the CITA 1969) and/or if it has its residency in the Netherlands according to facts and circumstances (article 4 of the General Tax Act (GTA)). Case law shows that judges have most often tended to determine the latter on the basis of the place of effective management. However, other criteria have proved to be relevant, including the head office, statutory seat, residences of the managers of the corporate body, meetings of the shareholders, company books and the carrying out of the enterprise of the corporate body.<sup>13</sup> Generally, the place of effective management is where the board of directors of the company exercises its managing activities.<sup>14</sup> Nonetheless, in some cases, the effective management is exercised by a person other than the board of directors, e.g. the sole shareholder to hold a steering role with respect to the key activities of the corporate body when these activities are no longer fulfilled by the board of directors.<sup>15</sup> According to the secretary of state for finance, a corporate body possessing any material assets and not

9. Art. 2.2(1) ITA 2001.

10. NL: Algemene Wet inzake Rijksbelastingen [General Tax Act], 1959 (amended 2024), art. 4(2).

11. NL: Wet op de Vennootschapsbelasting [Corporate Income Tax Act], 1969 [hereinafter CITA 1969].

12. I.e. an association/foundation carrying on an active business.

13. Reference is made to Vakgroep Belastingrecht (Groningen) & IBFD, *Nederlandse jurisprudentie inzake internationaal belastingrecht: Directe belastingen van internationaal opererende ondernemingen* [Dutch case law on international tax law: Direct taxation of internationally operating companies] (IBFD 1999), Books IBFD.

14. NL: HR [Supreme Court], 23 Sept. 1992, BNB 1993/193.

15. NL: HR [Supreme Court], 14 Oct. 2005, BNB 2006/79.

employing personnel – not only in the place in which the board of directors of a corporate body meet, but also the place of residence of the managing directors – is of relevance.<sup>16</sup>

#### **21.1.4. The impact of mobility of work on the place of residence of individuals**

Mobility of work may have an impact on the place of residence of individuals. A person working outside the Netherlands may not be impacted if they have sufficient personal ties with the Netherlands. The Court of Amsterdam, for example, decided that a person who worked 5 days a week in London but whose spouse and children were living in his house in Amsterdam was, according to the facts and circumstances, still a resident taxpayer in the Netherlands.<sup>17</sup> Furthermore, the fiction for a person who ceases living in the Netherlands but will be living in the Netherlands again within 1 year prevents a change in place of residence for such a person, assuming they have not lived in another sovereign power or on the BES Islands.

#### **21.1.5. The impact of the mobility of management board members on the place of residence of companies**

Management board members of a corporation who are living and working in different countries may have implications for a corporation's place of residence or may result in permanent establishment (PE) discussions. The place where the management board members do their work is of more importance than the place where they live. If management board members of a corporation live and work in different countries, this may complicate the determination of the place of residence of corporations for Dutch tax purposes. Moreover, if a corporation stops having its effective place of management in the Netherlands, the Netherlands only levies an exit tax on assets that, after the transfer of the effective place of management, are not allocated to a PE in the Netherlands (article 15c of the CITA 1969).

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16. See <https://zoek.officielebekendmakingen.nl/blg-174529> (accessed 30 Sept. 2022).

17. NL: HR [Supreme Court], 9 Dec. 2005, NTFR 2005/1704, V-N 2006/12.6.

## 21.1.6. Substance, substance requirements and economic nexus requirements

### 21.1.6.1. Substance

Substance is a factor for determining the place of residence of corporations, transfer pricing, beneficial ownership, the principal purpose test and the limitation on benefits. According to the secretary of state for finance, substance implies that an entity, in addition to its legal meaning, is recognizable by the possession and use of tangible assets and by the functions that natural persons perform for the account and risk of that body. The more substance, the less likely it is that deriving treaty benefits is the principal purpose and, generally, (significant) profits may not be allocated to companies without substance.<sup>18</sup>

Statutory substance requirements have been codified in various places in Dutch tax law. The statutory substance requirements do not directly have an impact on a company's residency for national or tax treaty law. Instead, the requirements are mostly relevant for other tax purposes (i.e. anti-abuse measures). Sometimes, these requirements act as a threshold for the entitlement to a tax benefit (e.g. in the case of the dividend withholding tax exemption). In other cases, they function as a carve-out to avoid additional taxation due to, for example, the controlled foreign country (CFC) rules. Not meeting the statutory substance requirements may, furthermore, trigger an automatic exchange of information by the Dutch tax authorities to states from which a resident taxpayer received interest, royalties, rents or lease installments (which is the case for so-called financial service entities). The substance requirements do not, for these purposes – except in the case of the automatic exchange of information regarding financial service entities – act as a safe harbour. The tax inspector has the opportunity to make plausible that the purpose, or one of the purposes, of meeting these requirements is to be able to make use of the substance carve-out.<sup>19</sup>

18. Note that, contrary to the general definition of substance mentioned in the main text above, for transfer pricing purposes, the secretary of state for finance defines substance as “the assets used by a company, the functions performed and the risk incurred”. Bijlage bij de Brief van de staatssecretaris van Financien 27 June 2012, section 2.3 (Substance en het arm's lengthbeginsel), <https://zoek.officielebekendmakingen.nl/blg-174529.pdf> (accessed 30 September 2022).

19. Art. 13ab(5) CITA 1969; and NL: Uitvoeringsbeschikking Vennootschapsbelasting [Implementation Decree Corporate Income Tax], 1971, art. 2e(1).

#### 21.1.6.2. Economic nexus requirement

For access to advance tax rulings and advance pricing agreements, a Dutch resident corporate taxpayer must fulfill the stricter requirement of economic nexus. It must exercise operational activities in the Netherlands and have sufficient relevant staff present in the Netherlands to fulfill operational activities at its own risk and expense.<sup>20</sup>

#### 21.1.6.3. The consequences of mobile board members/employees

If less than half of the statutory (and decision-making) board members of the taxpayer (or, in the case of the CFC rules, the controlled foreign company) are either a resident or factually located in the taxpayer's (or the controlled foreign company's) state of residence, or if employees performing so-called "relevant activities" work from home, the substance requirements may not be met (any longer). Moreover, the requirements for access to advance tax rulings and advance pricing agreements might not be met.

#### 21.1.7. Social security law

Some relevant parts of the Dutch social security laws are discussed in sections 21.1.7.1., 21.1.7.2, 21.1.7.3. and 21.1.7.4.

##### 21.1.7.1. National insurance

National insurances (*volksverzekeringen*) are compulsory for everyone who lives permanently in the Netherlands (subject to some exceptions). Non-residents are generally insured only if they perform activities on the basis of an employment contract in the Netherlands or on the Dutch continental shelf for which they are subject to payroll tax in the Netherlands. The residence of a natural person depends on the facts and circumstances. From settled case law, it follows that facts and circumstances should, for national insurance purposes, be defined similarly to how they are defined for tax purposes.

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20. *Besluit vooroverleg rulings met een internationaal karakter* [Decision on pre-consultation rulings of an international character] (19 Aug. 2021 – 17 June 2022), available at <https://wetten.overheid.nl/BWBR0042342/2021-08-19> (accessed 30 Sept. 2022); and *Besluit vooroverleg rulings met een internationaal karakter – vragen en antwoorden* [Decision on pre-consultation rulings of an international character – questions and answers], available at <https://download.belastingdienst.nl/belastingdienst/docs/besl-vooroverl-rulings-int-kar-vr-en-ant-rul0051z-5fd.pdf>.

Consequently, as discussed in section 21.2.1., residency is dependent on the existence of “a lasting bond of a personal nature between that person and the Netherlands”. The relevant national insurance laws provide some fictions with regard to the residency of an individual person.<sup>21</sup> These national insurance fictions do not exactly correspond to those for personal income tax purposes. The fiction for crew members, for example, is limited to the crews of sea vessels and does not extend to the flight or cabin crew of an aircraft.

#### 21.1.7.2. Health insurance

The information in section 21.1.7.3. is also relevant for health insurance (*zorgverzekering*), as the personal scope of the national insurance is used as the starting point for the personal scope of the health insurance.<sup>22</sup>

#### 21.1.7.3. Employee insurance schemes

For employee insurance schemes (*werknemersverzekeringen*), an employee performing their employment fully outside of the Netherlands is generally not insured unless they reside in the Netherlands and their employer:

- is located in the Netherlands;
- has the disposal of a Dutch PE for carrying on a business, a profession or a permanent agent; or
- has one or more persons employed in the Netherlands and has been appointed by the minister as the employer.<sup>23</sup>

#### 21.1.7.4. The coordination of social security laws within the European Union

Within the European Union, the social security systems are coordinated by Regulation 883/04.<sup>24</sup> One of the aims of this regulation is that an employee is always covered by the social security laws of one of the Member States. The national insurance laws, health insurance law and the employment insurance schemes therefore explicitly state that – notwithstanding

21. NL: Algemene Ouderdomswet [General Old Age Law], 1957 (amended 2024), art. 3(1) and (2); Algemene Nabestaandenwet [General Survivors' Law], 1996 (amended 2024), art. 7(1) and (2); and Wet Langdurige Zorg [Long-term Care Law], 2015 (amended 2024), art. 1.2.2(2) and (3).

22. See NL: Zorgverzekeringswet [Health Insurance Act], 2006 (amended 2024), art. 2(1).

23. NL: Werkloosheidswet [Unemployment Act], 1987 (amended 2024), art. 3(2).

24. Regulation (EC) no. 883/04 of the European Parliament and the Council of 29 April 2004 on the coordination of social security systems, PB L:2004:166:1.

the personal scope of these insurances, as discussed in sections 21.1.7.1. to 21.1.7.3. – a natural person is always considered to be insured if they are subject to these laws on the basis of an international regulation (e.g. Regulation 883/04). The opposite also applies.

Regulation 883/04 functions differently from tax treaties. Whereas tax treaties frequently divide the right to tax income from employment between states, the regulation tries to avoid the fragmentation of social security insurances. The general rule of the regulation is that a person pursuing an activity as an employed person in a Member State is subject to the legislation of that state (i.e. working state).<sup>25</sup> A special rule applies in the case of secondment. The employee will then remain subject to the social security laws of the Member State in which they normally pursue their activities, even while working elsewhere on a temporary basis.<sup>26</sup>

Furthermore, specific rules apply in the case of a person who normally pursues activities in two or more Member States.<sup>27</sup> For cross-border employees working out of their home on a regular basis, it is important that the regulation determines that such an employee is generally subject to the social security laws of their Member State of residence in the case that substantial activities (i.e. 25% or more) are pursued in that state. Otherwise, an employee is subject to the social security laws of the Member State in which the registered office or place of business of the employer employing them is situated. Specific rules apply if an employee has two or more employers.

## **21.2. Residence, tiebreaker rules and mobility of work: Individuals and entities**

### **21.2.1. Introduction**

This section considers, from the perspective of mobility, the tiebreaker rule, the allocation rule for profits from international shipping and airlines, and the allocation rule for directors' fees. In the approximately 100 general income tax treaties concluded by the Netherlands, these rules usually read similarly to the versions of the OECD Model Tax Convention on Income and on Capital (OECD Model) applicable at the time of negotiation (with some deviations). The Dutch Supreme Court considers the Commentaries

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25. Art. 11(3) Regulation 883/04.

26. Art. 12(1) Regulation 883/04.

27. Art. 13(1) Regulation 883/04.



on the OECD Model at the time of the negotiation and the conclusion of the tax treaty to be “of great importance” in the interpretation of that provision.<sup>28</sup> The Dutch tax administration applies a dynamic approach.<sup>29</sup>

## 21.2.2. Individuals and mobility of work

### 21.2.2.1. Place of residence of individuals

For individuals, mobility of work will not change tax treaty residency if the individual has a permanent home available. In line with paragraph 13 of the Commentary on Article 4(2)(a) of the OECD Model, a “permanent home” is a dwelling that is available to the individual at all times continuously and not occasionally for the purpose of a stay that, owing to the reasons for it, is necessarily of short duration. In addition, in the case that an individual has no permanent home, or a permanent home in two states, and the centre of vital interests is decisive, the degree of mobility of work may not be of importance. According to the Dutch Supreme Court, personal circumstances are of more relevance in such a case than the economic criterion of the place of work.<sup>30</sup>

If the centre of vital interests cannot be determined, or the taxpayer does not have a permanent home in either state, the habitual abode is the decisive criterion. In that case, a higher degree of mobility of work might imply a change of residence for the relevant tax treaty or tax treaties.<sup>31</sup> Note the OECD’s perception that this notion does not refer to simply counting days but to the frequency, duration, and regularity of stays that are part of the settled routine of an individual’s life and are therefore more than transient.<sup>32</sup>

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28. NL: HR [Supreme Court], 2 Sept. 1992, BNB 1992/379.

29. NL: *Notitie Uitgangspunten van het beleid op het terrein van het internationaal fiscaal (verdragen)recht* [Memorandum Starting points for international tax (treaty) policy], 15 Apr. 1998. Explicit provision concerning the dynamic interpretation can be found in the Protocols to the tax treaty the Netherlands concluded with Hong Kong and Indonesia.

30. NL: HR [Supreme Court], 9 Dec. 2005, NTFR 2005/1704, V-N 2006/12.6.

31. The same applies, in the authors’ view, to domestic law.

32. NL: HR [Supreme Court], 9 Dec. 2005, NTFR 2005/1704, V-N 2006/12.6.

### 21.2.3. Legal bodies and mobility of work

#### 21.2.3.1. Place of residence of companies

The change of the place of effective management due to the change in place of residence caused by a high mobility of work lifestyle of one or more of the board members might have treaty implications both for treaties containing a provision containing the effective place of management tiebreaker and for tax treaties containing an article similar to article 4(3) of the OECD Model (2017). When an applicable treaty contains a mutual agreement provision as a tiebreaker, a corporation runs the risk that dual residency will not be resolved. Board members with a highly mobile lifestyle enlarges the risk of dual residency and, thus, double taxation.

Case law shows that the place of effective management is:

- the place where the key decisions regarding the activities of the company are taken;
- the place where the ultimate responsibility for these decisions is borne; and
- the place from which, when appropriate, instruction is given.<sup>33</sup>

If these three activities take place in different states due to the fact that management board members of a corporation live and work in different states, it may be difficult to identify the corporation's effective place of management. This might be different for small or medium-sized companies, as the CEO of these kinds of companies, in practice, frequently plays a significant role in the decision-making. Board members living and working in different states may make the determination of the effective place of management difficult.

It may be that shareholders, rather than formal directors, fulfill key management decisions, as evidenced in the Supreme Court case BNB 2021/156, concerning a limited liability corporation incorporated under Dutch law acting as a personal holding company for its shareholder, a Dutch national who had emigrated to Sint-Maarten in 2006. The formal directors of X BV were employees of a trust company of a bank residing in Singapore. In the case at stake, the shareholder was highly mobile. He was so often in the

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33. NL: HR [Supreme Court], 19 Jan. 2018, BNB 2018/68, NTFR 2018/199.

Netherlands that it was likely that key management decisions were taken during the time that the shareholder was in the Netherlands.<sup>34</sup>

The criterion “place where key management decisions are taken” is not suitable for determining a company’s effective place of management in the case of videoconferencing or a board of directors arranging to meet in different places throughout the year. In such cases, the other factors mentioned in Dutch case law and in paragraph 24.1 of the Commentary on Article 4(3) of the OECD Model (2017)<sup>35</sup> including, among others, the state whose laws govern the legal status of the company will determine the place of residence for tax treaty purposes. A mutual agreement procedure and, in the case that this is provided for in the relevant tax treaty, an arbitration procedure, may be needed to prevent double taxation. For tax treaties containing the article 4(3) of the OECD Model (2017) provision, such dual resident companies shall be entitled to relief or exemption only to the extent agreed upon by the competent authorities of the contracting states.

#### 21.2.3.2. International shipping and air transport

The Dutch tax treaty policy used to be that profits from the operation of ships or aircraft in international traffic shall be taxable only in the contracting state in which the place of effective management of the enterprise is situated. Nowadays, as per the Memorandum on Dutch Tax Treaty Policy (2020), the Netherlands strives for a treaty article determining that the profits of an enterprise of a contracting state from the operation of ships or aircraft in international traffic shall be taxable only in that state. Article 3(1) (d) of the tax treaties concluded by the Netherlands, similarly to article 3(1) (d) of the OECD Model (2017), defines an “enterprise of a Contracting State” as an enterprise carried on by a resident of that contracting state. Thus, if, due to a higher mobility of work, the place of effective management or the place of residence of the person carrying on the shipping or aircraft enterprise changes, there will be implications for the allocation of the enterprise’s profits.

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34. Which would not be the case if the effective place of management had been in Sint-Maarten.

35. And previous versions.

#### 21.2.3.3. Directors' fees

Dutch tax treaties generally contain a distribution rule similar to that of article 16 of the OECD Model (2017). Consequently, directors' fees and other similar payments derived by a natural person or legal person in their capacity as a member of the board of a company are taxable in the state in which that company is resident.<sup>36</sup> The outcome of this distribution rule changes if a company moves its residence to another state or is considered a dual resident. This may cause international juridical double taxation if it results in the company becoming a dual resident. A mutual agreement procedure might solve the dual residency under the corporate tiebreaker rule of recent Dutch tax treaties – and older ones, whereby article 4 of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Sharing (MLI) needs to be taken into account. Prior to an agreement on the residency of the company (if any), the directors' fees and similar payments may be subject to tax in the Netherlands and the other state. This would be avoided if the agreement explicitly solves the dual residency with retrospective effect.

### **21.3. Permanent establishments and mobility of work**

#### 21.3.1. Physical permanent establishments

##### 21.3.1.1. Home office

This section lays out relevant teachings from Dutch case law about PEs (articles 5 and 7 of the OECD Model (2017)), fixed bases (article 14 of the pre-2000 OECD Model) and mobility of work. The Dutch Supreme Court decided that a home office may constitute a PE if the office is at the disposal of the employer on a permanent basis and is furnished for the specific needs of the employer.<sup>37</sup> This decision is in line with paragraphs 18 and 19 of the Commentary on Article 5 of the OECD Model (2017). In this case, the representative had taken the initiative to furnish a room in his house as a home office. He did not put the room at the disposal of the principal. Thus, the room was not a PE for the principal. A home office may also constitute a PE for, e.g. a self-employed person whose business is in another state

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36. This allocation rule does thus not apply to income derived in another capacity (e.g. as an employment contract).

37. NL: HR [Supreme Court], 13 Mar. 1957, BNB 1957/144.

or who owns houses in more than one state as the office is at his disposal (paragraph 19 of the Commentary on Article 5 of the OECD Model (2017)).

Of relevance is whether the activities are recurrent or one-off activities. According to the Dutch Supreme Court, a floating tank storage facility in India did not constitute the fixed base of a self-employed diver resident in the Netherlands and working on that floating tank for a one-off period of 89 days in the relevant tax year because of the fact the activities had a one-off nature.<sup>38</sup> Note that the Supreme Court explicitly pointed out that the Commentary on Article 5 of the OECD Model could be used to interpret the terms “permanent establishment” and “fixed base”. Nevertheless, in its motivation, the Supreme Court did not explicitly refer to this paragraph (i.e. currently paragraph 28 of the Commentary on Article 5 of the OECD Model (2017)) but did mention that there is no reason to assume that a PE or fixed base can only exist if the activities take place during a period of at least 6 months. Recurrency also seems to have played a decisive role in the decision of the Supreme Court in BNB 1990/107 (the gynaecologist case). A gynaecologist worked for 1 day per week in a clinic in Bremen (Germany) and the other days in the Netherlands. The Supreme Court decided that the gynaecologist had a PE in Germany. Note the difference between this case and BNB 1955/277 (the artificial eye doctor case). In the artificial eye doctor case, the hotel rooms in the Netherlands rented by a German artificial eye doctor for 30 days in a row during the year at stake did not constitute a PE, as the doctor could have done the work just as well in the homes of his clients, and the hotel rooms were not specifically furnished for the doctor. Recurrency did not play a role. Being specifically furnished was decisive. Also, note that such a requirement does not seem to be included in the OECD Commentary on Article 5 of the OECD Model (2017).

#### 21.3.1.2. Home office as a service permanent establishment

Tax treaties concluded by the Netherlands with developing and transition states generally contain the services PE provision of article 5(3)(b) of the UN Model (2011/2017) and paragraph 144 of the Commentary on Article 5 of the OECD Model (2017), though the required period may deviate. An example is article 5(3) of the treaty that the Netherlands concluded with Kosovo. According to this provision, the term “permanent establishment” also encompasses:

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38. NL: HR [Supreme Court], 15 Jan. 2016, BNB 2016/114, NTFR 2016/671.

- a) a building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than 12 months;
- b) the furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue within a Contracting State (for the same or a connected project) for a period or periods aggregating more than 9 months in any 12-month period commencing or ending in the fiscal year concerned.

For the days of the presence test in these treaties, the decisions of the Dutch Supreme Court in BNB 2003/177 and BNB 2003/178 and the guidance in paragraph 157 of the Commentary on Article 5 of the OECD Model (2017) are of relevance. According to the OECD, for the alternative services PE provision, the principles applicable to the computation of the days of the presence test of article 15(2) of the OECD Model (2017) are applicable. The Supreme Court decided that the days of presence test refers to physical presence.

#### 21.3.1.3. Flex office

A flex office – depending on the circumstances – may constitute a PE for a company if the use of the flex office is recurrent and the office is furnished for the needs of the company renting the office. The guidance of paragraphs 22, 23 and 25 (commercial and geographic coherence requirement for mobile activities) and that of paragraphs 28 and 29 (permanence requirement and recurrence) of the Commentary on Article 5 of the OECD Model (2017) will generally be of relevance. For example, an office hotel in which a consulting firm regularly rents different offices may be considered a single place of business of that firm since the building constitutes a whole geographically and the hotel is a single place of business.

Some tax treaties concluded by the Netherlands include a rule that a fixed base exists if the person performing an independent personal service is present in that state for a period or periods exceeding an aggregate of 183 days in the fiscal year concerned.<sup>39</sup> The latter criterion does not provide a definition but merely implies that, if this condition is fulfilled, there will be a fixed base, as evidenced by the Supreme Court's decision concerning an accountant who had been a partner of an accounting firm.<sup>40</sup> After his emigration to

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39. The tax treaties between the Netherlands and Croatia, Egypt, Israel, Latvia, Lithuania, Malta, Portugal, Romania and Saudi Arabia.

40. NL: HR [Supreme Court], 24 June 1981, BNB 1981/236.

Israel, he worked on a freelance basis for this firm. In the tax year at stake, he spent less than 183 days in the Netherlands. The tax treaty between Israel and the Netherlands contains a fixed base rule including a 183-day provision. The accountant could use office space of the accounting firm, which, at the time, had seven offices in the Netherlands. He also obtained assignments in the Netherlands and was paid in the Netherlands. Therefore, the Supreme Court decided that the accountant had a fixed base in the Netherlands.

### 21.3.2. Building or construction permanent establishments

The Dutch Supreme Court decided movable site shacks may be considered PEs in a case concerning a corporation resident in France that built a pipeline for the distribution of gas in the Netherlands during a period of 3 years.<sup>41</sup> In this case, the Supreme Court also decided that the intended period rather than the actual period is decisive for the duration test. The intended period was also considered the relevant test by the Lower Court of The Hague, a consideration which was not overruled by the Supreme Court in BNB 1986/100, a case concerning a construction work that was carried on for 11 months and 21 days. The court ruled that there was no PE as the duration of the work was less than 12 months and, moreover, the taxpayer did not prove that, during the work, it had seemed that the work would take longer than 12 months.

### 21.3.3. Dependent agents

An agency PE for tax treaty purposes is typically triggered when an individual has the power to habitually conclude contracts (for treaties including the pre-2017 OECD wording), habitually concludes contracts or habitually plays the principal role leading to such a conclusion of relevance (for treaties including the 2017 OECD wording) on a more than transitory basis outside the state of residence of the principle. The Netherlands has made a reservation regarding article 12 of the MLI.<sup>42</sup> In this respect, the wording of the older Dutch tax treaties is still in line with the pre-2017 OECD wording. Nonetheless, the 2017 OECD wording has been accepted in the Dutch tax treaties recently concluded with Chile (2021) and Columbia (2022).

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41. NL: HR [Supreme Court], 11 Mar. 1970, BNB 1970/89.

42. For more details, reference is made to R.P.C. Adema, *Het nieuwe vaste-inrichtingsbegrip van de nationale heffingswetten* [The new permanent establishment definition for national tax legislation purposes], NTFR-B 2020/10 (Part I) and NTFR-B 2020/14 (Part II).

An employee might perform the activities mentioned and, in such a case, the principal will have a dependent agent in the state of the employee's activities. Thus, the internationalization of business activities by sending an employee abroad on a more than transitory basis or hiring an agent who acts as a dependent agent in another state than the state of residence of the hiring principal from both a juridical and economical perspective will give rise to a dependent agent. The home office of an employee generally will not be at the disposal of the principal. However, the conditions of a dependent agent may be fulfilled. The extent and frequency of activities necessary to treat an agent as acting "habitually" depend on the nature of the contracts and the business of the enterprise (paragraph 98 of the Commentary on Article 5 of the OECD Model).

#### 21.3.4. Attribution of profits

Article 15e(6) of the CITA 1969 provides a provision similar to article 7(2) of the OECD Model for calculating the amount of profits of foreign PEs of corporate taxpayers resident in the Netherlands to be exempted. However, Dutch domestic law does not contain any provision elaborating on how to determine the amount of profits of a PE of a foreign enterprise situated in the Netherlands. Nevertheless, it is highly likely that the attribution of profits to a PE – including a home office PE – will take place on the basis of functions performed, assets used and risks assumed as, in his 2011 Memorandum on Tax Treaty Policy, the secretary of state for finance underlines that the Netherlands adheres to the functionally separate entity approach as described in the 2010 OECD Report on the attribution of profits to PEs. The secretary of state also indicated that he is prepared to apply the authorized OECD approach to older treaties as well as to the 2001 decree on the avoidance of double taxation (*Besluit voorkoming dubbele belasting*) providing unilateral prevention rules.

In a decree of 15 January 2011 (IFZ 2010/457M) and its successor, the decree of 14 June 2022 (2022-0000143421), the secretary of state for finance published his view on the attribution of profits to PEs. He explained that, in his perception, the terms "control" and "significant people functions" used by the OECD might have to be interpreted differently than in the case of associated companies. "Control" is probably less of a day-to-day activity than "significant people functions". However, the allocation of risks to a PE will be, to a great extent, similar to the allocation of risks to an independent enterprise in similar circumstances. The secretary of state also explained that, in his view, in general, there is no reason to attribute



profits to a dependent agent PE, as the agent will generally receive an arm's length fee. Profits should, however, be allocated to a dependent agent PE if the staff of the foreign principal exercises the significant people functions.

## **21.4. Physical presence according to articles 15(1) and 17 of the OECD Model**

### **21.4.1. Employment exercised out of home**

Unlike Regulation 883/04, the Dutch tax treaties do not make use of a threshold for cross-border employees working (incidentally) out of their home. On the basis of the Dutch tax treaties, the remuneration of an employee who exercises their employment out of their home is generally only subject to tax in the state of residence. This is different when these activities are of an auxiliary or ancillary nature or take place without approval from the employee. From case law, it follows that activities that are merely sustaining or secondary to the main task and are performed outside of the regular working hours – like commuting<sup>43</sup> – are usually not considered to be part of the activities agreed on and for which the salary is paid.<sup>44</sup> These activities are considered as being done in the employee's private time.

According to paragraph 1 of the Commentary on Article 15 of the OECD Model, an "employment is exercised in the place where the employee is physically present when performing the activities for which the employment income is paid".<sup>45</sup> The Dutch Supreme Court reached the same decision as early as 1986,<sup>46</sup> although without making reference to the OECD Commentary. In the last decade or so, working out of home every now and then has become more common. Just before the outbreak of COVID-19 in the Netherlands, the Dutch House of Representatives therefore asked the secretary of state for finance to discuss with Belgium and Germany whether it would be possible to agree on a separate clause for employees who work from home once in a while. Such a clause should avoid a situation in which employees who work out of their home occasionally are directly faced with residence state taxation (instead of working state taxation). The members

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43. NL: Hof Den Bosch, 16 Oct. 2014, ECLI:NL:GHSHE:2014:4282, V-N 2015/2.1.2, paras. 4.7 and 4.8.

44. NL: HR [Supreme Court], 22 Nov. 2013, ECLI:NL:HR:2013:1261, NTFR 2014/444, para. 3.3.1.

45. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 15*, para.1 (23 Nov. 2017), Treaties & Models IBFD.

46. NL: HR [Supreme Court], 15 Oct. 1986, ECLI:NL:HR:1986:AW7864, BNB 1987/72.

of parliament raising this point envisioned that discussions with Belgium and Germany should provide a solution in the short term whereas a discussion with(in) the OECD should provide a more sustainable solution in the long run.<sup>47</sup>

#### 21.4.2. Personal activities exercised by athletes and performers abroad

Most Dutch tax treaties provide for (limited) source taxation for income derived by athletes and performers from personal activities exercised abroad.<sup>48</sup> This requires a close connection between the income derived and the personal activities. From the OECD Commentary, it follows that “[s]uch close connection will generally be found to exist where it cannot reasonably be considered that the income would have been derived in the absence of the performance of these activities”.<sup>49</sup> This also seems to include a fee that is paid for any simultaneous livestreaming of a performance.

In its decisions of 9 February 2007, the Dutch Supreme Court reached the conclusion that (a part of) the (basic) emolument of a cyclist, respectively a speedskater, was connected with his personal activities that were not only considered to include the public performance itself but also the training, availability duty, traveling, and necessary stay as long as such occurred in the same state as the public performance.<sup>50</sup> However, as of 2014, paragraph 9.1 of the Commentary on Article 17 of the OECD Model makes it clear that, for source taxation, it is not necessary that these preparatory activities take place in the same state as that of the performance. It explicitly states that article 17 of the OECD Model also applies to income related to a rehearsal, training or other similar preparation (including related traveling), regardless of whether these preparations occur in relation to a public performance in the state in which they take place.

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47. Tweede Kamer, 26834 nr. 48, p.12 (1996-1997).

48. Between 2011 and 2020, the Netherlands strived for exclusive taxation in the residence state of an athlete or performer. In practice, however, new or existing tax treaty partners – with a few exceptions (e.g. Cyprus (2021), Ethiopia (2012), and Iraq (2019)) – were not willing to nullify the source state’s right to tax. As of 2020, the Netherlands abandoned the objective of an exclusive right to tax for the residence state and aims for the inclusion of a right to tax for the source state with some limitations.

49. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 17*, para. 9 (23 Nov. 2017), Treaties & Models IBFD.

50. NL: HR [Supreme Court], 9 Feb. 2007, ECLI:NL:HR:2007:AU3571, BNB 2007/142-144, paras 3.5.1, 3.5.2 and 3.5.3.

According to the OECD Commentary, article 17(1) of the OECD Model is not applicable with regard to compensation paid to an athlete or a performer for a public performance that was cancelled. Consequently, the right to tax depends on whether the athlete or performer is (self-) employed or merely an amateur (i.e. articles 7, 15 or 21 of the OECD Model (2017)).

## **21.5. Article 15(2) and (3) of the OECD Model**

### **21.5.1. Introduction**

In line with article 15(2) of the OECD Model, the residence state has an exclusive right to tax under Dutch tax treaties if:

- the employee is not present for more than 183 days in the working state in a 12-month period (or in the case of older tax treaties, a fiscal year);
- the remuneration is not paid by or on behalf of an employer who is a resident of the working state; and
- the remuneration is not borne by a PE of the employer situated in the working state.

Whether these conditions are fulfilled is not only of importance for the taxation in the working state, but also for the answer regarding the question of whether the resident state is obligated to avoid double taxation. These conditions are therefore concisely discussed in section 21.5.2.

### **21.5.2. Physical presence and the 183-day test**

According to settled case law from the Dutch Supreme Court, the 183-day test refers to physical presence. For the application of this test, the highest court of the Netherlands recently placed great importance on paragraph 5 of the Commentary on Article 15 of the OECD Model. On the basis of this paragraph, the Dutch Supreme Court deduced that not only the days in which actual work is performed in the working state should be taken into account but also all other days in which an employee is present in the working state and is somehow related to the work there. It is, however, not necessary for an employee to have spent a whole day for that day to qualify as a working day. From the Dutch case law, it follows that days on which an employee commutes from home to work in the other state are also regarded as days of physical presence for the 183-day test.

A day during which an employee works out of their home (i.e. in the residence state) thus does not count as a day of physical presence in the working state. It goes without saying that COVID-19 restrictions may have resulted in unexpected or undesirable outcomes of the 183-day test. In the case of the Dutch tax treaties with Belgium and Germany, as discussed in section 21.4.1., this has been addressed in the bilateral competent authority agreements (CAAs) with these states.

### 21.5.3. Mobility and the concept of employer

In addition to the 183-day test, the remuneration of the employee should not be paid by or on behalf of an employer who is a resident of the working state. For the application of condition b, the residency of the employer should be determined in accordance with article 4 of the OECD Model (2017). Consequently, if the residency of an employer is, for example, changed from one state to another state – for instance, due to the fact that the board members are working from home – this may impact the outcome of condition b.

The latter may also be true in the case of a secondment, whereby the employee's employment contract remains unchanged. The term "employer" is not defined in the OECD Model (2017). From Dutch case law, it follows that it is, for tax treaty purposes, not decisive whether an employee has entered into an employment contract with the person for whom they have performed the activities in the working state. Instead, for tax treaty purposes, it is required that the employee falls under a relationship of authority with that person while these activities need to take place for the account and risk of that person. According to the court, the latter requires that the remuneration paid to the employee for the activities performed in the working state is borne by the person for whom these activities are performed. Additionally, that person benefits from the advantages of these activities and bears any disadvantages and risks that may arise from them.

For practical reasons, the secretary of state for finance has indicated that he assumes that a non-resident employee who is posted with (a) Dutch group company (or companies) for a period not exceeding 60 days in a 12-month period is not considered to fall under the authority of the Dutch group company (or companies) (the 60-day test). In such a situation, no Dutch taxation should arise.

#### 21.5.4. Mobility and the presence of a permanent establishment

The third condition for taxation in the resident state is that the remuneration of the employee should not be borne by a PE in the working state. The existence of a PE should, according to the OECD Commentary, be determined on the basis of the tax treaty between the employer's state of residence and the working state (if any). As explained in more detail in section 21.3., the existence of a PE in the working state may become subject to discussion if employees are prevented from travelling to the establishment in the working state for a longer period of time due to COVID-19 restrictions.

#### 21.6. Frontier workers

The tax treaties with Belgium and Germany contain a specific clause for Dutch frontier workers. It concerns a general compensation measure for frontier workers residing in the Netherlands who derive income which is taxable in Belgium or Germany on the basis of articles 15, 16, 17 and 18(6) of the Dutch tax treaty with Belgium and articles 14, 15, 16 and 18(1) of the Dutch tax treaty with Germany, and for which the Netherlands, as the resident state, has to provide avoidance of double taxation on the basis of article 23 of the Dutch tax treaty with Belgium and article 22 of the Dutch tax treaty with Germany.<sup>51</sup> One of the conditions for the application of these measures is that the total sum of the tax and contributions for social security due in Belgium or Germany and the Netherlands exceeds the total sum of tax and contributions for social security that would be due in the Netherlands if the income had been derived from the Netherlands, instead of from Belgium or Germany.<sup>52</sup>

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51. The Dutch tax treaty with Belgium also contains a specific compensation measure that is related to the former treaty with Belgium (1970). A more in-depth discussion of this measure falls outside the scope of this paragraph.

52. Art. 27(1) of the Dutch treaty with Belgium (2001); and para. XII of the Protocol to the Dutch tax treaty with Germany (2012).

## **21.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)**

### **21.7.1. Position on the OECD Secretariat's COVID-19 guidance**

An unforeseen longer stay in the Netherlands, e.g. due to COVID-19 restrictions, does not right away result in worldwide taxation in the Netherlands. The Dutch Secretary of State for Finance, in his letter of 15 June 2020<sup>53</sup> containing answers to questions in Parliament, endorses the OECD Secretariat's analysis of 3 April 2020 of the effects of the COVID-19 crisis, stating that:

- the public health measures will not lead to any change in the place of residence of individuals. In maintaining the substance requirements posed in Dutch statutory and administrative law, the Netherlands will take into account the travel restrictions due to the COVID-19 crisis;<sup>54</sup> and
- an employee working out of their home due to COVID-19 restrictions will generally not trigger the presence of a PE for their employer. According to the secretary of state, in such a case, the home office is generally not at the disposal of the employer. In addition, the permanence requirement will not usually be met in the case that, due to the COVID-19 pandemic, an employee works from home on a temporary basis.<sup>55</sup>

Contrary to the OECD Secretariat, the secretary of state for finance did not give his view on the question of whether the activities of an individual temporarily working from home for a non-resident employer could give rise to a dependent agent PE. No questions were raised in parliament on this subject.

For the application of tax treaties, the Dutch secretary of state for finance seems to correctly hold the view that, also in the case of force majeure, guidance should be found in:

- Dutch case law;
- the OECD Commentary;

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53. See <https://www.rijksoverheid.nl/documenten/kamerstukken/2020/06/15/beantwoording-kamervragen-schriftelijk-overleg-over-de-fiscale-maatregelen-ivm-coronavirus> (accessed 30 Sept. 2022).

54. Tweede Kamer, *Verslag van een schriftelijk overleg*, 35420 nr. 77 (2019-2020), available at <https://zoek.officielebekendmakingen.nl/kst-35420-77.html> (accessed 30 Sept. 2022).

55. Ibid footnote 54.

- guidance provided by the OECD Secretariat approved by – for the Netherlands – the secretary of state for finance;
- administrative regulations or guidance such as, in the Netherlands, a decree issued by the secretary of state for finance containing his approval of applying the law or a tax treaty in a certain manner; and
- answers from the secretary of state for finance to questions raised in parliament.

This follows from the secretary of state for finance's letter of 15 June 2020, in which he explicitly mentioned that the guidance provided by the OECD Secretariat was, in his view, based on the OECD Commentary and was also in line with Dutch case law.

### 21.7.2. Competent authority agreements with Belgium and Germany

The particular nature of the COVID-19 pandemic and the ensuing need to remove uncertainty instigated the Netherlands to enter into separate – interpretative<sup>56</sup> – CAAs with Belgium and Germany that specifically address the application of the treaty equivalent to article 15 of the OECD Model (2017) in these situations. These CAAs<sup>57</sup> – which were terminated as of 1 July 2022<sup>58</sup> – establish by way of a fiction that the allocation rule for income from private employment in the treaties with Belgium and Germany will be applied (upon request) in accordance with the normal working pattern without any COVID-19 restrictions. The functioning of the fiction is limited to working days that would regularly be spent in the working state.

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56. Taxpayers are not always bound to mutual agreements concluded by the Dutch tax administration, as is evidenced by NL: HR [Supreme Court], 29 Sept. 1999, BNB 2000/16 and BNB 2000/17, concerning an interpretative mutual agreement between the Dutch and German tax authorities. The Supreme Court decided that the tax treaty should be interpreted differently (more favourably to the taxpayer) than agreed by the Dutch and German tax authorities. Therefore, the mutual agreement did not bind the taxpayer. These two interpretative CAAs with Belgium and Germany contain a number of non-mandatory relaxations compared to the applicable tax treaties and, thus, put the taxpayer in a better position. Therefore, the authors do not expect that the legitimacy of these CAAs will be subject to legal proceedings by taxpayers. Note also that the preambles to the CAAs with Belgium and Germany explicitly mention that the aim of these agreements is to provide certainty to taxpayers.

57. NL: Decree of Secretary of State for Finance of 10 Apr. 2020, Stcrt. 2020, 21381, part 2; and NL: Decree of state secretary for finance of 30 Apr. 2020, Stcrt. 2020, 25956.

58. NL: Decree of Secretary of State for Finance of 6 Apr. 2022, Stcrt. 2022, 9700 and 9701.

The CAAs require an employee making use of this option to apply the fiction consistently in both states and to keep the necessary records.

A similar fiction applies for a situation in which an employee is forced to sit idle at home while receiving a salary. In that case, the CAAs stipulate that “the same work pattern (i.e. the ratio of days worked in the work-state/total working days) would have been applied as when the employee would have continued working, provided that:

- an employee spends one or more days that would normally be working days idle at home (i.e. without working) and
- the employee continues to receive salary from the employer.”<sup>59</sup>

According to the authorities, such treatment is in line with the Commentary on Article 15 of the OECD Model. As discussed in section 21.6., the tax treaties with Belgium and Germany contain general compensation measures for frontier workers. These compensation measures do not seem to affect a frontier worker if said worker was prevented from working abroad due to the COVID-19 restrictions. This is the result of the fictions included in the CAAs mentioned. Note that the CAAs do not address problems regarding the allocation of business profits nor have such problems been signaled by the OECD Secretariat or the Dutch secretary of state for finance.

The Dutch CAA with Germany further addressed that the Netherlands unilaterally decided to exempt German social security payments (i.e. *Kurzarbeitergeld*, *Arbeitslosengeld* and *Insolvenzgeld*) paid to Dutch residents who normally worked in Germany and who, during the COVID-19 pandemic in 2020 and 2021, were forced to spend their time idle at home. This exemption has not been available as of 2022.

### 21.7.3. Other tax treaties

Apart from the CAAs concluded by the Netherlands with Belgium and Germany, the secretary of state for finance’s letter of 15 June 2020 is the legal basis for deeming employees working from a home office to still be exercising their employment in the working state. The letter provides certainty on the tax administration’s view with regard to domestic law and tax treaties containing an article reading similar to article 15 of the OECD

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59. Id, at part 3, fn. 57.



Model. The Netherlands has not taken action regarding the impact of COVID-19 on the application of tax treaties to athletes and performers.<sup>60</sup>

## **21.8. The future of the mobility of work: A need for adjusting the existing treaty rules?**

As mentioned (*see* section 21.5.2.), the secretary of state for finance is currently investigating whether Belgium and Germany would agree with a change of their tax treaties with the Netherlands in such a way that it will not affect the allocation of taxation rights on the income of the employee if the employee works from their home office for a certain number of days or a percentage of the working time.<sup>61</sup> For the latter, it makes sense to align with the threshold used in article 13(1)(a) of Regulation 883/04. In this case, resident state taxation would only be applied if an employee normally pursues – with the approval of their employer – a substantial part of their activities out of home or elsewhere in their resident state.

This would be a first step in ascertaining a solid legal framework. However, many other issues regarding mobility of work require the attention of the legislature and tax treaty negotiators, as this national report points out. Those issues include, to mention a few, residence of corporations, substance requirements, staff working (temporarily) elsewhere and alignment with Regulation 883/04 and social security treaties. The OECD and UN international governance, both regarding changes to tax treaties and new guidance in the commentaries, may give tax treaty negotiators direction that may result in more consistency. In this respect, there is also a task for the European Union, as the mobility of workers is paramount to an internal market. Investigating the possibilities for a multilateral instrument on the mobility of work issue is a topic for further research.

Interesting proposals relevant for the amendment of the PE definition in view of “digital nomads” have been put forward by De Wilde<sup>62</sup> and Kostić.<sup>63</sup>

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60. It might not have been considered necessary, as any payments other than those for personal activities such as athletes or performers seem to be covered by the measures taken with regard to the application of arts. 7 or 15(1) and (2) *OECD Model* (2017) or simply fell under art. *OECD Model* (2017).

61. *Toekomstvisie op de effecten van thuiswerken voor grensarbeiders* [Letter of the Secretary of Finance to the Second Chamber of Parliament] 2021-0000206074.

62. M.F. de Wilde, *Sharing the Pie: Taxing Multinationals in a Global Market* sec. 6.3.3.4. (IBFD 2017), Books IBFD.

63. S.V. Kostić, *A Plea for a Workforce Presence PE Concept in a Post-Covid Digitalized World*, 49 *Intertax* 10 (2021).

De Wilde has proposed that the taxable presence of multinationals could be assessed by means of some quantitative “labor factor presence test”, which refers to e.g. the operations undertaken by the multinational workforce within a state (workforce presence test or PE-when-functions-performed rule). Kostić proposes that the PE definition should encompass situations in which a non-resident enterprise engages dependent service providers (employees and/or independent workers) who perform activities that enable the business of the enterprise other than local marketing and distribution activities (workforce presence PEs).

All in all, there are good reasons for additional specific rules, but the authors warn that this may result in another layer of complexity. Cooperative compliance, in which the place of residence of employees is tracked, should also be one of the elements for internationally operating companies. Tax technology may be helpful, although this might infringe privacy legislation. For these reasons, simplicity and more alignment with Regulation 883/04 and social security treaties might be preferable.

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## Chapter 22

### **The Impact of Tax Treaties on International Mobility of Work in the Republic of North Macedonia**

Aleksandra Maksimovska Stojkova and Elena Neshovska Kjoseva

#### **22.1. Mobility of work and domestic tax law**

##### **22.1.1. Introduction**

The Republic of North Macedonia is a small Western Balkan country with a developing economy. According to the official data of the State Statistical Office taken from the 2021 census, the country has over 1.8 million citizens.<sup>1</sup> The Republic of North Macedonia declared independence in 1991, and since then it has continuously struggled with external migration. Due to the constant uncertainty brought about by political and socio-economic circumstances, it is assumed that in the last 20 years more than 500,000 inhabitants have left the country. This tendency has been even more evident in the past few years as a result of the intensive process of globalization, openness towards the free movement of people, goods and services, increased cross-border activities and the high mobility of persons.<sup>2</sup>

With respect to the mobility of workers, North Macedonia took a step forward during 2020. Previously, the domestic labour market was mostly restricted and focused on domestic/resident employees. North Macedonia also experienced a brain drain prior to the COVID-19 pandemic, which caused professionally recognized and well-educated workers to leave the country. Sixteen percent of workers aged between 25 and 39 left North Macedonia in the period between 2002 and 2020, which had a negative impact on the labour market. When the pandemic started in 2020, there was a positive change as a result of the easing of working conditions. Namely, the dominant, traditional mode of working was replaced by online or remote working when possible.

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1. State Statistical Office, *Census 2021*, available at <https://popis2021.stat.gov.mk/> (accessed 13 July 2022).

2. E. Neshovska Kjoseva, *Taxation in Era of Globalization and Digitalization – Issues and Challenges on National Tax Sovereignty*, Proceedings of the 2021 Annual International Conference: “Law, Socio-Economic and Politics in Troubled Times”, Iustinianus Primus Law Review, Special Issue (2021).

The turning point came when a worker returned to North Macedonia from Italy and transmitted COVID-19 in a rural Macedonian city. Soon after the spread of the pandemic, the legislator introduced a state of emergency that significantly expanded the power of the government. Economic legislative adjustments were made, mostly in the area of labour law and taxation, and fiscal actions to protect potential budget deficits were undertaken. Additionally, a number of accompanying legal actions were introduced with the aim of protecting citizens and ensuring their health and safety at work. The main goal of all these national fiscal, economic and social measures was to try to curb the spread of the COVID-19 virus by constraining the physical mobility of people. Ultimately, the government's top priority was to support the economy and provide stable tax revenue in the budget.

The state of emergency was accompanied by the closing of all national borders, nurseries, schools and universities, and there was a restriction placed on the freedom of movement and groups meeting within public spaces. Macedonian authorities proclaimed that "if people do not interact with each other and stay at home, the virus cannot spread". Such "social distancing" paradigm has come with large socio-economic costs. It resulted in a vast number of people being stranded in lockdown situations outside the country, and, vice versa, foreigners stranded in North Macedonia. Due to worldwide travel restrictions, the foreign workers could not leave North Macedonia, nor could Macedonian citizens working abroad come back to their home country. Besides the burgeoning health, social and economic difficulties, the question of taxation of the workers also arose. The situation has forced both workers and employers to change their traditional understandings of working space, working hours and work routine.

During the first 2 years of the COVID-19 pandemic, the Macedonian Public Revenue Office applied national tax rules and tax treaties in the same manner and in the same context as it did before the pandemic. In relation to lockdowns and travel restrictions, Macedonian tax authorities adopted a rather liberal approach to implementing domestic tax principles regarding the residency status of individuals, permanent establishments (PEs), income from employment and frontier workers. Consequently, North Macedonia opted to introduce tax measures rather than to make substantial tax legislative changes.<sup>3</sup>

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3. V. Pendovska & E. Neshovska Kjoseva, *Tax Policy Measures for Dealing with the Consequences of the Covid-19 Crisis: The Case of Republic of North Macedonia*, Essays in Honor of Professor Emeritus Dejan Popovic, Liber Amicorum, pp. 299-313 (University of Belgrade, Faculty of Law 2021).

First, most of the tax amendments made in 2020 set exemptions on the taxation of self-employment income and relaxed tax policy regarding the deadlines prescribed in Macedonian tax legislation. The deadline for the submission of tax declarations and tax returns was prolonged for 3 months.<sup>4</sup> In order to stimulate self-employed workers affected by the pandemic, especially lawyers, notaries, executors, accountants and consultants, the government released temporary tax measures and tax exemptions. Second, regarding the tax principle of residence, Macedonian tax authorities recognized the fact that workers, both domestic ones settled abroad and foreign ones settled in the country, were obliged to stay in the place in which the lockdown was enforced and for a longer period of time. Third, the tax authorities confirmed that “working from home” or the “home office” was “imposed or recommended” by the government in line with public health measures. With this strategy, North Macedonia continued to apply the 183-day tax rule to determine residency for tax purposes, without making any changes to it.<sup>5</sup>

Despite the OECD’s recommendations, published in its “Updated Guidance on Tax Treaties and the Impact of the COVID-19 Pandemic”, and different to other countries’ positions, North Macedonia did not publish any guidance regarding the method of application of Macedonian cross-border tax rules during the time of COVID-19 measures.<sup>6</sup> In absence of such announcements, taxpayers experienced legal uncertainty with respect to emerging practical tax problems caused by the pandemic and the imposed restrictions. Meanwhile, the Public Revenue Office acted very flexibly in relation to the procedural elements of the legal obligations of taxpayers and provided all its services, legal assistance and legal opinion by phone or email.

### 22.1.2. Individuals as (non) residents for tax purposes

The taxation of individuals’ income in North Macedonia is based on their residence status. Therefore, Macedonian tax residents are taxed on their

4. МК: Уредба со законска сила за примена на законот за данокот на личен доход за време на вонредна состојба (“Сл.весник на РСМ” број 79/2020 и 169/2020) [Decree with legal force for application of the Law on Personal Income Tax during a state of emergency (Official Gazette of RNM, 79/2020 and 169/2020)] [hereinafter Law on Personal Income Tax].

5. Art. 5(3) Law on Personal Income Tax (Official Gazette, 241/2018, 275/2019, 290/2020 and 85/2021).

6. OECD, Tackling Coronavirus (COVID-19): Contributing to a Global Effort, *Updated Guidance on Tax Treaties and the Impact of the COVID-19 Pandemic* (OECD 2021), available at [https://read.oecd-ilibrary.org/view/?ref=1060\\_1060114-o54bvc1ga2&title=Updated-guidance-on-tax-treaties-and-the-impact-of-the-COVID-19-pandemic](https://read.oecd-ilibrary.org/view/?ref=1060_1060114-o54bvc1ga2&title=Updated-guidance-on-tax-treaties-and-the-impact-of-the-COVID-19-pandemic).

worldwide income, while non-residents are taxed only on their income derived within the Macedonian territory. According to the Macedonian Law on Personal Income Tax (article 5(2)-(3)), individuals are considered Macedonian tax residents if they have a permanent or temporary residence in the country, irrespective of their citizenship. An individual is considered to have a temporary residence in North Macedonia if they stay in the country continuously or intermittently for 183 days or more within any 12-month period. The person who fulfils this 183-day requirement is treated as a resident for tax purposes and has unlimited tax liability under the Macedonian income tax system.

Surprisingly, although a dominant criterion and one that has been implemented in the Macedonian tax regulation since 1993, the Public Revenue Office has never published any guidelines on the method for calculating days of physical presence for the purposes of taxation. Unfortunately, regardless of the significant fiscal implications, it is still considered a solely administrative and technical matter. A foreign tax resident is defined as any individual who is not a Macedonian tax resident. These individuals have limited tax liability and they are subject to taxation based on the principle of territory, i.e. source taxation.

Income from employment, salaries and any additional remuneration from employment (including bonuses), as determined by the labour legislation, is also subject to compulsory social security contributions. The calculation and payment of all employee social security contributions is regulated by the Law on Mandatory Social Insurance Contributions.<sup>7</sup> This law also sets the minimum base for payment of social security contributions on salary and bonuses, which on a monthly basis is around 50% of the average salary paid in North Macedonia. The monthly maximum base for the payment of mandatory social security contributions is 16 average monthly salaries. No social security contributions are paid on the difference above this threshold.

Employers are obligated to calculate, withhold from employees' gross salary and pay into the accounts of respective funds compulsory social

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7. МК: Закон за придонеси од задолжително социјално осигурување, Сл.весник на РМ, бр. 142/2008, 62/2009, 64/2009, 156/2009, 166/2010, 53/2011, 185/2011, 44/2012, 150/2012, 15/2013, 91/2013, 170/2013, 97/2014, 113/2014, 180/2014, 188/2014, 20/2015, 48/2015, 129/2015, 217/2015, 190/2016, 171/2017, 35/2018, 47/2018 [Law on Mandatory Social Insurance Contributions (Official Gazette, 142/2008, 62/2009, 64/2009, 156/2009, 166/2010, 53/2011, 185/2011, 44/2012, 150/2012, 15/2013, 91/2013, 170/2013, 97/2014, 113/2014, 180/2014, 188/2014, 20/2015, 48/2015, 129/2015, 217/2015, 190/2016, 171/2017, 35/2018 and 47/2018)].

contributions and personal income tax. The current levels of the compulsory social contributions on gross salary are as follows:

- pension and disability insurance: 18.8%;
- health insurance: 7.5%;
- employment insurance: 1.2%; and
- additional health insurance: 0.5%.

The Public Revenue Office is authorized to control the calculation and payment of compulsory social contributions and personal income tax on salaries. All employers send their calculations to the Public Revenue Office, which checks them and, if they are correct, issues a declaration of acceptance that is then presented to the respective depository bank for the payment of mandatory social security contributions, personal income tax and net salaries.

Since the 183-day rule of physical presence in the country is a decisive factor for determining the residency status of individuals, COVID-19 has caused some insecurity among taxpayers. However, as previously mentioned, the Macedonian tax authorities took into account all government travel restrictions at home and abroad as well as lockdowns. Due to this pragmatic interpretation, Macedonian residents who could not return home and were forced to stay temporarily overseas were subject to taxation under the regular tax rules. In other words, although these individuals were present in the foreign country for a longer period of time than expected as a result of the facts and circumstances during the COVID-19, they preserved their Macedonian tax resident status.

Respectively, non-resident taxpayers who were locked down in North Macedonia for more than 6 months were not treated as Macedonian residents. The Public Revenue Office provided this interpretation acknowledging the following three facts: (i) foreigner workers were prevented from leaving North Macedonia due to circumstances beyond their control; (ii) foreign workers' prime intention was not to live in the country; and (iii) foreign workers would return to their home/resident country as soon as they were able to.

It is also worth mentioning that this legal assumption was in line with the OECD's proposals outlined in its document "Updated Guidance on Tax Treaties and the Impact of the COVID-19 Pandemic". Therefore, a person who is not a resident for tax purposes in that country, but is located there temporarily for some weeks or months because of COVID-19, will

not become a resident for tax purposes provided that person usually lives overseas permanently and intends to return there as soon as they are able to.

### 22.1.3. Legal entities as (non) residents for tax purposes

According to the Macedonian system for income taxation, all resident and non-resident legal entities operating through a PE are liable to pay corporate income tax. Macedonian resident entities have unlimited tax liability and are taxed on their worldwide income. A non-resident company has a limited tax liability and is taxed on the profit generated through its PE in North Macedonia.<sup>8</sup> To create equal market conditions for carrying out economic activity, the Law on Profit Tax prescribes that non-profit organizations (including non-governmental organizations, religious and humanitarian organizations, trade unions, political parties, etc.) are taxed on income from their business activities (if any) if their total annual revenues are higher than Macedonian denar (MKD) 1 million.<sup>9</sup>

A company is resident in North Macedonia for tax purposes if it is established or maintains its headquarters in the territory of North Macedonia.<sup>10</sup> Foreign legal entities with headquarters abroad are non-residents for tax purposes. However, their Macedonian branches are liable for tax on any profit generated in the territory of North Macedonia if they are considered as a PE for the foreign legal entity in the country.

### 22.1.4. Tax treatment of permanent establishments under domestic law

As stipulated in articles 5 and 6 of the Law on Profit Tax, a PE is a fixed place of business through which the business of an enterprise is wholly or partly carried on, either directly or through a dependent agent. More specifically, the domestic law provides that a PE may include:

- a place of management;
- a branch office;
- an office;

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8. MK: Закон за данокот на добивка, Службен весник на РМ, бр. 112/14, 129/15, 23/16, 190/16, 248/18, 158/19, 232/19, 275/19, Службен весник на РСМ, бр. 290/20, 151/2021 [Law on Profit Tax (Official Gazette, 112/14, 129/15, 23/16, 190/16, 248/18, 158/19, 232/19, 275/19, 290/20 and 151/2021)] [hereinafter Law on Profit Tax].

9. Art. 4-a Law on Profit Tax.

10. Art. 4 Law on Profit Tax.



- a factory;
- a workshop; or
- mining activities, or any other place of extraction of natural resources.

A building site or a construction or installation project, as well as related supervision activities, may constitute a PE if it lasts longer than 6 months. Furthermore, the provision of services, including consulting services with regard to one or several related projects, is deemed to give rise to a PE if such activities last longer than 90 continuous days within any 12-month period. If one or several persons establish a PE as per the above, any other non-related project on which they are working on becomes part of the PE, irrespective of its duration. The PE should be registered as a corporate taxpayer at the beginning of its activity in the country for the purposes of obtaining a tax number. Regarding the tax treatment of PEs, COVID-19 did not have significant impact on the novel tax measures. The Macedonian legislator has not made any changes in defining PE in the Law on Profit Tax.

The travel restrictions and recommendations for working from home introduced by the government raised some concerns for foreign companies. However, the Public Revenue Office followed the same approach and respected the same legal assumption as it did for the residency status of individuals. Thus, a PE was not created if a foreign company did not operate through a PE in North Macedonia before the pandemic, and foreign employees were only present in North Macedonia for a longer period of time because of the imposed COVID-19 measures to prevent the spread of the infection. Moreover, a home office does not constitute a PE of a foreign employer for tax purposes. The Macedonian corporate tax system has the dual criteria of “place of incorporation and place of settlement” for the residency of legal entities (article 4(2) of the Law on Profit Tax), and there was no need for legal amendments that will reinforce a different tax solution.

## **22.2. Residence, tiebreaker rules and mobility of work: Individuals and entities**

The growing importance of the mobility of work has resulted in increased interaction between different tax jurisdictions. Therefore, there are reasonable expectations of additional cases of double taxation of individuals and legal entities, and so there is a clear need for the application of tax treaties. The international tax law of North Macedonia consists of a network of 49 bilateral tax treaties for the elimination of double taxation on income and

capital and the prevention of fiscal evasion.<sup>11</sup> Most of the tax treaties cover income and capital and most of the provisions follow the OECD Model Tax Convention on Income and Capital (OECD Model).<sup>12</sup>

Article 4(1) of every Macedonian tax treaty is the same as the definition of “resident of a Contracting State” given in the OECD Model. Regarding tiebreaker rules for individuals, Macedonian tax treaties have accepted the principles incorporated in article 4(2) of the OECD Model in which an individual is a resident of both contracting states. Still, North Macedonia has not introduced any forms or published any procedure to detect and verify the residency status of individuals for tax purposes.

With respect to dual residence for taxpayers other than individuals, article 4(3) of Macedonian tax treaties differs depending on the period in which the treaty was signed and ratified. The older tax treaties take into account the place of effective management as a criterion to resolve the problem of dual residency of companies. According to article 4(3) of the tax treaties signed on and after 2010, the tiebreaker rule for legal entities is determined based on mutual agreement. Concerning the tiebreaker rules and residency of ships and aircrafts and directors’ fees, all tax treaties of North Macedonia include provisions that are comparable to article 8 (ships and aircrafts) and article 16 (directors’ fees) of the OECD Model.

The decision of the Macedonian government and tax authorities to not implement any amendments to the national tax rules regarding the principle of residence was also applied in cross-border tax legislation. Consequently, during the pandemic, North Macedonia made no changes to article 4 in any of its 49 tax treaties apropos the residence and tiebreaker rules of individuals and legal entities. In terms of application of the tiebreaker rules, Macedonian tax authorities acknowledged the fact that workers were forced to spend more time in their home country or abroad. This was especially due to travel restrictions. Although the Macedonian tax authorities are well aware of the highly mobile lifestyle of workers, this has not yet had any impact on the criteria laid down in article 4(2) of the Macedonian tax treaties.

Regarding the tiebreaker clause for entities, there were no tax consequences since the Macedonian Public Revenue Office respected the government’s

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11. Every double tax treaty that is applicable in North Macedonia is online, available at <http://www.ujp.gov.mk/mk/regulativa/pregled/tr/md> (accessed 18 Jan. 2024).

12. E. Neshovska Kjoseva, *Tax Treatment of Cross-border Activities According Double Tax Treaties* pp. 339-341 (Stobi trejd dool Skopje 2016).

recommendation to “work from home”. Thus, even though many companies introduced home working, and these companies no longer had sufficient workplaces for their workers, the tax authorities assumed that they still met the substance requirements. As a result, there was no risk that all these corporations could lose the treaty entitlement due to circumstances beyond their control.

### **22.3. Permanent establishments and mobility of work**

Article 5 of the Macedonian tax treaties defines the concept of PE. This definition is in line with article 5 of the OECD Model and identical to the provision incorporated into the Law on Profit Tax. The purpose behind the Macedonian legislator incorporating the PE definition into the domestic rules and the tax treaties en bloc was the determination to ensure legal certainty and consistency.

The emergence of the digital or platform economy (also known as the “sharing economy” and the “peer2peer economy”) is one of the most important transformations of the working world today. Initially, online working through digital platforms was mainly led by freelancers as a way to access international markets. This type of digital work, which is enabled by digital technologies, attracts different types of workers and results in significantly different outcomes for workers. On the one hand, digital workers have better working conditions, flexible working hours and other environment advantages. On the other hand, they are usually not formally employed, they do not have income taxes paid by their employers and they do not have social or health insurance. Therefore, there are both advantages and disadvantages for gig workers. While there is no reliable national data on the amount of digital work carried out in North Macedonia, recent international surveys placed the country, along with Serbia, as among the leading countries in Europe and the world due to the percentage of digital workforce relative to the country’s total population and total workforce. This is due to the high level of education and skills of the young professionals in North Macedonia but also due to the lower salaries expected by Macedonians in the international labour market.

The foreign IT companies that operate in North Macedonia mainly rely on the workforce of gig workers and digital nomads. The phenomenon of gig working is most relevant for Macedonian citizens, while the term “digital nomad” generally refers to a foreigner coming to live in North Macedonia.

Although many authors have made this distinction for practical reasons, it is not part of Macedonian tax and labour laws.

During the pandemic, the most important amendment to Macedonian legislation regarding digital nomads was the prolongation of the period of working without resident/administrative permission, from 3 to 12 months, as provided by article 2 of the Law of Foreigners.<sup>13</sup> Namely, before the pandemic, it was stipulated that digital nomads have administrative permission to stay in North Macedonia for a period up to 3 months, and after the governmental travel restrictions (under certain conditions) were introduced, this rule was replaced with a period of up to 12 months.

In this context, it is important to explain that for a long period of time, prior to the pandemic, North Macedonia was experiencing and suffering from the migration of young workers and a brain drain. Additionally, over the past 5 years, large numbers of young people with university diplomas have been working from their homes as outsourced freelancers, mainly for foreign companies. The circumstances of the COVID-19 pandemic have, once again, confirmed the necessity of the prompt establishment of legal solutions addressing the mobility of work.

Currently, there is no specific tax treatment for (i) persons who provide outsourcing services; (ii) freelancers; and (iii) digital nomads. Neither is their income, in significant part, declared to the Public Revenue Office, nor is it declared as self-employed income or other income gained from internet services. These workers include language teachers, digital workers on freelancing platforms such as Upwork, journalists, web designers, music or video editors, translators and a host of other professions suited to remote working in the digital age.

According to the applicable tax rules, gig workers and digital nomads are not treated as a special legal category. Their work does not constitute a PE of the foreign employer in North Macedonia. They are not recognized as classic employees under Macedonian labour law since the law does not recognize either the terms “freelancer” or “self-employed”. As a result, the firms that hire them have no obligation to pay social security contributions to the state. Such payments fall on the individual, as does the obligation to pay income tax.

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13. МК: Закон за странци, Службен весник на РМ, бр.97/2018, 108/19, 71/20, 125/20, 169/20 [Law on Foreigners (Official Gazette, 97/2018, 108/19, 71/20, 125/20 and 169/20)].

In practical terms, numerous freelancers and digital nomads are settled in North Macedonia, working for international companies and earning significant revenues that are neither declared nor taxed in North Macedonia by income taxes.<sup>14</sup> Although the Macedonian Public Revenue Office has detected this category of worker, it has no legal mechanisms to tax them. In fact, although these workers are declared as independent self-employed workers (freelancers), de facto they are related and connected to the international company they work for. This argument is based on the scope of work, instructions for their work and the amount of their income generated by the same international company. Further, most of these workers are paid on a monthly basis by the same international company.

Therefore, in response, the Macedonian Public Revenue Office has initiated a new legal rule (solution) as an amendment to the current legislation, which will be presented to the parliament in the near future. The amendment proposes the broadening of the PE definition in the Law of Profit Tax. The expected result will be inclusion of these de facto dependent employees in the legal definition for the taxation of PEs. This will surely have multiple benefits, such as increasing the Macedonian tax revenue, fighting harmful tax practices and taxing the income/profit exactly where the economic activity is performed.

#### **22.4. Physical presence according to articles 15(1) and 17 of the OECD Model**

Macedonian tax treaties have fully adopted article 15 of the OECD Model, which regulates the income from employment and sets out the rule for the allocation of taxing rights. Currently, if employment is exercised partly or totally in a home office in North Macedonia, the severance payment is taxed in the resident country under the rule “taxation of worldwide income”. Alternatively, if employment is carried out partly or totally abroad, the source state of income has the taxing authority, but this rule will be only applied if the worker is present for longer than 183 days.<sup>15</sup> Hence, the Macedonian tax authorities have the right to tax non-resident individuals on their income from employment only to the extent that the employment was carried out in North Macedonia.

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14. M. Pendovska et al., *Evaluation of Tax Procedural Solutions with Special Accent on Protection of Taxpayers' Rights in Republic of North Macedonia: Conditions, Problems and Solutions* (Iustinianus Primus Law Faculty 2020).

15. V. Pendovska et al., *Tax Law* p. 394 (Iustinianus Primus Law Faculty 2021).

The situation became more complicated during the pandemic due to travel restrictions and the vast exploitation of online distance work from home. The workers that were present in their domestic country (North Macedonia) were actually working remotely for a company abroad, and that company treated them as employees that only work from home, no matter where their physical presence was.

During the COVID-19 pandemic, the Macedonian tax authorities faced various dilemmas concerning the taxation of the salaries and other remunerations received as compensation for performing work tasks on behalf of an employer. Hence, a key question arose: what happens if a worker is stranded in a jurisdiction where they are not resident but where they were previously working? When foreign employees normally resident in North Macedonia are stranded in the country where they perform their employment, the 183-day requirement can easily be exceeded, so that North Macedonia, as a state of employment, also becomes the tax jurisdiction. Accordingly, the Macedonian Public Revenue Office considered the COVID-19 pandemic as a force majeure. Under this legal fiction, the income from employment received during working from home because of the health restrictions and lockdowns was taxed in the country where the employee would normally have worked.

Because workers were forced to stay in North Macedonia due to COVID-19 restrictions, they were treated as if they were working in their offices abroad. Thus, North Macedonia bypassed the physical presence rule of article 15 of the OECD Model. Macedonian tax authorities treated stranded workers as non-residents and lost potential tax revenue. The logic behind this practice is that these workers would not have been present in North Macedonia if COVID-19 restrictions had not been imposed by North Macedonia. This decision for non-taxation was justified to be correct because as soon as the borders were opened, the stranded workers left North Macedonia and returned to their employers' companies abroad. The same rules were applied to all stranded employees who could not exercise their employment due to restrictions or public health measures.

In order to cushion the impact of the COVID-19 crisis on the Macedonian economy and improve economic circumstances of the Macedonian citizens, the government adopted five packages of fiscal measures. These measures were mainly targeted at the sectors that were the most affected or restricted by the pandemic such as tourism, catering, hospitality, textile industry, culture, etc. As part of one fiscal package, the Macedonian government paid subsidies to companies for the amount of wages, taxes and social security

contributions owed for each worker. This type of compensation was not subject to taxation.

With respect to livestreaming by entertainers, North Macedonia did not impose taxes either before, during or after the COVID-19 crisis. The country has adopted the “wait and see” approach, meaning it will wait for an international solution and see the way in which its neighbouring countries react, and then follow by implementing country-specific tax solutions. This approach is also appropriate for dealing with influencers. For a long period of time, Macedonian tax authorities have been well aware of the amount of income and other types of compensation received in money, kind or any other type of remuneration by this category of individuals. Currently, the Macedonian personal income tax has not included a special tax treatment for influencers. However, their expansion during the pandemic has once again confirmed the necessity to tax influencers to ensure equal tax treatment of all persons that earn the same amount of income.

## 22.5. Article 15(2) and (3) of the OECD Model

Working from home has become an important feature of contemporary work, and this was especially the case during the COVID-19 pandemic. It encompasses higher-skilled workers on digital labour platforms, as well as remote workers (known as teleworkers) in service industries. The existing legal framework in North Macedonia does not regulate teleworking as a form of employment, i.e. the organization of work at a remote workplace, different from home-based work, which is carried out by using information technology.<sup>16</sup>

The pandemic increased the need for teleworking as an effective mechanism for organizing and performing work as well as protecting the health and safety of workers. Teleworking was not introduced into labour law nor into Macedonian tax regulations. During the state of emergency caused by the COVID-19 pandemic, teleworking was not fully regulated by any governmental decree with the force of law. The sole legal acts that implicitly recommended public and private sector employers to apply teleworking/home-based work were the by-laws adopted in early March 2020.<sup>17</sup> In sum, these were just recommendations given by the government of North Macedonia.

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16. N. Mojsoska Blazheski, M. Petreski & A. Ristovski, *Non-standard Forms of Employment in North Macedonia*, Final Integrative Report, International Labour Organization (2021).

17. MK: Measures and Conclusions of the Government of the RNM dated 10 and 11 March 2020; and MK: Decision of the Government dated 12 March 2020.

Consequently, the corporations that lost their substance due to all of their employees working from home were still qualified under article 15(2)(b) of the OECD Model. This was due to the legal assumption that the company retained economic and labour relations with its workers. During the pandemic restrictions, working from a home office had the same tax treatment as working at an employer's office. As a result, the home office of the employee was not treated as a PE of the broader company.

## **22.6. Frontier workers**

Although North Macedonia has good relations with neighbouring countries concerning cross-border work areas, none of the Macedonian tax treaties has a specific tax provision for frontier workers. However, in order to meet the needs of a number of Macedonian residents who live close to the border and work in another country, the Macedonian tax authorities derogate from the “work state” principle according to which the right to tax the income from employment is allocated to the country in which the employment is exercised. In other words, even though the employment is physically performed in a different country to the taxpayer's resident country, the resident country has the taxing right.

In order to implement this taxing rule, the Macedonian Public Revenue Office recognized that an employee of a contracting state can be categorized as a “frontier worker” if the employee:

- is resident for tax purposes in a territory that lies wholly or partly within 20 km of the border with the other contracting state;
- works as an employee in the border area of the other contracting state for a resident employer, a PE or a fixed base of that other state; and
- crosses the border on a daily basis in order to return home to the resident country.

One of the most important novelties for the mobility of work in North Macedonia is the establishment of the “Open Balkan Initiative”. This initiative originated from a old political idea of the Balkan leaders, but during the pandemic, it was strongly supported by economic reasoning. At the Economic Forum on Regional Cooperation held in Skopje on 29 June 2022, prime ministers/presidents of Albania, North Macedonia and Serbia unveiled a new name for the concept colloquially known as Mini-Schengen. This is a framework for broad cooperation that has since been officially called the Open Balkan Initiative. The legal basis for the Open Balkan Initiative is an



agreement<sup>18</sup> and two memorandums of understanding signed by these three countries, which deepen their political and economic ties.

The Open Balkan Initiative builds on an already achieved level of regional cooperation and trust established through the implementation of the Common Regional Market (CRM), but it offers a substantial contribution to further regional integration. While the CRM envisaged significantly lower waiting times at borders for goods and citizens travelling with only IDs, the Open Balkan initiative will completely abolish border controls, thus reducing waiting times to zero for both citizens and commerce. Additionally, as the free movement of labour under the framework of the CRM became limited in scope, with work permits only removed for intercompany transfers and particular service providers, the Open Balkan Initiative went a step further by enabling all labour to be employed across the region with one work permit being sufficient.

The Open Balkan Initiative offers more in-depth integration to those willing to pursue it while sharing the same goals as the CRM, namely, increasing the level of intra-regional economic and societal connections. It is expected that in the near future, North Macedonia will face a higher degree of mobility of work as the country is part of the Open Balkan Initiative alongside Serbia and Albania. One of the key benefits will be greater mobility of work among the participating countries. Surely, all these actions will result in overcoming the conventional perspective of work, including work conditions and ethics. The necessity for better regulation of non-standard types of employment and frontier workers and their requirement for legal and tax certainty will put significant pressure on the Macedonian government to redesign the national, bilateral and multilateral tax rules in line with the latest trends in this field.

## **22.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)**

During the pandemic, workers were working from a home office in North Macedonia as their state of residence for companies abroad. For tax treaty purposes, the government of North Macedonia deemed that those employees, although in their state of residence, were still exercising activities

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18. AL/MK/RS: Agreement on Conditions for Free Access to the Labour Market in the Western Balkans.

in their previous state of activity, namely the location of the foreign company. The legal basis for this was the decree of the government that gave them tax reliefs with legal force. Concretely, they were not taxed in North Macedonia, although they resided for over 183 days in North Macedonia.

Moreover, during the pandemic, the government assumed that no PE had been established if the worker only worked from home in North Macedonia. The tax authorities followed the government's assumptions and did not tax those activities with income taxes. In order to satisfy this assumption, the tax authorities cautiously reviewed whether the workers voluntarily decided to work from home or were forced to by the pandemic restrictions. In the first case, the outcome was the tax treatment according to the tax treaty, whereas the worker was taxed with Macedonian income taxes. In the second case, if the force majeure was relevant and applicable, the worker was taxed in the source state, according to the tax treaty.

All tax measures were unilaterally undertaken, and no mutual agreement between states was concluded. The only added value in the governmental relations between neighbouring states was the Open Balkan Initiative, considering that North Macedonia, Serbia and Albania had agreed for liberalization of the labour market. Hitherto, there have not been any tax adjustment measures to follow from this agreement. It is expected that in the near future governments will initiate a process of reviewing the necessary tax adjustments in the regulation.

## **22.8. The future of the mobility of work: A need for adjusting the existing treaty rules?**

The COVID-19 pandemic has, once again, brought to the surface the necessity for reshaping the conventional tax rules with respect to the mobility of work. The post-COVID-19 labour environment will be based on new forms of working and relations between employers and employees. It is expected that, in the near future, teleworking and home offices will be the predominant mode of working among the younger generation, bearing in mind their aspirations towards flexibility, openness and work/life balance. On the other hand, in times of huge migration and with a lack of skilled workers, employers are easing the working conditions.

The existing tax rules, in general, should be reviewed concerning working from home and teleworking, gig workers, digital nomads, freelancers, influencers, etc. The most important tax rule that needs to be reconsidered

or changed is article 4 of the Macedonian tax treaties. Put concretely, the following criteria should be adapted to the new circumstances of working:

- physical presence of 183 days in the resident country/permanent home;
- centre of economic interest/centre of vital interest; and
- place of usual habitat/habitual abode.

For example, the centre of habitual abode is very changeable for workers living near cross-border areas. These frontier workers are in a special tax situation because they pay taxes in one country while their habitual relations are in another country. The same applies to their economic interests. Another example is the case of teleworking, where there is a need to set a new tax treatment.

Most importantly, *pro futuro* tax change in North Macedonia should be broadening the legal definition of a PE. This will result in significant tax revenue for North Macedonia as, according to the current definition of PE, potential profit tax revenues are lost. The change should constitute the home office as a PE. There have been initiatives addressing these areas by academics and national tax experts, but it is still a subject of consideration for the Ministry of Finance. In connection with this issue, the Macedonian tax authorities have to resolve the question around whether and to what extent these individuals are treated as employees or self-employed persons for tax purposes.

First and foremost, the country should try to increase the tax revenues depleted by the pandemic. Second, the country should tackle tax evasion, tax avoidance and the grey economy caused by tens of thousands of freelancers and digital workers who are not formally employed by foreign firms in search of remote, educated and cheap labour. Third, it is time for North Macedonia to reshape its tax system towards the new normality and non-standard forms of employment, such as home working, telework, freelancing and social media influencers. Digital nomads form another category that requires a systematic approach, as long as the country is trying to attract this type of worker.

Comparative country-by-country analyses have confirmed that states have better results in resolving tax disputes if there are some guidelines and questionnaires published. In this sense, the authors suggest that it would be useful for both tax authorities and taxpayers if such publications were made available. This would strengthen the transparency of the Macedonian tax system and protect taxpayers from the eventual incorrect interpretation

of Macedonian tax rules or from being taxed differently to a taxpayer in the same or similar circumstances.

Lastly, the Macedonian government should consider the idea of implementing a software programme that would be used to identify the residence status of individuals and determine their proper tax treatment. On one hand, this solution would help tax authorities to detect and resolve cases of incorrect residency, and on the other hand, it would guarantee legal certainty and fair and equal taxation of every taxpayer.

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## Chapter 23

### **The Impact of Tax Treaties on International Mobility of Work in Norway**

Eivind Furuseth

#### **23.1. Mobility of work and domestic tax law**

##### **23.1.1. Introduction**

One of the most fundamental questions in domestic and international tax law is what creates tax liability to a country, including how the mobility of work influences this decision. In recent years, as our way of living and connections have become increasingly international – including how businesses are organized and connected – the world is getting smaller and smaller. The COVID-19 pandemic triggered the issue of the relevance of mobility and traveling or, maybe more correctly, the lack thereof. To what extent will the restriction on traveling influence the issue of tax liability to a country?

Issues related to mobility of work raises questions both within indirect and direct taxation. In this report, however, only direct taxation will be analysed. Further, the issues arising in relation to mobility of work are relevant both for personal and corporate direct income taxes. Both will be covered in this report. Before going into a detailed analysis of these questions, it might be useful to make some general comments on Norway and the Norwegian tax system. Norway is not an EU Member State but part of the European Economic Area (EEA) agreement.

Under the EEA Agreement, which is an agreement between the European Union, on the one hand, and Iceland, Lichtenstein and Norway, on the other hand, there are similar rules regarding the four fundamental freedoms, State aid and competition law under the EU treaty.<sup>1</sup> Hence, when interpreting the four fundamental freedoms, the State aid rules and competition law, case law from the Court of Justice of the European Union are important sources of law. One of the fundamental goals of the EEA Agreement is to make the European Union and Iceland, Lichtenstein and Norway to one single market without any restriction. Thus, is it important under the interpretation of the

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1. <https://www.efta.int/Legal-Text/EEA-Agreement-1327> (accessed 16 Dec. 2022).

EEA Agreement to take into consideration EU case law to ensure the fulfillment of the object and purpose of the EEA Agreement

Compare article 1 of the EEA Agreement:

1. The aim of this Agreement of association is to promote a continuous and balanced strengthening of trade and economic relations between the Contracting Parties with equal conditions of competition, and the respect of the same rules, with a view to creating a homogeneous European Economic Area, hereinafter referred to as the EEA.
2. In order to attain the objectives set out in paragraph 1, the association shall entail, in accordance with the provisions of this Agreement:
  - a) the free movement of goods;
  - b) the free movement of persons;
  - c) the free movement of services;
  - d) the free movement of capital;
  - e) the setting up of a system ensuring that competition is not distorted and that the rules thereon are equally respected; as well as
  - f) closer cooperation in other fields, such as research and development, the environment, education and social policy.

Norway is also an OECD member country, which means that it is loyal to the OECD Model Tax Convention (OECD Model) and the OECD Commentary. Further, most of the tax treaties Norway enters into are based on the OECD Model; however, there are some tax treaties based on the UN Model Tax Convention (UN Model), and both the Norwegian tax authorities and the Norwegian courts put great emphasis on the OECD Commentary when it comes to interpretation of tax treaties.<sup>2</sup>

For further analysis and discussion of issues related to mobility of work, court cases are relevant. Hence, it is also relevant to highlight that there are no specific tax courts in Norway, only general courts. The court system consists of three instances, namely the first instance court, the appeal court and the Supreme Court. Finally, it could be mentioned that there recently has been an evaluation by an expert panel<sup>3</sup> of the Norwegian tax system.<sup>4</sup> The expert group was appointed by the Ministry of Finance in June 2021,

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2. There are no specific tax courts in Norway, only general courts.

3. The expert panel consists of persons from the industry, tax lawyers and academia.

4. <https://www.regjeringen.no/no/dokumentarkiv/regjeringen-solberg/aktuelt-regjeringen-solberg/fin/pressemeldinger/2021/skatteutvalg-perspektiver-for-fremtidens-skatteog-avgiftssystem/id2861485/> (accessed 10 June 2022).

and one of the issues they were asked to look into is taxation of multinational companies, including the Norwegian tax system. The expert group, however, did not discuss issues related to mobility of workers and to what extent increase/decrease of mobility of workers should have any impact on tax liability to Norway. The expert group delivered its evaluation report of 19 December 2022. The report will get a formal status as a White Paper.

### 23.1.2. Tax residency under Norwegian law – An introduction

The Norwegian Tax Act (NTA)<sup>5</sup> applies a worldwide income taxation principle, which means that it is of great importance whether or not the taxpayer – both individual and corporation – is considered tax resident in Norway. For individuals, the number of days spent in Norway is important for determining the tax liability to Norway, as shown later in this section. Hence, the question arises as to whether the fact that an individual is forced to spend more (or less) time in Norway due to travel restrictions or limitations under a pandemic is relevant for determining where an individual is tax resident in Norway. This issue also arises for companies, although not as directly as for individuals. But the question is also relevant in the situations where, for example, the board members, the CEO or other key personnel in the day-to-day management are forced to spend more or less time in Norway due to the pandemic.

Although the Norwegian rules and the tax treaty rules, which will be subject to analysis in this report, are related to the COVID-19 pandemic, similar situations may also arise in the future. Travel restriction may occur because of, for example, volcanic eruption and ash in the air (which was the situation in 2010 in Iceland) or because of a war where people may not freely move around. It is important to develop solid and natural tax rules to cover all these situations.

### 23.1.3. Companies

Companies become tax resident in Norway under the NTA either because the entity is incorporated in Norway or effectively managed from Norway (cf. section 2-2(7) of the NTA). The latter is based on an overall evaluation.

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5. NO: Norwegian Tax Act, 26 Mar. 1999 no. 14 [hereinafter NTA]. Unfortunately, there is no official translation of the Norwegian Tax Act into English.

Companies incorporated under the Norwegian company law act are treated as tax resident in Norway without any conditions (section 2-2(7) of the NTA). This applies even to companies that no longer have any ties with Norway, and there are no substance requirements for a Norwegian incorporated company to be tax resident in Norway. Neither is the substance of the company, such as having several employees and/or premises, relevant for the tax liability to Norway. However, in a cross-border situation, the substance of a company may be relevant. If, for example, a Norwegian tax resident company is recipient of a dividend, interest or royalty payment, and there is a question of whether the Norwegian entity is entitled to the reduced withholding tax under the tax treaty (including being the beneficial owner of the payment), the substance of the Norwegian entity is relevant. In such a situation, the increase/decrease of mobility of the employees of the company may be relevant. (The tax treaty aspect of the mobility of workers will be further analysed in sections 23.4. and 23.5.)

For companies that are incorporated under *foreign* company law, an assessment needs to be made concerning their place of management. If the “management effectively takes place in or from Norway”, the company is treated as resident in Norway. Such an assessment takes into account (i) the management at board and CEO levels; (ii) the location of the offices; and (iii) whether or not the operations of the company take place in Norway. Before 2019, the assessment was only based on board level management.

The tax residency of a foreign established company is determined partly by where the management of the company effectively takes place, including where the CEO and other key personnel in the management reside, travel restriction, etc. Due to the COVID-19 pandemic, or other extraordinary circumstances that restrict traveling, this might influence the tax residency of a foreign established company. However, companies incorporated under Norwegian company law but treated as tax resident in another country under a tax treaty between Norway and that other country are not treated as resident in Norway for domestic tax law purposes (cf. section 2-2(8) of the NTA).

During the COVID-19 pandemic, there were no specific measures to ensure and/or avoid tax residency for companies. If an individual – because of the COVID-19 pandemic – is restricted from traveling to or from Norway, and this abnormal traveling impacts the question of tax residency of a company to Norway (e.g. the CEO is forced to stay abroad for a longer period),



it is however the author's impression that the Norwegian tax authorities would be lenient in their interpretation of the Norwegian tax rules when it comes to establishing tax residency to Norway.

#### 23.1.4. Individuals

An individual is deemed to be resident of Norway if they stay in Norway (and do not have the intention to stay only temporarily). Hence, an individual will be regarded as tax resident in Norway from day one if the intention is to stay in Norway permanently. A stay of at least 6 months is anyhow sufficient for the taxpayer to be considered as tax resident (from the date of arrival), even if the stay is only temporary (section 2-1 of the NTA).

The counting of days will start at the day of arrival and stop at the day of departure. Extraordinary circumstances will in general *not* influence the counting of days, even though the date of arrival/departure are influenced by extraordinary circumstances. The tax authorities might, however, take these extraordinary circumstances into consideration in an overall evaluation (cf. later in this section regarding the COVID-19 pandemic).

A taxpayer is treated as having terminated their residence only if they have established a permanent home in another state and are present in Norway for less than 61 days during the tax year. Also, neither the taxpayer nor their spouse or dependent children may have a permanent home available in Norway. Any taxpayer who has been resident in Norway for at least 10 years before emigration is deemed to have emigrated 3 years after the end of the tax year in which they became resident abroad.

During the COVID-19 pandemic, there were no specific measures to ensure and/or avoid tax residency for individuals. However, it is the author's impression that if an individual is meeting the threshold for being tax resident in Norway due to travel restrictions, etc. (e.g. is trapped in Norway due to the pandemic), the Norwegian tax authorities would be lenient in their interpretation of the Norwegian tax rules when it comes to establishing tax residency to Norway.

#### 23.1.5. Non-resident individuals and/or companies

In addition to residence taxation, Norway also has source taxation. The source taxation applies among others to immovable property, withholding

taxes on interest, royalties and dividends, as well as business activity in Norway. During the COVID-19 pandemic, a special provision applied for FY 2020 and 2021.<sup>6</sup> For these 2 years, to the extent that a non-resident company performs activity in Norway which, under normal circumstances, would not have been performed in Norway, but the activity is performed in Norway due to the COVID-19 pandemic, the non-resident company is not liable to source taxation in Norway. Although there were specific measures in FY 2020 and 2021, when it comes to establishing tax liability to Norway due to the COVID-19 pandemic, the 2-3 years of pandemic has (to some extent) changed the way of living, including working, in Norway and probably also the rest of the world. Based on the author's experience, it is mainly two situations that have changed.

Firstly, it is much more common to work from home. Under the pandemic, workers were forced – and became accustomed to – working from home. Many people find it convenient and more efficient to work from home, even if the pandemic is not forcing them to work from home anymore. In Norway, it has become quite common to allow employees to work two days a week at their home office and the remaining three in the ordinary office. It is the author's impression that this “new standard” is quite common in other countries as well.

Secondly, people are now confident using Teams, Zoom, etc., and much of the traveling related to business meetings is no longer taking place. Digital meetings are more efficient in many ways. They take less time, are cheaper and more sustainable (i.e. environmentally friendly). This new way of conducting business may influence the evaluation of whether a non-resident company has sufficient nexus to Norway to be taxable to Norway. Under the current wording of the NTA, it is the activity of the business itself, and not the activity of the employee, which is decisive:

(1) Persons, companies or undertakings, which are not liable to tax pursuant to Section 2-1 or Section 2-2 [i.e. is tax resident in Norway], shall pay tax on:

(...)

b. wealth in, and income from, business activities in which he, she or it is engaged or participates, and which take place in this country or are managed from this country, including business activities in which employees are made available to others in Norway;<sup>7</sup>

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6. See sec. 2-3(5) NTA.

7. Sec. 2-3(1)(b) NTA.

Thus, the fact that the employees are partly working from their home office and business meetings takes place digitally is maybe not that decisive under the NTA. But of course, where the employees are carrying out the work may, in some situations, be the deciding factor and creates tax liability to Norway.

### 23.1.6. Exit taxation

#### 23.1.6.1. In general

To the extent that an individual or company ceases to be tax resident in Norway, or a permanent establishment in Norway ceases to exist, an exit tax applies. The applicability of exit taxes is not influenced by whether departure from the Norwegian tax jurisdiction is voluntary or imposed by travel restrictions, such as those that have been in place during the COVID-19 period.

An exit tax is levied on the deemed capital gain when tangible and/or intangible assets are moved out of the Norwegian tax jurisdiction. A fixed asset is considered to be transferred out of the Norwegian tax jurisdiction when income relating to the fixed asset is no longer taxable in Norway or when the owner, ordinarily liable to tax in Norway, is no longer subject to taxation in Norway.

However, if the assets are moved to another EEA state, the tax payable on tangible assets (except for inventory items) may be deferred until the assets have been alienated. To be entitled to the deferment, the taxpayer must provide the tax authorities with a guarantee for the deferred exit tax; however, no guarantee is required if there is a tax treaty concluded between Norway and the EEA state to which the taxpayer moves, which provides for exchange of information and the assistance in the collection of taxes. The deferral of the exit tax applies only when the taxpayer moves to another EEA state. Although the tax may be deferred, one-seventh of the deferred tax may be paid annually. An interest charge is calculated on the exit tax that has been deferred and is charged until the date of “realization” of the asset. The interest rate is equal to the interest rate on underpaid tax and refunds for companies. The exit tax may not be reduced even though the value of the asset may decrease. No tax credit can be claimed for any tax paid in the other state against the exit tax liability in Norway. For intangible assets and inventory items, the exit tax is due on the day of exit; that means there is no deferral, and the exit tax is based on the market value of the assets.

#### 23.1.6.2. For individuals

An exit tax on shares may be imposed on individuals who cease to be tax resident in Norway, either according to Norwegian tax law or the applicable tax treaty (section 10-70 of the NTA). Where exit tax is applicable, capital gains on shares (including subscription rights to shares, options and other financial instruments related thereto) in all types of companies (both domestic and foreign), including those held through partnerships that the taxpayer owned on the last day of residence in Norway may be taxed on that day. The tax on the deemed gains is payable only if the shares are sold within 5 years of emigration. If the total deemed gains do not exceed NOK 500,000, the deemed gains are not taxable anyhow; if the gains exceed NOK 500,000, the whole amount is taxable. Taxpayers moving to an EEA state may deduct deemed losses from the gains.

Taxpayers emigrating to a country with which Norway does not have a tax treaty must pay the exit tax upon emigration. However, a refund may be claimed if the shares have not been sold during the 5 years after emigration. If the taxpayer provides the tax authorities with a satisfactory guarantee (e.g. a bank guarantee) on the deemed tax payable, the taxpayer is not required to pay the exit tax upon emigration. No guarantee is required, however, if the taxpayer moves to an EEA state with which Norway has a tax treaty that entitles Norway to information regarding the taxpayers' income and wealth, together with assistance in recovery of taxes. Taxpayers who have provided the tax authorities with a satisfactory guarantee, and thus postponed the payment of exit tax, must annually file declarations with the tax authorities to demonstrate that no taxable event has taken place over that period.

### **23.2. Residence, tiebreaker rules and mobility of work: Individuals and entities**

#### 23.2.1. Introduction

As mentioned previously, Norway is an OECD member country and most of the Norwegian tax treaties are based on the OECD Model; furthermore, the OECD Commentary to the OECD Model is an important source of law when interpreting tax treaties. Norway has neither made any reservation to articles 4 and 16 of the OECD Model nor any observation to the OECD Commentary on these articles. However, Norway has made a reservation to article 8 of the OECD Model, holding that it reserves the right to insert a special provision regarding profits derived by the air transport consortium

Scandinavian Airlines. Norway has not made any observation to article 8 of the OECD Commentary.

The increased mobility of work is highly relevant for several articles under the OECD Model, including articles 4, 8 and 16. However, under article 4(1) of the OECD Model, the impact of a higher degree of mobility of work will only have an indirect effect since the residency under this paragraph of the article makes reference to the concept of tax residency under domestic law. Hence, the increased mobility of work may influence the concept of tax residency under domestic law (*see* section 23.1., which discusses that the increased mobility of work may influence whether both an individual and a company become tax resident in Norway).

### 23.2.2. Article 4(2) of the OECD Model – Individuals

For treaty purposes, the increased mobility of work is however relevant in relation to article 4 of the OECD Model if *both* contracting states consider the individual or company as tax resident in their country. For *individuals*, the tiebreaker article is, in the author's view, relatively solidly drafted. Both the concept of "permanent home" in letter a) and the "center of vital interest" in letter b) will, to a small degree, be influenced by the increased mobility of work. The fact that a person spends more time traveling and/or cannot return home due to COVID-19 restrictions will, to a small extent, influence where a person has their permanent home or centre of vital interest. Travel restrictions due to the COVID-19 pandemic or other extraordinary circumstance are most likely not permanent enough to influence the "permanent home" and/or "centre of vital interest". A similar view is put forward in the OECD updated guidance on tax treaties and the impact of the COVID-19 pandemic from 21 January 2021.<sup>8</sup>

In the author's view, a highly mobile lifestyle in which people are traveling more, both for business and leisure, will not impact the criteria laid down in article 4(2). A "permanent home", the "centre of vital interests" and the "habitual abode" will not change due to travel activities even if the travel activities are intensive and/or for longer periods. However, this might be different if the travel restrictions follow from, for example, a war. In such situation, the restriction may be relatively long/permanent and might influence where a taxpayer has their permanent home and/or centre of vital interest.

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8. Updated guidance on tax treaties and the impact of the COVID-19 pandemic - OECD (oecd-ilibrary.org) (accessed 13 June 2022) [hereinafter OECD Updated Guidance].

### 23.2.3. Article 4(3) of the OECD Model – Companies

For *companies*, the increased mobility of work, including travel restrictions, may – in the author’s view – more easily (than for individuals) influence the country of residence under article 4(3) of the OECD Model. To the author’s knowledge, there have not been any cases in Norway regarding whether the COVID-19 pandemic and potential travel restrictions have influence on the question of tax residency under a tax treaty, neither in the tax authorities nor the Court.

However, due to the inertia in the system, it is not unlikely that we will see some cases related to the COVID-19 pandemic and the question of residency in the near future in Norway (it normally takes 2-3 years from the fiscal year at discussion before the cases start running and become public). If one examines the OECD Commentary on Article 4(24)(1), it is evident that the increased and/or decreased mobility of work – both because of the COVID-19 pandemic and other extraordinary situations – as well as business are becoming increasingly international, which more often will trigger the question of tax residency.

Competent authorities having to apply paragraph 3 would be expected to take account of various factors, such as where the meetings of the person’s board of directors or equivalent body are usually held, where the chief executive officer and other senior executives usually carry on their activities, where the senior day-to-day management of the person is carried on, where the person’s headquarters are located, which country’s laws govern the legal status of the person, where its accounting records are kept, whether determining that the legal person is a resident of one of the Contracting States but not of the other for the purpose of the Convention would carry the risk of an improper use of the provisions of the Convention etc. Countries that consider that the competent authorities should not be given the discretion to solve such cases of dual residence without an indication of the factors to be used for that purpose may want to supplement the provision to refer to these or other factors that they consider relevant.

As seen from the Commentaries, people moving and residing across borders may influence where a company is tax resident. However, it is also important to take into consideration the comments from the OECD on 21 January 2021, whereby the OECD in brief argues that the extraordinary circumstances under the COVID-19 pandemic should not influence the question of where a dual resident company is tax resident for treaty purposes. The main argument is that the temporality of the COVID-19 pandemic should not impact the overall evaluation stated in the OECD Commentary on Article 5(24)(1) mentioned previously.

In a more permanent situation, where the board members of a corporation for example decide to move to another country, the tiebreaker clause and the overall evaluation that follows from article 4(3) of the OECD Model and its Commentary may, in some situations, entail that the company changes its tax residency. Under the pre-2017 OECD Model, the place of effective management will be the only criterion used to determine the residence of a dual resident entity for tax treaty purposes. Further, according to OECD Commentary on Article 4(24) (2014), the place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are (in substance) made. All relevant facts and circumstances must be examined to determine the place of effective management. Under the OECD Model (2017), the movement of the board of directors to another country will most likely not influence the residence of the company since the tax residency should be determined by an overall evaluation, in which the tax residency of the board members of the company is only one of several other factors to be taken into consideration.

In conclusion, an entity's place of residence under the tiebreaker provision included in a tax treaty is unlikely to be impacted by the fact that the individuals participating in the management and decision-making of an entity cannot travel because of public health measures imposed or recommended by at least one of the governments of the contracting states involved. However, in the extreme, if all employees work from home in another jurisdiction than the one in which the company is established and the corporation no longer has a sufficient workplace in the country where it is tax resident, it is arguable that the corporation does not meet the substance requirements under the tax treaty and is not entitled to treaty benefits.

As argued previously, the mobility of work may influence both the tax residency on individuals and companies. Hence, an important question in relation to this is whether countries can track where an individual spend their time. It might, for example, be that key personnel splits their time between mobile work and the remaining time in their home country. In the author's view, this is difficult, and with a system based on counting days and tracking where individuals are present, there will be a system with great surveillance. The practical difficulties with tracking individuals are maybe good arguments for putting less value to where individuals are spending their time. If one examines the recent work by the OECD regarding base erosion and

profit shifting (BEPS) 2.0 and the two-pillar system, especially Pillar One, the physical presence is of less importance.<sup>9</sup>

### **23.3. Permanent establishments and mobility of work**

#### **23.3.1. Introduction**

Although the OECD is working on BEPS 2.0, it is not dealing directly with the issues related to mobility of work. However, if the rules suggested under both Pillar One and Pillar Two are adopted in the near future, it might be that some of the issues in relation to permanent establishments will be solved. However, until the new rules are implemented,<sup>10</sup> the issues regarding whether an activity in another country may create a permanent establishment (cf. article 5 of the OECD Model) – and, thus, tax liability to the country of the permanent establishment – are still highly relevant. Further, the increased mobility of work in the future will most likely affect the discussion on the outlook of the PE concept. Both people and businesses are more flexible and more internationally oriented, and this will unsurprisingly affect the discussion of the creation of a permanent establishment.

#### **23.3.2. Home office**

If an individual works from home – not only temporarily – the home office may be considered to have a certain degree of permanence. Thus, the question arises of under what circumstances does the home office constitute a fixed place of business (and a permanent establishment) for tax treaty purposes? In the OECD Commentary on Article 5(18) and (19), the question of whether a home office may create a permanent establishment is commented. In brief, an individual's home office will not automatically lead to a permanent establishment. Further, a home office will often not create a permanent establishment because the home office will be so intermittent or incidental that the home will not be considered to be a location at the disposal of the enterprise. In addition, the activity that takes place in the home office will often be merely auxiliary and will, therefore, fall within the exception of article 5(4) of the OECD Model, as follows:

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9. See OECD, *Addressing the Tax Challenges of the Digital Economy – Action 1: 2015 Final Report* (OECD 2015), Primary Sources IBFD.

10. The author believes that it will take several years before the full effects of OECD BEPS Pillar One and Pillar Two are seen around the world. Hence, the PE issues are still relevant for many years.



Whether or not a home office constitutes a location at the disposal of the enterprise will depend on the facts and circumstances of each case. In many cases, the carrying on of business activities at the home of an individual (e.g. an employee) will be so intermittent or incidental that the home will not be considered to be a location at the disposal of the enterprise (see paragraph 12 above). Where, however, 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.

(...) Also, the activities carried on at a home office will often be merely auxiliary and will therefore fall within the exception of paragraph 4.<sup>11</sup>

The use of a home office is especially commented in the updated guidance on tax treaties and the impact of the COVID-19 pandemic from 2021. In paragraph 16, the OECD holds:

[T]he extraordinary nature of the COVID-19 pandemic, teleworking from home (i.e. the home office) because of an extraordinary event or public health measures imposed or recommended by government would not create a PE for the business/employer, either because such activity lacks a sufficient degree of permanency or continuity or because the home office is not at the disposal of the enterprise.<sup>12</sup>

Further, the OECD maintains:

If an individual continues to work from home after the cessation of the public health measures imposed or recommended by government, the home office may be considered to have certain degree of permanence. However, that change alone will not necessarily result in the home office giving rise to a fixed place of business PE.<sup>13</sup>

When comparing the 2017 Commentary with the updated COVID-19 pandemic commentary from 2021, the consideration and evaluation of whether a home office creates a permanent establishment under article 5 of the OECD Model is still the same. The evaluation is based on an overall assessment in which the key question is whether the home office is at the disposal of the enterprise (following this permanent change to the individual's working arrangements). To the extent that the employee or other key personnel of

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11. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 5* paras. 18 and 19 (23 Nov. 2017), Treaties & Models IBFD.

12. OECD Updated Guidance, *supra* n. 8, at para. 16.

13. *Id.*, at para. 17.

the company are working from a flex office<sup>14</sup> rather than a home office, the office space will more easily (compared to a home office) be considered at the disposal of the company. Thus, the flex office may constitute a permanent establishment under article 5.

To the author's knowledge, there are no ongoing cases with the Norwegian tax authorities and/or the court system regarding these issues. However, as pointed out previously, as Norway is an OECD member country, the Norwegian tax authorities will most likely follow the OECD guidelines – both the 2017 OECD Commentary and the 2021 COVID-19 updated guidelines.

### 23.3.3. Service PE

Both the OECD Commentary (Article 5, paragraph 132 et seq.) and the UN Model contain rules for a service PE. In Norway, there are no specific domestic rules when it comes to “service PE”. Concerning the question of whether services provided in Norway for a non-resident company must be determined under the general rule for taxation of non-resident entities (section 2-3(1)(b) of the NTA), “wealth in, and income from, business activities in which he, she or it is engaged or participates, and which take place in this country or are managed from this country, including business activities in which employees are made available to others in Norway”.<sup>15</sup>

Hence, there is no requirement regarding physical presence under the domestic NTA for a non-resident entity to be liable to tax in Norway. The question is more whether or not the activity of the business takes place in Norway, i.e. whether (some of) the income has sufficient nexus to Norway to be taxable in Norway. Physical presence in Norway is only one of several factors to take into consideration. Thus, the fact that the employees are partly working from their home offices and business meetings take place digitally is not decisive under the NTA. But of course, where the employees are carrying out the work may, in some situations, be the deciding factor and creates tax liability to Norway.

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14. A flex office is a dedicated workspace that can be rented on flexible terms. Flex offices allow employees to have a private office space without being in the office building of the company/employer. Flex offices are more often than not found in coworking spaces, which include many business professionals within different fields.

15. Sec. 2-3(1)(b) NTA.

To the author's knowledge, there is very limited Norwegian case law regarding the relevance of a home office in relation to the question of whether a home office may create a permanent establishment under a tax treaty. However, there is one Supreme Court decision from 2009,<sup>16</sup> in which the taxpayer had a home office with facilities for meetings (unfortunately, there is no further information regarding the home office), and the tax authorities and taxpayers agreed that this was sufficient to create a permanent establishment under the tax treaty between Norway and Canada.

Because of the lack of guidelines from case law, the Norwegian tax authorities will most likely follow the OECD Commentary regarding whether a home office may create a permanent establishment in Norway. This also applies for the calculation of the 183-day "threshold" for an "ordinary" permanent establishment. In the overall evaluation of whether a non-resident entity will create a permanent establishment in Norway under the tax treaty, the tax authorities will most likely take into consideration the extraordinary circumstances that influence the days stayed in Norway. To the extent that extraordinary circumstances, to a small extent, impact the total days spent in Norway (i.e. the extraordinary circumstances influence the date of arrival and/or the date of departure), the author's impression is that the Norwegian tax authorities will disregard the extra days spent in Norway.

#### 23.3.4. Construction PE

The mobility of work, both because of the change of business environment more generally and extraordinary circumstances, will most likely change the way of taxing cross-border activities. BEPS 2.0 is an excellent example of this. The requirement for physical presence becomes less important (or, at least, not the only requirement for tax liability under article 7 of the OECD Model, cf. article 5).

However, to the extent that article 5(3) of the OECD Model will be upheld as it is, it is the author's impression that when there is a strict rule with an expressed 12-month threshold, the interpretation of the construction PE rule will be directly influenced by the increased mobility of work. It will be very difficult to interpret the 12-month threshold if the increased mobility of work should not influence the interpretation. Ideally, the construction PE rules should be amended to take this into consideration.

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16. NO: *Høyesterett* (Supreme Court), 12 Nov. 2009, Case no. HR-2009-2145-A (Rt. 2009, p. 1400).

It might be that with the increased internationalization in relation to how business is structured, including more dividing of the various activities performed under a contract, the increased mobility of work may – at least indirectly – affect the question of permanent establishment. For example, if supervisory activities are exercised outside of the state where the construction site is located, it might result in less activity taking place in the PE state and, thus, less income should be attributed to the permanent establishment. It might also be the situation that so much of the activity in the project takes place outside the PE state, that the activity in the PE state is not enough to create a permanent establishment.

This might, however, be different under extraordinary circumstances, such as the COVID-19 pandemic. As mentioned in section 23.1.4, the NTA implemented a temporary addition (for FY 2020 and 2021) to the general rule regarding tax liability for non-resident companies to Norway. For these 2 years, to the extent that a non-resident company performs activity in Norway which, under normal circumstances, would not have been performed in Norway – but the activity is performed in Norway due to the COVID-19 pandemic – the non-resident company is not liable to source taxation in Norway. If so, it does not matter if the activity creates a permanent establishment in Norway under a tax treaty since Norway will not use its right to tax under the current tax treaty (because of the temporary domestic legislation).

## **23.4. Physical presence according to articles 15(1) and 17 of the OECD Model**

### **23.4.1. Article 15(1) of the OECD Model**

Article 15(1) of the OECD Model allocates taxation rights exclusively to the state of residence, unless the employment *is exercised* in the other contracting state. As a starting point, this is a relatively easy and practical rule, but because of the increased internationalization of business, fragmentation of the tasks and increased mobility of work, the question of where the employment is exercised is not always so easy to determine. In the case of a home office, for example, is the activity always exercised in the state where the home office is located, or could it be argued that the activity is exercised in the country of the enterprise? Further, does it make a difference if the home office is imposed by government measures (e.g. COVID-19 prevention measures)?

These are all important and relevant questions both in relation to the COVID-19 pandemic, but also more in general. The use of the home office is becoming increasingly common and, after the pandemic, the new standards (at least in Norway) is 2 days working from home and 3 days at the office. Hence, the question of the relevance of the home office concerning article 15(1) of the OECD Model will be triggered more easily in the near future. To the author's knowledge, as of today, there have not been any cases in Norway regarding whether the work at a home office may, for treaty purposes, be considered work exercised in the other contracting state. However, after the pandemic, this issue may arise in Norway also.

A specific issue, which may arise in relation to the use of a home office in a situation regarding article 15 of the OECD Model, is the taxation of a severance payment (also often referred to as a "redundancy payment"). A severance payment is a payment that an employer is required (by law or contract) to make to an employee whose employment has been terminated. Such a payment is often – but not always – calculated by reference to the period of past employment with the employer. According to the OECD Commentary on Article 15(2)(7):

Absent facts and circumstances indicating otherwise, such a severance payment should be considered to be remuneration covered by the Article [OECD MC Art. 15] for the last 12 months of employment, allocated on a pro-rated basis to where the employment was exercised during that period; as such it constitutes remuneration derived from that employment for the purposes of the last sentence of paragraph 1.

Hence, the answer to where the severance payment should be taxed depends on where the ordinary salary has been taxed. As previously mentioned, the fact that an employee is entitled or obliged to work from a home office may influence where the ordinary salary can be taxed, which again will influence the taxation of severance payment. For other extraordinary payments, such as payments for damages, the tax treatment depends on what it is a payment for. To the extent that the payment is a compensation for a severance payment not received, the payment for damages should be treated as a severance payment. Contrarily, if the payment is more meant as punitive damages, the payment will most likely fall under article 21 of the OECD Model.

In extraordinary situations, such as the COVID-19 pandemic, several issues related to increased/decreased frequency of traveling may arise. For example, should "stranded workers" who – due to travel restrictions – are prevented from returning to their state of residence or the state where they usually exercise their employment be taxed in the state where they

are physically present? How should employees of a factory who work in one country and live in another be taxed when they cannot exercise their employment due to travel restrictions or public health measures?

The answers to these questions, and many other COVID-19-related issues, must be determined on a case-by-case basis. Often, there are domestic rules and/or practices which solve the issues (typically in the form of not taxing the income under domestic law and, thus, there will be no double taxation). However, there might also be situations in which there is no domestic solution to the issue. In these situations, the solution must be found by interpreting the applicable tax treaty. Under this interpretation, the object and purpose of the treaty are important. Further, in the author's view, under the interpretation of the applicable tax treaty, whether the extraordinary situation is relatively short (e.g. a few months) or more permanent should also be taken into consideration. The tax revenue on a few months' salaries should not be that important for either the residence state or the source state. Under such a case-by-case evaluation, a disadvantage is uncertainty for the taxpayer. However, if the application of the tax treaty in these extraordinary situations entails a more lenient application/interpretation of the treaty, the taxpayer may live with the uncertainty.

#### 23.4.2. Article 17 of the OECD Model

For top artists and athletes, cross-border tax issues may easily arise. For example, if an athlete does the training in one state but competes in another state, which country is entitled to tax the income of the athlete? According to article 17(1) of the OECD Model, "income derived by a resident of a Contracting State as an entertainer, such as a theatre, motion picture, radio or television artiste, or a musician, or as a sportsperson, from that resident's personal activities as such exercised in the other Contracting State, may be taxed in that other State".

If it is assumed that the residence state of an athlete applies a worldwide income taxation principle and that the athlete receives all their income from prize money earned in the other contracting state(s), both the source state and the residence state may tax the income. However, the residence state must grant a foreign tax credit for taxes paid in the source state/the state where the sport competition has taken place. Hence, if the tax rate in the source state is equal to or higher than the residence state, the latter will not receive any tax revenue on the income of the athlete.

It may be questioned whether this is fair to the residence state. Much of the basis for the income (i.e. the training) is done in the residence state, but no tax revenue will be due to the residence state. It may be argued that the source state (the state where the competition takes place) should not be entitled to tax all the prize money, but only a share of it. A more typical situation is probably where the athlete, in addition to the prize money, also has some basic income during the year. This could be various forms of sponsorships, etc. where part of the amount is fixed and part is calculated based on results. In this situation, a suggested solution can be found in Example 2 of the OECD Commentary on Article 17(9)(3):

A cyclist is employed by a team. Under his employment contract, he is required to travel with the team, appear in some public press conferences organised by the team and participate in training activities and races that take place in different countries. He is paid a fixed annual salary plus bonuses based on his results in particular races. In that case, it would be reasonable to allocate the salary on the basis of the number of working days during which he is present in each State where his employment-related activities (e.g. travel, training, races, public appearances) are performed and to allocate the bonuses to where the relevant races took place.<sup>17</sup>

Hence, the taxing right to the fixed salaries/sponsorship of the athlete's income is shared between the residence state and the source state based on the number of days spent in the two contracting states.

In extraordinary situations, such as the COVID-19 pandemic, the days of traveling and performing for artists and athletes are often different from what is normal. The question arises whether this will (or should) influence the taxation of the income. Based on the OECD Commentary on Article 17(9)(3), the fact that the artist or athlete is not traveling – but staying in the residence state – entails that the income is taxed in the residence state only. The person has not stayed in the other contracting state and, thus, the other contracting state should not be entitled to tax the income. Contrarily, it may also be the situation that the person stays longer than normal in the other contracting state and, thus, the other contracting state will be entitled to tax a bigger share of the income than what would have been under normal conditions (i.e. counting days in the residence state and the other contracting state).

A final issue to be mentioned, which most likely will be increasingly relevant in the future, is the taxation of artists and athletes when the performance is livestreamed. To what extent should the country where the

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17. Para. 9.3 *OECD Commentary on Article 17*, Example 2.

performance is being watched/streamed be able to tax a part of the income of the artist (which is the payment from the audience)? This question is at the core of what BEPS 2.0 is dealing with (especially Pillar One) and will not be further analysed here.

## **23.5. Article 15(2) and (3) of the OECD Model**

### **23.5.1. Introduction**

Article 15(2) of the OECD Model contains a general exception to the rule in article 15(1) of the OECD Model. This exception applies to individuals rendering services in the course of an employment (sales representatives, construction workers, engineers, etc.), to the extent that their remuneration does not fall under the provisions of other articles in the OECD Model. The following three conditions must, however, be met for the remuneration to qualify for the exemption:

- the exemption is limited to the 183-day period, and it is further stipulated that this time period may not be exceeded “in any twelve month period commencing or ending in the fiscal year concerned”;
- the employer paying the remuneration must not be a resident of the state in which the employment is exercised; and
- if the employer has a permanent establishment in the state in which the employment is exercised, the exemption is given on the condition that the remuneration is not borne by that permanent establishment.

### **23.5.2. The 183-day limitation**

A relevant question to ask in relation to the 183-day limitation is how to count the days. This question is especially relevant today when there is an increased mobility of work, and it is increasingly common to spend working days in a home office. In general, the OECD Commentary highlights that there might be different ways of counting days, but there is only one way that is consistent with the wording of article 15(2) of the OECD Model: the “days of physical presence” method:

The application of this method is straightforward as the individual is either present in a country or he is not. The presence could also relatively easily be documented by the taxpayer when evidence is required by the tax authorities. Under this method the following days are included in the calculation: part of a day, day of arrival, day of departure and all other days spent inside the State of activity such as Saturdays and Sundays, national holidays, holidays before,



during and after the activity, short breaks (training, strikes, lock-out, delays in supplies), days of sickness (unless they prevent the individual from leaving and he would have otherwise qualified for the exemption) and death or sickness in the family.<sup>18</sup>

The principle of physical presence is an easily applicable principle that provides the taxpayer with predictability of its tax liabilities. By applying this principle, it also solves potential issues with increased home office use. One must simply consider where the person is physically located.

### 23.5.3. The employer paying the remuneration must not be a resident of the state in which the employment is exercised

The second requirement that must be fulfilled is that the remuneration is paid by, or on behalf of, an employer that is not a resident of the state where the employment is exercised. In some rare situations, it may be the situation that the employer changes its tax residency because of increased mobility of work, including most of the employees are working from home. In these situations, the question arises whether article 15(2) of the OECD Model still applies.

In the author's view, the wording in article 15(2) of the OECD Model is straightforward and clear. All three requirements must be fulfilled for the exemption to apply. Hence, if one of the requirements are not met, the exemption does not apply. Further, it is also important to have in mind that OECD MC Art. 15 (2) is an exemption, and we should be careful with an expanding interpreting of exemptions.

### 23.5.4. Permanent establishment

The third and final requirement for the exemption in article 15(2) of the OECD Model to apply is that the remuneration is not borne by a permanent establishment that the employer has in the other state. In relation to the increased mobility of work (including increased use of home offices) and the internationalization of businesses, the activity in the source state may create a permanent establishment in that state. If the remuneration to the

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18. Para. 5 *OECD Commentary on Article 15*.

employee is borne by/allocated to the permanent establishment, the exemption in article 15(2) of the OECD Model is not applicable.

However, as mentioned previously, in the author's view, we should be careful to expand any exemptions from the main rule. Further, the fact that we are talking about expanding an exemption, and that it is only in rare situations in which the increased use of home offices may entail home offices creating a permanent establishment (cf. section 23.3.2.), the author is of the opinion that we should be very careful to interpret article 15(2)(c) of the OECD Model to be fulfilled in these situations.

### 23.5.5. Article 15(3) of the OECD Model

Article 15(3) of the OECD Model follows a different concept, compared to article 15(1) and (2) of the OECD Model, for employees working in international traffic:

[R]emuneration derived by a resident of a Contracting State in respect of an employment, as a member of the regular complement of a ship or aircraft, that is exercised aboard a ship or aircraft operated in international traffic, other than aboard a ship or aircraft operated solely within the other Contracting State, shall be taxable only in the first-mentioned State.

It is interesting to question whether the concept applied in article 15(3) could be a better alternative than the concept applied in article 15(1) and (2). Under article 15(3), the remuneration is taxable in the residence state only, unless the employee solely stays in (and performs work) the other contracting state. This is a relatively simple and straightforward rule, which provides ease for both the taxpayer and the tax authorities to apply. Hence, this concept keeps the compliance cost low.

However, a disadvantage with such concept is that it is relatively easy to abuse. When there is a "solely" requirement, it is relatively easy to hinder taxation in the source state. If only a minor part of the work is performed in the residence state, the source state may not tax the remuneration at all (only the residence state may tax). With more use of home offices, the concept applied in article 15(3) of the OECD Model will, in fact, in many cases result in resident taxation of the remuneration.

## 23.6. Frontier workers

Contrary to the OECD Model, some bilateral tax treaties contain specific rules for the taxation of frontier workers. These rules normally require daily return to the state of residence. The increased mobility of work, such as increased use of home office, and travel restriction due to extraordinary circumstances may trigger some interesting questions when interpreting these frontier worker rules.

Norway has an onshore border with Russia, Finland and Sweden. There is no specific regulation of frontier workers in the tax treaty with Russia. In the Nordic tax treaty, however, there are specific regulation for frontier workers between Norway and Sweden and Norway and Finland.<sup>19</sup> The specific regulation of frontier workers is included in section VI of the Protocol to the treaty:

With reference to Articles 15 and 19

Notwithstanding the provisions of paragraphs 1 and 2 of Article 15 and paragraph 1 of Article 19, income derived by a resident of a municipality in *Finland or Norway* which borders upon the land frontier between these States, in respect of work performed in such a municipality situated in the other of these States, shall be taxable only in the State of which the person in question is a resident, provided that such person is regularly present at his permanent address in that State.

(...)

Notwithstanding the provisions of paragraphs 1 and 2 of Article 15 and paragraph 1 of Article 19, income derived by a resident of a municipality in *Norway or Sweden* which borders upon the land frontier between these States, in respect of work performed in such a municipality situated in the other of these States, shall be taxable only in the State of which the person in question is a resident, provided that such person is regularly present at his permanent address in that State.

The expression “is regularly present” means that the taxpayer is normally present at least once every week at his permanent address in the Contracting State of which he is a resident. In order for the taxpayer to be deemed to be present at his permanent address, his presence in the State of which he is a resident

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19. The Nordic tax treaty is a multilateral tax treaty between the five Nordic countries: Iceland, Denmark, Finland, Norway and Sweden. The Nordic tax treaty is however based on the OECD Model.

must comprise at least 2 days. In this connection, as in any other place where the term “day” is used in this Convention, “day” also means part of a day.<sup>20</sup> [Emphasis added.]

The frontier worker rules in the Nordic tax treaty are relatively straightforward. It is the place of residence of the employee that may tax the income of the employee. The state of the employer may not tax.<sup>21</sup> Hence, more use of, for example, home offices does not create any difficulties and/or changes to the current rules. However, what might create difficulties – although the author does not find it very practical – is if the increased mobility of workers entails the employee spending so much time in the country of the employer that the employee becomes tax resident under domestic rules in that country. However, under the tiebreaker rule in the tax treaty, the employee will most likely still become tax treaty resident in the original residence state (i.e. the other state than the state of the employer). The permanent home and the centre of vital interest is not changed. *See* section 23.1.3. regarding this issue.

It may be questioned whether the frontier worker rules have played their role due to the increased mobility of work. In the author’s view, the question is more the opposite. The more employees are traveling, and the more international the work becomes, the more important it is to have easy practical rules for determining which country may tax the employment income. A rule such as the frontier work rule in the Nordic tax treaty (cf. previously in this section) is easy to practice. It is the residence country of the employee that may tax the income.

### **23.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)**

During the pandemic, for tax treaty purposes, some governments deemed that employees – although working from a home office in the state of residence – were still exercising their activities in their previous state of activity. Further, some governments also assumed that – through the home office – no permanent establishment was constituted, except for the time period of the pandemic. It may be questioned whether there is legal basis for these two lines of applying the tax treaty. The answer to this question must be

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20. [https://www.regjeringen.no/contentassets/24bd8e3ac9b44651804beca5dcdbd4472/den\\_nordiske\\_skatteavtalen\\_innarbeidet\\_versjon.pdf](https://www.regjeringen.no/contentassets/24bd8e3ac9b44651804beca5dcdbd4472/den_nordiske_skatteavtalen_innarbeidet_versjon.pdf) (accessed 19 Dec. 2022).

21. *See* Skatte-ABC, available at <https://www.skatteetaten.no/rettskilder/type/handboker/skatte-abc/2021/utland--grensegjengere/U-12.004/U-12.005/> (11 Mar. 2024).

differentiated between the situation where the contracting state that applies the tax treaty in this way is (i) the source state; and (ii) the residence state.

To the extent that the contracting state is the source state (i.e. the PE state), the tax treaty only provides the contracting state with a right to tax – and no obligation. Hence, it is up to the legislator (and the tax authorities) in the PE state whether they would like to tax the income from the permanent establishment (or what should have been a permanent establishment if the tax treaty were interpreted in a normal way). Norway is an example of a country with this view. To the extent that the tax liability to Norway is due to the COVID-19 pandemic travel restriction, the temporary rules for FY 2020 and 2021 entails that the company will not be liable to tax in Norway anyway. However, please note that this temporary rule follows under domestic law and, thus, says nothing about how to interpret the PE provision in a tax treaty. But as long as there is no taxation of the potential permanent establishment under domestic law, it is not necessary to look into the treaty and consider whether the tax treaty restricts domestic taxation.

For the residence state, however, this is different. To the extent that the activity in the PE state normally creates a permanent establishment, but the resident state does not accept this interpretation – and thus does not provide for elimination of double taxation according to the treaty – cf. article 23 of the OECD Model, it would result in a treaty override by the residence state. However, to the extent that the contracting state concludes a mutual agreement or a consultation agreement, the answer is quite different. In such a situation, there is no treaty override for the residence state to disregard a permanent establishment in the other state. To the author's knowledge, Norway has not entered into such mutual agreements or consultation agreements.

### **23.8. The future of the mobility of work: A need for adjusting the existing treaty rules?**

An important question today is whether the existing tax treaty rules still make sense in an environment of increased mobility of work. Should we still rely on the current treaty rules, or should we aim for rules where the “new way” of working and doing business are taken into consideration? Answering this question is difficult and there are, in the author's view, no right or wrong answers. Further, the answer probably also depends on how the current rules are interpreted. Although there are some flexibilities in the current rules, many of them are based on physical presence and number of days, etc. Such rules are, in the author's view, not appropriate in a situation

where there is an increase in the mobility of work and the internationalization and fragmentation of business are increasing rapidly.

For taxation of individuals, the OECD Model has mainly either residence taxation or source taxation rules. Where there is an increase in the mobility of work and the internationalization and fragmentation of business are increasing rapidly, it will become more difficult to have “either/or” rules. An alternative to “either/or” rules are those where the taxing right is shared between the contracting states in the tax treaty based on, for example, an apportionment of income according to the effective presence within a jurisdiction. Experience has, however, shown that it might be difficult to come to an agreement regarding the formula used in a formula apportionment method.<sup>22</sup> Further, it may be highlighted that the OECD, in general, is skeptical of formula apportionment, as seen in paragraphs 1.16-1.32 of the OECD Guidelines. According to paragraph 1.21, “OECD member countries do not accept these propositions and do not consider global formulary apportionment a realistic alternative to the arm’s length principle.”<sup>23</sup>

The author is, however, more positive towards the use of formula apportionment to sharing the taxing right between the contracting states. Through the BEPS 2.0 work, use of formula apportionment is becoming acceptable as an alternative to the arm’s length principle (or, at least, as a supplement to the arm’s length principle). Further, the formula apportionment method is often much easier to apply than the arm’s length principle. Easy practical rules are a great benefit both for the tax authorities and the taxpayer (i.e. it will reduce the compliance costs both for the tax authorities and the taxpayer).

The recent work by the OECD BEPS Project and the ongoing work in BEPS 2.0 are, in the author’s view, important steps in the right direction. The internationalization and digitalization of business are taken into consideration when drafting new rules for allocation of taxing rights between the contracting states in a tax treaty. As member of the OECD and the Inclusive Framework, Norway is actively taking part in the OECD BEPS Project. Internally in Norway, the discussion has mainly been focused on the implementation of Pillar One and Pillar Two.

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22. E.g. within the European Union, it has been difficult to come to an agreement on the formula to be used under the Common Consolidated Corporate Tax Base rules.

23. *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* para. 1.21 (24 Jan. 2022), Primary Sources IBFD.

Before the OECD launched Pillar One and Pillar Two, it was a discussion of whether Norway should implement a digital services tax.<sup>24</sup> However, the official view from the Ministry of Finance, expressed by the Finance Minister, was that Norway should wait for the OECD and not implement domestic rules contrary to the OECD rules to come.<sup>25</sup> Domestic rules corresponding to the OECD Pillar Two Model Rules were implemented as from 1 January 2024.<sup>26</sup> Regarding the Pillar One, Norway is still waiting for the OECD proposed solution.

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24. <https://www.stortinget.no/nn/Saker-og-publikasjoner/Saker/Sak/?p=70308> (accessed 19 Dec. 2022).

25. <https://e24.no/naeringsliv/i/50WqxO/siv-jensen-google-skatten-er-ikke-nok> (accessed 19 Dec. 2022).

26. NO: *Lov om suppleringskatt på underbeskattet inntekt i konsern (suppleringskatteloven)*, 12 Jan. 2024, no. 1 (with effect from 1 Jan. 2024).





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## Chapter 24

### The Impact of Tax Treaties on International Mobility of Work in Portugal

Marisa Ouro

#### 24.1. Mobility of work and domestic tax law

##### 24.1.1. Mobility of work and taxation

Portugal taxes an individual's income based on the Individual Income Tax Code (IRS Code).

The IRS Code makes a distinction between:

- residents, who are subject to taxation on the total amount of their income, including the income obtained abroad (article 15(1)); and
- non-residents, whose subjection only includes income sourced within Portuguese territory (article 15(2)).

As a general rule, an individual is a resident if:

- (1) they are present in Portugal for more than 183 days, consecutive or otherwise, in any 12-month period starting or ending in the calendar year concerned;
- (2) they have been present in Portugal for a shorter period but have, on any day during the period mentioned in (1), a home under circumstances which imply their intention to keep and occupy such abode as a habitual residence;
- (3) they are, on 31 December of any year, a crew member of a ship or aircraft operated by a resident entity; or
- (4) they are performing public functions or commissions for the Portuguese state.

The OECD Secretariat published a note on 3 April 2020<sup>1</sup> (updated on 21 January 2021<sup>2</sup>), addressing the impact of the COVID-19 crisis on tax treaties (OECD Secretariat note). Accordingly, if a person becomes a

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1. OECD, *OECD Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis* (OECD 2020) [hereinafter OECD Secretariat note].

2. OECD, *Updated Guidance on Tax Treaties and the Impact of the COVID-19 Crisis* (OECD 2021).

resident under domestic legislation and a tax treaty is applicable, a temporary dislocation should have no tax implications in most cases.<sup>3</sup> The Portuguese tax authorities did not release any guidance following the note published by the OECD Secretariat. The rules in place do not consider whether one is forced to stay in Portuguese territory, including travel restrictions or limitations for office use. Thus, if employees reach the threshold of more than 183 days in Portugal, they may be subject to personal income tax (PIT) for their worldwide income under rule (1).

Workers with a high degree of mobility who want to apply for the non-habitual resident<sup>4</sup> (NHR) special tax regime do not need to spend more than 183 days in Portuguese territory in a given year. Under rule (2), it is sufficient to have a dwelling under circumstances which imply the intention to keep and occupy such abode as the habitual residence. The legislator did not specify which conditions fulfil the criterion of intention to occupy as a permanent residence.<sup>5</sup> Some authors<sup>6</sup> have criticized this lack of definition as leading to legal uncertainty.

In relation to the concept of residence, Portuguese law is halfway between an objective notion, which is content with the simple corpus (i.e. mere presence), and a subjective notion that demands corpus and animus<sup>7</sup> (i.e. presence plus intention). In the author's opinion, both these criteria are sensible as they are both based on a person having a strong connection to the Portuguese state. However, the principle of equality demands that any

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3. Id., at paras. 40-41. Different from the initial version (2020), the updated version (2021) opens the door to the possibility of someone being considered a resident due to a temporary dislocation.

4. PT: Individual Income Tax Code, arts. 16(8)-(9) and 81(4)-(5) [hereinafter IRS Code]. Workers eligible for NHR can benefit from a special 20% flat rate on employment income sourced in Portuguese territory arising from high added-value activities of a scientific, artistic or technical nature for a period of 10 consecutive years. In the case of a taxpayer with income from employment and self-employment obtained abroad, the exemption method from taxation applies if the criteria from arts. 81(4) and (5) of the IRS Code are met.

5. On this topic PT: Tax Arbitration Tribunal (CAAD), 27 Oct. 2017, Processo nº 214/2017-T, states as follow: "The intention to keep and occupy a given dwelling as a habitual residence must be reconstructed on the basis of objective elements that clearly presuppose the individual's will."

6. See P. Roma, *Residência Fiscal Parcial Em IRS* pp. 142-143 (Almedina 2018); and S.E. Gonçalves, *Residência Fiscal Em IRS*, 8 Cadernos de Justiça Tributária 1, p. 24 (2015).

7. See A. Xavier, *Direito Tributário Internacional* p. 285 (2nd ed., Almedina 2020); and H.G. Magno, *A Residência Fiscal Das Pessoas Singulares* pp. 60-61 (Vida Económica 2019).

intention must be evidenced by proven objective facts rather than being a simple subjective feeling, absent any other evidence.<sup>8</sup>

#### 24.1.2. Exit taxes, trailing taxes and extension of residence

Except in respect of expiry under the tax neutrality rules applicable to (i) merger, splitting and share-swap operations; and (ii) the contribution of assets to constitute the share capital of the company,<sup>9</sup> the general rule is that there are no exit taxes if an individual changes their residence to another country. Although, there is a trailing tax, which means that – disregarding the fact that Portuguese citizens have become residents in another state – such citizens are still subject to Portuguese tax during the year they left the country and for 4 years more.<sup>10</sup> This rule is applicable only while the taxpayers move their residence to a territory or region subject to a clearly more favourable tax regime included in a list approved by ministerial order of the member of government responsible for the tax area.<sup>11</sup> In this case, the author may argue that there is no connection with the Portuguese state besides nationality. However, the taxpayer may prove reasonable grounds to set aside this rule, for example, being seconded by their employer for performing a temporary activity.

In Portugal, the 2014 IRS reform introduced the partial residence concept, similar to the concept of a “split year” in the United Kingdom, to promote international mobility. The resident or non-resident status does not have to apply for the whole year. Thus, a given taxpayer may have two different residence statuses in the same year if the moment at which they come to reside in Portuguese territory or the moment at which they go to reside abroad does not coincide, respectively, with the beginning or end of the tax year. As Pereira<sup>12</sup> states, this regime aims to “achieve greater predictability of residence status, reduce the number of potential positive conflicts of tax

8. The author shares the opinion of A. Báez Moreno, *Unnecessary and Yet Harmful: Some Critical Remarks to the OECD Note on the Impact of the COVID-19 Crisis on Tax Treaties*, 48 *Intertax* 8-9, sec. 2 (2020) when he says that: “This author has always been in opposition of taking into account ‘intentional’ elements in the construction or interpretation of tax concepts. This ultimately undermines the objective criteria upon which equality should be based in tax matters (ability to pay and/or benefit principle).”

9. See arts. 10.º-A(1) and 38.º IRS Code.

10. Art. 16(6) *id.*

11. Art. 16(7) *id.*; and PT: Ministerial Order n.º 150/2004 of 13 February issued by the Portuguese Ministry of Finance and subsequently updated.

12. P.R. Pereira, *Reforma Do IRS: Mobilidade Internacional e Residência Fiscal Parcial*, in *Temas de Direito Tributário IRC, IVA e IRS* sec. 3 (Centro de Estudos Judiciários 2016).

residence with other states and limit situations of possible international juridical double taxation to the period of the person's effective residence in Portuguese territory – thus contributing to the safeguarding of adequate conditions for the international mobility of taxpayers”.

However, the law also provides for several cases of residence extension, considering the taxpayer resident for the whole year instead of a partial resident. This regards cases in which (i) the taxpayer was already considered resident on any day of the previous year;<sup>13</sup> or (ii) they acquired the resident status during the year following the one in which they lost Portuguese residence.<sup>14</sup> After being in Portuguese territory for more than 183 days, if a taxpayer leaves and, in the same year, obtains any income that would be considered subject to Portuguese tax had they been a resident, they are also considered to be a resident for the whole year.<sup>15</sup> As Roma<sup>16</sup> states, all these residence extension rules may give rise to situations of double tax residence, contrary to the objective of promoting international mobility.

### 24.1.3. Residence of the management board members and residence of the corporation

The change of residence of the management board members from Portugal to another country or the fact that they may live and work in different countries may not impact a corporation's Portuguese tax residence. This is a result of the Portuguese corporate tax residence test being a mitigated real seat theory,<sup>17</sup> which requires either incorporation or place of effective management (PoEM) as relevant factors for tax corporate tax residence. In other words, for a corporation to lose its Portuguese tax residence, it must transfer both its statutory seat and its PoEM.<sup>18</sup>

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13. See art. 16(3) IRS Code.

14. See art. 16(16) id.

15. See art. 16(14) id. Para. 15 of the same article excludes the rule of para. 14 if a similar tax taxes the person in another EU Member State and with which there is an exchange of information or, in the case of another state, the tax rate applicable to that income is not less than 60% of that which would be applicable if they maintained their residence in Portuguese territory.

16. Roma, *supra* n. 6, at p. 185.

17. See M. dos Prazeres Rito Lousa, *Chapter 19: Portugal*, in *Corporate Tax Residence and Mobility* sec. 19.1.2 (E. Edoardo Traversa ed., IBFD 2019), Books IBFD.

18. Id., at sec. 19.1.3.1.

The concept of PoEM is not defined in Portuguese law. Xavier<sup>19</sup> explains that the concept of PoEM adopted is the “place where the company’s management and supervisory bodies are concentrated and function, considered in its universality”. Prazeres Lousa<sup>20</sup> states that besides the place where the board of directors meets, “the place in which the main day-to-day management decisions are taken and executed” should also be considered. This opinion, with which the author agrees, takes into account the recent development of communication technology and the mobility of business executives, which means that an update to the interpretation of PoEM (as Prazeres Lousa explains) is required.

According to article 83 of the Corporate Income Tax Code (IRC Code), the corporation is subject to an exit tax if it changes its PoEM and statutory seat. That is, even if there is no PoEM in Portugal, but the corporation has its statutory seat in Portuguese territory, it will not trigger an exit tax. On the other hand, it is enough for a corporation to move its statutory seat or PoEM for Portuguese tax residence rules to apply.

#### 24.1.4. Influence of working from home in the substance requirements of the company

On 22 December 2021, the European Commission presented a proposal for a directive<sup>21</sup> laying down rules to prevent the misuse of shell entities for tax purposes. In the scenario where a corporation permits its employees to work from home, it may be asked if the company meets the substance requirements. In Portugal, there are no substance requirement rules yet. The lack of substance is addressed by a specific or general anti-abuse rule. The concept of “economic substance” has not been defined or clarified under national legislation or case law.

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19. See Xavier, *supra* n. 7, at p. 289. See also F.S. da Câmara, *A Dupla Residência Das Sociedades à Luz Das Convenções de Dupla Tributação*, in *Planeamento e Concorrência Fiscal Internacional* pp. 248-251 (Fisco 2003).

20. Prazeres Lousa, *supra* n. 17, at sec. 19.1.3.1.

21. European Commission, Proposal for a Council Directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU (22 Dec. 2021).

### 24.1.5. Home office as a permanent establishment

Article 5 of the IRC Code lists the situations in which a permanent establishment (PE) is deemed to exist. In the light of this article, we can analyse whether working from a home office for a foreign company constitutes a PE from three perspectives:

- (1) any fixed installation through which a commercial, industrial or agricultural activity is exercised (fixed place of business);
- (2) a service PE; or
- (3) a dependent agent.

Various rulings issued by the Portuguese tax authorities follow closely the Commentary on Article 5 of the OECD Model. Until now, and to the author's best knowledge, the hypothesis that a home office constitutes a fixed place of business has not been subject to analysis by the Portuguese tax authorities. In the author's opinion, the home office can constitute a fixed place of business in Portugal. In light of current labour legislation,<sup>22</sup> there is a series of rights and duties of the employer that leads to the conclusion that the home office is at the disposal of the corporation, namely (i) the employer is responsible for providing the worker with the equipment and systems necessary for the work's performance and must pay additional costs, such as electricity and Internet, that the worker uses in their home office;<sup>23</sup> (ii) in compliance with the conditions laid down by law, the employer may visit the home of the employee to check on the work activity and the instruments of work;<sup>24</sup> and (iii) the employer is obliged to provide good working conditions, both from a physical and psychological point of view.<sup>25</sup> This situation applies whether the employer or the employee requested the home office because, in both cases, the parties must sign an agreement stipulating the place of work.

Regarding perspective (2) for having a PE in a home office, article 5(3) of the IRC Code was extended on 1 January 2021<sup>26</sup> by the inclusion of a paragraph c). According to this provision, an enterprise which has staff in Portugal (whether employees or sub-contractors) who carry out activities (including the provision of consulting services) in Portugal will have a PE, as long as those activities are carried out for more than 183 days in a 12-month period starting or ending in the relevant tax year.

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22. PT: Law 83/2021, of 6 December 2021.

23. Art. 168 id.

24. Art. 170(3) id.

25. Art. 170(1) id.

26. Due to PT: Law 75-B/2020, of 31 December 2020.

Regarding perspective (3), since 1 January 2021, a new paragraph 6 has been added to article 5 of the IRC Code, which follows the 2017 version of paragraph 5 of article 5 of the OECD Model very closely and has updated the notion of a dependent agent. As a result of (2) and (3), foreign corporations providing services within Portuguese territory with employees working from home in Portugal that do not have a fixed place of business, (1), may still have a PE in Portugal under these rules.

#### 24.1.6. Substance requirements based upon premises and mobile work

As seen in section 24.1.4., in Portugal, there are no substance requirement rules. In the author's opinion, the requirements of substance that refer to premises remain valuable in the context of increased mobile work patterns. What may be needed is to adapt this concept to mobile work situations. For example, in home office situations, installations are not available for the exclusive use of work activities. In those cases, the focus should be on proving that there is an effective and sufficient home office for the individual to properly function as per the role to be performed from the worker's house.

#### 24.1.7. Social security

Under Portuguese domestic law and EU Regulations,<sup>27</sup> the relevant criterion to define where to pay social security contributions is where the employee carries out the work. There is no alignment between social security law and the tax residence nexus in Portugal. Therefore, individuals working in Portugal should be subject to Portuguese social security contributions, regardless of their residence.

Portuguese social security authorities have issued the following guidelines regarding COVID-19,<sup>28</sup> in which they established exceptional and tempo-

27. Regulation (EC) No 883/2004 of the European Parliament and the Council of 29 April 2004 of the coordination of social security systems, OJ L 166/1 (2004), Primary Sources IBFD. *See also* Regulation (EC) No 987/2009 of the European Parliament and of the Council of 16 September 2009 laying down the procedure for implementing Regulation (EC) No 883/2004 on the coordination of social security systems, OJ L 284/1 (2009).

28. Director-General of Social Security, *Circular No 3 of 1 April 2020: COVID-19 - exceptional and temporary measures - application of Regulation (EC) Nos 883/2004 and 987/2009 - posted and cross-border workers*, available at [https://www.seg-social.pt/documents/10152/16921457/CIT\\_3\\_2020.pdf/48fbb5db-8acb-456c-9b19-ea405532a496](https://www.seg-social.pt/documents/10152/16921457/CIT_3_2020.pdf/48fbb5db-8acb-456c-9b19-ea405532a496) (accessed 24 July 2022) [hereinafter Director-General Circular].

rary measures concerning posted and cross-border workers: “Restrictions on free movement, as well as telework situations temporarily imposed as result of COVID-19 pandemic, should not entail changes to the legislation applicable to posted and cross-border workers.”

Furthermore, these guidelines<sup>29</sup> determined that in case of workers who carry out activities in two or more member states: “[I]f there are other circumstances that may entail a change in the applicable legislation, nothing prevents the employer or the self-employed worker from requesting an exception agreement under article 16 of Regulation (EC) No. 883/2004, under which, in the worker’s interest, they remain subject to the legislation that currently covers them.”

## **24.2. Residence, tiebreaker rules and mobility of work: Individuals and entities**

The number of remote workers has increased, partly driven by the pandemic. In 2018, according to Eurostat data,<sup>30</sup> the workforce in the European Union was comprised of 5.2% remote workers. By 2020, that percentage had risen to 12%. A report presented in 2020 by researchers from the Joint Research Centre<sup>31</sup> concludes that, when comparing the various sectors impacted by the COVID-19 crisis, the most significant proportion of workers with higher qualifications and wages is in sectors where teleworking is possible.

De la Feria and Maffini<sup>32</sup> predicted that remote working would (i) become a trend; (ii) have effects on the worker’s tax residence and; consequently, (iii) impact the countries’ tax revenues from individual income and social

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29. Id. The Portuguese guidelines followed European Commission, *Guidelines concerning the exercise of the free movement of workers during COVID-19 outbreak*, OJ CI 102/12 (30 Mar. 2020).

30. See European Commission, *Eurostat: Employed Persons Working from Home as a Percentage of the Total Employment, by Sex, Age and Professional Status (%)*, available at [https://ec.europa.eu/eurostat/databrowser/view/lfsa\\_ehomp/default/table?lang=en](https://ec.europa.eu/eurostat/databrowser/view/lfsa_ehomp/default/table?lang=en) (accessed 24 July 2022), which shows data from 27 EU Member States.

31. See European Commission, *The COVID Confinement Measures and EU Labour Markets* sec. 4.3 (2020), available at <https://data.europa.eu/doi/10.2760/079230> (accessed 24 July 2022). This report also points out, in sec. 5, that the most remarkable differences in the prevalence of telework are not by sectors but by countries, namely that telework is less prevalent in southern European countries. In turn, the countries with a lower prevalence of telework before the COVID-19 crisis are, according to the report, the ones hit hardest by the crisis.

32. R. de la Feria & G. Maffini, *The Impact of Digitalization on Personal Income Taxes*, British Tax Review 2 (2021).



security. They stated, and the author agrees, that a qualified and well-paid workforce in sectors where remote work is possible means that the employer's location is no longer an obstacle to where these workers will reside. This will necessarily impact countries' tax revenues because, although the number of individuals affected is not large, their incomes are high.

A highly mobile lifestyle may cause a growing number of taxpayers to fall outside the scope of the tiebreaker rules: they have no permanent home or habitual abode in any contracting state, and their personal and economic relations are not close enough with each state.<sup>33</sup> On the other hand, divergences of interpretation may be caused by the increase in individual mobility, which may also lead to an increasing number of dual-resident individuals and test the application of the "State with which his personal and economic relations are closer" (article 4(2)(a) of the OECD Model).<sup>34</sup> As Olivier<sup>35</sup> states: "Although Article 4(2) OECD has not undergone any major amendment since its introduction in 1963, there have been a lot of other changes which could have an impact on the way in which these tie-breaker criteria should be interpreted."

Portugal signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI).

33. See J.A. Jones et al., *Chapter 22 – Round Table: On the desirability to change Art. 4 OECD Model Convention and its Commentary*, in *Residence of Individuals under Tax Treaties and EC Law* sec. 22.1.2.2.4. (G. Maisto ed., IBFD 2010), Books IBFD. Le Gall refers to the difficulty of applying tiebreaker rules to wealthy individuals due to mobility: "Frequent, easy movement, means that localizing people in both their private and professional life is more and more difficult. In parallel, assets move more and more quickly and are less and less identifiable. All of these factors progressively render the traditional methods for determining the residence of individuals obsolete."

34. See P. Baker, *Chapter 8 – The Expression 'Centre of Vital Interests' in Art. 4(2) of the OECD Model Convention*, in *Residence of Individuals under Tax Treaties and EC Law* sec. 8.3.7. (G. Maisto ed., IBFD 2010), Books IBFD, which says: "Unquestionably, one of the most difficult issues relating to the application of the CVI concept is the relative weight to give to different factors. Most specifically, what is the position where an individual's person relations are closer with State A, while his economic relations are closer with State B? The experience of the author is that this is not an unusual situation." See also E. Reimer & A. Rust, *Klaus Vogel on Double Taxation Conventions*, vol. I, art. 4, paras. 89-105 (Wolters Kluwer 2022), which state that "determining an individual's residence status requires a highly factual analysis [and that] no abstract preference can be given to either relationships, which result is supported by the explicit wording of Article 4(2)(a) OECD and UN MC".

35. See T.B. Olivier, *Developments in the Analysis of the Tie-Breaker Rules for Individuals Under Article 4 (1) OECD*, 45 Intertax I, sec. I.2 (2017). This author also points out: "Apart from increases in mobility and globalization, there have also been developments in certain simple concepts, such as that of 'family', which, in light of civil unions, same sex marriages and cohabitation, is no longer construed in the same way as the past."

However, as regards dual resident entities and under article 4(3)(a) of the MLI, the Portuguese Republic reserves the right for the entirety of article 4 not to apply to its covered tax agreements (CTAs), as did most of the MLI signatory countries.<sup>36</sup> Regarding the tiebreaker clause in article 4(3) of the OECD Model, of the current 77 tax treaties that Portugal has in place, 68 apply the criterion of PoEM, following the practice of the majority of the OECD countries.<sup>37</sup>

Only a minority of Portuguese tax treaties establishes that the contracting states shall endeavour by mutual agreement to settle the question and determine the tax treaty's mode of application to such person. In the case of tax treaties with Canada, Chile, Japan, Peru and the United States, in the absence of such agreement, such person shall be considered not to be a resident of either contracting state for the purposes of enjoying benefits under the tax treaty.

The abuse of dual residence, with the development of new technologies and the mobility of people (particularly, the corporation's board members) may no longer be rare and can often be unintentional.<sup>38</sup> In this sense, the author agrees with Gerlach and Niemeyer<sup>39</sup> when they suggest: "An inclusion of further examples or guidelines in the Commentary to identify which arrangements should specifically be addressed by the new provision to fight tax avoidance by dual resident companies would had been helpful to tailor the scope of the MAP."

At a time when it is normal for an individual to divide their time between mobile work and remaining in their home country, it would be important for

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36. See C. Gerlach & N. Niemeyer, *The New Tie-Breaker-Rule for Companies According BEPS Action Point 6: A (Too) Radical Change?*, 46 Intertax 10, sec. 2.2. (2018), who state: "Only twenty-eight states of the seventy-eight signatories, thereof sixteen of the forty OECD states, opted for a general introduction of the MAP within their CTAs pursuant to Article 4 section 2 in conjunction with Article 4 section 4 and/or Article 4 section 3 e] MLI."

37. Id., at sec. 2.3.

38. See G. Maisto et al., *Dual Residence of Companies under Tax Treaties*, 1 International Tax Studies 1, sec. 5.2.3. (2018). This article gives several examples of situations in which unintended dual residency situations may occur and those that are intended but do not reflect a tax abusive intent. The article concludes as follows: "It is therefore too simplistic to draw the conclusion – as the OECD does – that dual residence reflects an abusive corporate conduct. The new article 4(3) of the OECD Model is likely to be less effective in tackling abusive situations than domestic law anti-abuse provisions and/or redundant in the presence of a treaty GAAR based on article 7(1) of the MLI or article 29(8) of the OECD Model."

39. Gerlach & Niemeyer, *supra* n. 36, at sec. 3.3.

states to adopt – at least at the level of tax treaties – a split-year treatment.<sup>40</sup> Portugal has such a clause in its tax treaty with Austria. Portugal also introduced a partial residence tax regime in 2014 (in force since the beginning of 2015) to reduce the number of potential double taxation conflicts (*see* section 24.1.2.).

### 24.3. Permanent establishments and mobility of work

If an individual works from home permanently, the home office may be considered to constitute a PE. A home office may fall under the PE rules of article 5 of the OECD Model if:

- the home office constitutes a fixed place of business under article 5(1) of the OECD Model; or
- the home office of an employee of a foreign enterprise may lead to a dependent agent under article 5(5) of the OECD Model.

To the author's best knowledge, there are no Portuguese court decisions that recognize the home office as a PE in any of those cases. Also, the Portuguese tax authorities did not issue any guidance about the constitution of a PE related to the COVID-19 situation. Paragraphs 18 and 19 of the Commentary on Article 5 of the OECD Model lead to a case-by-case solution. The Commentary explains that for the home office to be a fixed place of business, it must be used on a continuous basis and be at the disposal of the enterprise. It is also relevant if the employee insists on working at home and the enterprise has other places made available to them. For example, in the case of cross-border workers, in that situation, the home office would not be at the disposal of the enterprise.

Considering the relevant paragraphs of the Commentary, in the author's opinion, when the home office is imposed or recommended by the government in line with public health measures, it will have an intermittent or necessarily temporary usage. Therefore, it will not fulfil the requirements to be a fixed place of business. Conversely, in the case of a worker that insists on working in another country and the enterprise has no premises made available to them there – but agrees to pay for additional expenses incurred in working at home – the home office is at the disposal of the enterprise. Payment of those expenses can be considered a circumstance showing that

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40. *See* F. Pitrone, *Tax Residence of Individuals within the European Union: Finding New Solutions to Old Problems*, 8 World Tax J. 3, sec. 3.1.1. (2016). Pitrone suggests a directive that obliges each EU Member State to implement the split-year treatment.

the enterprise has agreed to the home office and provides it. Digital nomads pose a different situation since they can work from any location, many times in different co-working places worldwide. That is, the enterprise does not have a fixed place at its disposal. Therefore, in the author's opinion, a flex office cannot constitute a PE by way of a fixed place of business.<sup>41</sup>

Another possibility is an employee's home office of a foreign enterprise, leading to a dependent agent under article 5(5) of the OECD Model. The concept of the dependent agent is included in many Portuguese tax treaties and has been ever present in the model treaties since the initial League of Nations Model of 1928.<sup>42</sup> It is considered that where a person – other than an agent of an independent status – is acting on behalf of an enterprise and has, and habitually exercises, in a contracting state an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a PE in that state. The dependent agent may be an employee or even a self-employed person, provided that they are subject to detailed instructions or significant control by the company on whose behalf they are acting.

Another relevant question is whether work mobility affects the 12-month time limit contained in article 5(3) of the OECD Model. What happens if, for example, the exercise of supervisory activities is in a different state from the construction site? This question is even more critical when the tax treaty foresees a 6-month period, as is the case with 32 of the Portuguese tax treaties,<sup>43</sup> and which is also the relevant time limit specified in article 5(3)(a) of the IRC Code. Having regard to the provisions of paragraphs 54 and 55 of the Commentary on Article 5 of the OECD Model, a site exists from the date the contractor begins the work in the country where the construction is undertaken, and a construction site continues to exist until the work is completed. Moreover, temporary interruptions should be included in determining the life of a site. Because of this, it is the author's opinion that once the construction begins in the state of the construction site, then any supervisory

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41. That is not to establish a principle. The existence of a PE is a matter of fact and requires a case-by-case analysis, though in the previous scenario, it is most likely that it will not constitute a fixed place of business.

42. Art. 3 of the *League of Nations Draft Model Convention on Double Taxation and Tax Evasion* (Oct. 1928).

43. Portugal has made a reservation to art. 5(3) *OECD Model* (2017), saying: "Portugal reserves the right to treat an enterprise as having a permanent establishment in Portugal if the enterprise carries on an activity consisting of planning, supervising, consulting, any auxiliary work or any other activity in connection with a building site or construction or installation project lasting more than six months, if such activities or work also last more than six months."

activities exercised outside that state do not interrupt the calculation of the 12-month period.

The most crucial questions, in the author's opinion, are as follows: as residence is the primary way through which enterprises are liable to tax – and having a PE is an exception to that rule, which equates to something close to “source” – can mobile workers be considered a PE, thus changing the exception into the rule? Is the concept of PE designed to cover the increasingly common situations of mobile working? Will it eventually become the primary method by which income is taxed, as workers become ever more mobile? These issues indicate, in the author's view, that the mobility of work affects the discussion on the future of the PE concept.

#### **24.4. Physical presence according to articles 15(1) and 17 of the OECD Model**

Article 15(1) of the OECD Model allocates taxation rights exclusively to the state of residence, unless the employment is exercised in the other contracting state. In the case of the home office, an official ruling<sup>44</sup> was published by the Portuguese tax authorities. In it is mentioned that there is a well-established understanding which results in “the exclusive taxing power of Portugal when the work is being carried out in Portugal online, whereas the taxing power may be shared with regard to the period of stay in foreign territory”.

This position is based on a reading of the Commentary to the OECD Model (2008), in particular those relating to article 15 (employment), which states that a resident of a contracting state who receives remuneration (by way of employment) from sources situated in the other contracting state, but who does not exercise this employment in that other state, cannot be taxed there by way of that remuneration simply because the results of their work are exploited in that state.

In the absence of a tax treaty, Portuguese domestic law taxes employment income under the residence criteria, even if the employment is carried out in another state. It also taxes income obtained in Portuguese territory

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44. *Processo 7502/2020*, Order of 06/01/2021, of the Subdirector General of the area of IR Tax Management and International Relations (2021), available at [https://info.portaldasfinancas.gov.pt/pt/informacao\\_fiscal/informacoes\\_vinculativas/rendimento/DSRI/Documents/PIV\\_CDT\\_Portugal\\_Irlanda\\_varios.pdf](https://info.portaldasfinancas.gov.pt/pt/informacao_fiscal/informacoes_vinculativas/rendimento/DSRI/Documents/PIV_CDT_Portugal_Irlanda_varios.pdf) (accessed 24 July 2022).

by non-residents. Income – when from employment – is deemed to have been obtained in Portuguese territory if (i) it arises from activities carried out in Portuguese territory; or (ii) it is owed by entities that have their residence, head office, effective management or PE in Portugal, to which the payment is attributable (article 18(1)(a) of the IRS Code). Despite the note published by the OECD Secretariat, Portugal made no allowance for cases where the government imposed the home office as a preventive measure for COVID-19 cases.

As far as artists are concerned, article 17 of the OECD Model, as Tenore<sup>45</sup> says, “allows the State where the performance is held to levy a tax on the income related therefrom regardless of the duration of the performance ... is a performance-based provision ... places a decisive role on the place where the entertaining activity is physically exercised”. That is, artists may be taxed not only in the state where they practice or train but also in the state where they perform. Furthermore, as is stated in paragraph 9 of the Commentary on Article 17 of the OECD Model: “Payments received in the event of the cancellation of a performance are also outside the scope of article 17 and fall under article 7 or 15.”

Because article 17 makes a condition for taxation in the state where the shows are performed that the artist must be performing in person, this leads to a differentiation according to whether one is referring to online or offline performance. Therefore, persons who qualify as artists, according to article 17 of the OECD Model,<sup>46</sup> but exercise their performances on digital platforms do not fall under the scope of this article. In this regard, as Tenore<sup>47</sup> says, it is possible to draw a parallel with the debate that has been developing on the suitability of the PE concept in the context of digital activities.

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45. M. Tenore, *Esports and Tax: How the OECD Model Tax Convention Applies to Player's Income*, LawInSport (7 Sept. 2020), available at <https://www.lawinsport.com/topics/item/esports-and-tax-how-the-oecd-model-tax-convention-applies-to-players-income> (accessed 25 Apr. 2022).

46. See C. Marcello, *I'm Entertained, but Who's Doing the Entertaining? A Look at the International Tax Consequences for International "Entertainers"*, 28 *Tulane Journal of International & Comparative Law* 1 (2019), about the concept of what is entertaining: “The concept of what is entertaining has changed. People now watch videos of others playing and commenting videogames ... They search for their favorite ‘influencer’ suggestions on restaurants before going out to dinner. There is now an entertainment character in activities that were not as heavily present or did not exist years ago.”

47. Tenore, *supra* n. 45.

## 24.5. Article 15(2) and (3) of the OECD Model

As regards article 15(2), all of Portugal's tax treaties follow the wording of the OECD Model. In calculating the 183-day period, the method indicated in paragraph 5 of the Commentary on Article 15 of the OECD Model, i.e. the "days of physical presence" method, is to be followed. According to the provisions of the Commentary, under this method, one should include "days of sickness (unless they prevent the individual from leaving and he would otherwise have qualified for the exemption)".

As previously mentioned, Portugal has not taken any public position on the OECD Secretariat's note, nor has it disclosed any exceptional measures that are of a similar nature. Thus, taking only the provisions of the Commentary into account, it seems possible to argue that in cases where an employee is obliged to remain in Portugal (working from the home office) on the recommendation or imposition of the government in line with public health measures, those days do not count for the purposes of article 15(2) of the OECD Model (as they are akin to days of sickness that prevent a person from leaving a state and, as such, should be disregarded). Both the sickness situation envisaged in the Commentary and the public health measures situation are facts that prevent events from unfolding in their normal terms. Both are based on health issues affecting an individual's freedom of movement. To ensure a consistent interpretation of the counting of days and also the situations in which those days do not count for the purposes of article 15(2), one must apply this exception to the remaining subparagraphs. Thus, for example, if an employer has all its employees or board members situated in home offices in their states of residence due to public health restrictions recommended or imposed by the government, then – by that fact – the corporation's residence should not be challenged with respect to subparagraph b. For the same reason, an employee's home office cannot be considered to qualify as a PE in those situations.

Since 2017, paragraph 3 of article 15 of the OECD Model has adopted the principle of exclusive taxation in the employee's state of residence. In the Portuguese case, 46 of its tax treaties use the PoEM. Moreover, under the terms of article 16(1)(c) of the IRS Code, ship or aircraft crew members are resident in Portuguese territory if, on 31 December of any given year, they are at the service of an entity with its PoEM in Portuguese territory. Therefore, it can be concluded that – whether based on the new wording of article 15(3) or the previous wording – under Portuguese domestic law, the connection with the PoEM is maintained for the attribution of the employee's residence.

One might ask whether article 15(3) of the OECD Model provides for rules which could be discussed as an alternative to article 15(1) and (2) of the OECD Model. However, the fact is that international telework, provided via home office, already leads to many situations being attributed to the residence state. In this regard, Jesús Martos<sup>48</sup> considers that if the tax treaties wish to maintain the same allocation of the right to tax, it would be advisable to amend article 15 regarding teleworkers – as well as the relevant Commentary – so that, for these new forms of teleworking, the place where the person paying for the services is located or where the service is enjoyed should be established as the criterion for taxation. Furthermore, referring to article 15 of the OECD Model, Beretta<sup>49</sup> notes the following:

The current physical presence criterion of article 15(1) and (2) of the OECD Model is difficult to reconcile with the post-pandemic “work-from-anywhere” reality. Both the second and the third rule were conceived at a time when the physical presence of the employee was, arguably, the most reliable sourcing criterion to establish a strict connection with the work state. This assumption is no longer tenable in an age where international mobility of workers and remote work have taken hold.

The author’s opinion is that article 15 should reflect the growing existence of international remote workers who are physically present in one state (usually the state of residence) but employed by an enterprise carrying out its business in another state, meaning that the employee may be described as “virtually present” in the state of their employer. However, before making any changes, it is essential to clarify which connecting factors should be relevant for tax residence.<sup>50</sup>

## **24.6. Frontier workers**

The tax treaty between Portugal and Spain follows the OECD Model, namely article 15. As Portugal and Spain share a land border, article 15 of the Portugal-Spain Income Tax Treaty (1993) contains an additional

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48. J. Jesús Martos, *Criterios de Sujeción de Las Rentas Del Teletrabajo Internacional Residencia Fiscal y Doble Imposición Internacional*, 11 *Revista Iberoamericana de Relaciones Laborales* p. 187 (2001-2002).

49. G. Beretta, ‘*Work on the Move*’: *Rethinking Taxation of Labour Income under Tax Treaties*, 5 *Intl. Tax Stud.* 2, sec. 3.3 (2022), *Journal Articles & Opinion Pieces IBFD*.

50. See A. Cediel Serra, *Residencia Fiscal Virtual, Identidad Digital y Criptomoneda*, in *Documentos de Trabajo 6/2019 - Residencia Fiscal: Problemática y Cuestiones Actuales* (Instituto de Estudios Fiscales 2019), who mentions the crisis in the concept of tax residence and the possibility of establishing a single and universal digital identity that would establish the link between a state and an individual’s taxable income.



paragraph 4, which states: “Notwithstanding the provisions of paragraphs 1 and 2, remuneration earned from an employment exercised in a Contracting State by a frontier worker, that is, who has his habitual residence in the other Contracting State to which he normally returns each day, may be taxed only in that other State.”

In the case of a Portuguese cross-border worker who carries out their work online from a home office for an employer resident in Spain, Portuguese tax authorities consider this a case of online work. They apply article 15(1) of the tax treaty, giving the exclusive power to tax to the residence state (*see* section 24.4.). It is clear to the author that the rules regarding cross-border workers contained in article 15(4) of the Portugal-Spain treaty are not relevant to a worker delivering employment on one side of the border with their employer on the other side of the border. This is because the requirement to “return” to a habitual residence in the other state, which is necessary for paragraph 4 to apply, is not fulfilled.

Regarding COVID-19-related subsidies, the OECD Secretariat note states the following:<sup>51</sup> “To the extent these may be the last payments received in respect of the employment, the payments resemble termination payments. These are discussed in paragraph 2.6 of the Commentary on Article 15 of the OECD Model, which explains that they should be attributable to the place where the employee would otherwise have worked.”

In this case, paragraph 2.6. of the Commentary on Article 15 of the OECD Model goes in the same direction as Portuguese social security. Social security guidelines<sup>52</sup> determine that restrictions on free movement resulting from the COVID-19 pandemic “should not entail changes to the legislation applicable to posted and cross-border workers”, with the aim of “avoiding, during this exceptional period, both unnecessary changes in the situation of workers and heavy administrative procedures”.

## **24.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)**

During the pandemic, many tax authorities issued guidance that translated into “stopping the clock” in counting days needed for PE or residence.

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51. OECD Secretariat note, *supra* n. 1, at para. 50.

52. Director-General Circular, *supra* n. 28, at sec. II.I.

Tax authorities may issue guidance in the interpretation they follow when applying tax law. However, this guidance cannot turn a rule into an exception because that exception must be by force of law. Furthermore, it is not applicable to rules contained in tax treaties (as one side cannot unilaterally change a treaty).

Unlike many tax authorities, Portugal has not issued guidelines following the OECD Secretariat note. Every change concerning COVID-19 was by law, and it translated into the suspension of procedural time limits.<sup>53</sup> Another measure taken was that the State Secretary for Tax Affairs allowed the deferral of the payment of taxes.<sup>54</sup> It also allowed accountants to deliver tax declarations later than normal. In the author's opinion, these measures were the correct method to alleviate distress caused by COVID-19 as they both provided practical help and did not interact by unilaterally revising the method of identifying residence, PEs and other relevant factors contained in tax treaties. To the best of the author's knowledge, neither a Portuguese court nor the tax authority considered a case of force majeure in tax matters regarding COVID-19. Further, Portugal did not conclude agreements with other states relating to the COVID-19 situation.

## **24.8. The future of the mobility of work: A need for adjusting the existing treaty rules?**

As far as the author knows, there has not been a public discussion in Portugal about the tax treaty rules that must be changed due to the increasing mobility of work. In the author's opinion, there are four possible approaches to the tax challenges brought by work mobility, namely (1) discuss if the environment of increased mobility of work changes the concept of residence and source as regards the weight each one should have in tax treaties; (2) see the questions brought by mobility of work in tax treaty rule application and either change them or introduce harmonized definitions; (3) increase the investment in technologies and auditing capabilities; and (4) facilitate compliance.

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53. PT: Law No 1-A/2020 of 19 March: establishes exceptional and temporary measures in response to the epidemiological situation caused by the SARS-CoV-2 coronavirus and the COVID-19 disease.

54. *Order No. 104/2020-XXII, issued by the Secretary of State for Tax Affairs* (3 Sept. 2020), available at [https://info.portaldasfinancas.gov.pt/pt/informacao\\_fiscal/legislacao/Despachos\\_SEAF/Documents/Despacho\\_SEAF\\_104\\_2020.pdf](https://info.portaldasfinancas.gov.pt/pt/informacao_fiscal/legislacao/Despachos_SEAF/Documents/Despacho_SEAF_104_2020.pdf) (accessed 24 July 2022).

All these approaches are much needed and are not mutually exclusive. One's first instinct is to think that a more profound reflection regarding (1) should occur before going to (2). This is not entirely true. It is necessary also to analyse the impact of the increased mobility of work on the application of tax treaties and discuss whether introducing changes in some rules is sufficient to solve the challenges.<sup>55</sup> At the same time, it is essential to avoid a patchwork of solutions, which would bring confusion and inequality to an already complex system.

Concurrently, the legislator must always invest in approach (3), in order to bring greater effectiveness to domestic law enforcement. There is still a lot of potential to be extracted from the bulk tax and financial information that results from the exchange of information between states<sup>56</sup> and the use of big data.<sup>57</sup> Naturally, this can only happen while respecting taxpayers' rights, freedoms and guarantees.<sup>58</sup> Facilitating compliance (4) is indisputably important. In this matter, the legislator should consider the proposal of either setting up central one-stop-shops<sup>59</sup> or allowing for revenue sharing

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55. See proposals of Beretta, *supra* n. 49; and S.V. Kostić, *A Plea for a Workforce Presence PE Concept in a Post-Covid Digitalized World*, 49 Intertax 10 (2021).

56. See H. Brown & G. Jackson, *A Practitioner's Guide To International Tax Information Exchange Regimes - DAC6, TIEAs, MDR, CRS, and FATCA* (Spiramus 2021). The authors point out: "Over the last century, the jurisdictions have had many opportunities to take steps toward automatic information exchange. Their failure to do so must be considered a contributing factor in taxpayer (mis)behaviour."

57. See Agencia Tributaria, *The Tax Agency Regularised Tax Bases for 5,578 Million, 81% More, in 112 Checks on the International Taxation of Large Multinational Companies* (21 July 2022), available at [https://sede.agenciatributaria.gob.es/Sede/en\\_gb/notas-prensa/notas-prensa/2022/julio/21/agencia-tributaria-regularizo-bases-imponibles-multinacionales.html](https://sede.agenciatributaria.gob.es/Sede/en_gb/notas-prensa/notas-prensa/2022/julio/21/agencia-tributaria-regularizo-bases-imponibles-multinacionales.html) (accessed 24 July 2022), which claims that, in Spain, the incorporation of a tool based on "big data" analysis allowed the detection of false non-residents with relevant assets.

58. See recent news in Autoriteit Persoonsgegevens, *Tax Administration Fined for Fraud Blacklist* (6 May 2022), available at <https://autoriteitpersoonsgegevens.nl/en/news/tax-administration-fined-fraud-blacklist> (accessed 24 July 2022), which states: "The Dutch Data Protection Authority has imposed a €3.7 million fine on the Tax Administration for illegally processing personal data over a period of years in its 'fraud identification facility' (FSV). This was a blacklist which the Tax Administration used to register indications of fraud, often with major repercussions for people who had been wrongly included on the list." This shows that there is still much to do in this matter. About the need for taxpayer privacy protections, see also A.J. Cockfield, *Sharing Tax Information in the 21st Century: Big Data Flows and Taxpayers as Data Subjects*, 67 Canadian Tax Journal/ Revue Fiscale Canadienne 4 (2019), which proposes a multilateral taxpayers bill of rights that "could set out widely accepted fair information practices and promote legal certainty as well as the effective implementation and enforcement of EOI measures".

59. See European Commission, *Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee: Removing Cross-Border Tax Obstacles for Eu Citizens* sec. 5 (20 Feb. 2010), which proposes "setting

between the residence and employment state.<sup>60</sup> In conclusion, adjusting the existing treaty rules is not the only possible way to respond to the increasing work mobility. Overall, the author believes that, in a dynamic and changing world, the old forms of model treaty and approach in domestic law to residence, PE and taxing right allocation cannot remain untouched.

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up central one-stop-shops in tax administrations where mobile workers and investors could not only seek relevant and reliable tax information, but also directly pay taxes and receive all the necessary certificates for their home country's tax authorities".

60. For a more detailed proposal, see the article of H. Niesten, *Revising the Fiscal and Social Security Landscape of International Teleworkers in the Digital Age*, 49 Intertax 2, sec. 6.2.2. (2021). This solution may seem counterintuitive, given that no state wants to give up revenue. But the establishment of a fixed annual percentage of total gross income to be transferred by the state of residence reduces compliance obligations and the obligation of assessing possible credits. The author agrees with Niesten when noted that the proposed model "is not a one-size-fits-all approach and requires a case-by-case assessment. The implementation requires an appraisal of the specific economic bilateral relations between the countries and the specific modalities of the social security systems".

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## Chapter 25

### The Impact of Tax Treaties on International Mobility of Work in the Slovak Republic

Matej Kačaljak

#### 25.1. Mobility of work and domestic tax law

In the Slovak Republic, there are several circumstances that affect the design of the personal income tax rules. Firstly, the Slovak Republic is essentially a labour-force exporter. It ranks in the top five European Union countries whose populations travel to work abroad (more than 41,000 workers travelled to Austria alone in 2019).<sup>1</sup> Conversely, according to 2018 data, only 1% of the total workforce in the Slovak Republic comprised non-nationals<sup>2</sup> (2019 data is not available due to low reliability).<sup>3</sup>

Secondly, personal income tax is not as important from a political perspective in the Slovak Republic, despite its relatively significant yields. The ratio of personal income tax to total tax incomes in the Slovak Republic of 21% is comparable<sup>4</sup> to the average of other OECD countries at 23.5%.<sup>5</sup> However,

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1. Eurostat (2020), *People on the Move: Statistics on Mobility in Europe – 2020 Edition*, sec. 2.3. (Eurostat 2020), available at <https://ec.europa.eu/eurostat/cache/digipub/eumove/bloc-2c.html?lang=en>.

2. Statistical Office of the Slovak Republic, *Slováci pracujúci v Rakúsku sú v TOP rebríčku EÚ cezhraničnej mobility za prácou* (18 Dec. 2019), available at [https://slovak.statistics.sk/wps/portal/ext/aboutus/office.activites/officeNews/vsetkyaktuality/81b47113-30ce-40f5-a04a-54091f7cdc06!/ut/p/z1/tVLBUsIwFPwWDz2278WkNHgLDEOr4giKQC5OWloasS22kcrfGxwP6jiwRySl8zuvrezAQLzkKXa6pUyuirVo70vZOd-HES81yMCcXTRx4hG4bgnJoSRU5h9BvCryQCjW3E9nJwzgsWHeZh\\_BxJkUpqNyWFRxY3K3Wbt6jJz1do4aDe91WZnz2f1aAsHt01q1h8fOIlZQAhlKSapyzDzXYVMuT7DLsmCZJlgZ99lk-glLI5Cz36zvXeFPyyBli\\_fIP2hCFIwicgVhz5GIpxOumNKUdBB3wAGNhZ0h-HGGkMBs q9MWpmVVFzapmz9aDBHOQeq48Nqk8NAjnHc4ww7xfUvuWoTNXj88PUlhA6pKk74YmP9jQrbdaT3qj1bWhjL5vkMF8y9aMD9WS5Qx5VarTrOOTmrvuba\\_OTdm05w56GDbt6sy5WXXVIWD3xHyqrGGP-JgU0wLTnfuOhsNKJPx7sWPd604eQX4LrL7/dz/d5/L2dBISEvZ0FBIS9nQSEh/](https://slovak.statistics.sk/wps/portal/ext/aboutus/office.activites/officeNews/vsetkyaktuality/81b47113-30ce-40f5-a04a-54091f7cdc06!/ut/p/z1/tVLBUsIwFPwWDz2278WkNHgLDEOr4giKQC5OWloasS22kcrfGxwP6jiwRySl8zuvrezAQLzkKXa6pUyuirVo70vZOd-HES81yMCcXTRx4hG4bgnJoSRU5h9BvCryQCjW3E9nJwzgsWHeZh_BxJkUpqNyWFRxY3K3Wbt6jJz1do4aDe91WZnz2f1aAsHt01q1h8fOIlZQAhlKSapyzDzXYVMuT7DLsmCZJlgZ99lk-glLI5Cz36zvXeFPyyBli_fIP2hCFIwicgVhz5GIpxOumNKUdBB3wAGNhZ0h-HGGkMBs q9MWpmVVFzapmz9aDBHOQeq48Nqk8NAjnHc4ww7xfUvuWoTNXj88PUlhA6pKk74YmP9jQrbdaT3qj1bWhjL5vkMF8y9aMD9WS5Qx5VarTrOOTmrvuba_OTdm05w56GDbt6sy5WXXVIWD3xHyqrGGP-JgU0wLTnfuOhsNKJPx7sWPd604eQX4LrL7/dz/d5/L2dBISEvZ0FBIS9nQSEh/).

3. See Eurostat, *supra* n. 1.

4. Ministry of Finance of the Slovak Republic, *Príloková časť k rozpočtu verejnej správy na roky 2022 až 2024 [Public Sector Budget for Years 2022-2024]*, p. 42 (Ministry of Finance of the Slovak Republic 2021), available at [https://www.mfsr.sk/files/archiv/57/Hlavna\\_kniha.pdf](https://www.mfsr.sk/files/archiv/57/Hlavna_kniha.pdf).

5. R. de la Feria & G. Maffini, *The Impact of Digitalisation on Personal Income Taxes*, British Tax Review 2, p. 156 (2021), available at <http://dx.doi.org/10.2139/ssrn.3835095>.

personal income tax revenue in the Slovak Republic is allocated by law<sup>6</sup> in its totality to local municipalities (70% of revenue) and local self-governing regions (30% of revenue). Therefore, despite retaining absolute control over the personal income tax legislation in the Slovak Republic, the central government and central legislature are not particularly motivated to increase yields from this tax.<sup>7</sup>

These factors are then visible in the overall philosophy of the Slovak personal income tax rules affecting the mobility of work, where these seem to be deliberately designed to facilitate such (almost to motivate Slovak workers to travel abroad). This may be best illustrated by a unilateral exemption present in the *Zákon o dani z príjmov* (Income Tax Act, ITA),<sup>8</sup> according to which the employment-related income of a Slovak tax resident is exempt from tax in the Slovak Republic provided this is subject to tax abroad.<sup>9</sup>

The same philosophy is visible in the design of Slovak personal income tax rules concerning tax residency. These are essentially the same now as those established in the first post-socialist ITA effective in the Slovak territory,<sup>10</sup> and only minimal changes have been introduced over time. Thus, Slovak personal income tax rules concerning tax residency<sup>11</sup> employ a three-criterion test, for which worldwide taxation is then triggered if any of the criteria are fulfilled.

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6. SK: *Zákon č. 564/2004, Z. z. o rozpočtovom určení výnosu dane z príjmov územnej samosprávy a o zmene a doplnení niektorých zákonov* [Act No. 564/2004 Coll. on the Budgetary Allocation of Revenues from Personal Income Tax to Local Self-Government, as amended].

7. To the contrary, save for certain rather technical changes concerning, e.g., anti-abuse rules, most of the recent changes have had a negative impact on the total revenues and have been introduced despite vocal opposition from the local municipalities.

8. SK: *Zákon o dani z príjmov* [Act No. 595/2003 Coll. on Income Tax, as amended] (amended 2004), sec. 45(2)(b) and (c) [hereinafter ITA (amended 2004)]. The provision reads as follows: “The exemption method under paragraph 1 shall apply if the taxpayer with unlimited tax liability derives income from a dependent activity:

- a) for work carried out for the European Union and its institutions which has been demonstrably taxed for the benefit of the general budget of the European Union;
- b) from sources abroad, from a state with which the Slovak Republic has not concluded a double taxation treaty, and such income has been demonstrably taxed abroad; or
- c) from sources abroad from a state with which the Slovak Republic has concluded a double taxation treaty and such income has been demonstrably taxed abroad, if this procedure is more advantageous for the taxpayer.”

9. Furthermore, if there is a tax treaty between the Slovak Republic and the respective jurisdiction that employs a credit method, the local law exemption would apply if this is more advantageous for the Slovak tax resident.

10. CS: *Zákon o dani z příjmov obyvatelstva* [Czechoslovak Act No. 389/1990 Coll. on the Income Tax of Population].

11. Sec. 2(d)(1) ITA (amended 2021).

The criteria comprise:

- “permanent (registered) residence” as a formal circumstance of being registered with a state-run registry of addresses of Slovak Republic citizens and persons being granted resident status under the Slovak immigration laws;<sup>12</sup>
- “permanent home” as a factual circumstance of the individual having means of accommodation at one’s disposal, not having a purely occasional purpose and, in the view of all the relevant facts, including the personal and economic ties of the individual, there is a clear intention to permanently stay at the accommodation; and
- “habitual abode” as a factual circumstance of the individual staying within the Slovak territory for more than 183 days in a calendar year. It is not relevant whether the presence is continuous or divided into several shorter periods. Each partially spent day within the Slovak territory counts as a full day for the purposes of this residency criterion.

From the construction of these criteria, it follows that a higher degree of mobility of work would make it more likely that worldwide taxation would be triggered in the Slovak Republic for an individual spending more time within the Slovak territory. On the other hand, for an individual for whom worldwide taxation has already been triggered on the basis of the “permanent (registered) residence” and “permanent home” criteria, it is of no relevance whether such an individual would spend more time abroad and, as a result, fewer than 183 days within the Slovak territory.

However, Slovak personal income tax rules concerning tax residency also comprise several negative criteria<sup>13</sup> that override the positive criteria listed above. Under these negative criteria, the worldwide taxation would not be triggered:

- if the habitual abode criterion is fulfilled (although this is only when the individual is present in the Slovak Republic due to medical treatment or studies); or
- if, under the tie-breaker rules of an applicable tax treaty, the respective individual would be deemed a tax resident of the other contracting state.

12. SK: Zákon č. 253/1998 Z. z. o hlásení pobytu občanov Slovenskej republiky a registri obyvateľov Slovenskej republiky v znení neskorších predpisov [Act of Reporting of Residency of Citizens of the Slovak Republic and on the Registry of Inhabitants of the Slovak Republic 1998 (as amended)] Zákon č. 404/2011 Z. z. o pobyte cudzincov a o zmene a doplnení niektorých zákonov v znení neskorších predpisov [Act on Residency of Foreigners 2011 (as amended)].

13. Sec. 2(e)(1) and (2) ITA (amended 2021).

The latter negative criterion is particularly relevant in light of a relatively extensive network of tax treaties between the Slovak Republic and other countries, which currently amount to 70.<sup>14</sup> Under the Slovak monist approach to international treaties (*see* section 25.2.), the tax treaty will have prevalence, and the treaty rules would prevent worldwide taxation. However, the procedural rules (essentially unaffected by the tax treaty) would still apply and would cause additional (unnecessary) compliance costs. By “waiving” the application of a local tax residency regime in a situation where global taxation is prevented by a tax treaty, additional compliance costs are avoided.

This should mean that the Slovak tax residency rules would not trigger the worldwide taxation of foreigners in situations when a tax treaty applies, and the ties of the individual to the home jurisdiction seem stronger. Therefore, even if the individual would be required to stay in the Slovak Republic for a significant amount of time due to, for example, travel restrictions, this does not necessarily result in triggering worldwide taxation for the individual.

From this perspective, the author finds the Slovak tax residency rules relatively resilient against the challenges faced by the COVID-19 pandemic and does not see a necessity for their redesign. The three-criterion structure should ensure that an individual would not cease to be a Slovak Republic tax resident solely due to a prolonged involuntary presence abroad caused by pandemic-related travel restrictions, e.g. if the individual spends a significant amount of time abroad as a result of which the worldwide taxation would normally be triggered. Provided the individual still retains a permanent (registered) residence or permanent home in the Slovak Republic, it seems likely that, under the tax treaty tie-breaker rules, such would remain a Slovak Republic tax resident.

On the other hand, the negative criteria, including the overriding effect of the tax treaty tie-breaker rules, should ensure that an individual would not become a Slovak tax resident due to a prolonged involuntary presence within the Slovak territory, either. Such an individual would become a Slovak tax resident only if the existing tax residency ties to another treaty jurisdiction are severed.

Finally, as the Slovak Republic does not have exit tax rules targeting individuals, none of the considerations above should pose any concerns from

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14. SK: List of valid and effective Double Tax Treaties, available at <https://www.mfsr.sk/files/archiv/priloha-stranky/4412/4/List-valid-effective-Double-Tax-Treaties.pdf> (accessed 15 May 2022).



the perspective of exit tax implications. An individual may, thus, freely switch tax residencies without this triggering a special tax obligation. The policy rationale behind this may stem from the Slovak communist history where high net worth individuals were practically non-existent and, in general, moving abroad was extremely difficult if not entirely impossible for most of the population. Currently, the overall income tax framework in the Slovak Republic does not seem to trigger tax-motivated migration of high net worth individuals either (the top income tax rate in the Slovak Republic is 25%) and, thus, exit tax rules do not seem to be entirely necessary.

With respect to corporations, the Slovak Republic tax rules concerning tax residency<sup>15</sup> employ a two-criteria test where worldwide taxation is triggered once any of the criteria is fulfilled. The criteria comprise:

- a “registered seat” as a formal circumstance of the corporation having a seat registered with a state-run registry in the Slovak Republic (businesses must register their seat in the Slovak Republic commercial register); and
- a “place of effective management” as a factual criterion of having a place in the Slovak Republic where the key managerial and business decisions are made or adopted.<sup>16</sup>

Further, the ITA employs a negative criterion<sup>17</sup> that overrides the positive criteria above. Under this negative criterion, the worldwide taxation would not be triggered if, under the tie-breaker rules of an applicable tax treaty, the respective corporation would be deemed a tax resident of the other contracting state.

15. Sec. 2(d)(3) ITA (amended 2021).

16. The “place of effective management” criterion was introduced into Slovak law only with the ITA in 2003. Previously, only the “corporate seat” criterion was applied. Nevertheless, this was not entirely identical to the current “registered seat” criterion, as the Slovak corporate laws also briefly applied the so-called “real seat” theory (essentially a corporate equivalent of the place of effective management concept). Following up on the triad of ECJ decisions *Centros* (DK: ECJ, 9 Mar. 1999, Case C-212/97, *Centros Ltd v. Erhvervs- og Selskabsstyrelsen*, Case Law IBFD), *Überseering* (DE: ECJ, 5 Nov. 2002, Case C-208/00, *Überseering BV v. Nordic Construction Company Baumanagement GmbH (NCC)*, Case Law IBFD), and *Inspire Art* (NL: ECJ, 30 Sept. 2003, Case C-167/01, *Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd*, Case Law IBFD), the “real seat” concept may be considered unapplicable in corporate rules throughout the European Union. See also M. Gelter, *Centros, the Freedom of Establishment for Companies, and the Court’s Accidental Vision for Corporate Law*, in *EU Law Stories* (F. Nicola & B. Davies eds., Cambridge University Press 2017).

17. Sec. 2(e)(3) ITA (amended 2021).

Thus, the mere presence of the management board members in different countries should not necessarily result in complications with identifying the tax residency of a Slovak corporation. Even if doubts would arise with respect identifying the place of effective management, the corporation would remain a Slovak tax resident on the basis of the “registered seat” criterion.

It then follows that a corporation would cease to be a Slovak tax resident if the following occurs simultaneously:

- the board members of the corporation change their residence to a different country;
- the board members hold their management meetings in the said different country (as a result of which a place of effective management is effectively established in such country); and
- the place of effective management is a tax residency criterion under the laws of that country, and is also a tie-breaker criterion under the corresponding tax treaty.

As a result, Slovak exit tax rules would apply, under which the fair value of the assets of such a corporation would become taxable in the Slovak Republic at a 15% or 21% corporate income tax rate. However, the exit tax rules would not be triggered with respect to assets that would remain connected to the permanent establishment (PE) of the corporation in the Slovak Republic (if it comes into existence as a result of its change of tax residency).

In general, Slovak tax rules do not set any substance requirements upon Slovak tax resident corporations, save for the participation exemption rules with respect to the transfer of shares in a subsidiary.<sup>18</sup> These require that the taxpayer claiming the exemption performs functions connected with the holding of the shares and has the necessary personnel at its disposal. These rules are relatively new,<sup>19</sup> and no circular has been issued to specify the requirements with respect to the performance of functions and having personnel at its disposal. This issue has also not yet been dealt with by Slovak courts.

Assuming the functions of managing the holding of shares may be performed by a single employee, if this employee moves to a different country, issues with the fulfilment of the above criteria may arise. Nevertheless, it

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18. Sec. 13c ITA (amended 2018).

19. Effective from 1 Jan. 2018.

could be argued that changing the work regime of the employee(s) to a (permanent) home office does not automatically result in this employee ceasing to be at the disposal of the corporation. However, the opposite might be argued if the permanent presence of the respective employee(s) abroad would constitute a PE in the other country, and this PE would be performing the functions connected with the holding of the shares. As a result, it might be concluded that the performance of functions connected with the shares has moved from the Slovak Republic to another jurisdiction, and the participation exemption would not apply.

Concerning the possibility that a PE arises due to working from home, this would need to be assessed on a case-by-case basis. In practice, the Slovak tax authorities adhere to the principles set by the Commentary on Article 5 of the OECD Model (2019),<sup>20</sup> also with respect to the interpretation of domestic rules concerning PEs (particularly those concerning the fixed place of business PE and dependent agent PE).

The Slovak social security system, governed by the Social Insurance Act<sup>21</sup> and the Public Health Insurance Act,<sup>22</sup> refers to the classification used by the ITA and, therefore, the treatment under social security law is essentially aligned with the tax rules. However, under EU regulations governing the applicable social security systems,<sup>23</sup> a separate set of criteria is applied. Under these, the *lex loci laboris* rule<sup>24</sup> is applied as the main criterion that may result in the change of applicable social security laws in a permanent home-office setting. This would, for example, be the situation when

20. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 5* para. 18 et seq. (25 Apr. 2019), Treaties & Models.

21. SK: Zákon č. 461/2003 Z. z. o sociálnom poistení [Act on Social Insurance 2003].

22. SK: Zákon č. 580/2004 Z. z. o zdravotnom poistení [Act on Health Insurance 2004].

23. See Regulation (EC) No 883/2004 of the European Parliament and of the Council of 29 April 2004 on the coordination of social security systems (Text with relevance for the EEA and for Switzerland) (as amended), OJ L166 (2004); Regulation (EC) No 987/2009 of the European Parliament and of the Council of 16 September 2009 laying down the procedure for implementing Regulation (EC) No 883/2004 on the coordination of social security systems (as amended), OJ L284 (2009); and Council Regulation (EC) No 859/2003 of 14 May 2003 extending the provisions of Regulation (EEC) No 1408/71 and Regulation (EEC) No 574/72 to nationals of third countries who are not already covered by those provisions solely on the ground of their nationality (as amended), OJ L124 (2003).

24. The *lex loci laboris* rule stipulates that the social security (and mandatory health insurance) rules of such a Member State will apply where the gainful activity is performed. This, in practice, means that an individual may be a tax resident of one Member State due to their, for example, permanent residency and permanent home being there, but would be subject to the social security laws of another Member State due to the work being performed there.

an employee that has first reported (and travelled) to an office in one EU Member State switches to a model where working from home would be permanent. As a result, the work would be performed in the home EU Member State, and the social security laws of this EU Member State would apply in place of the laws where the office is situated.

## **25.2. Residence, tiebreaker rules and mobility of work: Individuals and entities**

As to the interrelation of tax treaties and local laws in the Slovak Republic, the constitutional model currently corresponds to the monist approach with the primacy of an international treaty over the Slovak laws. This model was adopted as from 1 July 2001 and, with respect to older treaties, a soft dualist approach has been preserved.<sup>25</sup>

The tax treaties belong to the category of treaties that prevail over the national legislation according to the abovementioned provisions of the constitution but also according to the ITA<sup>26</sup> and the Act on Tax Administration.<sup>27</sup> However, the position is different depending on whether the treaty was ratified and promulgated:

- before 1 July 2001 (when the soft dualist approach applied and their precedence over national law stemmed from provisions in the ITA and the Act on the d of Taxes referred to above); or
- on or after 1 July 2001 (when the monist approach applies and their precedence over national law stems directly from the constitution).<sup>28</sup>

As to their application, in general, the Slovak tax authorities adhere to the principles set by the Commentary on the OECD Model<sup>29</sup> and tend to follow any additional guidelines by the OECD.<sup>30</sup> OECD material is referred to

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25. D. Lantajová, J. Jankuv & J. Kušlita, *Slovakia*, in *International Law and Domestic Legal Systems: Incorporation, Transformation and Persuasion* (D. Shelton ed., Oxford University Press 2011).

26. Sec. 1(2) ITA [2003].

27. SK: *Zákon č. 563/2009 Z. z. o správe daní (daňový poriadok)* [Act No. 563/2009 Coll. on Tax Administration (Tax Procedural Code)], sec. 162.

28. See also A. Koroncziová & M. Kačaljak, *GAAR as Tax Treaty Override – Slovak Perspective*, 8 *Danube: Law, Economics and Social Issues Review* 3, pp. 139-155 (2017).

29. *OECD Model Tax Convention on Income and on Capital* (25 Apr. 2019), *Treaties & Models*.

30. See, for example, OECD, *Updated guidance on tax treaties and the impact of the COVID-19 pandemic* (21 Jan. 2019), available at [https://read.oecd-ilibrary.org/view/?ref=1060\\_1060114-o54bvc1ga2&title=Updated-guidance-on-tax-treaties-and-the-impact-of-the-COVID-19-pandemic](https://read.oecd-ilibrary.org/view/?ref=1060_1060114-o54bvc1ga2&title=Updated-guidance-on-tax-treaties-and-the-impact-of-the-COVID-19-pandemic).

regularly in the circulars of the tax authorities and, in the past, tax administrators have had a tendency to refer to it as if it were a binding source of law (even overriding actual Slovak laws or tax treaties).<sup>31</sup>

As already stated, from the construction of the tax residence criteria in Slovak law, it follows that an unintentional change of tax residency seems rather unlikely. To the contrary, the change of tax residency would need to be a deliberate choice either by the individual (who would have to deregister their permanent residence and dispose of any permanent home present in the Slovak territory) or the corporation (that would have to deliberately adjust its modus of management to create a place of effective management in another country).

Therefore, article 4(1) of the OECD Model would not be as relevant in Slovak practice as article 4(2) and (3) of the OECD Model (though there are no known interpretation issues to date with respect to these). Slovak law does not employ any special taxation regimes excluding particular classes of taxpayers from taxation. Therefore, essentially all individuals who are deemed to be Slovak tax residents are subject to a comprehensive worldwide taxation.

As to the tie-breaker criterion with respect to corporations, it must be noted that a majority of Slovak tax treaties use a pre-2017 version of article 4(3) of the OECD Model. Therefore, the switch of tax residency due to a change of place of effective management of the corporation would be automatic (and should not result in a temporary loss of treaty entitlement as opposed to a post-2017 version of article 4(3) of the OECD Model). Similarly, as with individuals, Slovak law does not employ any special taxation regimes excluding particular classes of taxpayers from taxation. Therefore, essentially all corporations that are Slovak tax residents are subject to a comprehensive worldwide taxation. The only exemption is Slovak general partnerships (*verejná obchodná spoločnosť*) that are considered transparent entities for tax purposes.

To date, there are no known cases of controversy arising out of the application of tie-breaker rules to situations concerning the mobility of work. This may stem from the fact that the Slovak Republic is essentially a workforce

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31. This led to a number of court disputes. See, for example, SK: *Najvyšší súd Slovenskej republiky* [Supreme Court of the Slovak Republic], 2015, 8Sžf/67/2014 and SK: *Najvyšší súd Slovenskej republiky* [Supreme Court of the Slovak Republic], 2017, 8Sžf/15/2015. See also M. Kačaljak & P. Rakovský, *Právny charakter OECD Smernice o transferovom oceňovaní na Slovensku*, 71 *Justičná revue* 11 (2019).

exporter, and the tax authorities do not focus on the identification of potential tax-resident individuals. With respect to corporations, the issue may lie in the insufficient use of data gathered through international cooperation and, as a result, a low number of disputes concerning tax residency.<sup>32</sup> This is despite the significant amount of anecdotal evidence suggesting that the use of shell companies for tax structuring is relatively widespread in the Slovak Republic.<sup>33</sup>

### **25.3. Permanent establishments and mobility of work**

The ITA recognizes four types of PEs, of which three are also usually reflected in Slovak tax treaties (the fourth is a digital PE that has shown to be an ineffective concept<sup>34</sup>), namely:

- fixed place of business,
- services PE; and
- dependent agent PE.

In practice, the Slovak tax authorities adhere to the principles set by the OECD Commentary on article 5 to the OECD Model (2019),<sup>35</sup> also with respect to interpretation of domestic rules concerning PEs (particularly those concerning the fixed place of business PE and dependent agent PE), and take a rather pragmatic approach with respect to the identification of such. Under this, it is first investigated which place is agreed between the foreign employer and the employee as the place of performance of work. If this place is agreed to be on the premises of the employer abroad, it might be further investigated whether these premises are actually made available to the employee.

As a rule of thumb, it is concluded that a fixed place of business PE should not come into existence if the following occurs simultaneously:

- the use of a home office (or any other suitable place for the performance of work, such as a flex office) is at the will of the employee; and

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32. A. Szakács, *Využívanie informácií finančnou správou získaných v rámci automatickej výmeny daňových informácií*, in *Milníky práva v stredoeurópskom priestore 2019* pp. 250-258 (Právnická fakulta UK 2019).

33. See one of many businesses offering offshore incorporation services in the Slovak Republic, for example <http://www.companyformation.sk/>.

34. S. Geringer, *National Digital Taxes—Lessons from Europe*, 35 *South African Journal of Accounting Research* 1 (2021). In greater detail, see T. Cibul'a & M. Kačaljak, *Tax Treaty Override in Slovakia-Digital Platform Permanent Establishment*, 2 *Bratislava Law Review* 1 (2018).

35. Para. 18 et seq. *OECD Model: Commentary on Article 5* (2019).

- the employer still maintains an option for the employee to use the office at the premises of the employer.

Under the same logic, the involuntary work of an employee from a home office that is a result of a government restriction should not constitute a PE, either.

The home-office implications do not seem to have an effect on practice with respect to the dependent agent PE. This, in line with circulars published by the Slovak tax authorities,<sup>36</sup> still focuses on whether the individual or legal entity has and exercises competences of the foreign business that led to entering into contracts with customers in the Slovak Republic. Whether these competences are being exercised from a home office is not relevant.

A services PE is deemed to exist in Slovak law as well as in the tax treaties (where the services PE wording is based on the UN Model) when:

- activities are performed within the Slovak territory while providing services; and
- the total duration of such activities exceeds 183 days in aggregate in any 12-month period.

From the circulars of the tax authorities,<sup>37</sup> it follows that not all services are deemed to be provided in the Slovak territory; rather, only those that have a customer within the Slovak territory are defined as such. This seems sensible as, otherwise, the scope of the services PE would essentially overlap with the fixed place of business with respect to businesses that could provide services from a distance but would lead to exactly opposite conclusions as indicated above.

The means of attribution of profits to a PE, should this arise in line with the above, is not addressed by the circulars of the tax authorities. Nevertheless, it is generally accepted that the approach would vary depending on the particular contribution/role of the employee present in the Slovak Republic. In most of the cases, it might be anticipated that the activities performed in the Slovak Republic through a home-office PE would concern low value-adding

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36. Financial Directorate of the Slovak Republic, *Circular on the Dependent Agent Permanent Establishment* (Financial Administration Slovak Republic 2014), available at [https://www.financnasprava.sk/\\_img/pfsedit/Dokumenty\\_PFS/Profesionalna\\_zona/Dane/Metodicke\\_pokyny/Medzinarodne\\_zdanovanie/2014.09.22\\_MP.pdf](https://www.financnasprava.sk/_img/pfsedit/Dokumenty_PFS/Profesionalna_zona/Dane/Metodicke_pokyny/Medzinarodne_zdanovanie/2014.09.22_MP.pdf).

37. Financial Directorate of the Slovak Republic, *Circular on the Services Permanent Establishment* (Financial Administration Slovak Republic 2019), available at [https://www.financnasprava.sk/\\_img/pfsedit/Dokumenty\\_PFS/Zverejnovanie\\_dok/Dane/Metodicke\\_pokyny/Medzinarodne\\_zdanovanie/2019/2019.08.30\\_posudz\\_sluzieb.pdf](https://www.financnasprava.sk/_img/pfsedit/Dokumenty_PFS/Zverejnovanie_dok/Dane/Metodicke_pokyny/Medzinarodne_zdanovanie/2019/2019.08.30_posudz_sluzieb.pdf).

activities. This would justify the application of the cost-plus method for the attribution of profits with the salary costs of the employee constituting the basis to which a relatively low margin would be applied.

In general, discussions in the Slovak Republic are focussed on finding clear and simple delimitation criteria with respect to a home office as a potential trigger of a PE. It still seems that the general tendency is to avoid its creation where possible, which affects the setting of internal processes. This tendency likely stems from the administrative burden connected with such than from the resulting tax burden.

To counter these tendencies, the tax authorities may have to think of streamlined ways on how to manage the reporting and collection processes connected with the creation of a home-office PE. The aim of such would be to eliminate excessive administrative burden (e.g. through aligning and streamlining the reporting and collecting processes with the processes connected with payroll taxes and social security contributions of the employees working in the Slovak Republic). Thus, it might be possible to counter the tendency to avoid the creation of a PE even in situations when, from a business perspective, it would be the most sensible.

#### **25.4. Physical presence according to articles 15(1) and 17 of the OECD Model**

The ITA<sup>38</sup> considers income from employment performed in the Slovak territory as income from sources in the Slovak Republic and subject to tax. Simultaneously, under an exemption<sup>39</sup> partly mimicking article 15(2) of the OECD Model, the Slovak Republic essentially waives the source taxation of employment-related income if the following three criteria are fulfilled:

- the presence of the employee in the Slovak Republic does not exceed 183 days in any 12-month period;
- the remuneration is paid by or on behalf of an employer having a seat abroad;<sup>40</sup> and
- the remuneration is not borne by the PE of the foreign employer in the Slovak Republic.

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38. Sec. 16(1)(b) ITA (as amended).

39. Sec. 5(7)(g) ITA (as amended).

40. This aspect is the main difference with the OECD Model wording that refers to the tax residency concept. Slovak law expressly refers to a registered seat abroad.



In practice, it seems more likely that the home-office scenarios would concern mostly employees that are subject to worldwide taxation in the Slovak Republic. As mentioned above, this is mainly due to the fact that the Slovak Republic is still a workforce exporter, and the expected salaries are competitive with those in the western states.<sup>41</sup> On the other hand, most of the situations concerning employment performed by a foreign employee in the Slovak territory would relate to work performed for a Slovak resident employer. Based on the exemption referred to above, short-term, cross-border engagements should not result in the income from employment being taxable in the Slovak Republic.

The collection of payroll tax in the Slovak Republic is the responsibility of the employer. Therefore, once the employment income becomes taxable at source in the Slovak Republic, the employer is required to register as a withholding agent in the Slovak Republic<sup>42</sup> and fulfil its withholding and reporting duties with respect to tax,<sup>43</sup> as well as (likely) social security and health insurance contributions. This applies irrespective of whether the employer is a Slovak resident or not. An issue may arise with the enforceability of such an obligation with respect to foreign employers from states with which the Slovak Republic does not have a treaty on cooperation in tax matters.<sup>44</sup> Nevertheless, there are no known controversies concerning such situations,<sup>45</sup> and the tax authorities currently do not seem to be targeting non-resident individuals when their salary would be subject to source taxation in the Slovak Republic.

On the other hand, as a result of the COVID-19 restrictions, there are known situations where non-residents working for Slovak employers became stranded in their home state and continued working from a home office. As a result of this, the rules concerning the withholding of tax at source in the Slovak Republic by the Slovak employer became inapplicable, and the employers had to make corrections retrospectively. This sparked some discussions on whether, in such situations, the employee should not be entitled

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41. Eurostat, *Wages and Labour Costs* (Eurostat 2021), available at: [https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Wages\\_and\\_labour\\_costs#Labour\\_costs](https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Wages_and_labour_costs#Labour_costs) (accessed 18 March 2024).

42. Sec. 48 and 49a(3) ITA (as amended).

43. Sec. 35 ITA (as amended).

44. See T. Hlinka & A. Szakács, *Niekoľko poznámok k vymáhaniu pohľadávok v nadväznosti na novelu zákona č. 222/2004 Z. z., 7 Bulletin SKDP 4* (2021).

45. In general, the case law of the supreme court instances on tax treaty matters in the Slovak Republic is almost non-existent, and it may only be guessed as to why these do not attract too much litigation.

by law to claim a refund of the withheld payroll tax directly, for example through the annual tax return.

With respect to artists and sportspersons, the ITA<sup>46</sup> reflects the wording of article 17 of the OECD Model. In practice, there are no known controversies with respect to this type of income. In general, the Slovak tax authorities advise Slovak withholding agents to withhold tax from the entire payment of remuneration paid out to the artist/sportsperson or their intermediary. In the case of a payment to the intermediary, the tax is to be withheld from the entire amount unless the part of payment corresponding to the remuneration of the artist/sportsperson could be precisely identified. The tax withheld is deemed a prepayment, and the recipient has a possibility to claim any tax-deductible expenses through a tax return.

## **25.5. Article 15(2) and (3) of the OECD Model**

Though there is no express convention stipulated for counting the days for the purpose of the 183-day rule in tax treaties, when the wording contains a provision identical to article 15(2) of the OECD Model, in the Slovak Republic, in general, even each partially spent day in the Slovak territory is counted as a full day.<sup>47</sup> The same applies for the Slovak law equivalent, stipulating an exemption of such income from source taxation in the Slovak Republic.

This equivalent exemption<sup>48</sup> partly mimicking article 15(2) of the OECD Model essentially waives the source taxation of employment-related income if the following three criteria are fulfilled:

- the presence of the employee in the Slovak Republic does not exceed 183 days in any 12-month period;
- the remuneration is paid by or on behalf of an employer having a seat abroad;<sup>49</sup> and
- the remuneration is not borne by the PE of the foreign employer in the Slovak Republic.

As indicated above, though there is a possibility that a foreign employee present in the Slovak Republic would become subject to source taxation

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46. Sec. 16(1)(d) ITA (as amended).

47. *Mutatis mutandis* sec. 2(1)(d)(1b) ITA (as amended).

48. Sec. 5(7)(g) ITA (as amended).

49. This aspect is the main difference from the OECD Model wording that refers to the tax residency concept. Slovak law expressly refers to a registered seat abroad.

in the Slovak Republic if their stay exceeds 183 days, the author finds this possibility rather theoretical. The majority of cases concern the so-called economic employment structure and, in the minority of remaining cases, the foreign employer is aware of the PE implications. There are no known controversies concerning the above situations, and the Slovak tax authorities currently do not seem to be targeting non-resident individuals when their salary would be subject to source taxation in the Slovak Republic.

On the other hand, it does not seem possible in the Slovak environment that complications could result from a Slovak resident employer losing its substance in the Slovak Republic. This is due to the dual criteria for the tax residence of corporations, which take into consideration both the registered seat and place of effective management. Combined with the different Slovak construction of the exemption,<sup>50</sup> this means that, should an employer having a registered seat in the Slovak Republic lose its substance, it would still retain its tax residence based on the registered-seat criterion alone. Simply said, it seems close to impossible that the employee would accidentally become eligible for the exemption just because the Slovak resident employer lost its Slovak tax residency status.

Between the criteria for the application of both article 15(2) of the OECD Model and the local law exemption, is the non-existence of a PE. Therefore, the discussion to be found in section 25.3. is also relevant here. Likewise, the tax authorities would look at the contractual arrangement between the employer and the employee and assess whether the following occurs simultaneously:

- that the use of a home office (or any other suitable place for performance of work such as a flex office) is at the will of the employee; and
- that the employer still maintains an option for the employee to use the office at the premises of the employer.

The ITA recognizes the concept of an economic employer,<sup>51</sup> under which the employment income would be taxable at source from the beginning (i.e. the local law exemption<sup>52</sup> would not apply) even though the contractual (legal) employer would have a registered seat abroad. This would be due to the fact that the economic employer would be taken into consideration when it is anticipated that this will have a registered seat in the Slovak Republic. It then follows that, in such economic-employer scenarios, the PE of the

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50. Sec. 5(7)(g) ITA (as amended).

51. Sec. 5(4) ITA (as amended).

52. Id.

contractual (legal) employer would not come into existence in the Slovak Republic. The above applies irrespective of any home-office implications.

As for article 15(3) of the OECD Model, most of the Slovak tax treaties have rules based on the pre-2017 OECD Model. Thus, these rules stipulate that the income of employees working in international traffic is taxable in the state where the employer operating the vessel has a registered seat/place of effective management/tax residence.

On the other hand, certain other treaties<sup>53</sup> do have wording similar to that of article 15(3) of the OECD Model, but this also covers vessels used in domestic transport, which has led to certain counterintuitive conclusions and controversies in the past.<sup>54</sup> Still, in the Slovak environment, the employee may still resort to the option in the ITA<sup>55</sup> to have its foreign employment income exempt in the Slovak Republic, provided this was subject to tax abroad.<sup>56</sup>

## **25.6. Frontier workers**

None of the tax treaties of the Slovak Republic with its neighbouring states contain specific rules for the taxation of frontier workers. Neither is the author aware of any initiatives, present or past, that would seek the introduction of such rules into any of the tax treaties. Moreover, in the past,<sup>57</sup> there was a specific exemption from worldwide taxation in the ITA in the form of a negative criterion. This negative criterion stated that an individual would not be regarded as a tax resident even if the 183-day rule was fulfilled

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53. For example, *Convention between the Kingdom of the Netherlands and the Czechoslovak Socialist Republic for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital* (4 Mar. 1974), Treaties IBFD [hereinafter *Neth.-Czech. Income and Capital Tax Treaty*].

54. See J. Mertl & Y. Legierská, *Czech Boatmen Employed In the Netherlands: Unusual Income Taxation and an Unresponsive Public Policy*, 18 *Balkan Social Science Review* 18 (2021), for a case study concerning the *Neth.-Czech. Income and Capital Tax Treaty*, but with impact on the Czech Republic (which acceded to the treaty after the split of Czechoslovakia). The controversy concerned Czech boatmen that were employed in the Netherlands to work on vessels operating in Dutch canals (i.e. in domestic transport). Thus, despite any logical link to the Czech Republic, the salaries of these boatmen were taxable there instead of in the Netherlands.

55. Sec. 45(2)(b) and (c) ITA (as amended).

56. The wording of the ITA does not require that the employment income is taxable in the foreign state in line with the tax treaty (which would seem rather logical). Therefore, the Slovak employee does not even need to claim the tax treaty application towards the foreign state tax authority (or towards the employer being a withholding agent).

57. Sec. 2(e)(2) ITA 2003 effective until 31 Dec. 2020.

as a result of the daily, or (more or less) regular, crossing of borders for the purposes of employment in the Slovak Republic. This exemption was abolished with a justification that the existing OECD-based rules in the tax treaties effective between the Slovak Republic and its neighbouring states are sufficient for solving any tax residency conflicts, and a supplementary domestic rule was not necessary.

Once again, the situation of Slovak frontier workers is addressed through a unilateral exemption present in the ITA,<sup>58</sup> according to which the employment-related income of a Slovak tax resident is exempt from tax in the Slovak Republic, provided this was subject to tax abroad.<sup>59</sup> Slovak frontier workers do not have to report any foreign employment income in the Slovak Republic (provided this was duly reported and subject to tax in the other state). Thus, even a Slovak frontier worker stranded in the Slovak Republic due to COVID-based travel restrictions was unaffected by a change of tax regime. Provided the foreign employer simply continued withholding tax and remitting it to the foreign tax authorities, the employee could rely on the Slovak unilateral exemption.

## **25.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)**

The Slovak Republic is a country exporting labour force and, therefore, even during the pandemic, there was not a strong focus on home-office implications. That said, the Slovak tax authorities adhere to the principles set by the Commentary on the OECD Model, and the Slovak Ministry of Finance outlines the conclusion of the OECD Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis<sup>60</sup> with an express statement that it agrees with these in full.

Under this, the general message to the public was that temporary changes to the usual processes resulting from the COVID-19 pandemic measures

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58. Sec. 45(2)(b) and (c) ITA (as amended).

59. Furthermore, if there is a tax treaty between the Slovak Republic and the respective jurisdiction that employs a credit method, the local law exemption would apply if this is more advantageous for the Slovak tax resident.

60. OECD, *OECD Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis* (OECD 2020), available at [https://read.oecd-ilibrary.org/view/?ref=127\\_127237-vsdagpp2t3&title=OECD-Secretariat-analysis-of-tax-treaties-and-the-impact-of-the-COVID-19-Crisis](https://read.oecd-ilibrary.org/view/?ref=127_127237-vsdagpp2t3&title=OECD-Secretariat-analysis-of-tax-treaties-and-the-impact-of-the-COVID-19-Crisis).

and travel restrictions should be disregarded when assessing, *inter alia*, the existence of a PE or tax residency. Nevertheless, for source taxation, it was notified that the actual presence of the employee should be monitored for the purposes of the application of tax rules, which implies that no legal fictions would be imposed in this respect to counter the effects of travel restrictions mandated by the governments.

The publicly discussed controversies concerning the COVID-19 pandemic and tax issues concerned relatively technical issues with respect to specific relief schemes (including loosened procedural rules). The author is not aware of any initiatives on the side of the Slovak tax authorities where it would actively enter into consultations with other states concerning the application of tax treaties, particularly with respect to implications concerning the mobility of work.

That said, personal discussions with officials of the Slovak tax authorities now indicate that, when the business processes have been changed permanently (e.g. in situations where the pandemic was a trigger of optimization processes within the businesses or even within entire industries), the new status quo would need to be regarded as permanent and deliberate on the side of the taxpayers. As a result, the tax authorities would look at these processes as the new normal, and would apply the existing statutory rules accordingly.

This would particularly apply to situations when entire units of frontier workers would permanently remain in a home-office setting. The possibilities granted by new technologies provide for such, and the pandemic has forced a change in the existing customs within businesses. As a result, it may be expected that the existence of a PE could be found.

### **25.8. The future of the mobility of work: A need for adjusting the existing treaty rules?**

Even the Slovak policy discussions are affected by the fact that the Slovak Republic is still more or less a labour force exporter. Combined with this, the unilateral exemption rules in the ITA<sup>61</sup> provide an exemption of employment-related income generated abroad if such income is already subject to tax in the other state (irrespective of whether the state is a tax treaty state). This implies that the Slovak Republic has made a deliberate policy choice

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61. Sec. 45(3) ITA (as amended).

to waive its tax incomes from employment<sup>62</sup> in order to make Slovak workers more competitive abroad and to liberate them from the administrative burden caused by the need to deal with taxation issues.

Given this landscape, and from the perspective of the Slovak Republic, there does not seem to be an urgent need to redesign the existing rules, as increased mobility of work might even work in favour of Slovak revenues. In particular, increased work from a home office will likely lead to source taxation abroad not being triggered and, consequently, the income being subject to tax in the Slovak Republic.

Further, the increased complexity of tasks performed by Slovak employees (leading to increased generated added value) might lead to a greater share of the added value being attributable to the PE in the Slovak Republic. This, nevertheless, requires that the existence of PEs in the Slovak Republic is more closely monitored by the tax authorities. Up until now, court disputes concerning the (non-)existence of a PE in the Slovak Republic are rare.

The challenges that lie ahead of the Slovak tax authorities are more of a technical nature: foreign employers may refrain from hiring Slovak employees as permanent remote workers more due to the administrative obstacles connected with this than any other limiting factor. Simply said, the taxes by themselves do not pose such a significant burden compared to the relative complexity of their administration and connected additional costs. In general, the processes of taxpayer management in the Slovak Republic are still lagging behind those in most developed countries.

The discussions on the use of digital tools to facilitate tax collection in the Slovak Republic are still only in their beginning stages. There is still no widespread use of automatically collected data or pre-populated tax returns.<sup>63</sup> Most facilitation measures to date rely predominantly on the employment of withholding agents. Moreover, the necessity to deal with three different collection agencies (the tax office, the social security agency and the health insurance company) adds to the complexity.

Finally, the Slovak tax authorities might exert additional effort for managing taxpayers with respect to ideal revenue attribution models in situations

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62. It is noteworthy that this choice is without any negative impacts on the central government budget, as the entire individual income tax revenues are being transferred to the municipal budgets.

63. See also M. Kačaljak, *Paying Taxes in the Digital Age*, 4 *Bratislava Law Review* 2, pp. 21-30 (2020).

when a permanent home-office engagement would result in a PE in the Slovak Republic. This would likely need a shift of paradigm from viewing the employee merely as a workforce (i.e. as a cost-generating element) to a unit generating significant added value to the business.<sup>64</sup> This might then indeed justify moving from simple cost-plus methods to profit split methods or formulary apportionment methods. The formulary apportionment method might seem particularly tempting in situations when this could be combined with a single tax collection place covering several jurisdictions.

In any case, at least within the OECD, one may anticipate that any new solutions would rely greatly on intensive automatic exchange of information and utilization of sophisticated new technologies.<sup>65</sup> This, combined with the will of the global community to move forward through the use of multilateral instruments, provides a chance to come to a coordinated solution.

On the other hand, judging purely from the Slovak perspective, the Slovak Republic does not seem a likely candidate to be on the forefront of any reform initiatives in the near future. It still being a labour force exporter with (relatively generous) domestic rules would not immediately be threatened by the intensified migration of workers. At the same time, and for the same reasons, the Slovak Republic would need to remain close to the international community, and it can be anticipated that it will participate in any new coordination initiatives.

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64. See also De la Feria & Maffini, *supra* n. 5.

65. Minding, on the other hand, the fact that new technologies are never a panacea. Therefore, they cannot compensate for poor design choices in the tax law itself. See also R. de la Feria & M.A. Grau Ruiz, *The Robotisation of Tax Administration*, in *Interactive Robotics: Legal, Ethical, Social and Economic Aspects* ch. 20 (A. Grau ed., Springer Nature 2022), available at <https://ssrn.com/abstract=4045621>.



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## Chapter 26

### The Impact of Tax Treaties on International Mobility of Work in Slovenia

Mateja Babič

#### 26.1. Mobility of work and domestic tax law

The definition of an individual resident in Slovenia with comprehensive tax liability is laid down in the Personal Income Tax Act (PITA).<sup>1</sup> It is comparable to the definition of a resident in neighbouring European states<sup>2</sup> with a civil law system. The individual triggers worldwide taxation not only on the basis of their registered permanent address and habitual abode but also by their mere presence in Slovenia for more than 183 days at any time in a tax year.<sup>3</sup> The centre of personal and economic interests is the fourth criterion. Every criterion has to be analysed on a stand-alone basis.

Residency in Slovenia, regardless of the time spent in Slovenia or abroad for work purposes, is established in the following circumstances:

- when an individual resides outside of Slovenia due to diplomatic or consular status;<sup>4</sup>
- when an individual who is a resident of Slovenia at any time in the past or current year resides outside of Slovenia due to employment in institutions or representations of the Republic of Slovenia; or
- when the other state would not grant the individual residency based on the principle of reciprocity.

Worldwide taxation can therefore be very quickly triggered in Slovenia. Conversely, it is also very difficult to escape from it. Slovenia has not yet implemented exit taxation on individuals, but the negative jurisprudence on a tax residency waiver and, consequently, the retention of taxation on a worldwide basis in Slovenia is vast and will be discussed in the next

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1. SI: *Zakon o dohodnini* [Personal Income Tax Act, PITA], [2011], art. 6, Primary Sources IBFD.

2. AT: *Einkommensteuergesetz* [Personal Income Tax Act], [1988], art. 1(2).

3. Tax year is the same as calendar year.

4. Employment relationship in the consulate, diplomatic representation office, international mission of the Republic of Slovenia, permanent representation office of the Republic of Slovenia in Brussels, etc. The same status of residency is also received by the family members.

sections. If an individual who is a resident in Slovenia with an employment and secured workplace in another state works from a home office in Slovenia, the obligation for the income tax assessment is triggered immediately. The obligation for an income tax assessment starts on the first day of working in the home office in Slovenia. It is irrelevant if working from home is obligatory or voluntary.

Months after the OECD Secretariat published an analysis of the impact of COVID-19 on the implementation of international agreements on the avoidance of double taxation,<sup>5</sup> the Slovene finance administration issued an explanatory note in September 2020<sup>6</sup> on the Slovene position of taxation of residents or non-residents who were forced to stay in Slovenia due to the closed borders and travel restrictions. In their view, the emergency situation does not change the current (pre-COVID-19) procedures for determining the resident status of individuals (cross-border workers) and the interpretation of the implementation of articles 15(1) and 15(2) of tax treaties when working in Slovenia for a foreign employer. The explanatory note further provides two examples.

The first example includes a resident cross-border worker who used to commute daily between his residence state and the state of activity. Due to COVID-19, the individual is working from his home in Slovenia. The conclusion of the Slovene Finance Administration is based on the first sentence of article 15(1) of the OECD Model, saying “salaries, wages and other similar remuneration derived by a resident of a Contracting State (in this case a resident of Slovenia) in respect of the employment shall be taxable only in that State (i.e. Slovenia)”. Slovenia has the exclusive right to tax the worker’s remuneration for the time when he works from Slovenia. They further conclude, according to the treaty interpretation rules, that income from employment related to work performed in Slovenia is taxed only in the country of residence of the worker (i.e. in Slovenia) because the employment was not performed in the usual state of activity. For this part of the income from employment, the taxpayer cannot take into account the tax paid abroad and he can claim a tax refund from the competent tax authority of another country.<sup>7</sup>

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5. OECD, *OECD Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis* (3 Apr. 2020).

6. Tax Administration of Slovenia, *Mednarodno obdavčenje – Obdavčevanje dohodkov iz zaposlitve po mednarodnih pogodbah* [International Taxation – Taxation of employment income in international tax treaties] (Sept. 2020).

7. Id.

The second example of the Slovene finance administration is a non-resident seconded by a foreign employer for 2 months to Slovenia as a state of activity. Due to the emergence of the COVID-19 pandemic, the foreign worker cannot return to the state of usual residence and continues to execute his daily working tasks for a foreign employer from Slovenia. He is working on projects that would normally be done outside of Slovenia in the absence of closed borders and travel restrictions.

In this specific case, the right to taxation in Slovenia is assessed under article 15(2) of the OECD Model concluded with the residence state of the worker posted to Slovenia. If all of the conditions referred to in article 15(2) of the OECD Model are cumulatively met, tax on income from employment in the residence state or where the person is a resident shall be paid. If one of the conditions is not met, this income may also be taxed in the state where the employment is exercised in accordance with the national law of that contracting state (in this case, Slovenia).

However, article 15(2) of the OECD Model may not be applied to cases in which the conditions referred to in article 15(2) are not cumulatively met. In such cases, article 15(1) of the OECD Model applies according to which (also in cases of short-term employment) income from employment is taxed in the country where the employment is performed (in this case, Slovenia).

In the author's opinion, this was not the response one would expect from the Slovene finance administration in such a special situation as it was with COVID-19 in 2020. It shows the inflexibility of the Ministry of Finance to adapt to the new sudden situation and issue a ruling that would enable many cross-border workers who were unable to physically perform their duties in their country of employment to have a soft transition instead of the immediate effect of exclusive home taxation. In the years 2020 to 2022, the Slovene finance administration required resident employees to prohibit the foreign employer from deducting any foreign income tax immediately if the employee was working in a home office. In practice, the non-deduction really occurred in few cases of the smaller employers where the payroll department and HR department would be able to change their processes immediately.

The domestic rules in Slovenia provide for the deduction of foreign tax on foreign-source income. When a resident receives income from a source or employment country with which Slovenia has not concluded an international agreement on the avoidance of double taxation of income and property (tax treaty) and the resident's income has been taxed abroad, the

domestic legislation<sup>8</sup> allows the deduction of tax paid. The foreign tax may be deducted from the assessed personal income tax in Slovenia. The amount of the deduction is recognized up to the actual amount of any tax payment but not more than the amount calculated by the domestic tax rules. In practice, the Slovene tax authorities demand written statements from the foreign tax authorities stating the amount of tax and the fact that the tax was paid in the source country. Similarly, if Slovenia has a tax treaty with the source country, the emphasis is on the selection of the proper allocation rule and application of the correct method for eliminating double taxation of income.

Legal entities are subject to taxation laid down in the Corporate Income Tax Act (CITA).<sup>9</sup> A legal entity is regarded as a resident taxpayer if it is incorporated with the official seat or has a place of effective management in Slovenia.<sup>10</sup> The Slovene finance administration would need to have insight into the foreign company registers in order to identify residents of Slovenia who are board members in a foreign company. An absence of that (at least European) company register prevents the tax administration from identifying foreign companies with a place of effective management in Slovenia. In the opposite case, any state would not voluntarily report to the other contracting state about the residents of the other contracting state who are living and working in Slovenia as that would lead to a reduction of the tax income in Slovenia from a corporate income tax source.

## **26.2. Residence, tiebreaker rules and mobility of work: Individuals and entities**

The traditionally used principle of the residence state triggers more interpretation issues with the higher mobility of work that cannot be easily answered by the existing criteria such as domicile or residence for individuals or place of management for the entities. The Commentary on the OECD Model<sup>11</sup> does not differentiate in article 15 between forced or voluntary residence in a particular state. Any kind of personal attachment to the state is required to establish residency.<sup>12</sup>

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8. Art. 136 PITA.

9. SI: *Zakon o davku od dohodkov pravnih oseb* [Corporate Income Tax Act, CITA], Primary Sources, IBFD.

10. Art. 5(1) CITA.

11. *OECD Model Tax Convention on Income and on Capital* (21 Nov. 2017), Treaties & Models IBFD.

12. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 4*, para. 8 (2017), Treaties & Models IBFD.

The definition of the residence state is, without a doubt, defined according to the domestic rules. In Slovenia, the most important controversial criterion in the case of dual residents is the “registered permanent address” listed as the first criterion in the domestic Slovene PITA.<sup>13</sup> Many other countries do not differentiate between the permanent and temporary registered address whereas, in Slovenia, the difference between rights and obligations between the two address registrations for an individual is extreme.

One example is the decision of the Slovene administrative court<sup>14</sup> denying the application of a Slovene national living and working in the United Kingdom but still retaining a registered permanent address in Slovenia. The Slovene authorities generally do not allow the individual deregistration from the permanent address register in Slovenia unless the individual is presenting a permanent address confirmation from another state. In this particular case, the individual argued that, in the United Kingdom, the requirements for a permanent address registration are not the same as in Slovenia and, therefore, he is unable to deregister his permanent address in Slovenia. The court has correctly concluded that, following article 6(1) of the Slovene PITA, the individual remains a tax resident of Slovenia according to his registered permanent address in Slovenia. Subsequently, the individual is obligated to submit an annual income tax report on a worldwide basis in Slovenia.

Following this court decision, the individual has high tax uncertainty until the end of the fiscal year and beyond, as there is no certainty for the correct decision about his residency by the tax authorities of the other contracting state. Will the tax authorities understand and determine his resident status according to the bilateral tax treaty correctly or not? In the court case at hand, one expects double taxation as the consequence of dual residency in Slovenia and in the United Kingdom. Slovenia must therefore determine residency according to article 4 of the tax treaty with the United Kingdom, which states that the individual is deemed to be a resident only of the state in which they have a permanent home available to them. In this case, the permanent home was available to the individual in both states; therefore, it will be decided by the Slovene tax authorities at a later point that his centre of vital interest and especially habitual abode is in the United Kingdom.

An additional supporting point for the future correct decision about the residency in this case lies in the Slovene domestic rule of article 6(7) of

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13. Art. 6(1), point 1 PITA.

14. SI: US [Administrative Court], 31 July 2020, no. I U 1291/2019-30.

the PITA. The taxpayer is regarded as a tax non-resident in Slovenia in the period when he would be regarded as a tax resident according to the domestic rules of article 6 of the PITA in Slovenia and, at the same time, also regarded as a resident of the other contracting state in its domestic tax rules. If the individual would be regarded as a tax resident according to the other contracting state's tax treaty, then Slovenia would follow the same or the corresponding interpretation in the domestic decision.

From a tax point of view, the “registered permanent address” should not be substituted with the wording “permanent home”. The latter undoubtedly has a wider definition, which the Slovene administrative court also confirmed.<sup>15</sup> An individual had been living and working in Slovenia and the Czech Republic for 30 years. Until 2011, he had a registered permanent address in Slovenia and also a centre of vital personal interests in Slovenia. He was undoubtedly a tax resident of Slovenia. In 2011, he deregistered his permanent address in Slovenia and also obtained his permanent residency in the Czech Republic. In both countries, he retained a home available to him.

Normally, the criterion of a permanent home is sufficient for solving the conflict because the individual has a permanent home in one contracting state and has only made a stay of some length in the other contracting state. However, the Slovene tax authorities conclude that, although his permanent address is no longer in Slovenia, the individual still has a permanent home in Slovenia available to him. It was concluded that the home in Slovenia is regarded as being used permanently because the individual must have arranged and retained it for his permanent use as opposed to staying at a particular place under such conditions. Therefore, it is evident that the intention is that the stay will be of a short duration. If the individual has a permanent home in Slovenia and in the Czech Republic, then it is necessary to look at the personal and economic relations.

The Slovene tax authorities concluded that his centre of vital interest remains in Slovenia through his wife, who is still a resident of Slovenia. In that context, the major issue arises if the Czech Republic issues the same decision based on the understanding of article 4 of the double tax treaty between Slovenia and the Czech Republic regarding the individual as a (non)resident of the Czech Republic. Even though both countries apply and use the interpretation and commentary of article 4 of the OECD Model, the allocation of taxing rights can only be decided with a mutual agreement procedure.

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15. SI: US [Administrative Court], 11 Dec. 2012, no. I U 958/2012.

A permanent home is considered as a residence home if, in the place where the individual possesses the home, this home is permanent, which is to say, the individual must have arranged and retained it for their permanent use.<sup>16</sup> It is irrelevant if the home is legally owned or rented as long as the use of it is permanent. The case law shows how reluctant the Slovene tax administration is to waive the taxing right of an individual if there is even small connection with Slovenia. With the increasing mobility of individuals, the current concept of “residence of a Contracting State” in the OECD Model, based on permanent homes, will slowly lose its importance as mobility and a new society with less attachment to material things (also permanent homes) is on the rise. Additionally, rising mobility calls for larger international departments of tax administrations to handle the rising amount of applications by dual residents.

An individual moving from one country to another for work purposes every 10 months in a year would therefore be obligated to register and pay income tax in all of the countries where they perform their working activities. One can only speculate what the administrative burden would be for the individual or their employer. There are no court cases on the decision of increasing home office cases in Slovenia (so far) that would arise during the COVID-19 pandemic and would include the dispute over the taxing right between the employment country and their forced home office work. The definition of the “resident” for any other person except the individual is laid down in article 4(3) of the OECD Model. It is obvious by the pre-2017 definition of article 4(3) of the OECD Model that the only criterion was the place of effective management.<sup>17</sup> The definition has not changed importantly in the 2017 version of the OECD Model in substance; only the decision on a case-by-case basis was given more importance. An enterprise is a resident of the state where the meetings of the board of directors or equivalent body are usually held, where the chief executive officer and other senior executives usually carry on their activities, where the senior day-to-day management is carried on, where the headquarters are located, which country’s laws govern the legal status, where its accounting records are kept, etc.<sup>18</sup> If the board of directors is suddenly not meeting anymore in the headquarters, the day-to-day management is done in home offices rather than in the office

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16. Para. 12 *OECD Model: Commentary on Article 4* (2017).

17. *OECD Model Tax Convention on Income and on Capital*, art. 4(3) (15 July 2014), Treaties & Models IBFD would read as follows: “Where by reason of provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, the it shall be deemed to be a resident only of the State in which its place of effective management is situated.”

18. Para. 24.1 *OECD Model: Commentary on Article 4* (2017).

building of the enterprise and the accounting records are kept in the cloud, the requirements for the place of effective management are suddenly scattered across many locations in and outside of the state where the enterprise has official headquarters.

In the author's opinion, the current decisive factor of "place of incorporation" should again be given priority. It has to be noted that, in the past, the "place of incorporation" posed a high risk for tax avoidance by establishing enterprises in low-tax jurisdictions, which is the reason that the tax rules departed from the principle of incorporation. In today's highly digitalized world and after a decade of fast development in the area of international cooperation in tax matters among OECD countries, it is possible to get back to the "incorporation" criterion.

The blacklist of non-cooperative or low-tax countries can be an additional refraining factor for investors to set up an enterprise therein as they value public opinion more than ever before. With digitalization, the negative or positive news can reach everyone in the world in minutes. On the other side, the business culture and strategic goals of enterprises no longer concern only profitability but also higher social and environmental awareness and intrinsic added value.

What is more, the enterprises will not give up their headquarters completely. It is impossible to be successful in business in the long-run if there is no cooperation between the key decision makers in the company and if the organizational culture is not nourished in person as well. Human beings are social creatures, so the place of effective management principle should also be the leading principle in the future for deciding on the tax residency of the enterprise.

Following this understanding, the rules of articles 9 and 16 of the OECD Model should stay unchanged.

### **26.3. Permanent establishments and mobility of work**

Slovene law stipulates in article 6 of the CITA<sup>19</sup> that a permanent establishment is a fixed place of business through which the business of an enterprise is carried out, especially but not exclusively a branch, an office, a factory, a workshop, a mine, etc. It can also be a building or construction site or

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19. Art. 6 CITA.



installation project if the duration extends over 12 months. An office is a typical example of that and, by renting an office in Slovenia, a permanent establishment shall be constituted. In this case, employees are liable to income tax and social security contributions in Slovenia. It is important that there is a “place of business” such as a premises and that the place of business is “fixed”, meaning it must be established at a distinct place with a certain degree of permanence.

Under certain circumstances, an employee’s home office can be seen as a permanent establishment for the foreign employer. According to the explanations of the Slovene tax authorities,<sup>20</sup> a home office is considered a permanent establishment of the foreign employer if the following requirements are met:

- there is regular use of the employee’s home office when completing work tasks for the foreign employer;
- the employer provides a clear statement of requirement that the employee works from home;
- office supplies and maintenance costs for facilities are borne by the employer;
- the home office is designated in the phone book as part of the foreign employer and a business card is made with the address of the home office; and
- the home office of the employee is accessible to other employees of the same employer.

When determining whether a home office is a permanent establishment, the type or significance of the employee’s activity for the foreign employer plays a major role.<sup>21</sup> Moreover, the extent to which the home office is available to the employer (e.g. control by the board) is also a main factor that could determine if a home office is, in fact, a permanent establishment of the foreign employer. The Slovene tax authorities are following the commentaries on the OECD Model by stating that an individual’s home office should not lead to the automatic conclusion that the location is at the disposal of their employer simply because that location is used by an employee who works for that foreign company. It always needs to be concluded on the facts and circumstances of each case.<sup>22</sup> Also, the German Federal Tax

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20. Tax Administration of Slovenia, *Mednarodno obdavčenje – poslovna enota* [International Taxation – Permanent Establishment] (16 July 2021).

21. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 5*, para. 59 (2017), Treaties & Models IBFD.

22. Para. 18 *OECD Model: Commentary on Article 5* (2017).

Court considers the control over a place of business as a crucial criterion for a fixed place of business.<sup>23</sup>

The key feature that constitutes a permanent establishment is a tangible place that is fixed in a geographic as well as temporal sense, meaning that an enterprise must be physically present at a fixed place of business over a particular duration of time in another country. Additionally, the enterprise must be able to show sufficient degrees of control over the employee's home.<sup>24</sup> It is also correctly noted in the informal writing of the Slovene tax authorities that only if it is clear from the facts and circumstances that the enterprise has required the individual to use their own location to carry on the enterprise's business, the existence of a permanent establishment is given.

An example<sup>25</sup> is a cross-frontier worker who performs most of his work from his home situated in one state rather than from the office that is available to him in the other state. If the employee is not required by the employer to work from home, then it should not be concluded that the home of the employee is at the disposal of the enterprise as it is employee's own decision to carry on its business activity from home. Conversely, the employer has given the employee the opportunity to work from the employer's headquarters. In this case, the home office as a permanent establishment is not constituted. Furthermore, it has to be noted that the accessibility of the foreign employer to access the home office of the employee is very important. If the employer has the key to the home office of the employee, then this could lead to the determination of the permanent establishment in Slovenia.

One can see how, in some places, the commentaries to the OECD Model are outdated, saying, "it should be noted that the vast majority of employees reside in a state, where their employer has at its disposal one or more places of business to which this employees report".<sup>26</sup> The recent 2 years of the COVID-19 pandemic combined with increasing digitalization have shown that this conclusion is not correct that even residents of the state of their employer would move to another state due to the fact that physical presence is no longer needed in many working situations or simply because cross-border migration is not possible.

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23. DE: BFH [Federal Tax Court], 4 June 2008, no. I R 30/70.

24. A. Storck & A. Zeiler, *Changes in the Concept of Permanent Establishment, in The OECD-Model-Convention and its Update 2014*, p. 243 (M. Lang et al. eds., IBFD 2015), Books IBFD.

25. Para. 19 *OECD Model: Commentary on Article 5* (2017).

26. Para. 19 *OECD Model: Commentary on Article 5* (2017).

Some authors<sup>27</sup> imply that simply activities and presence at a certain place over a sufficiently long period will be the decisive factor to create a permanent establishment. These authors seem to argue that, in the case of employees, it would mean that, in an extreme case, a company with any kind of offices would have permanent establishments in every single state in which one employee would stay for a longer period, such as 6 months or more. This would lead to extreme administrative burdens for the enterprise and, on the other side, would not bring any important income for the tax administrations and states budgets. An example is a painter<sup>28</sup> who spends 3 days a week for 2 years in the large office buildings of their main client. The mere presence of the painter in that office building where they are performing the most important function of their business (i.e. painting) constitute a permanent establishment of that painter.

In the author's opinion, article 5(1) of the OECD Model should be changed in a way that it would incorporate not only the simple activity but the term "effective power over the fixed place", which requires a qualified ability to use and access the home office of the employee at any given time. The enterprise must have an unrestricted right to use the place autonomously at any time. The power to effectively control a location and the permanence of the business activities are interconnected issues.<sup>29</sup> If an enterprise is able to exert a significant level of control over a place, the duration of an activity is less important for creating a permanent establishment.

Slovenia follows the international standards and the Commentary on the OECD Model, which now already explains clearly that the home office cannot per se trigger a permanent establishment of the employer in the employee's home state. The time threshold is of less importance than the control over the employee's home office by the enterprise, including whether the home office status is demanded by the enterprise or voluntarily chosen by the employee. With the rising mobility of work, the Commentary to Article 5 of the OECD Model on home offices needs to be redefined.

The extensive mobility of workers in Slovenia who use computer-based tools to perform their work activities is displayed in the practice of working

27. J. Lüdicke, *Recent Commentary Changes Concerning the Definition of Permanent Establishment*, 58 Bull. Intl. Taxn., p. 190 (2004), Journal Articles & Opinion Pieces IBFD; S. Bendlinger, *Ist das eine Betriebsstätte?* Nationalbericht zum IFA-Kongress 2009, Steuer und Wirtschaft International Tax and Business Review, p. 334 (2009).

28. Para. 17 *OECD Model: Commentary on Article 5* (2017).

29. J. Schaffner, *How Fixed is a Permanent Establishment?*, p. 137 (Wolters Kluwer 2013).

from their holiday home, which is often a second home. Historically, many Slovenians' holiday homes are on the Adriatic coast in Croatia. In the author's opinion, this means that Slovenia and Croatia have an extensive cross-border issue that is not approached by either of their tax authorities. This is due to the fact that it would require close cooperation between the two states' officials, and it is usually not positively accepted by Slovenia to be the country losing the tax income. It is possible in many cases that the holiday home on the Croatian coast fulfils all of the decisive factors for the long-term home office as it is fixed and permanent and usually owned by one of the family members. The reasons against the creation of a permanent establishment of the employer in the employee's holiday home are the facts that it is not accessible by the employer and that the employer has not ordered the employee to work from that location. In many cases, the employer has no information regarding the location where the employee is performing their work. One could start checking the employees' IP addresses, but it would represent an extreme administrative burden for the employer.

#### *Dependent agent as permanent establishment*

The definition of dependent agent in Slovene domestic legislation<sup>30</sup> is very close to the one from the OECD Model: "a person acting on behalf of an enterprise who has and habitually exercises an authority to conclude contracts in the name of the foreign enterprise, unless the activities of such person are limited to the activities of the preparatory or auxiliary character". A permanent establishment can also be assumed when a person operates in an area of any business activity in the name of the non-resident enterprise in Slovenia and is furthermore authorized to conduct contracts in the name of a non-resident and also frequently uses this right. This means that, even though a permanent establishment may not be constituted by working in a home office, the existence of dependent agent permanent establishment must be examined. As soon as a person signs the contracts, or if they are only playing the principal role leading to the conclusion of the contracts in the name of the enterprise that are routinely concluded without material modification by the enterprise, a permanent establishment of the foreign enterprise in Slovenia could be assumed. It is a clear case that the contracts must be in line with the enterprise's business, meaning that only the contracts are directly or indirectly leading to the turnover of the enterprise. Any kind of internal contracts such as employment contracts or contracts with

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30. Art. 6(3) CITA.

the electric, internet and water distributors are outside the scope of the qualifying contracts for a permanent establishment of the foreign enterprise.<sup>31</sup>

In the case of the dependant agent in the meaning of article 5(5) of the OECD Model, the importance of a fixed place of business for the foreign enterprise is not questionable. If the home office of the dependant agent is not supervised and easily accessed by the foreign enterprise, and in the absence of a right to conclude contracts, the dependant agent does not constitute a permanent establishment for the foreign enterprise.

#### *Service permanent establishment and home office*

The domestic legislation in Slovenia only follows the general definition of a permanent establishment without having any special provision on the service permanent establishment, including consultancy or management activities. Nevertheless, there is a definition of a service permanent establishment found in the tax treaties between Slovenia and Bulgaria, Canada, China, the Czech Republic, Malta, Slovakia and Thailand.<sup>32</sup> The purpose of the tax treaty is to remove the obstacles that lead to juridical double taxation. If the domestic legislation has no special rules for the service permanent establishment, then the non-resident performing services, including consultancy or management services, should be classified as having a permanent establishment in Slovenia only by the general rules of the fixed and permanent establishment.<sup>33</sup>

## **26.4. Physical presence according to articles 15(1) and 17 of the OECD Model**

Employment is exercised in the place where the employee is physically present when performing the activities for which the employment income is paid.<sup>34</sup> Further, if the employment is exercised in the home office of

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31. Tax Administration of Slovenia, *Mednarodno obdavčevanje - Izvajanje mednarodnih pogodb o izogibanju dvojnemu obdavčevanju* [Double Tax Treaties in the practice], p. 12 (Nov. 2019).

32. Art. 5(3b) of the tax treaty between Slovenia and the other contracting party – service PE: “the furnishing of services, including consultancy and managerial services, by an enterprise of a Contracting State through employees or other personnel engaged by the enterprise for such purpose, but only where activities of that nature continue in the territory of the other Contracting State for a period or periods aggregating more than 183 days within any twelve-month period”. . YES]

33. See Tax Administration of Slovenia, *supra* n. 31, at p. 8.

34. *OECD Model Convention on Income and on Capital: Commentary on Article 15*, para. 1 (2017), Treaties & Models IBFD.

the employee that is located in a different state than the headquarters of the employer, then the taxation right is completely with the residence state of the individual. The Commentary to the OECD Model is very clear on the allocation of taxation of an individual who is working at home. The Slovene finance administration follows the OECD definition in every detail without any deviation from it. As already extensively noted in section 26.1. of this report, it is irrelevant to the Slovene finance administration whether the home office is imposed by the government measures of any state or is chosen voluntarily by the individual.

According to domestic law, the term “salary, wages, and other similar remuneration” would include all income from an employment relationship and also from any other contractual relationship. Employment remuneration in a wider sense<sup>35</sup> has the same tax treatment also in cases where the employee received a payment but was not physically present at the workplace due to government restrictions. Legally, the indefinite contractual relationship between employee and employer is unchanged in pandemic times. Therefore, any kind of remuneration during the COVID-19 restrictions have the same treatment as the employment income before the pandemic.

The tax treatment is similar to that in the case of termination payments. Slovenia characterizes termination payments deriving from past employment as employment income.<sup>36</sup> Any kind of payment that a former employee receives from a former employer after the employment relationship has ceased to exist is viewed as a later payment of salary. It would be qualified under article 15 of the OECD Model as employment income.

The 2017 Commentary on the OECD Model provides guidance that such remuneration is covered by article 15 of the OECD Model. The income should be allocated on a pro rata basis to where the employment was exercised within the last 12 months, absent facts and circumstances indicating a longer period of time.<sup>37</sup> The same explanation should be used for payments in a time of imposed government measures and forced “stay-at-home” status

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35. Employment income is “compensation for giving to the disposal of the other party its working power and includes not just salary but also any kind of subsidies, benefits in kind, received in the respect of an employment, such as stock-options, the use of a residence or the use of the car, health or life insurance coverage, special club memberships, which are not in connection with the employers business, loan contract without interests, more favourable purchase of goods and services from the employer, cost of education of the employee or its family member, when there is no direct connection with the business purpose of the employer.”

36. Art. 35(1) PITA.

37. Para. 2.7 *OECD Model: Commentary on Article 15* (2017).

for many employees. The income received for that period of “stay-at-home” time has a sufficient connection to the previously exercised employment, therefore, it should follow predominant international practice in this respect.

Some jurisprudence in the European Union shows that non-working days (private and public holidays and weekends) may not be considered in the formula to define the allocation of the tax ratio between the employment and residence state because the country of employment has the taxation rights for only that part of the remuneration for which the employee effectively worked in the country of employment.<sup>38</sup> The exclusive right to tax the employment income during the pandemic is where the individual is actually physically present.

Physical presence in taxation is also important for sportspersons. Resident sportspersons or entertainers in Slovenia can pay a withholding tax in the state of performance or training but only to the extent of their physical presence in that state. Not only performance but rehearsal and training (or similar preparation) are part of the normal activities of entertainers and sportspersons.<sup>39</sup> Slovenia will grant resident sportspersons or entertainers the right to deduct the foreign imposed source tax. Nevertheless, the exclusive taxation right is with the resident state of Slovenia only in cases where the performing artists or sportspersons receive any remuneration on the basis of the exchange programme concluded between Slovenia and the other contracting state or when the remuneration is directly financed from the public funds of the Republic of Slovenia.

In domestic legislation, the non-resident sportspersons or entertainers performing in Slovenia are taxed at the rate of 10.5% on their gross income that is gained in Slovenia unless they claim with presented evidence to have costs that are higher than 30% of their gross income. The measurement of their taxation at source are the days of physical presence in Slovenia. When the remuneration received by an entertainer or sportsperson employed by a team, troupe or orchestra covers various activities to be performed during a period of time (e.g. an annual salary covering various activities such as training or rehearsing; travelling with the team, troupe or orchestra; participating in a match or public performance, etc.), it will therefore be appropriate, absent any indication that the remuneration or part thereof should be allocated differently, to allocate that salary or remuneration on

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38. For Austria, AT: Federal Ministry of Finance, EAS484, 5 Aug. 1994. For Belgium, BE: Circular AFZ 2005/0652 of 25 May 2005.

39. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 17*, para. 9.1 (2017), Treaties & Models IBFD.

the basis of the working days spent in each state in which the entertainer or sportsperson has been required under their employment contract to perform these activities.<sup>40</sup>

In the era of new types of entertainers such as influencers who use new live streaming on social media or other apps, one would need to think about the taxation based on place of consumption rather than on the taxation of the physical presence of the entertainer. The entertainer can easily choose the place of physical presence in order to achieve optimal tax planning. As these apps are usually controlled and managed by bigger software developing companies, the taxing should be made at source by the controller of the platform that the influencers are using. It would mean an important shift from the taxation place of their physical presence to taxation based on revenue that they generate from a specific market jurisdiction.

## **26.5. Article 15(2) and (3) of the OECD Model**

The employment income of a resident of the first contracting state performing work in the other contracting state is, according to article 15(2) of the OECD Model, in the other contracting state if any of the following three conditions is not met: (i) the 183-day threshold; (ii) the economic employer; and (iii) the permanent establishment of the employer in the residence state of the employee.

The first condition is that the exemption is limited to the 183-day period in any 12-month period.<sup>41</sup> There are no specific rules in Slovenia on the definition of the 183-day period. The “days of physical presence” method is followed. Under this method, the following days are included in the calculation: part of a day, day of arrival, day of departure and all other days spent inside the state performing employment such as Saturdays and Sundays; national holidays; holidays before, during and after the activity; short breaks (training, strikes, lockouts, delays in supplies); days of sickness (unless they prevent the individual from leaving and they would have otherwise qualified for the exemption); and death or sickness in the family.<sup>42</sup> In practice, it is extremely difficult to determine upfront whether the employee will be performing their work in the other contracting state over the 183-day period.

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40. Para. 9.2 *OECD Model: Commentary on Article 17* (2017).

41. Para. 4 *OECD Model: Commentary on Article 15* (2017).

42. Para. 5 *OECD Model: Commentary on Article 15* (2017).



The administrative and financial burden connected with the retroactive taxation in the state of activity often leads to double taxation.

The second condition of an economic employer requires that the employment remuneration is not paid by an employer that is a resident of the state of activity. It requires that the headquarters of the employer or any other (associated) enterprise bearing the cost of the payroll of the specific resident individual are not in the state of activity. Usually, the employer in this case is the resident of the same state as the employee trying to define taxing rights under article 15 of the respective tax treaty. Under the presumption that the employer has no headquarters anymore, the location of the CEO working from home is the decisive factor for the determination of the residence of the employer. For the purpose of this article, the CEO should not be a resident of the state of activity. The rule is fulfilled if the resident state of the employer, based on the place of effective management, is any other state than the state of activity of the employee.

In the author's opinion, the current widening of the permanent establishment principle could, in conjunction with article 15(2)(c) of the OECD Model, lead to many more cases of taxation of employment income in the state of activity than the two other conditions of article 15(2) of the OECD Model, which would then become obsolete. Further, as discussed, the employee can only be understood as constituting a permanent establishment for the employer if the employer would have access to the employee's home office without restrictions and if the demand to work from home would come from the employer and would also be inserted into the employment contract.

The mobility of workers in international traffic has obviously showed the legislature that it is impossible and only with the extreme administrative burden to allocate the taxing rights of an employee who is a member of the regular complement of a ship or aircraft exercised and is aboard the ship or aircraft while operating in international traffic. The residence state has exclusive taxation right of such an employee. This principle of taxation could be used for the taxation of employees working exclusively in a home office. The mixed model of working in a home office and in an employer's headquarters would still require the split of the taxing right as the employee is using the public services of the state of activity when working in the headquarters of the employer.

## 26.6. Frontier workers

Slovenia borders the three other EU states of Austria, Croatia and Hungary. As all of the neighbouring countries are within the European Union, the free movement of people has enabled many residents of Slovenia to work in those countries but live in Slovenia. The bilateral tax treaties, however, do not incorporate any rules for special tax treatment of frontier workers although, in current daily tax practice, special treatment for the daily commuters from Slovenia as a resident country would be greatly welcomed.

## 26.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)

A change to domestic law as in the time of the COVID-19 pandemic has no effect on the application and interpretation of international law except otherwise concluded. Tax treaties are a source of international law. They are concluded following the principles of free consent and good faith (*pacta sunt servanda*).<sup>43</sup> Any contracting state ratifying a treaty has consented to be bound by the treaty and cannot unilaterally change its position. During the COVID-19 pandemic, the Slovenian Government did not accept any internal tax rule that would oppose the application of the tax treaty. There were no consultations or any mutual agreements on tax matters accepted.

Force majeure is not relevant in the application of the tax treaty as the purpose and aim of the tax treaty is to eliminate juridical double taxation. If the individual was forced to stay in the home country for a longer period than planned due to restrictions to travel, then they would have to check the regulations on individual taxation immediately according to the definition of the Slovene view. However, in practice, the author has not seen many changes in taxation yet. It is noted that, in the time after COVID-19 pandemic, interested parties, employers and employees are making the decisions on long-term models of taxation and social security attribution slowly, especially in the case of frontier workers.

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43. UN Vienna Convention on the Law of Treaties, art. 26 (23 May 1969), Treaties & Models IBFD.

## **26.8. The future of the mobility of work: A need for adjusting the existing treaty rules?**

The mobility of work has increased exponentially throughout the last 15 years with fast development of computer-based working tools and increasing digitalization creating new forms of working platforms followed by increasing international taxpayer mobility. Digitalization has enabled work from almost<sup>44</sup> anywhere. This type of work can usually be executed by individuals who are commonly in the higher income brackets and can relocate more easily to the places where taxation is more favourable. As a consequence of increased mobility, countries could face personal income tax and social security contribution base erosion.

Article 15(2) of the OECD Model should limit the taxation right of the state of activity to the days of physical presence only and give more taxing rights to the resident state of the employee. The 183-day rule is not appropriate anymore as, in practice, the changes in work tasks and locations are often more frequent, and the upfront decision on the fulfilment of the 183-day rule is not possible. On the contrary, if the upfront decision on meeting the 183 days in the state of activity is not made, the employers often face double taxation of the salaries of posted workers under article 15(2)(a) of the OECD Model, firstly in the residence state and secondly (usually) retroactively in the state of activity. The allocation rule in article 15(2)(a) should be adjusted so that the source state would retain the tax for the days of physical presence of the employee regardless of the actual days of physical presence. One could argue that the administrative burden would be much higher, but not necessarily. The author sees more coherence and justice in the taxation of an individual and fairer distribution of tax income among countries. As far as effective tax collection is concerned, the digitalization of the worldwide systems goes hand-in-hand with the mobility of work.

With the expanding mobility of work, it should be made much easier to employ a person who is a resident of any other state to be able to fulfil the administrative obligation of the tax and social security registration in the individual's residence or activity state. In general, the right of taxation should stay with the residence state or the state where the individual is using the public service. The question arises of what kind of consequences would arise with an employee who changes their working location on a frequent basis among many places also in Slovenia. In the present system, the employer has the legal obligation to calculate, submit and pay

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44. As long as there is fast and reliable internet connection.

the personal income tax and social security contributions in the name of and for the account of the employee. Moving from the employer's state of activity to the state of residence, the administrative obligation would fall on the employee. It should be the responsibility of the individual and not the employer to report the income from employment to the competent tax authority. This is already the system in Slovenia. There is no reporting obligation of the foreign employer. The whole administrative burden is on the employee. Following that, there is an even greater challenge regarding tax avoidance and evasion as many individuals do not have enough knowledge to fulfil their tax obligation in the residence state. Digitalization poses the opportunity for improving tax platforms into interconnected ones. The banks have all of the information on an individual's residence state through their financial accounts. This information is updated regularly and already accessible. Sharing this information across OECD countries on their residents would mean a step forward in determination of the correct resident state of an individual and to give the full responsibility of the tax reporting to the employee. The employer would then give the employee the full gross salary including the employer's social security contribution and the employee would be liable to report the received salary in due time and manner to the tax authorities of their residence state. In this case, the foreign employer(s) have no administrative or other tax and social security obligations in Slovenia.

As has been seen in the area of corporate taxation,<sup>45</sup> the introduction and implementation of taxation rules among the OECD member states and beyond does not take decades but can be adopted and implemented in a few years.

It is true that increased mobility poses risks for the tax revenues of a particular state but, on the other side, an easy-to-use digital platform for OECD countries should be introduced to enable very mobile individuals to submit the data about the monthly gross payment and their physical presence directly to this uniform platform. The tax administrations of every state in which they have been present would issue the tax decision on their personal income tax to be allocated and paid to that state of activity. The tax administration of the residence state would have all of the data accessible in digital form and also the other contracting states' tax decisions on personal income tax.

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45. Pillar One seeks to ensure a fairer distribution of taxing rights among countries for MNEs, and Pillar Two seeks to introduce the minimum global corporate tax rate.

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## Chapter 27

### The Impact of Tax Treaties on International Mobility of Work in South Africa

Jennifer Roeleveld

#### 27.1. Mobility of work and domestic tax law

There are two tests for tax residency<sup>1</sup> of natural persons in South Africa. One is the ordinarily resident test, and if that does not apply, then the physical presence test could apply if a person exceeds a certain number of days' stay in South Africa, determined over a 5-year period. Residents<sup>2</sup> under either test are taxed on their worldwide income. Non-residents are taxed only on South Africa-source income. Being compelled to spend more than the threshold number of days in South Africa could trigger worldwide taxation.

The physical presence test is: a "natural" person is one who is physically resident in South Africa for periods of at least 91 days in each of the current and preceding 5 years as well as at least 915 days in aggregate for the 5 years preceding that. The number of days does not need to be consecutive. If any one part of the test is negative, the test fails.<sup>3</sup> If the person is physically outside South Africa (after being deemed a physical resident) for at least 330 consecutive days from the date of departure, they will be deemed a non-resident from the date of that departure. There is an override of the residency test if the person is deemed to be exclusively a resident of another country for the purposes of the application of a double-tax agreement. This override also applies in the case of corporate residency.<sup>4</sup>

There are no concessions for forced prolonged periods spent in South Africa. This is unfortunate, as the implications of being deemed a tax resident can

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1. ZA: Income Tax Act 58 of 1962 (ITA), 25 May 1962, sec. 1(a) Definition of "resident", Primary Sources IBFD.

2. The term resident or non-resident in this article refers to tax residency.

3. For example, if only 80 days are spent in South Africa in 1 of the 5 years and all the other requirements are met, the test fails and the person is not deemed to be physically resident.

4. A company or trust is deemed a resident if it is incorporated, established, formed or has its place of effective management (PoEM) in South Africa (sec. 1(b) Definition of "resident" ITA).

have disastrous tax effects. However, the override of being deemed exclusively a resident of another country (once this is established) would serve to prevent such an event. The other override of being absent for 330 days could also assist, but it is retroactive and can only be invoked after 330 days, which may only be established in the following year of assessment.

### 27.1.1. Work abroad

A special exemption exists in respect of remuneration earned while temporarily absent from South Africa. For this to apply, the employee must spend in excess of 183 days in any 12-month period outside South Africa. Of the 183 days, 60 must be consecutive. For a limited period during the pandemic (2021 year of assessment), the 183 days were reduced to 117. It is doubtful that any exit tax could be imposed in these circumstances.<sup>5</sup> Exit tax can only be imposed when a person declares that they are no longer ordinarily resident or, if physically tax resident, they no longer qualify under the days test. Moreover, there is no compromise regarding voluntary or imposed stays.

### 27.1.2. Corporate residence

The residence of a corporation<sup>6</sup> is where it is incorporated, established, or formed, or else which has its place of effective management (PoEM) in South Africa.<sup>7</sup> The company bears the onus of proving its PoEM and must retain the necessary evidence to support the view taken.<sup>8</sup> Where it has to be determined whether a person that is a foreign investment entity has its PoEM in South Africa, no regard must be given to any activity that:

(1) constitutes —

(a) a financial service as defined in section 1 of the Financial Advisory and Intermediary Services Act, 2002 (Act no. 37 of 2002), or

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5. Sec. 10(1)(0) ITA.

6. Sec. 1(b) Definition of “resident” ITA.

7. SARS, *Resident: place of effective management (persons other than natural persons)*, Interpretation Note 6 (issue 2) (3 Nov. 2015), available at <https://www.sars.gov.za/wp-content/uploads/Legal/Notes/LAPD-IntR-IN-2012-06-IN-6-Resident-Place-of-effective-management-companies.pdf> [hereinafter *SARS Interpretation Note 6*].

8. ZA: *Tax Administration Act 28 of 2011* (TAA), secs. 29 and 102, Primary Sources IBFD. The SARS approach aligns with the OECD Commentary on PoEM.

(b) any service that is incidental to a financial service contemplated in subparagraph (a) where the incidental service is in respect of a financial product that is exempted from the provisions of that Act, as contemplated in section 1(2) of that Act; and

(2) is carried on by a financial service provider as defined in section 1 of the Financial Advisory and Intermediary Services Act, 2002 (Act no. 37 of 2002), in terms of a licence issued to that financial service provider under section 8 of that Act.<sup>9</sup>

The PoEM of a corporation could shift if board members are in a different country from the corporation. This means that the residence of the corporation could change. When residency changes, there are capital gains tax implications. If this occurs, there is, on becoming tax resident in South Africa, a market value base cost assumed for assets (for the future) and a deemed capital gains tax disposal (exit tax) on ending residency in South Africa.<sup>10</sup> In *Commissioner for the South African Revenue Service v Tradehold Ltd*,<sup>11</sup> the residency of Tradehold moved from South Africa to Luxembourg when the decision was made to hold all future board meetings in Luxembourg. This illustrates the proviso to the residency test that if a person (which includes a company) is exclusively resident in another country for the purposes of the application of a tax treaty, then they are not resident in South Africa.<sup>12</sup>

If all employees work from home, in a different country, and the company no longer has sufficient workplaces to substantiate a presence in South Africa, then the PoEM will have to be redetermined. It is possible that this could still be in South Africa but, if not, an exit tax would arise on ceasing

9. Section 1(b) Definition of “resident” ITA.

10. There is, however, no exit tax in respect of an asset which is immovable property or shares in a company, their value being at least 80% derived from immovable property in that company. The exit tax for these assets will only occur on actual disposal of the property or shares.

11. ZA: SCA [Supreme Court of Appeal], 8 May 2012, *Commissioner for the South African Revenue Service v Tradehold Ltd* ZA; See C. West & J. Roeleveld, *Chapter 4: South Africa: Transfer of Seat and Exit Taxation: Treaty Override?*, in *Tax Treaty Case Law around the Globe* 2012 (E.C.C.M. Kemmeren et al. eds., IBFD 2013), Books IBFD. The main contention in this case was the timing of an exit tax, in respect of capital gains tax on ceasing to be resident, when the PoEM moved. The domestic law was amended after this decision to ensure that residency ended the day immediately preceding ceasing to be a resident, so that the exit tax could be levied in the last tax return of the company. ZA: SCA, 8 May 2012, *Commissioner for the South African Revenue Service v. Tradehold Ltd* (132/11), [2012] ZASCA 61; [2012] 3 All SA 15 (SCA); 2013 (4) SA 184 (SCA), available at <https://www.saflii.org/za/cases/ZASCA/2012/61.html>.

12. Sec. 1 Definition of “resident” proviso ITA.

to be resident. If the company is a foreign company with a permanent establishment (PE) in South Africa, and there is no longer a significant presence in South Africa, this could mean that the status of permanent establishment ceases and exit taxes will arise.<sup>13</sup> A person working from home in South Africa for a foreign company could constitute a PE for the company. This would depend on satisfying all the requirements for establishing whether a PE exists as per article 5 of the OECD Model.<sup>14</sup> It is clear that premises-based substance requirements are no longer appropriate for all situations in the context of the increasing mobility of work.

### 27.1.2. Retirement funds

The rules in respect of retirement funding and where lump sums and/or annuities are to be taxed will certainly be affected when residency changes. South African exchange control rules also restrict the movement of retirement interests on ceasing to be resident.<sup>15</sup> The nexus currently is where the services are rendered while making contributions, which in turn determines how much of a future annuity or lump sum will be subject to tax in South Africa. If part of the services are rendered offshore for qualifying periods (e.g. in excess of 183 days in a 12-month period), then the ratio of years outside South Africa over total years of service applied to the lump sum or annuity will be excluded from the South African tax base. The income tax and retirement fund laws are currently aligned, but the fact that funds can be blocked in South Africa is no longer deemed appropriate.<sup>16</sup>

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13. At the time of writing, no changes have been made to *SARS Interpretation Note 6*, *supra* n. 7.

14. South Africa has reserved against the agency PE changes in the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (7 June 2017), Treaties & Models IBFD and reserved against the use of the new art. 7 *OECD Model* and the so-called authorized OECD approach (AOA) to PE profit attribution.

15. An attempt was made in 2021/22 to levy an exit tax on retirement fund interests on ceasing to be resident. This was put on hold as it became clear that double tax treaties would have to be amended or revised by protocols before such changes could be made.

16. In 2020/21, legislation was proposed to enable retirement fund interests to be exported on ceasing to be resident and also that an exit tax would be imposed. This proposal was withdrawn as it was not in accordance with existing tax treaties. It was proposed that this would be revisited together with taking the treaties into account or renegotiating treaties if necessary. The calculations required to determine the taxable and exempt portions of retirement annuities are found in the Second Schedule to the ITA.



## **27.2. Residence, tiebreaker rules and mobility of work: Individuals and entities**

### **27.2.1. Article 4(1) of the OECD Model**

There should be no impact on residence status when either more or less time is spent in South Africa, providing the individual has claimed that they are *ordinarily resident* in South Africa. Even if no time is spent in South Africa, they will still be tax resident. However, if an individual is only tax resident because of the physical presence test, then spending more or less time in South Africa for whatever reason will redetermine tax residency under article 4(1) of the OECD Model. If all employees of a corporation commence working from home, there is a risk that the corporation no longer meets the substance requirements and therefore loses treaty entitlement.

### **27.2.2. Article 4(2) of the OECD Model**

The tiebreaker clauses in 4(2) a-c of the OECD Model are not dependent on work time spent in a particular country, so unless personal circumstances also change, the author would submit that there is no impact here. If dual residence and circumstances have not changed (e.g. none of the permanent homes are given up), then it would still be up to the competent authorities to settle the question by mutual agreement. If personal circumstances, such as having a different habitual abode or disposal of one of the permanent residences changes because of mobility of work, then the residence status will need to be redetermined.

Unless the factual circumstances change, it is doubtful whether residence status will change because of involuntary longer work stays in a country. It may well be that for convenience's sake, as longer work stays become more permanent, individuals choose to change their personal and family living arrangements, which in turn need to be re-evaluated under article 4(2) a-c of the OECD Model. It remains to be seen if interpretation issues do arise in future. Longer stays in a country could influence the competent authorities as to factual residence, when these are voluntary.

It is possible that factors such as “permanent home”, “centre of vital interests” or “habitual abode” will in future be more complex and maybe prove inadequate for determining residency, leaving it up to the competent authorities, who would probably decide in favour of their own country, leaving the individual subject to tax in both countries. It is submitted that existing

decisions of the courts regarding residency<sup>17</sup> may no longer be sufficient, as lifestyles no longer “fit the norm”.

### 27.2.3. Article 4(3) of the OECD Model

If the board members of a corporation move to or from a country, this can certainly affect the residency of the corporation.<sup>18</sup> Prior to the OECD Model (2017) wording, in situations of dual residence, the competent authorities had to decide where the residence of the corporation was deemed to be. The authorities would need to take the PoEM and the place where it is incorporated or otherwise constituted as well as any other relevant factors into account. Treaties with this wording would indicate that if board members move residence, whether voluntarily or not, that this could be regarded as “other relevant factors” to be taken into account when determining residency. According to the OECD Model (2017) wording, the determining factor is the PoEM, which is crucial in determining the residency of the corporation. Recent case law in South Africa suggests conflicting views on where the PoEM may be.<sup>19</sup> In terms of the South African Revenue Service (SARS) Interpretation Note no. 6, issue 2, it states at 4.2.5: “[a]ccordingly, it is important not to place an undue focus on the location where board meetings take place without considering the surrounding facts and circumstances of a particular case.”<sup>20</sup> It is submitted that the PoEM is dependent on the specific facts and circumstances. To the extent that extraordinary and temporary situations arise, as with the COVID-19 pandemic, it is unlikely that

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17. See ZA: HC ECB, 31 Mar. 1992, *Commissioner for Inland Revenue v. Kuttel* (349/90) [1992] ZASCA 60; 1992 (3) SA 242 (AD); [1992] 2 All SA 151 (A), *Cohen v. CIR* [1946] AD 174, 13 SATC 362.

18. In ZA: Court of Appeal, 17 Apr. 1906, *De Beers Consolidated Mines Ltd v. Howe* [1906] AC 455, the finding was that “the directors’ meetings in London are the meetings where the real control is always exercised in practically all the important business of the company except the mining operations” and set the principle that “the real business is carried on where the central management and control actually abides.”

19. ZA: HC WCC, 13 June 2011, *Oceanic Trust Co Ltd NO v. C: SARS* [2012] JOL 28880 (WCC), 74 SATC 127.

20. SARS Interpretation Note 6, *supra* n. 7. The PoEM is deemed to be the place where key management, and commercial decisions that are necessary for the conduct of its business as a whole are in substance made. A number of factors are however to be considered such as: where the real top level of management or realistic, positive managements of the taxpayer is exercised; where the decisions are made at more than one location, the company’s PoEM will be the location where those decisions are primarily or predominantly made; and a substance over form test, which requires the identification of those persons in a company who actually “call the shots” and exercise “realistic, positive management” and which recognizes that changes in telecommunications, information technology, global travel and modern business practices can impact on the PoEM.

the PoEM will be impacted. However, if relocations of executives become more permanent, then the PoEM will need to be re-assessed as the tax residency of the company could have shifted, which will give rise to different tax consequences. If a company ceases to be resident in South Africa, exit taxes will arise in the form of capital gains tax and dividends tax. Capital gains tax exit charges could also be triggered for directors in their personal capacities as their tax residency changes. Directors' fees paid would have their source where the company is resident.<sup>21</sup> Therefore, if the company's residency shifts, so does the source of directors' fees. The shifting of corporate residence will also affect the source of dividends for shareholders as these would require a withholding in the country of residence of the company (article 10 of the OECD Model).

It will be difficult to track these movements in residency status. The SARS has introduced additional new questions to the annual e-filing return (from 2021) which requires taxpayers to state when they became tax resident in South Africa and when tax residency in South Africa ceased. This was not a requirement previously. Evidence of this will be required.<sup>22</sup> The requirement will apply to ceasing South African residency on the bases of either (i) no longer being ordinarily resident or (ii) proving that the physical presence test is not met and (iii) declaring non-residence through a tax treaty. It is a start in keeping more accurate data on the timing of shifting residence, but does place the onus on the taxpayer to provide the evidential information. Becoming tax resident in South Africa comes with the onus on the taxpayer to value all their assets at that date in order to set the base cost for future capital gains tax when disposals of these assets take place. For listed shares, there is always a public listing of market value at any given time, so this is not problematic. However, for other assets, such as unlisted shares, movable assets or immovable property, it would have to be proven with a valuation certificate or similar document what its value was on the day of becoming tax resident. If this cannot be proven, a value of nil will be assumed, which means higher capital gains when the assets are sold or when residence ceases. This applies to both corporates and individuals and is not a desirable outcome.

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21. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 16* (21. Nov. 2017), Treaties & Models IBFD.

22. The SARS has published guidance on its website which sets out the documentary requirements that must be met to evidence the cessation of an individual's South African tax residence. Standard requirements are (i) a signed declaration indicating the basis on which the taxpayer qualifies; (ii) a letter of motivation setting out facts and circumstances in detail supporting the declaration; and (iii) a copy of the taxpayer's passport/travel diary. Specific additional information in support of the declaration is also laid out in the guidance note.

The problems associated with article 4(3) of the OECD Model extend into the distributive rules of article 8 (shipping, inland waterways transport and air transport) and article 16 (directors' fees). Residence of the corporation determines the taxing rights, so the PoEM becomes crucial. It is also necessary to distinguish between remuneration for services (article 15) and remuneration for attending board meetings in each case. Remuneration for services will be taxed where the services are rendered and directors' fees taxed in the country where the company is resident.

### **27.3. Permanent establishments and mobility of work**

A home office or board room could constitute a fixed place of business if it is considered to have a certain degree of permanence. This was considered to be the case in a 2015 court judgment.<sup>23</sup> If an individual works from home on a more permanent basis, it could be considered a fixed place of business PE for tax treaty purposes. However, it would need to be established that the employee is not an independent agent under article 5(6). As an employee, it is doubtful whether they would be independent. A self-employed individual is more likely to be an independent agent under article 5(6) of the OECD Model, but the terms of the contract would need to be explored to establish the nature of the relationship. If the self-employed person is working in the ordinary course of their own business, they would not create a PE for the foreign entity.<sup>24</sup>

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23. In the unreported case of ZA: TC, 15 May 2015, *AB LLC and BD Holdings LLC v. the Commissioner of SARS* (heard in Feb. 2015), the court had to determine whether or not a US company acting as an advisory group for the South African airline industry had created a PE in South Africa. The court held that the US company had created a PE because its employees had been in South Africa furnishing the consultancy services for more than 183 days and because it had a fixed base in the boardroom of its South African client (it had exclusive use of the boardroom for the entire duration of its contract). Based on this reasoning by the court, the US company was found to be liable for tax on the profits attributable to the services it rendered to its South African client. Penalties and interest were also charged.

24. In ZA: TC, 1975, *SIR v. Downing* (1975) (4) (SA 518(A) 37 SATC 249), it was established that the broker in South Africa was acting within the scope of his ordinary functions as a stockbroker (for all his clients including Downing) under para. 5 of art. 5 applied in terms of the *Convention between the Republic of South Africa and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income* (8 May 2007), Treaties & Models IBFD.

### 27.3.1. Digital nomads

The activities of digital nomads (working from a flex office rather than a home office) affected by the pandemic could constitute a PE. If the flex office is a permanent feature of their contracts, then the flex office could be regarded as a fixed place of business under such an arrangement. The author submits that this would be the case even if there was no pandemic.

When calculating the period of time spent in a country, the aggregate number of days spent there by each employee is added together with that of other employees to determine whether the 183-day threshold has been breached. (The 183 days is calculated with reference to a 12-month period and not assessment years). For example, if there are three salespersons, each spending 2 months in a 12-month period in South Africa, this could give rise to a PE, taking into consideration any exemptions in a tax treaty such as ancillary work (not part of the real business of the company). Once a PE is established, it becomes resident in South Africa, and all profits properly attributed to that PE will be subject to transfer pricing, thin capitalization rules and any other adjustments required in terms of the Income Tax Act (ITA).

South Africa has reserved the right to use the version of article 7 of the OECD Model and the relevant commentary immediately prior to the July 2010 update. Article 7(2) of this model requires that the profits to be attributed to a PE are those which that business would be expected to make if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar market conditions. As South Africa interprets article 7 in accordance with the Commentary as it stood before the 2010 update, the SARS will apply arm's length principles when attributing profits to a PE, and will not accept notional charges or expenses in calculating the profits to be attributed to the PE. The SARS will apply consistent principles. Currently it does not make a difference whether a home office is imposed or recommended by government to satisfy public health measures, as this is not catered for in the legislation. The author submits that if a PE is constituted because of the COVID-19 pandemic or a similar situation continuing for a much longer period than was expected, the facts and circumstances will need to be redetermined. The conditions created may also become a more permanent way of working, regardless of a pandemic or similar emergency measures.

### 27.3.2. Article 5(3) of the OECD Model

The mobility of work could well affect geographical and economic coherence for future PEs, for example, if supervisory activities are exercised outside of the state where the construction site is located, due to the fact that these activities can now be conducted remotely. Overall, the construction project is still the same and should still be treated as a PE. However, it is not yet clear how these situations will be dealt with. If the 12-month period could so easily be broken up that a PE not be established under article 5(3) of the OECD Model, this will lead to avoidance. It is submitted that article 5(3) is too rigid to accommodate the new way of working. It is further submitted that merely adding to the commentary is also not helpful. Article 5(3) needs to be seriously reconsidered in the light of the mobility of work. The PE concept has already changed/evolved with the addition of case law and commentaries. It will also become even more difficult to detect a PE in many cases where certain activities are conducted remotely. The PE requirements have already been stretched beyond what was envisaged, and this means that the concept we currently have is no longer appropriate.

### 27.4. Physical presence according to articles 15(1) and 17 of the OECD Model

South Africa has abundant case law on the concept of source as, prior to 2001, it had a source-based tax system. The source of the income had to be established, and through case law, the principle of “where the services are rendered” became the rule to determine the source of the services and in turn to determine the taxing rights.<sup>25</sup> This would still be a determining factor for non-residents as they will be taxed on South Africa-source income. It seems that the dominant cause of earning the income (for a non-resident) will determine South Africa’s right to tax according to recent case law. This means looking at the contract and, if predominantly related to work performed in South Africa, South Africa would have the right to tax all of that income.<sup>26</sup> For South African residents who are taxed on their worldwide income, absences from South Africa would have to satisfy the 183-day rule (article 15(2) of the OECD Model) in order to enjoy some exemption from South African taxation.

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25. ZA: A, 30 Mar. 1946, *CIR v. Lever Bros and Unilever Ltd* (1946 AD 441) 14 SATC 1; ZA: TC, 1958, *COT v. Shein* (1958 FC) 22 SATC 12 (where the responsibility was exercised) and ZA: HC WCC, 9 Mar. 2018, Income Tax Case No: 14218 (employment contract required the work to be done predominantly in South Africa).

26. Income Tax Case No: 14218 (9 Mar. 2018).

It would make no difference if a home office were imposed by government measures during COVID-19 prevention measures, as the law has not provided for this. There is only an exception for article 15(2). The absence of a particular measure also impacts the deductions permitted for using a home office,<sup>27</sup> which can be claimed against remuneration earned. Deductions for using a home office are extremely limited and rigid, and although taxpayers attempted to claim additional periods of home office use, these were mostly denied by the SARS, as it was not a requirement of their employer. Independent contractors and commission earners are not limited in the deductions they may claim, provided the expense is in the production of income. As employees working from home becomes more common, there may well be a shift towards employees re-engaging with their employer as independent contractors or commission earners. A potential new classification may be required between a fully-fledged employee at the one end and the independent contractor at the other.

If severance payments are made, these would follow the source of the income, and if South Africa and none of the income were exempt, then South Africa would be entitled to tax. Severance payments are specifically included in gross income under “gross income”, paragraph (d) of the ITA. This means the domestic law overrides the capital nature of such amounts. It does not override source, but once source is established as South Africa, paragraph (d) operates to include these payments in income. The source would be where the services were rendered, giving rise to the severance payment.

“Stranded workers” who, due to travel restrictions, are prevented from returning to their state of residence or to the state where they usually exercise their employment, will be taxed in the resident state, as temporary absences are ignored. Non-residents could arguably split their income between the source state and their resident state, but there would have to be a splitting of the employment contract, as the dominant source may be applied in South Africa, as noted above.

#### 27.4.1. Article 17 of the OECD Model

Artists and athletes are taxed where public performance takes place. This is in accordance with domestic law<sup>28</sup> and article 17 of the OECD Model. These

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27. Sec. 11(a) ITA read together with sec. 23.

28. Part IIIA Income Tax Act 58 of 1962, secs 47A-47K.

sections mirror article 17 of the OECD Model. Rehearsing and training would be taxed in the resident state as these are not regarded as performing to the public. When the artist or athlete is prevented from performing in another contracting state due to travel restrictions and public health measures, then no performance has taken place, and under domestic law, sections 47A to 47K of the ITA do not apply, nor does article 17 of the OECD Model. This is because no concessions were made for pandemic situations and also because article 17 of the OECD Model is quite rigid with regard to “public performance” actually happening. It remains to be seen whether concessions may be introduced.

There are various alternative measures of which use was either increasingly made or which were introduced during the COVID-19 pandemic, such as live streaming and conducting virtual concerts. These are methods of enabling public viewing which substantiates that a performance takes place and is viewed by the public. Where the artist or athlete actually performs determines the taxing rights. This may now be in the entertainers’ own resident state. It must be foreseen that where different countries are competing, this would still require performance in a particular country. However, taking the example of a choir or orchestra, when unable to travel to other countries, they merely live-stream their performance from the resident state. This renders article 17 of the OECD Model and sections 47A-K of the ITA inapplicable, and the normal rules of where the services are rendered will apply. However, public performance has still taken place, but the source remains in the resident state. It is submitted that South African influencers be taxed under the normal rules of services rendered or business income on a worldwide basis in situations where they have not moved into the realm of entertainer. There is no policy or guidance issued by the SARS for these types of income streams and, therefore, normal domestic rules would apply, depending on the nature of the income.

### **27.5. Article 15(2) and (3) of the OECD Model**

The equivalent domestic law (section 10(1)(0) of the ITA) applying under article 15(2) of the OECD Model requires periods exceeding 183 full days in aggregate during the year of assessment (for ship crews, section 10(1)(0)(i) of the ITA) and during any period of 12 months (for other employment, section 10(1)(0)(ii) of the ITA) outside South Africa. In addition, for other employment, there must be a period of 60 days of continuous absence. Full days run from 00H00 to 24H00. Remuneration is deemed to be earned evenly over the 12 months where the absence straddles years



of assessment so that an apportionment can be made. The number of days spent outside South Africa over total days within the period is used to calculate the exemption. The SARS omits leave days, weekends and public holidays. This is considered overtly restrictive.

Transits through South Africa are not deemed to be South African days, and no account is taken of periods outside South Africa where no remuneration was earned, i.e. these do not fall under the scope of section 10(1)(0) of the ITA. A concession was made for the 2020 and 2021 years of assessment only, due to the pandemic, where the 183 days were reduced to 117 days. The section 10(1)(0)(i) of the ITA employment outside South Africa exemption has been limited from 1 March 2020 to ZAR 1.25 million. There is no longer a full exemption (except for ship crews) for income earned in respect of employment exercised in another state for South African residents. In terms of section 10(1)(0)(1) of the ITA, the resident status of the employer is irrelevant as it states: services rendered outside South Africa for or on behalf of *any employer*. It is also clear that the section can only apply to residents.

When there is a determined/established change in residence of the employer, directors' fees of board members will be taxed where the new residence is located, under article 16 of the OECD Model. Where the board members earn employment income/remuneration apart from directors' fees, the source rules would apply as mentioned above. Where the board members reside could re-determine the residence status of the employer, and once that is established, the source of the directors' fees would be impacted.

If the relocation of the employees results in creating a PE for the employer in South Africa, then the PE becomes a resident for South African tax purposes. Employees would be taxed on worldwide income, and the only concession would be the section 10(1)(0)(i) of the ITA part exemption as discussed above. If the employees create a PE for the employer outside South Africa, they will probably no longer fall under section 10(1)(0)(i) of the ITA and only be taxed on South African source income. Whether home offices are imposed or recommended by the government in terms of public health measures makes no difference, as tax law has not been amended to cater for this.

Article 15(3) of the OECD Model follows a different concept to that of article 15(1) and 2 in that it looks to where effective management lies. Section 10(1)(0)(i) of the ITA provides an exemption from tax on remuneration for crews on ships engaged in transportation for reward of passengers or goods and certain other qualifying operations for periods exceeding 183 full

days in aggregate. The author would submit that the whole realm of shipping is not sufficiently clear or coherent between countries, and that a more globally suitable regime should be considered. Article 15(3), therefore, in its current form, may not hold the answers required, and a more in-depth analysis is needed. The author would further suggest that article 15 cannot be looked at in isolation. Perhaps source rules could assist. Mobility of employees and employers as well as the digitalized way of doing business are all interrelated, and perhaps structured source rules could solve some of the issues. Economic ownership has some merit as opposed to legal ownership, but there does not seem to be a great consensus between countries on specifying the meaning of economic ownership.

## **27.6. Frontier workers**

South Africa does not have any specific frontier worker rules in any of its bilateral treaties with neighbouring countries. There are six countries (Botswana, Lesotho, Mozambique, Namibia, Lesotho, Swaziland) who share a border with South Africa. The tax treaties with Zimbabwe, Swaziland and Mozambique<sup>29</sup> have no special rules for employment and follow the OECD Model. The tax treaty with Lesotho has an article 14 for independent services,<sup>30</sup> and these services can only be taxed in the source state if a fixed base is regularly made available to them in that state for the purpose of performing their activities. The tax treaty with Namibia has the same article 14, but extends it by presuming a fixed base to be established when the person spends more than 183 days in the source state within a period of 12 months.<sup>31</sup> The tax treaty with Mozambique includes an article 19 for professors and teachers, exempting them from tax in the source country if their stay does not exceed 2 years. It also includes an article 20 for students, apprentices and business trainee students who will be exempt from tax in the source state from payments received outside of the resident state for maintenance, education or training. Article 19 has a subject-to-tax rule in the resident state for the exemption to apply.<sup>32</sup>

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29. Except for using 180 days instead of 183 for the foreign employment exemption.

30. Independent services are defined as professional or other activities of an independent nature, and professional services include independent scientific, literary, artistic, educational or teaching activities and also independent activities of physicians, lawyers, engineers, architects, dentists and accountants or other professional persons.

31. <https://www.sars.gov.za/wp-content/uploads/Legal/Agreements/LAPD-IntA-DTA-2012-11-DTA-Namibia-GG-19780.pdf>.

32. <https://www.sars.gov.za/wp-content/uploads/Legal/Agreements/LAPD-IntA-DTA-2012-10-DTA-Mozambique-GG-31983.pdf>.

### **27.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)**

During the pandemic, certain temporary concessions were granted. These concessions were legislated. With regard to any other situations, such as change of the PoEM or home office requirements, legislation remained in place, and status can only be determined on a factual inquiry requiring evidential documentation. Employees, although working from a home office in the state of residence, could still be exercising their activities in their previous state of activity, which is evidenced in Income Tax Case no: 14218.<sup>33</sup> However if temporary absences become more permanent, the outcome may be different. It is very possible that dictating that a PE was established during the pandemic was not on the agenda, and even if it came to light (as tax return filing happens some time after the event), it could be established that it was inadvertent and of a temporary nature. There have not been any specific guidance nor rules issued.

There are no relevant criteria for the application of tax treaty law, whether a taxpayer decided voluntarily to work in a certain country or was forced to make such a decision by travel restrictions or public health measures. To a certain extent, force majeure is relevant in the application of tax treaties, especially where the competent authorities must resolve a matter. There would be difficulty where force majeure only occurs in one particular country, or a few as opposed to all. The author would suggest that when a treaty is signed in good faith, it should be assumed that extraordinary uncontrollable circumstances must be taken into account automatically, without this having to be written into the treaty.

### **27.8. Future of the mobility of work: A need for adjusting the existing treaty rules?**

The amount of commentary added to the treaty rules seems to suggest rules are never perfect but do need to meet challenges over a considerable length of time. Current treaties have fulfilled that up until the recent past, but the mobility of work and the digital economy have forced us to consider whether a serious overhaul of the treaty models themselves needs to be undertaken. Unfortunately, while South Africa would be party to treaty

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33. *Supra* n. 14. This is not a Supreme Court Decision so has limited precedence, but does give an indication of the SARS view.

policy discussions, it is not a leader in this respect and would follow what the OECD proposes whether this is appropriate or not. The African Tax Administration Forum (ATAF), of which South Africa is a member, has issued the ATAF Model, which may be more appropriate for many African countries. However, existing treaties on the African continent mostly follow the OECD Model, as does South Africa.

Article 4 of the OECD Model, as discussed above in section 27.2., will prove more difficult to apply, as changes in tax residency will occur more frequently. As residency changes because of circumstances involuntarily imposed, so too will it change because of the resulting tax effects that were not contemplated. The author foresees particular problems with articles 15 and 17, as the nature of many things we do has taken on a different form.

Recent developments in technologies and auditing capabilities can enable the implementation of an efficient system of apportionment of income according to the effective presence within a jurisdiction. However, there needs to be adequate capacities in place for the required implementation. Not all countries would have this capacity, which is the case in many African countries.

To have a consensus on the meaning of employee and employer is not the problem, as these terms are defined in domestic law and having them in the OECD or UN Model would be too restrictive. Conceptual changes are thus needed. The increase in mobile work conceptually changes the way that tax authorities will approach the value creation process. For example, if value is created by a group of mobile individuals based in different jurisdictions and working virtually, this will affect both personal and corporate tax. It does certainly raise an issue for the attribution of income, and it seems likely we will see an increased use of the profit split method or even formulary apportionment.

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## Chapter 28

### The Impact of Tax Treaties on International Mobility of Work in Spain

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#### 28.1. Mobility of work and domestic tax law

The position of the Spanish tax authorities regarding the tax residence of individuals during the COVID-19 pandemic varied depending on whether a tax treaty was applicable. The Spanish tax authorities<sup>1</sup> analysed whether the number of days that a Moroccan citizen had to stay in Spain due to the COVID-19 state of emergency counted towards the 183-day rule of stay in a Spanish territory established in article 9 of the Personal Income Tax Law.<sup>2</sup>

The Spanish tax authorities had already expressed its opinion on this issue in an earlier ruling, although in relation to a married couple who were tax residents in Lebanon, a country with which Spain has not signed a tax treaty.<sup>3</sup> In this situation, the tax authorities concluded that, despite the pandemic, the number of days of stay in a Spanish territory should be computed. Therefore, their stay in Spain for more than 183 days in 2020 determined their status as taxpayers for personal income tax purposes since the domestic residence rules were not modified to take into account travel restrictions.

However, this conclusion was clarified in the previously mentioned 2021 ruling in which the General Directorate for Taxation expressly referred to the “OECD Secretariat Analysis of Tax Treaties and the Impact of the Covid-19 Crisis Report” in connection with article 4 of the Morocco-Spain Income and Capital Tax Treaty (1978) and paragraph 4 of the Commentary on Article 4 of the OECD Model (2017).<sup>4</sup>

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1. See ruling of 13 April 2021 (ref. V0862-21) of the Spanish General Directorate for Taxation.

2. ES: Law 35/2006, of 28 November, on Personal Income Tax [hereinafter PITL].

3. See ruling 17 June 2020 (ref. V1983-20) of the Spanish General Directorate for Taxation.

4. See ruling of 13 April 2021 (ref. V0862-21) of the Spanish General Directorate for Taxation.

According to the above-mentioned OECD report, it is the responsibility of each contracting state to declare a taxpayer's tax residence. However, if the taxpayer is considered a tax resident in both states under their domestic laws, article 4(2) of the OECD Model provides criteria for settling the residence conflict. Thus, the first criterion to be considered is the location of a taxpayer's permanent residence. If a permanent residence exists in both states, it would be the state in which the taxpayer maintains the centre of their activities or vital interests. If this criterion does not allow the question to be resolved, then the state where the taxpayer habitually lives and the criterion of nationality would be taken into account, with the question being resolved in the last instance by mutual agreement between the contracting states.

On the other hand, the OECD report contains non-binding guidelines for the application of such criteria in the context of the situation generated by COVID-19. In paragraph 34 it points out that the criteria mentioned, especially the first, should be sufficient to resolve the issue as it is "unlikely that the conflict of residence will be resolved in favour of the state of temporary movement [Spain], since it is much more likely that the person who came from abroad has his base or centre of interests, lives habitually and is a national of his state of habitual residence [Morocco]".

This idea, reiterated in paragraph 31 of the above-mentioned OECD report with respect to those cases for which a tax treaty is applicable, has led the Spanish General Directorate for Taxation to accept the assessments of the OECD with respect to the application of the criteria for resolving residence conflicts in article 4(2) of the OECD Model in these circumstances.

Therefore, in accordance with the Spanish General Directorate for Taxation's decision, when a tax treaty is applicable, no tax implications should arise, as these persons are unlikely to be considered tax residents in Spain under Spanish domestic law despite the prolongation of their stay in Spanish territory as a result of the COVID-19 pandemic. If they were considered resident, the criteria established to resolve situations of dual residence provided in the applicable convention should be sufficient to maintain the original residence of the individuals concerned.

The recognition of the relevance of the criteria elaborated by the OECD to clarify the application of a tax treaty's different provisions in the current context of limited mobility as a consequence of the COVID-19 pandemic is of great practical importance for achieving a more consistent application of a tax treaty by the Spanish tax authorities. However, given the non-binding

nature of these treaties, they will not necessarily be interpreted in the same way by the Spanish courts.

## **28.2. Residence, tiebreaker rules and mobility of work: Individuals and entities**

Regarding the tax residence of corporations, the Spanish tax authorities ruled in a case concerning whether a company incorporated in Estonia by an individual who is also a shareholder and director of said company and who provided his services online from Spain operating as a self-employed person, and received remuneration for this, can be considered as a resident in Spain.<sup>5</sup>

For this purpose, the General Directorate for Taxation referenced the tax treaty between Spain and the Republic of Estonia, reiterating that it refers to the internal regulations of each of the contracting states to determine the residence of legal entities. In accordance with the provisions of article 8 of the Spanish Corporate Income Tax Law, even if the company is incorporated under Estonian law and domiciled there, the fact that its sole shareholder and director resides in Spain determines that the management and control of all the entity's activities lies in Spanish territory. Therefore, the entity has its effective place of management in Spain.

Thus, if under Estonian domestic law the company can also be considered as a resident there, the question would have to be settled – in accordance with article 4(3) of the OECD Model – by referring to a mutual agreement procedure to resolve the issue and taking into account, for these purposes, the provisions of the Commentary on Article 4 of the OECD Model.

In this regard, it was understood with the initial wording of article 4(3) of the OECD Model that preference was to be given to the criterion of the place of effective management. However, in 2017, the Committee on Fiscal Affairs recognized that, in view of some cases of tax avoidance involving companies with dual residence, the best way to resolve such disputes was to do so on a case-by-case basis.

This is the reason why the current version of paragraph 3 establishes that the competent authorities of the contracting states shall resolve, by mutual

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5. See the ruling of 16 June 2020 (ref. V1964-20) of the Spanish General Directorate for Taxation.

agreement, cases of dual residence of persons other than natural persons. Such mutual agreement would take into account aspects regarding the legal person, such as:

- the place where the meetings of the board of directors or a similar body are usually held;
- the place where the chief executive officer and senior management usually perform their duties;
- the place where the day-to-day management is carried out;
- the place where the head office is located;
- the national law governing its legal status;
- the place where its accounting records are kept;
- whether the determination that the legal person is a resident of one of the contracting states but not the other could entail the risk of misuse of its provisions for the purposes of the OECD Model.<sup>6</sup>

However, in situations in which the treaty contains the pre-2017 OECD Model tiebreaker rule, the place of effective management will be the only criterion used to determine the residence of a dual-resident entity for tax treaty purposes.<sup>7</sup> On this basis, the Spanish General Directorate for Taxation considered that the company incorporated in Estonia – in view of the facts and circumstances – is tax resident in Spain in accordance with the corporate income tax (CIT) regulations.<sup>8</sup>

During the COVID-19 pandemic, the Spanish tax authorities did not issue a ruling that takes a directors' inability to travel into account for determining the tax residence of a corporation. However, in the authors' opinion, it can be assumed that the General Directorate for Taxation will follow the criterion set by the OECD in the "OECD Secretariat Analysis of Tax Treaties and the Impact of the Covid-19 Crisis Report". According to it, "all relevant facts and circumstances should be examined to determine the 'usual' and

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6. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 4* para. 24.1 (21 Nov. 2017), Treaties & Models IBFD.

7. According to para. 24 *OECD Model: Commentary on Article 4* (2014), the place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are, in substance, made. All relevant facts and circumstances must be examined to determine the place of effective management. To this effect, para. 149 *OECD Model: Commentary on Article 29* (2017) explains that the concept of the "place of effective management" was interpreted by some states as being *ordinarily* the place where the most senior person or group of persons (for example, the board of directors) made the key management and commercial decisions necessary for the conduct of the company's business.

8. ES: Law 27/2014, of 27 November, on Corporate Income Tax [hereinafter CIT].



‘ordinary’ place of effective management, and not only those that pertain to an exceptional and temporary period such as the COVID-19 crisis”.

Therefore, in principle, the entity’s place of residence under the tiebreaker rule provided for in a tax treaty is unlikely to be affected by the fact that the individuals participating in the management and decision-making of an entity cannot travel because a public health measure has been imposed or recommended by at least one of the governments of the jurisdictions involved.

However, from a practical perspective, the post-pandemic situation presents increased difficulties for identifying the place of effective management when directors live and work in different countries. Traditionally, in Spain, the place where the board of directors meets is taken as a reference to determine the place of effective management, although this is not a definitive or final criterion.<sup>9</sup> Regarding those situations in which employees work from their residence, in the authors’ view, under the rules that are currently in force in Spain, this should not affect the residence of the company due to a lack of substance. In other words, the company cannot be considered to be a sham company just because the work is mainly carried out remotely.

Spanish tax law does not include any substance criterion connected to the residence of legal persons. However, such a criterion is present in the Spanish controlled-foreign-company rules that require taxpayers to include the total income obtained by any non-resident entity in Spanish territory or permanent establishment (PE) in their taxable base in those cases in which they do not have the corresponding organization of material and personal means to obtain it.<sup>10</sup>

In this vein, on 22 December 2021, the European Commission published a proposal for a directive: “laying down rules to prevent the misuse of shell entities for improper tax purposes and amending Directive 2011/16/EU” (ATAD 3). The proposed Directive introduces reporting requirements for EU tax-resident companies – *irrespective of their legal form* – that possess certain mobile and passive income streams and inadequate operational substance. In certain cases of inadequate substance, the benefits provided by the tax treaties and EU directives may be denied, resulting in an increase

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9. See J.M. Almudí, *Los sujetos pasivos en el Impuesto sobre Sociedades*, in *El impuesto sobre sociedades y su reforma para 2007* p. 78 (J.A. Rodríguez Ondarza ed., Civitas 2006); and ruling of 29 Sept. 2014 (ref. V0128-04) of the Spanish General Directorate for Taxation.

10. See art. 100(2) CIT.

in the withholding tax as well as potential penalties for the failure to report or incorrect reporting.

According to the proposed Directive, companies in the European Union that are required to report must declare whether they meet certain minimum substance requirements in their tax return as follows:

- the company has an office space or exclusive use of an office space;
- the company has at least one active bank account in the European Union; and
- the company meets one of the following two indicators:
  - (1) at least one director of the company:
    - is resident of or lives close to the company’s jurisdiction;
    - is qualified and authorized to make relevant decisions;
    - actively, independently and on a regular basis, makes use of their authorization; and
    - is not an employee of an unrelated party and is not a director of any other unrelated company; or
  - (2) the majority of the company’s employees are resident or live close to the company’s jurisdiction and those employees are qualified to carry out the income-generating activities.

A company may still rebut the presumption of inadequate substance based on substantiating the business rationale of its activities within the Member State. The burden of proof in the rebuttal process falls on the company and is subject to an assessment by the tax authorities. If an EU tax-resident company is presumed to have inadequate substance based on its self-assessed reporting or a failed rebuttal process, the following consequences shall take effect:

- other Member States will disregard the application of tax treaties and disregard the application of the Parent-Subsidiary Directive (2011/96) and Interest and Royalties Directive (2003/49) in relation to transactions concerning the reporting company. Nonetheless, the relevant Member State may allow benefits under domestic law or tax treaties to apply in relation to the shareholder of the reporting company (i.e. look-through treatment);
- if the reporting company has an EU shareholder, the EU jurisdiction of the shareholder will tax the relevant income of the reporting company as if the income had accrued to the company directly according to its national rules with a credit for taxes paid at the reporting company level; and
- the reporting company will, in principle, no longer receive a tax residency certificate, or the respective tax authority will issue an amended

tax residency certificate indicating that the reporting company is no longer entitled to the benefits of the treaty or the relevant EU directives.

Consequently, although Spanish law does not condition the tax residence to the existence of substance, the evolution of secondary EU legislation may lead to such a requirement. As previously stated, according to the proposal for ATAD 3, the company's tax residence requires that a director is resident of or lives close to the company's jurisdiction. Additionally, the majority of the company's employees are resident or live close to the company's jurisdiction, and those employees are qualified to carry out the income-generating activities. The amendments mentioned previously seek to ensure that the criteria for the attribution of residence for CIT purposes reflect a real and effective link to the country of residence.

### **28.3. Permanent establishments and mobility of work**

Regarding the existence of a PE due to working from home during the pandemic, the Spanish tax authorities have referred to the instance of an entity who was resident in the United Kingdom having a PE in Spain during 2020. This analysis was made, on the one hand, in the context of the pandemic measures that prevented international mobility and, on the other hand, also assessing the generally applicable criteria once these measures have been lifted.<sup>11</sup>

In summary, an employee of this entity who was also a tax resident in the United Kingdom worked remotely in a Spanish territory for more than 6 months in 2020, and during this time, the company did not pay him any additional expenses or additional remuneration. In this specific case, the employee owned a property in Spain that he used mainly for vacation purposes, and he became temporarily stuck in Spain as a consequence of the COVID-19 pandemic. However, once the sanitary measures that prevented his return were lifted, he decided unilaterally and for personal reasons to extend his stay in Spain, and he ended up staying for more than 183 days in the Spanish territory during 2020, performing the company's main activity remotely. The work did not involve signing any contracts in the name and on behalf of the employer company.

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11. See ruling of 18 Jan. 2022 (ref. V0066-22) of the Spanish General Directorate for Taxation.

The UK entity that did not pay any expenses related to the employee's office at his home or any additional remuneration for working from Spain refused the employee's request to work from Spain, and, as a consequence, the employee resigned in February 2021. The employee had a senior role and generated business for the group in Europe, but he did not have sufficient authority to sign contracts on behalf of the UK entity.

Following the provisions of article 5 of the Spain-United Kingdom Income and Capital Tax Treaty (2013), the Commentaries to this article of the OECD Model (2017) and, particularly, in light of the "OECD Secretariat's Analysis of Tax Treaties and the Impact of the Covid-19 crisis" published on 3 April 2020 and its updated version of 21 January 2021, the General Directorate for Taxation analysed whether the UK entity was deemed to operate in Spain through a PE not only during the COVID-19 lockdown and travel ban but also once these restrictions were lifted. In particular, it had to determine whether the UK entity was deemed to either (i) have a fixed place of business in Spain at its disposal that does not carry out activities of a preparatory or auxiliary character ("fixed place" requirement); or (ii) have an agent who acts in Spain on the UK entity's behalf and has and habitually exercises the authority to conclude contracts in the name of the UK entity ("dependent agent" requirement).

With regard to the "fixed place" requirement, article 5 of the Spain-United Kingdom Income and Capital Tax Treaty (2013) defines the concept of PE and requires:

- the existence of a fixed place of business; and
- the existence of a fixed place of business through which the company carries out all or part of its activity.

In this regard and with reference to the provisions in article 5(1) of the Spain-United Kingdom Income and Capital Tax Treaty (2013) as well as to paragraph 6 of the Commentary on Article 5 of the OECD Model (2017), the fact that the place where the activity is carried out is the home owned by an employee means that it is necessary to specify whether it is "at the disposal of the company". This must be analysed in the context of the pandemic situation.

Consequently, the General Directorate for Taxation referred to the "OECD Secretariat Analysis of Tax Treaties and the Impact of the Covid-19 Crisis" report, which issues non-binding guidelines to solve interpretation problems

that may arise from the application of tax treaties as a result of COVID-19. Based on the above, the Spanish tax authorities concluded that:<sup>12</sup>

- The work performed by the employee during those months in which the public health measures were in force did not involve a sufficient level of permanence to consider the existence of a PE. The use of the employee's home in Spain during that time was considered to be discontinuous and incidental. Therefore, the General Directorate for Taxation understands that such a circumstance, by itself, would not create a fixed place of business in Spain for the company.
- Regarding the time that the employee remained in Spain after the end of the lockdown period and until 183 days had been exceeded in 2020, the particularities of such continuity must be analysed to determine the existence of a PE since it is a question of proof that is based on the circumstances of each particular case.

Having examined the facts of the case (the employee's unilateral decision to continue working in Spain when the measures that prevented him from leaving the country had been lifted; the employee had a place to work at his disposal in the United Kingdom provided for by the company; and no payment or remuneration whatsoever was given to the employee for the use of his home to carry out his work), the General Directorate for Taxation concluded that these factors determined that the office is not at the company's disposal and therefore does not constitute a PE.

However, these circumstances may change once the exceptional nature of the pandemic has passed, taking into consideration that the definition of a PE or fixed place of business does not require the existence of a legal right of use over a property. It would be sufficient with the mere possibility of using it with a certain degree of permanence and from where the company totally or partially carries out its business activity.

With regard to the "dependent agent" requirement, the existence of someone who acts on behalf of the company and habitually exercises powers that enables them to conclude contracts on behalf of the company (agency PE) must be considered. To this effect, the General Directorate for Taxation refers to the provisions of article 5(5) of the OECD Model, taking into account paragraph 32.1 of the Commentary on Article 5 of the OECD

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12. See ruling of 18 Jan. 2022 (ref. V0066-22) of the Spanish General Directorate for Taxation.

Model (2014), which is applicable in this case as well as the relevant provisions of the above-mentioned OECD reports.

For these purposes and after noting that the employee did not sign contracts in the name and on behalf of the company, but that he carried out the company's activity without it being known whether he was able to conclude contracts in this respect, the General Directorate for Taxation concluded that:

- During those months in which the public health measures were in force, there was not sufficient habituality in the exercise of the powers that the employee may have had for him to be considered as a dependent agent of the company.

According to the above-mentioned OECD report, it is unlikely that the COVID-19 situation will create any changes to the determination of a PE. The exceptional and temporary change in the location in which employees carry out their employment because of the COVID-19 crisis, such as working from home, should not create new PEs for the employer. Similarly, the temporary conclusion of contracts in the employees' or agents' homes because of the COVID-19 crisis should not create PEs for the businesses. A construction site PE would not be regarded as ceasing to exist when work is temporarily interrupted.

- During the employee's extended period of stay in the country, it cannot be concluded from the information provided that the activities carried out by the employee can be identified as an agent's activity since there is no indication that he is acting as such. In any case, this would be a question of fact that would have to be proven. In short, in this case, the General Directorate for Taxation did not recognize the existence of a PE in Spain with respect to the employee who was stuck in Spain during the COVID-19 crisis. Therefore, the exceptional and temporary change of place where the employee carried out his employment due to the pandemic should not create new PEs for the employer.

In other words, it would not be possible to consider the existence of a PE when there are exceptional and forced circumstances such as those that gave rise to the health crisis for 3 months in Spain. However, if such a stay had been prolonged, the specific facts and circumstances would have to be analysed on a case-by-case basis, namely (i) in the case of an employee who does not carry out ancillary or preparatory activities; (ii) the existence of a fixed or available place of business; or (iii) whether the worker has powers that enable them to conclude contracts on a regular basis.

In previous rulings relating to home offices, the General Directorate for Taxation did not clearly go into the details of the criteria described in the OECD Commentaries. This is the first ruling in which the tax authorities confirmed that an office is not at the disposal of the non-resident employer when it is set up in a home, the cost of having an employee in Spain is not borne by the non-resident company, and when the decision to move to Spain was driven by the employee's personal reasons rather than any business and/or strategic reasons, it expressly confirmed alignment with OECD standards.

Therefore, according to that criteria, the Spanish tax authorities could consider that when an employee's home is paid for by the company and their work is carried out without any other facilities available to them to carry out their work, the employee's home constitutes a fixed place of business for PE purposes. Additionally, if the employee has agreed to working remotely for the company and habitually concludes contracts on behalf of the company, it will be considered to have a PE in Spain.

Finally, regarding economic activities that have been interrupted by the COVID-19 crisis, it cannot be ruled out that they should be considered as insignificant interruptions to find out whether the PE lasted more than 12 months under the OECD Model (2017) or more than 6 months according to the UN Model (2017).<sup>13</sup> To this effect, the non-binding 2020 "OECD Secretariat Analysis of Tax Treaties and the Impact of the Covid-19 Crisis" report states that the duration of such an interruption of activities should be included when determining the lifespan of a construction site and will therefore affect the determination as to whether it constitutes a PE.<sup>14</sup>

## **28.4. Physical presence according to articles 15(1) and 17 of the OECD Model**

Under Spanish domestic law, employment income is only considered to have been obtained in Spain when it derives, directly or indirectly, from a

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13. According to paras. 44 and 54 *OECD Model: Commentary on Article 5(3)* (2017), periods of inactivity do not cause a PE to cease to exist (i.e. holidays, staff illnesses and inactivity due to technical defects).

14. Para. 55 *OECD Model: Commentary on Article 5(3)* (2017) explains that a site should not be regarded as ceasing to exist when work is temporarily discontinued (i.e. shortage of material or labour difficulties).

personal activity carried out in Spanish territory.<sup>15</sup> This source rule follows article 15(1) of the OECD Model (2017) where employment is carried out in the place in which the employee is physically present when performing the activities for which the employment income is being paid. Therefore, the fact that an employee's work is exploited in Spain is irrelevant in this respect unless the personal activity for which the remuneration is being paid was physically carried out in a Spanish territory.

Employment income obtained from an activity carried out from an office at an employee's home ("home office") will only be considered to be obtained in Spain if said home is located in a Spanish territory. It will not make a difference if the decision to work from home is caused by government measures, including COVID-19 lockdown measures. This conclusion derives from the fact that the number of days of stay in a Spanish territory, even when this stay was compulsory due to the COVID-19 restrictions, would count for the purposes of the domestic 183 day-rule.<sup>16</sup> Therefore, non-resident workers stranded in Spain could become Spanish tax residents. However, the opposite situation (loss of tax residency) will not occur with Spanish (resident) employees stranded abroad due to the travel restrictions. This is because sporadic absences are included when calculating the number of days that an individual spends in Spain unless the taxpayer proves that they are a tax resident in another country or if the period of absence from Spanish territory exceeds 183 days.<sup>17</sup>

The same position was adopted with respect to a domestic exemption for Spanish residents concerning employment income earned abroad.<sup>18</sup> One of the requirements of this exemption is that the work is performed outside of a Spanish territory. During the COVID-19 pandemic, the question arose as to whether this exemption would be applicable to work carried out in Spain that would have been performed abroad if there were no travel restrictions in place. This situation was irrelevant for the Spanish tax authorities

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15. See ES: Non-Residents' Income Tax, Royal Legislative Decree 5/2004, of 5 March 2004, art. 13(1)(c)(1<sup>o</sup>) [hereinafter NRIT]. However, there are some special rules for remuneration obtained by public servants and a ship or aircraft's crew operating in international traffic.

16. See rulings of 13 Apr. 2021 (ref. V0862-21); 8 July 2021 (ref. V2046-21); and 18 Aug. 2021 (ref. V2337-21) of the Spanish General Directorate for Taxation. For further details, see I. Gil García, *La residencia fiscal de las personas físicas: indeterminación, ubicuidad y deslocalización*, Revista española de Derecho Financiero 193, pp. 126-130 (2022).

17. See art. 9(1)(a) PIT; and the following five decisions of the Supreme Court (*Tribunal Supremo*): ES: TS, 28 Nov. 2017, 807/2017, 809/2017, 812/2017, 813/2017 and 815/2017.

18. See art. 7(p) PIT.



considering that the exemption requires, without any exception, an actual performance of a personal activity abroad. Therefore, the exemption is not applicable even if it was impossible to carry out the work outside of Spain due to a government measure being imposed.<sup>19</sup>

Moreover, severance payments will be categorized as employment income under domestic law. Regarding non-residents, only the part of the severance payment received that has been calculated based on the time worked in Spain will be considered to be from a Spanish source. Therefore, if the severance payment is not linked to the work previously carried out in Spain, this income will not be deemed to be from a Spanish source.<sup>20</sup>

Regarding entertainers and sportspersons, Spanish domestic law provides a similar source rule when their income is not categorized as employment income. According to article 13(1)(b)(3<sup>o</sup>) of the Non-Resident Income Tax Law (NRIT), income derived from activities that have been carried out in Spanish territory is income from a Spanish source. The Spanish source rule follows article 17 of the OECD Model (2017) where the physical presence of the entertainer or sportsperson is also required in order to attribute the right to tax the income linked to a performance to the other contracting state. Therefore, the remuneration paid by a Spanish company to non-resident artists for a performance that takes place outside the Spanish territory is not from a Spanish source.<sup>21</sup>

In 2021, there was a major debate in the media about whether certain Spanish youtubers and influencers who have moved their tax residence to Andorra should be taxed in Spain.<sup>22</sup> As is well known, Andorra is a sovereign landlocked microstate on the Iberian Peninsula in the eastern Pyrenees bordered by France to the north and Spain to the south where the personal income tax threshold is significantly lower than Spain. Andorra was no longer considered a tax haven according to Spanish domestic law since 14 January 2011 when the tax information exchange agreement signed with Spain in 2010 entered into force. Additionally, in 2015, Spain signed a tax treaty with Andorra that follows the OECD Model (2017).

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19. See rulings of 23 Mar. 2021 (ref. V0694-21); and 21 Apr. 2021 (ref. V1040-21) of the Spanish General Directorate for Taxation.

20. See rulings of 23 July 2018 (ref. V2188-18); and 30 Mar. 2021 (ref. V0753-21) of the Spanish General Directorate for Taxation.

21. See ruling of 10 July 2020 (ref. V1887-20) of the Spanish General Directorate for Taxation.

22. See A. Báez, *Un sistema fiscal del siglo XIX frente a un contribuyente del siglo XXI: el irrefrenable éxodo fiscal de los youtubers al Principado de Andorra*, Revista de Contabilidad y Tributación, CEF 466, pp. 43-86 (2022).

It is not feasible to consider these Spanish tax nomads as residents in Spain for tax purposes if they avoid staying in Spain for more than 183 days. In addition, it will also be challenging to consider these individuals as residents in Spain by applying other criteria provided in domestic law, for example, the so-called centre of economic interests' criterion. According to domestic law, an individual will be considered a resident in Spain if their main base or centre of economic activity and interests is located directly or indirectly in Spain regardless of how many days they physically spend in Spain.<sup>23</sup> This is considered the case if Spain becomes the place of the individual's main source of income or if their property is located in Spain.<sup>24</sup> One of the main factors to take into account when applying this criterion is whether the individual earns most of their income in Spain. This must be determined according to Spanish domestic source rules.

Given the type of income generated by youtubers and influencers, a large part of their income cannot be considered to be from a Spanish source. This prevents both the application of this residence criterion and taxing them in Spain as non-residents. In any case, if these tax nomads were to be considered residents in Spain under Spanish law, a situation of dual tax residence would arise that would probably be resolved in favour of Andorra. This is because, in most cases, these individuals do not have a permanent home at their disposal in Spain whereas they do in Andorra.

The income frequently received by youtubers and influencers is unlikely to be from a Spanish source. Hence, it cannot be included for the purpose of considering them as residents in Spain nor will they be liable for Spanish income tax on non-residents. Among other reasons, this occurs because the income does not derive from a payment made by an entity resident in Spain (or a PE located in a Spanish territory) or from the performance of an activity requiring physical presence in a Spanish territory.<sup>25</sup>

Furthermore, in the few cases in which all or part of this income can be considered as originating from a Spanish source, the Andorra-Spain Income Tax Treaty (2015) prevents it from being subject to taxation in Spain. This occurs with business income (article 7) and royalties received from third countries

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23. See art. 9(1)(b) PIT.

24. See F. Carreño, *Spain*, in *Global mobility of ultra-high-net-worth individuals* p. 187 (N. Saccardo ed., Global Law and Business 2021).

25. For further details, see A. Báez, *Un sistema fiscal del siglo XIX frente a un contribuyente del siglo XXI: el irrefrenable éxodo fiscal de los youtubers al Principado de Andorra*, *Revista de Contabilidad y Tributación*, CEF 466, pp. 76-81 (2022). Much of the advertising revenue is not paid by the advertiser to the youtuber or influencer but by YouTube/Google AdSense, which is a company that is currently resident in Ireland.

(articles 12(5) and 20(1) of the Andorra-Spain tax treaty). In short, it is not possible under current tax rules to tax youtubers and influencers who have migrated to Andorra for the purpose of paying a much lower personal income tax than they would pay in Spain. In Spain, the rate in some autonomous communities is close to 50% while, in Andorra, the applicable rate is 10%.

## 28.5. Article 15(2) and (3) of the OECD Model

### 28.5.1. 183-day rule

The Spanish tax authorities follow paragraphs 4.1-5.1 of the Commentary on Article 15 of the OECD Model (2017) to determine which days count and which do not for the purpose of this rule. The rule requires a minimum presence of the employee in the other contracting state. As the physical presence of the employee is required, the days during which the employee remains in their state of residence (working from home days) are not counted.

The authors understand that article 15 of the OECD Model (2017) does not allow working from home days to be included in the calculation, and this also applies to the COVID-19 pandemic period when there were travel restrictions in place. This is consistent with the fact that the days during which the taxpayer is a resident of the state in which they work should not be considered in the calculation.<sup>26</sup>

Regarding the days when the employee had to stay in the other treaty country against their will due to the COVID-19 pandemic travel restrictions, the authors consider that the solution proposed by the OECD Secretariat is correct.<sup>27</sup> According to the OECD reports published in 2020 and 2021, the days that the taxpayer was prevented from leaving the state in which they work due to COVID-19 travel restrictions and would have otherwise left should not be included in the calculation. The OECD Secretariat considers these days to be comparable to sick days that prevent the worker from returning to their state of residence.<sup>28</sup>

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26. See para. 5.1 *OECD Model: Commentary on Article 15* (2017).

27. OECD, *Updated Guidance on Tax Treaties and the Impact of the COVID-19 Pandemic* (21 Jan. 2021); and OECD, *OECD Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis* (3 Apr. 2020).

28. According to para. 5 *OECD Model: Commentary on Article 15* (2017), “under this method the following days are included in the calculation: [...] days of sickness (unless they prevent the individual from leaving and he would have otherwise qualified for the exemption)”.

However, it is the authors' understanding that those periods of time during which the employee remained in the other state against their will should count for the purposes of the rule to the extent that they would have continued to perform their work. The exception for sick days would not be applicable because, in this case, the individual is not only staying in the territory of the other state but also performing their work. This is not the case for sick days where the employee is present but not working in the territory of the other state.

In this regard, it should be highlighted that it may be extremely complex for the source state's tax authorities to prove that, during the time when the employee was unable to return to their country of residence, they continued performing their work. Insofar as the employment relationship continued to exist during the period in question, it can be presumed to be the case unless this was not possible due to the type of work performed (not all work can be done remotely).<sup>29</sup> It would therefore be reasonable, in such cases, to require the employee to prove that they could not perform their work during the time that they remained stranded in the other state.

To date, no administrative rulings or court decisions have been handed down on this matter. If they were to be made, it is likely that they would be resolved in line with analysis made in the above paragraph. The OECD Model Commentaries are usually followed in the interpretation of tax treaties, and the considerations made by the OECD Secretariat – along with the nuances set out by the authors in this section – fit in with what is foreseen in the Commentaries.

### 28.5.2. Economic employer

In 2010, the OECD revised its guidance relating to article 15 and introduced the concept of the economic employer. The Commentary on Article 15 of the OECD Model (2017) establishes that the employee's "employer" is not necessarily the legal employer. In determining who the employer is, the Commentary on Article 15 (paragraph 8.14) provides several factors.<sup>30</sup>

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29. See G. Beretta, *Work on the Move: Rethinking Taxation of Labour Income under Tax Treaties*, 5 International Tax Studies 2 (2022).

30. These factors include: "who has the authority to instruct the individual regarding the way the work must be performed; who controls and has responsibility for the place at which the work is performed; the remuneration of the individual is directly charged by the formal employer to the enterprise to which the services are provided", etc.

According to this approach, substance should prevail over form. The term “employer” should be considered in a broader sense, and the whole context of the employment should be evaluated to determine which entity is the employee’s economic employer. If the economic employer is a resident of the state in which the work is carried out, the latter will have the right to tax the employee’s income under article 15(2)(b) of the OECD Model (2017).

The Norway-Spain Income and Capital Tax Treaty (1999) is the only Spanish tax treaty that expressly refers to the concept of economic employer. Article IV of the Protocol reads as follows:

In order to prevent tax avoidance and to clarify the application of paragraph 2 of Article 15, in particular in situations of hiring out of labour, the competent authorities shall, where necessary, determine by mutual agreement whether the conditions of said paragraph are met.

A situation of hiring out of labour shall be considered to exist where an employee is put at disposal by a person (hirer), to another person (user) to carry out work for the latter in the course of an activity the user carries on in the State where the work is performed, and where the hirer does not bear the responsibility and risk for the results produced by the employee’s work.

In determining whether an employee shall be considered hired-out, a general evaluation shall be made where particular weight shall be put on whether:

- a) the authority to instruct the worker is with the user;
- b) the work is performed at a place which is under the control and responsibility of the user;
- c) the remuneration to the hirer is calculated on the basis of the time utilised, or there is in other ways a connection between this remuneration and wages received by the employee;
- d) tools and materials are essentially put at the employee’s disposal by the user;
- e) the number and qualifications of the employees is not solely determined by the hirer.

As can be observed, this provision establishes criteria similar to those contained in the Commentary on Article 15 of the OECD Model (2017) on the concept of an economic employer. However, there are no administrative rulings or court decisions on this provision, so it is not possible to know whether it has been applied in practice.

There are at least three court decisions that refer in some way to the concept of an economic employer.<sup>31</sup> All three cases refer to a contract for a service

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31. See ES: TSJ [High Court of Justice of Madrid], 7 Mar. 2006, 396/2003; ES: AN [National Court], 18 May 2006, 398/2003; and ES: TSJ [High Court of Justice of Madrid], 19 April 2012, 436/2010.

where the non-resident company had to send some of its employees to Spain in order to provide the service to its Spanish client. In all three cases, albeit differently, all or part of the cost of the seconded employees was charged back to the Spanish client under the contract for the service. None of the three cases referred to the modifications introduced in the Commentary on Article 15 of the OECD Model (2010) because the events audited by the Spanish tax authorities occurred prior to this date. As the three cases are similar, the authors will refer exclusively to the most recent one, i.e. the decisions handed down on 19 April 2012 by the High Court of Madrid.

The facts date back to 2006 when a German company sent one of its employees to Spain. The employee spent less than 183 days working in the Madrid offices of the Spanish subsidiary of the German company. The German company continued to pay the employee's salary, and there was no evidence that the employee received any remuneration from the Spanish subsidiary.

The court decision does not contain any information about the type(s) of services performed by the employee in Spain. There is also no information on the contract between the German parent company and its Spanish subsidiary that gave rise to the secondment of the employee. The decision denies that the Spanish subsidiary could be considered the employer of the seconded employee for the purposes of article 15(2)(b) of the Germany-Spain Income and Capital Tax Treaty (1966). If the tax authorities had provided evidence on the factors included in paragraph 8.14 of the Commentary on Article 15 of the OECD Model (2017), the decision would have probably been different.

This decision refers to another of the three existing court rulings, i.e. the decision handed down on 18 May 2006 by the National Court. In this case, the Spanish tax authorities proved that the German parent company had invoiced the Spanish subsidiary for the seconded employee's salary costs. However, the Spanish subsidiary was not considered to be the employer because no evidence was provided on the work carried out by the seconded employees for the Spanish subsidiary. In summary, the tax authorities did not prove that the contract between the German parent company and its Spanish subsidiary was a service contract rather than a contract for service.<sup>32</sup>

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32. Para. 8.4 *OECD Model: Commentary on Article 15* (2017) reads as follows: In many States, however, various legislative or jurisprudential rules and criteria (e.g. substance over form rules) have been developed for the purpose of distinguishing cases where services rendered by an individual to an enterprise should be considered to be rendered in an employment relationship (contract of service) from

### 28.5.3. Employees working in international traffic

Article 15(3) of the OECD Model (2017) refers to the taxation of income in respect of employment exercised aboard a ship or aircraft operating in international traffic. This article was amended in 2017. Tax treaties following the pre-2017 OECD Model establish that the contracting state where the employee was not resident had the right to tax said income if the company's place of effective management was situated in that contracting state. The OECD Model (2017) confers tax jurisdiction exclusively to the employee's state of residence. The purpose of this new rule is to provide a clearer and administratively simpler rule regarding the taxation of the remuneration earned by crews working aboard ships or aircraft operating in international traffic.

Most Spanish tax treaties follow the rule provided in the OECD Model before it was modified in 2017. However, in practice, the pre-2017 rule did not necessarily imply that the employee's income was taxable under Spanish domestic law. According to article 13(1)(c)(3°) of the NRIT, this income is not subject to taxation in Spain if the work was carried out entirely outside a Spanish territory and such income was subject to an identical or similar tax to the Spanish personal income tax in the other country. This rule requires that the difficult task of verifying where the employee had physically carried out their activity is undertaken.

The ruling V2536-21 (14 Oct. 2021) of the Spanish General Directorate for Taxation is a good example of this, although it is true that it refers to a case in which article 15(3) of the OECD Model (2017) would not apply. Article 15(3) of the OECD Model (2017) has been held to not apply to Portuguese employees of a Spanish company engaged in fishing in national and international waters.<sup>33</sup> Therefore, under article 15 of the Portugal-Spain Income Tax Treaty (1993), the Portuguese employees could only be taxed in Spain on the part of the salary that corresponds to the time when the vessel was fishing in Spanish waters (including the time when the vessel was moored in Spanish ports).

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cases where such services should be considered to be rendered under a contract for the provision of services between two separate enterprises (contract for services). That distinction keeps its importance when applying the provisions of Article 15, in particular those of subparagraphs 2 b) and c).

33. See ruling of 14 October 2021 (ref. V2536-21) of the Spanish General Directorate for Taxation.

Considering this, it appears that article 15(3) of the pre-2017 OECD Model is not an alternative for modifying the rules established in the two previous paragraphs of this provision unless the alternative is to give the residence state exclusive power to tax income from employment. If so, the rule now provided in article 15(3) of the OECD Model (2017) would be unnecessary as it would provide the same rule. The question at stake is whether the state where the worker does not reside should have any power to tax employment income without requiring their actual physical presence in its territory.

## **28.6. Frontier workers**

The daily movement of workers between countries occurs more frequently in those countries that share borders. Spain has signed double taxation conventions with the four countries with which it shares borders (Andorra, France, Morocco and Portugal).<sup>34</sup> However, only the tax treaties with France (1995, article 12 of the Protocol) and Portugal (1993, article 15(4)) contain a special provision for frontier workers. Both treaties deviate from article 15 of the OECD Model (2017) in that they fully allocate the right to tax to the residence state.

According to the Portugal-Spain Income Tax Treaty (1993), only employees who normally return from the country where they work to the country where they reside on a daily basis are considered frontier workers. The treaty does not include a limit on the number of days an employee could stay overnight in the state where they work without returning home. However, although there is no regulation in this respect, it is possible that a few overnight stays in the state where they work may be allowed, as the treaty does not require that the employee must return on a daily basis but only normally.

The France-Spain Income and Capital Tax Treaty (1995) also requires that the employee returns to the country of residence daily. This requirement is not expressly provided in the treaty but in an agreement between France and Spain signed in 1961 to facilitate the daily transit of workers across the borders of both countries. The application of this provision has been controversial since the 1961 agreement only recognizes employees as “frontier workers” when their residence and place of work are both located in a municipality situated in the frontier zone of both countries. Frontier zones

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34. No reference is made to Gibraltar as the tax treaties concluded by Spain with the United Kingdom (1975 and 2013) have never been applicable to this territory located at the southern tip of the Iberian Peninsula.



are those “with a depth of ten kilometres, on both sides of the border”. This distance was extended to 20 kilometres in 1964. To facilitate the identification of these zones, the Annex to the agreement contains a list of French and Spanish towns that are included in the frontier zone.

In Spain, the Basque provinces of Alava, Biscay and Gipuzkoa, as well as the autonomous community of Navarre, have jurisdiction over the taxation of non-residents as does the central government tax administration. The tax administrations of Gipuzkoa and Biscay have considered that the provision regarding frontier workers is applicable even if the employee’s place of work and/or residence is not one of those towns indicated in the agreement with France provided that the employee’s daily return is accredited.

On the other hand, the central government tax administration as well as the tax administrations of Alava and Navarre consider that the clause is only applicable if the employee’s residence and place of work are in one of the towns on the list. This also appears to be the French tax administration’s interpretation, but, to date, no mutual agreement has been signed between the two countries’ tax administrations to clarify this aspect.<sup>35</sup>

The Spanish Supreme Court has yet to rule on this controversial matter. However, the lower courts have ruled that what is relevant is the proof of daily return, leaving aside whether the towns where employees reside and/or work were those specified on the list.<sup>36</sup> Finally, in order to avoid withholding taxes on their salaries and wages, the Navarre and Gipuzkoa’s tax administrations have approved a special procedure for frontier workers residing in France to prove the application of this provision to their Spanish employers.<sup>37</sup>

Apart from this controversy, the relevant issue is that administrative rulings and court decisions have considered that an employee’s daily return is necessary for the provision to be applicable.<sup>38</sup> This explains why a person residing in Spain and working in Portugal was denied its application because it

35. See ruling of 20 November 2018 (ref. V2989-18) of the Spanish General Directorate for Taxation.

36. See, among others, the following decisions: ES: TSJ [High Court of Justice – Navarre], 28 Dec. 2007, 118/2007; and ES: TSJ [High Court of Justice – the Basque Country], 6 Nov. 2018, 1269/2017.

37. See F. Vega, *No residentes y Concierto Económico: cuestiones internas, internacionales y de Derecho europeo*, in *Concierto Económico y Derecho de la Unión Europea* pp. 362-363 (I. Merino & J.I. Ugartemendía eds., IVAP 2013).

38. See rulings of 14 May 2009 (ref. V1089-09); 22 May 2009 (ref. V1201-09); and 15 Mar. 2010 (ref. V0496-10) of the Spanish General Directorate for Taxation.

was impossible for them to return daily due to the distance between their place of work and their home.<sup>39</sup>

This situation contrasts with European social security regulations where daily return is not required, and it is sufficient if the employee returns home once a week. According to article 1(f) of Regulation (EC) No 883/2004 of the European Parliament and of the Council of 29 April 2004 on the coordination of social security systems, “frontier worker means any person pursuing an activity as an employed or self-employed person in a Member State and who resides in another Member State to which he/she returns as a rule daily or at least once a week”.

Moreover, neither before nor after the COVID-19 pandemic has the Spanish tax authorities approved or published any rules regarding how travel restrictions affected the application of the frontier worker provisions of the tax treaties with France and Portugal. In this regard, during the period when daily commuting was not possible, these employees would have lost their status as frontier workers. This would have had little effect in practice. Indeed, despite not being frontier workers, Spain would still not be entitled to tax these employees’ income under article 15 of the OECD Model (2017) as they were not physically on Spanish territory when carrying out their work.<sup>40</sup>

In the authors’ view, the frontier worker provisions should be revised to allow the employee’s status to be maintained without the daily commuting requirement. This could be done by establishing several working days per year when such commuting is not required, which could be, for example, 60 working days per year. This would facilitate the application of these provisions as well as bring it up to date with the new reality that it is now commonplace and possible for part of the work to be carried out remotely. This threshold of 60 working days would include both the days when the employee stays overnight in the state in which they work and the days when they stay in their home state.

Finally, regarding the last aspect of the conference questionnaire that this chapter is based on, it should be noted that, during the COVID-19 pandemic the Spanish government established some exceptional social security benefits for both employed and self-employed workers. Since these grants and benefits were paid by the Spanish Social Security Administration, they

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39. See ES: TSJ [High Court of Justice – Asturias], 21 Mar. 2012, 1250/2010.

40. See ruling of 22 November 2021 (ref. V2960-21) of the Spanish General Directorate for Taxation.

qualify under Spanish domestic law as employment income (*rendimientos del trabajo*). However, this does not mean that article 15 of the OECD Model (2017) would be applicable to those payments. The authors understand that article 21 of the OECD Model (2017) applies to these types of benefits except in those tax treaties that have special rules for benefits paid by social security regardless of their nature.<sup>41</sup>

## **28.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)**

In Spain, COVID-19 has changed the way tax rules have been applied when a tax treaty is applicable, following the release of the OECD report “OECD Secretariat Analysis of Tax Treaties and the Impact of the Covid-19 Crisis”. However, after the pandemic, the provisions associated with the place where an employee is physically present have continued to be applied in the same way. In fact, even during the COVID-19 crisis, in the absence of a tax treaty, the actual place where the work was carried out was taken into account without using any fictitious criteria, i.e. where an employee would have been located if there had been no travel restrictions.

From this perspective, it is considered irrelevant that a situation beyond an employee’s control changes the place where they are expected to carry out their work. However, it cannot be overlooked that the COVID-19 pandemic has prompted the regulation of situations that already existed and have become normalized and widespread such as remote working. In fact, the regulation of this type of work has been approved in Spain because of the pandemic.<sup>42</sup> The new rule only applies when a work activity is carried out on a regular basis in the employee’s home or in a place chosen by them. Remote working is voluntary, and the act guarantees the right of the employee to return to work on-site.

The approved legislation has not addressed any tax aspect, not even the treatment of the compensation to be paid to the employee by the employer for the expenses related to the equipment, tools and means linked to them carrying out their work activity. Furthermore, Spain has not signed any agreements with other countries to resolve the tax issues arising from the

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41. See A. Báez, *Unnecessary and Yet Harmful: Some Critical Remarks to the OECD Note on the Impact of the COVID-19 Crisis on Tax Treaties*, 48 Intertax 8-9, p. 827 (2020).

42. ES: Remote Working Act (Royal Law-Decree 28/2020 and Act 10/2021).

pandemic. This has not even happened with France and Portugal, even though the tax treaties with these countries include a provision for frontier workers.

The increase in remote working activities has given rise to a social debate on the obligation to contribute to financing public expenditure especially because of certain influencers and youtubers who have changed their tax residence from Spain to Andorra. This situation has highlighted the difficulties entailed in taxing income derived from personal performances when there is no physical presence. This situation is common to employees, artists and sportspersons. This should prompt a review of the traditional taxation rules with the aim of moving towards a model in which the location or presence of the individual is considered less relevant. Indeed, from a purely domestic point of view, it would be possible for Spanish law on non-residents to return to where it was in 2003 when all income paid to non-residents was from a Spanish source irrespective of where the activity being remunerated took place.

## **28.8. The future of the mobility of work: A need for adjusting the existing treaty rules?**

The mobility of people in the new context of labour and residence requires a review of the current tax rules in the same way that corporate profits are being reviewed due to the digitalization of the economy. In this current situation, it may no longer make as much sense to make the physical presence of a worker in a state a sourcing criterion for taxing employment income. One solution could be to allow the employer's state of residence to tax employment income but with a maximum rate. However, this right would accrue to the state where the employer's PE is located to the extent that the employee's remuneration is borne by the PE.<sup>43</sup> This allocation rule would be very similar to the one that applies to dividends, interest and royalties under articles 10, 11, and 12 of the OECD Model (2017). The mobile nature of capital income that, in the past, justified this allocation rule would justify establishing the same solution now for employment income.

This solution has the advantage of matching the jurisdiction where the employer pays CIT (or the income tax levied on the PE) with the jurisdiction where the employee pays income tax, albeit not exclusively, if the employee

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43. To determine when this secondary rule would apply, the same criteria set out in paras. 7-7.2 *OECD Model: Commentary on Article 15(2)(b)* (2017) would apply.

resides in a different state. Likewise, it would also make it more feasible to control the taxation of employment income in the source state because, in most countries, there will be no doubt that the employer (or its PE) is obligated to withhold tax on such income. This is not the case with the current rules, especially when the income payer does not reside in the state where the work is carried out or does not have a PE there.

The main disadvantages of this proposal are as follows: (i) each tax treaty would establish its own tax threshold creating different situations in each tax treaty as is currently the case with dividends, interest and royalties; and (ii) it would also increase cases of double taxation that would have to be resolved by the residence state either through the method provided in the treaty or its domestic law.

This situation could be alleviated by introducing, as with other EU countries, the option for the taxpayer to be taxed as a resident in the source state when they obtain most of their income in the latter state. It would also have to be considered whether it is still appropriate to include special provisions for frontier workers in tax treaties insofar as the source state's taxation rights would be limited. Currently, there is no draft or proposal from the Spanish government to amend the current rules. The authors understand that any changes will only be introduced to the extent that they have been previously promoted by the OECD and the European Union.



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## Chapter 29

### The Impact of Tax Treaties on International Mobility of Work in Sweden

Katia Cejie<sup>1</sup>

#### 29.1. Mobility of work and domestic tax law

##### 29.1.1. Introductory comments

A hundred years ago, people typically lived and worked in the same country for their entire work life. Since then, it has become more common that individuals work partly outside their country of residence (e.g. posted workers, frontier workers, digital nomads and gig economy workers).

During the COVID-19 pandemic, many individuals were forced to *work from home* (WFH),<sup>2</sup> which – in the aftermath of the pandemic – has developed into different strategies taken by companies and countries. Some companies attract employees with the possibility to *work from anywhere* (WFA).<sup>3</sup> Others attract employees with the possibility to work remotely on a more temporary basis,<sup>4</sup> such as from home or other places with reliable Internet connections. Some countries attract the mobile workforce using different appealing tax regimes, such as the introduction of Golden visas or other programmes to encourage foreign persons to temporarily work outside their jurisdictions. Examples of such jurisdictions are the Cayman Islands, the Bahamas, Bermuda, Malta, Georgia, Estonia and Portugal.<sup>5</sup>

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1. The author wishes to thank the Torsten Söderberg Foundation for the research grant on the project *Income Taxes and Social Security Contributions in Cross-border situations* (R13/18). Material published before 31 May 2022 is regarded.

2. In Sweden, 40% of the workforce worked from home during parts of the pandemic. SCB, <https://www.scb.se/pressmeddelande/ny-statistik-sa-manga-har-jobbatt-hemifran-under-pandemin/> (accessed 7 Feb. 2022).

3. P. Choudhury, *Our Work-from-Anywhere Future*, 98 Harvard Business Review 6, pp. 58–67 (2020); K. Cejie, *Lex Loci Laboris – en förlegad EU-rättslig princip i ljuset av Coronapandemin och nya sätt att arbeta?* pp. 240–252 (SkatteNytt 2021); and in regards to Spotify, A. Lundström & A. Westerdahl, *Introducing Working From Anywhere* (12 Feb. 2021), available at <https://hrblog.spotify.com/2021/02/12/introducing-working-from-anywhere/> (accessed 26 Apr. 2022).

4. Sometimes referred to as teleworking, see OECD, *Teleworking in the COVID-19 Pandemic: Trends and Prospects* (OECD 2021).

5. M. Tjernberg, *Migration, mobilitet och skatter – kan det hänga ihop?*, 71 SkatteNytt, pp. 273–277 (2021); L. Bolter, *Guide-Distansarbete utomlands, Flytta till solen* (Dagens

In April 2020, the OECD Secretariat (first OECD report) published its views on some of the problems identified concerning tax treaties and the COVID-19 pandemic.<sup>6</sup> In January 2021, an updated version of the report was published (second OECD report).<sup>7</sup> Several of the problems mentioned in the reports will be discussed in this chapter. Notice that Sweden was not one of the expressly sampled jurisdictions in the second OECD report. Hence, in this chapter, the Swedish tax legislation, policy and practice in the area of mobility of work will be described and analysed. Based on the assumption that the post-COVID-19 work patterns – i.e. an increase in mobility and flexibility in the choice of (cross-border) work place – will remain, the main question is whether existing rules still make sense or should be changed. A further question addressed is whether it makes a difference to the application of the existing tax rules if one is forced to work from a specific location or is doing so on a voluntary basis. In addition, a few comments in regard to social insurance affiliation and social security contributions will be made. The outline follows the eight topics discussed at the 2022 Conference in Rust, Austria.

### 29.1.2. Taxation of individuals<sup>8</sup>

Similar to many countries, worldwide taxation is applied to persons with unlimited liability to tax in Sweden. An individual has unlimited liability to tax if they have (i) domicile; (ii) habitual abode; or (iii) essential ties to Sweden, having been previously domiciled there.<sup>9</sup> The first two criteria are based on the fact that the person is present in Sweden. Usually, a person is

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Industri 2021); and G. Beretta, *Jurisdictions (Even) After the BEPS Project*, 47 Intertax 1, sec. 3.2. (2019). See also secs. 22-23 a SE: *Inkomstskattelagen* (Income Tax Law) (1999:1229) [hereinafter IL].

6. OECD, *Tackling Coronavirus (COVID-19) Contributing to a Global Effort – OECD Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis* (OECD 2020) [hereinafter First OECD Report]. For a rather critical comment on the report, see A. Báez Moreno, *Unnecessary and Yet harmful: Some Critical Remarks to the OECD Note on the Impact of the COVID-19 Crisis on Tax Treaties*, 48 Intertax 8-9 (2020); and K. Cejie, *EU/OECD/Sweden/Denmark, New Problems Caused by the COVID-19 Pandemic – Income Taxes and Social Security Contributions (an Overview)*, 61 Eur. Taxn. 5, pp. 185-194 (2021), Journal Articles & Opinion Pieces IBFD.

7. OECD, *Tackling Coronavirus (COVID-19) Contributing to a Global Effort – Updated guidance on tax treaties and the impact of the COVID-19 pandemic* (OECD 2021) [hereinafter Second OECD Report].

8. Parts of this sec. are based on K. Cejie, *Taxes and Contributions on Cross-Border Employment Income – Before and During the COVID-19 Pandemic*, 74 Bull. Intl. Taxn. 12, sec. 2.1 (2020), Journal Articles & Opinion Pieces IBFD.

9. Ch. 3, sec. 3 IL.



*domiciled* in Sweden if they live in Sweden. The person should have taken a permanent and real residence in Sweden to be considered domiciled.

A person can fulfil the criterion of *habitual abode* in different ways. The prerequisites have been interpreted by the Supreme Administrative Court (SAC) and are found in case law. First, a person fulfils the criterion by being continuously present in Sweden for a period of more than 6 months in a 12-month period.<sup>10</sup> Second, a person can have habitual abode if they visit Sweden on a regular basis, travelling back and forth to Sweden. In these situations, the regularity and duration are of importance. In more recent case law, habitual abode has been considered when a person spends 4 to 5 months in Sweden during the summer, returns several more times during the year and continues to do so for a period of years.<sup>11</sup> Habitual abode exists regardless of whether the person spends more time in their home country than in Sweden.<sup>12</sup> Furthermore, to be regarded as having habitual abode, the person needs to also stay overnight in Sweden, which means that frontier workers can never have habitual abode.

This means that worldwide taxation is triggered, depending on the amount of time physically present in Sweden. If a person fulfils the criteria of habitual abode, regardless of the reasons, they will be deemed unlimited liable to tax. According to the law, there is no exception or relief in the time criterion due to exceptional circumstances, for example, closed borders during a pandemic. If a person exceeds the 6-month threshold, they will be deemed unlimited liable to tax, regardless of whether this is a “covid accidental expat” situation or not.<sup>13</sup> Temporary interruptions in the 6-month period, when the taxpayers leave Sweden, are disregarded and included in 6-month period.<sup>14</sup> The reasons for staying in Sweden or temporarily leaving are of no relevance to the overall calculation.

10. SE: Government bill (prop.) 2004/05:19, p. 30.

11. See, for instance, SE: SAC HFD 2018, ref. 30 I, in which the person would visit Sweden another 3 weeks plus two more times of 4 days each. In SE: SAC HFD 2019, not. 26, a person was deemed to have habitual abode in Sweden based on the fact that he would spend 4 months during the summer, plus visit Sweden a few more times – making a total of 3 weeks.

12. See SE: SAC RÅ 2008 ref. 56; and case SE: RÅ 2008 not. 166.

13. The expression “covid accidental expat” is founded by Báez Moreno, *supra* n. 6.

14. In a Position Statement, the Tax Agency has tried to clarify its view on temporary interruptions in *Vad är tillfälligt avbrott i en stadigvarande vistelse?* dnr. 130 92654-05/111 (14 Feb. 2005) and also interpreted SE: SAC RÅ 1997 ref. 25, as fewer than 78 nights in a 6-month period may result in habitual abode in Position Statement, *Krävs 78 övernattningar för stadigvarande vistelse?* dnr. 131 612166-05/111 (15 Nov. 2005).

During the pandemic, the Tax Agency interpreted the law in accordance with previous case law and explicitly made clear on its website that there are no exceptions.<sup>15</sup> Since administrative burdens are put on unlimited tax liable persons in comparison to limited tax liable persons, a more casual interpretation of this criterion would have been desirable during the pandemic when travel restrictions were in effect. Hence, no such discussion has taken place so far in Sweden.<sup>16</sup> On the other hand, if a domiciled person leaves Sweden for work or other reasons, they might be unlimited liable to tax based on *essential ties*.<sup>17</sup> This extended exit tax liability would, for example, apply also if the person was stranded in another country due to travel restrictions, etc. All individuals who are not unlimited liable to tax in Sweden are limited liable to tax.<sup>18</sup> The taxable incomes are those that have their sources in Sweden.<sup>19</sup>

### 29.1.3. Taxation of companies

Companies (legal persons) are unlimited liable to tax based on registration in Sweden (*principle of incorporation*). In case there is no registration, the place of effective management (PoEM) is used.<sup>20</sup> This means that – at a purely domestic level – the PoEM for Swedish companies is of no relevance, due to the incorporation principle being used. However, there is an exit tax rule stating that if a company changes its tax treaty residency to another country, an exit tax is triggered.<sup>21</sup> The shift of a tax treaty residency, based on board members moving out of Sweden (PoEM), could be one example when this exit tax is triggered.<sup>22</sup> This exit tax has been discussed

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15. Available at [https://www.skatteverket.se/privat/etjansterochblanketter/svarpavanliga\\_fragor/corona/corona/jagborutomlandsmenvistaspagrundavcoronapandeminisverigeblirjagobegransatskattskyldigisverigenu.5.109dcbe71721adafd2510d1.html?q=stadigvarande+vistelse](https://www.skatteverket.se/privat/etjansterochblanketter/svarpavanliga_fragor/corona/corona/jagborutomlandsmenvistaspagrundavcoronapandeminisverigeblirjagobegransatskattskyldigisverigenu.5.109dcbe71721adafd2510d1.html?q=stadigvarande+vistelse) (accessed 2 Apr. 2022).

16. See sec. 29.7.; and Second OECD Report, *supra* n. 7, at paras. 53-55, for opposite view.

17. See Cejje, *supra* n. 8, at sec. 2.1.2.; or K. Cejje, *Den utsträckta hemvistprincipen* (Iustus 2015).

18. Ch. 3, sec. 18 IL.

19. In regard to employment income, for example, see SE: *lagen om särskild inkomstskatt*, (1991:586) [hereinafter SINK].

20. Ch. 6, sec. 3-4 IL.

21. Ch. 22, sec. 5(4) IL.

22. In the well-known case SE: SAC, 24 Apr. 2008, RÅ 2008 ref. 30 (6639-06), Case Law IBFD, the effects of a transfer of a company's treaty residency from Sweden to Malta were discussed (exit taxes).

intensively in Swedish legal doctrine, especially in relation to EU law.<sup>23</sup> As the rule now stands, it seems to be in compliance with EU law and the Treaty on the Functioning of the European Union.

As elsewhere, the possibilities of remote work are increasing in Sweden. However, if a company does not provide any workspace (office), there are no direct tax consequences per se. Since the workspace is often used for various fringe benefits, there will be indirect tax consequences.<sup>24</sup>

Foreign companies are limited liable to tax in Sweden if they have a permanent establishment (PE) there.<sup>25</sup> The domestic rule on the PE concept<sup>26</sup> corresponds largely to article 5 of the OECD Model (1963).<sup>27</sup> See section 29.3.1.

#### 29.1.4. Social security system

Finally, a note on social security should be made. Social security contributions and benefits are dealt with in separate laws from those for income taxes.<sup>28</sup> One can regard them as parallel systems, even though the administrative aspects of contributions and taxes are handled by the same agency, i.e. the Tax Agency. However, the parallel system of social security means that it has its own definitions and concepts, separated from tax law. One such example is the concept of domicile for the individual. Therefore, one could say that there is, in fact, no coordination or alignment between social

23. See K. Cejje, *Regeringsrättens tolkning och tillämpning av svenska utflyttningsskatte regler* pp. 532-543 (SkatteNytt 2008/9); K. Cejje, *Ändrade regler vid utflyttning?*, SvSkT 10, pp. 760-764 (2008); K. Cejje, *New Swedish Emigration Taxes on Business Income*, European Tax Studies, 1/2012 pp. 1-13 (2010); K. Cejje *Utflyttning av bolag*, SvSkT 2, pp. 161-188 (2012); and K. Cejje, *Anstånd med betalning av utflyttningsskatter – har rättsläget klarnat?*, 64 SkatteNytt, pp. 295-308 (2014).

24. For the definition of “work place” (*tjänsteställe*), see ch. 12, sec. 7-8 IL and for some related benefits, ch. 12, sec. 5. On benefits and work trips, etc., see for example, ch. 12, sec. 6-6a IL and sec. 29.3.2.

25. Ch. 6, secs. 7 and 11 IL.

26. Ch. 2, sec. 29 IL.

27. *OECD Draft Convention on Income and on Capital* (30 July 1963), Treaties & Models IBFD. See also P. Herzfeld Olsson et al., *Likabehandlingsprincipens olika ansikten* pp. 121-125 (Iustus 2019). In regard of tax treaties, Sweden’s mainly follow the *OECD Model* (2010), see K. Cejje & F. Wendleby, *infra* n. 37, at sec. 6.1.

28. See for example SE: *Socialförsäkringsbalken* [Social Insurance Law] (2010:110); and SE: *Lag om socialavgifter* [Law on social Security contributions], SAL (2000:980). For an overview of the social security contributions, see Cejje, *supra* n. 8, at sec. 3.

security law and tax residence nexus in Sweden.<sup>29</sup> However, one exception does exist for companies. If a foreign company has a PE in Sweden, it will be liable to pay the general payroll contribution for its employees who are covered by the social security system of Sweden. If it does not have a PE, it is not liable to pay this contribution of 11.62%. The rationale behind this is that the general payroll contribution is a tax.<sup>30</sup>

## **29.2. Residence, tiebreaker rules and mobility of work: Individuals and entities**

### **29.2.1. Taxation of individuals**

The Swedish Tax Agency has not discussed the possibility of changing tax treaty residency as such during the pandemic. Nor has it been subject to review by the courts or the Board of Advanced rulings. However, as mentioned previously, if a person stays in Sweden more than 6 months in a 12-month period, they will become unlimited liable to tax – regardless of the reason for their stay. This, of course, may raise the question of the tiebreaker rule since, before this point, the tax treaty residency was settled by article 4(1). In the case of dual residency, the tiebreaker rule will settle the question for individuals. The opinion expressed in the OECD reports is that such tax treaty residency should not be shifted. The author of this chapter is of similar opinion and finds a shift in tax treaty residency less likely.<sup>31</sup>

Nonetheless, in the aftermath of the pandemic, when voluntary remote work increased, a shift in tax treaty residency according to the tiebreaker rule may take place. For example, assume that a Swedish employee has a summer house in Spain and a flat in Stockholm, i.e. two permanent homes, according to the tiebreaker rule. If this person starts to work remotely from Spain to a large extent and becomes unlimited liable to tax in Spain, depending on a case-by-case assessment, it may very well shift their centre of vital interests or habitual abode from Sweden to Spain.<sup>32</sup>

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29. See E. Sevelin, *Är du bosatt lille vän? Om bosättningsbegreppet i skatte-, socialförsäkrings- och folkbokföringsrätten*, Förvaltningsrättsligt tidskrift 4 (2021).

30. See Cejje, *supra* n. 8, at sec. 3.2.3.

31. See Cejje, *supra* n. 6.

32. In an older case, the Supreme Administrative Court (SAC) settled the case giving the personal circumstances more importance than economic circumstances when determining the centre of vital interest; see SE: SAC, 29 Oct. 1974, RÅ 1974 ref. 97. In a more recent case, the Administrative Court of Appeal in Stockholm (SE: ACA, 5 Apr. 2019, 5531-18-5538-18), paid more attention to the economic circumstances. The taxpayer has asked

From a practical perspective, it is of course hard to track employees when working remotely from, for example, a summer house in Spain. In Sweden, discussion is taking place on whether more employees should be allowed to work remotely and changing policy to enable this. Although these policies vary, it is quite common for companies to let their employees work remotely abroad for between 15-30 days per year. These policies can be seen as a pragmatic way to balance the risks of ending up with administrative burdens, such as registrations and having to pay taxes and contributions in a variety of jurisdictions, while meeting the demands from the employees.

### 29.2.2. Taxation of companies

If a company endorses remote work (such as WFH or WFA) and no longer has an office or workspace, the question from a tax treaty perspective may arise of whether the company still has treaty access or may lose treaty entitlement. In regard of treaty access, the Swedish position ought to be that there is no problem since the company is still registered in Sweden and, therefore, unlimited liable to tax.

In addition, as touched upon in section 29.1.3., a further problem may arise from a company taxation perspective, namely if a board member of a Swedish company moves abroad and starts to work remotely.<sup>33</sup> In this section, the question of the tiebreaker rule in article 4(3), as well as other tax consequences that will arise for the company due to the actions taken by the board members, will be highlighted.

First, for some time, the Swedish position has been to favour a mutual agreement procedure (MAP) in article 4(3).<sup>34</sup> Interestingly, Sweden has chosen not to include article 4 of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI). Although the rationale for this decision is unclear, the Swedish

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for a leave for appeal based on the lack of guidance in the interpretation of the tiebreaker rule. According to the opinion of this author, both economic and personal circumstances should be given the same importance in this regard.

33. Firstly, it should be highlighted that at least half of the board members must be resident within the EEA area; see SE: *Aktiebolagslagen* [Company Law Act] (2005:551) ch. 8, sec. 9. Secondly, it is possible to have the board meetings digitally. In comparison, the annual meeting of shareholders is, as a main rule, normally not allowed to be held digitally.

34. See, for instance, *Philip.-Swed. Income Tax Treaty* (1998), Treaties & Models IBFD; and *Pol.-Swed. Income Tax Treaty* (2004), Treaties & Models IBFD.

overall approach to the MLI is held to be rather cautious.<sup>35</sup> The rationale for not following the earlier OECD approach (PoEM) is the incorporation principle used in domestic law.<sup>36</sup> However, Swedish treaty practice is not consistent and, in some treaties, the PoEM can be found.<sup>37</sup>

Second, from a corporate taxation perspective, when a company transfers its tax treaty residency, it will also affect the allocation rules. For example, article 7 will not allocate the taxing rights to Sweden as the former resident state any longer (unless a PE is kept). This is the rationale behind the exit tax mentioned in section 29.1.3.<sup>38</sup>

Third, when a board member works remotely from a jurisdiction other than Sweden (as the resident state of the company), some tax implications for the company may occur, such as the need to pay social security contributions in the foreign jurisdiction.<sup>39</sup> In addition, the question of a foreign PE may arise (*see* section 29.3.).

Conversely, if a board member of a foreign company works remotely from Sweden, similar questions arise. However, individuals who are limited liable tax<sup>40</sup> are not liable to tax for directors' fees if the company is not Swedish. At the same time, social security contributions might need to be paid based on the *lex loci laboris* principle.<sup>41</sup>

## **29.3. Permanent establishments and mobility of work**

### **29.3.1. Defining a permanent establishment in domestic law**

Whether or not a foreign employer has a PE in Sweden is important in several respects. In addition to the question of tax liability, it is important from

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35. See SE: Government Bill 2017/18:61, pp. 23 ff.

36. See sec. 29.1.3.

37. See K. Cejic & F. Wendleby, *Sweden - Global tax treaty Commentaries - Country Policy & Practice*, sec. 5, Country Tax Guides IBFD.

38. However, as the law now stands, a deferral of paying the tax is possible. See SE: *Skatteförfarandelagen* 2011:1244, ch. 63, sec. 14 [hereinafter SFL].

39. EU Regulation No 883/2004 of the European parliament and of the Council of 29 April 2004 on the coordination of social security systems, OJ L 166 (2004), Primary Sources IBFD [hereinafter EU Regulation]. In addition, double taxation issues may occur since the directors fee is taxable in Sweden, regardless if the board member is limited or unlimited liable to tax. See sec. 5, para. 3 SINK.

40. Who does not fulfill the 183-day test.

41. EU Regulation, *supra* n. 39.

the perspective of levying social security contributions in Sweden.<sup>42</sup> The domestic rule on the PE concept is to be found in the IL (Income Tax Act).<sup>43</sup> As previously mentioned, the rule corresponds largely to article 5 of the draft OECD Model (1963). According to the first paragraph of the relevant chapter and section of the IL, a PE is “a fixed place of business through which the business of an enterprise is wholly or partly carried on”. In the second paragraph, a list of examples is included, similar to article 5(2) of the OECD Model. The third paragraph states that a PE exists in Sweden if a person acts on behalf of a foreign enterprise and concludes contracts in the name of the enterprise. Finally, the fourth paragraph includes an agent rule similar to that in the OECD Model.

According to the domestic PE concept, the time criteria is usually set at 6 months, as determined by case law.<sup>44</sup> However, on its website, the Tax Agency stresses that the permanency can be fulfilled even if a company is present in Sweden for less than 6 months. The example given according to the Tax Agency is that, if the foreign company’s activity continues for 3 months each year for three consecutive years, a PE will exist.<sup>45</sup> Since the Swedish PE concept is based on the OECD Model, the Model and its Commentaries are used also when interpreting the domestic concept.<sup>46</sup>

### 29.3.2. Home office as a PE

Regarding the question of whether or not a home office can constitute a PE according to article 5(1) of the OECD Model (2017), the position taken in the first OECD report is that a home office does not fulfil the PE criteria. A home office of an employee is neither permanent nor “at the disposal of” the employer (the foreign enterprise).<sup>47</sup> After 2 years of lockdowns and requirements to work from home, at least the permanency prerequisite can be questioned.<sup>48</sup> Typically, the permanency requirement is fulfilled once

42. See sec. 29.1.4.

43. Ch. 2, sec. 29 IL.

44. See L. Jacobsson, *Permanent Establishment through Related Persons. A Study on the Treatment of Related Persons under Article 5 of the OECD Model Tax Convention* p. 197 (Uppsala U. 2018); and Olsson et al., *supra* n. 27, at p. 124, with reference to case law from the Administrative Court of Appeal in Stockholm, case 2166-15 and 2167-15.

45. Tax Agency, <https://www4.skatteverket.se/rattsligvagledning/edition/2022.4/2690.html#h-Stadigvarande> (accessed 3 May 2022).

46. See SAC RÅ 2009 ref. 91 and RÅ 1998 not. 188.

47. First OECD Report, *supra* n. 6, at paras. 2.8-9.

48. See Cejje, *supra* n. 6, at p. 187.

a 6-month threshold has been reached.<sup>49</sup> In the second OECD report, on the one hand, the importance of the pandemic as an extraordinary event is stressed.<sup>50</sup> On the other hand, it is admitted that the permanency requirement can be fulfilled if the home office will also be used after the pandemic. However, this stipulation is not enough since a home office also needs to be at the disposal of the employer.<sup>51</sup>

This latter requirement has to be decided on a case-by-case basis, as the facts and circumstances of individual cases ought to be regarded when deciding whether or not a home office is at the disposal of the employer.<sup>52</sup> Hence, in RÅ 2009 ref. 91, the SAC found that a home office in Sweden constituted a PE for a foreign company. The company's core business was asset management, and the employee and owner of the company worked from his home in Sweden when issuing instructions for sales and purchases to the bank. The company did not have any other offices.<sup>53</sup>

Similar arguments can be found in both OECD reports. The second report presents, as arguments against the establishment of a PE, the fact that the employer still provides an office elsewhere and the employees are working from home on a voluntary basis.<sup>54</sup> Already prior to the pandemic, the Swedish Tax Agency emphasized that if the employer has not provided a workspace and there was either a joint understanding or a contract that the work should be performed from a home office, a PE may exist. If the person was self-employed, it held that a PE may exist even without such contract or unspoken demand.<sup>55</sup>

The Swedish Tax Agency has commented on the first OECD report concerning PEs. In May 2020, it agreed with the OECD's interpretation of tax treaties based on the OECD Model but stressed that it might change its view in the event that the pandemic did not end up being temporary.<sup>56</sup> In

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49. See B.J. Arnold, *Article 5: Permanent Establishment - Global Tax Treaty Commentaries*, sec. 2.1.1.2, Global Topics IBFD.

50. Second OECD Report, *supra* n. 7, at para. 16.

51. *Id.*, at para. 17.

52. Para. 18 *OECD Model: Commentary on Article 5* (2017).

53. The Board of Advanced rulings reached a similar conclusion in case nr. 127-14/D (1 Feb. 2016); however, the SAC eliminated the decision in case nr. 1026-16 (28 June 2016), as it found the case was based on unreliable and conflicting circumstances.

54. Second OECD Report, *supra* n. 7, at para. 18.

55. SE: Tax Agency, Position Statement, *När medför en anställds arbete i hemmet att ett utländskt företag får fast driftställe?*, dnr 131 160469-15/111 (16 Mar. 2015). However, see *infra* n. 59, since this Position Statement was replaced in May 2022.

56. SE: Tax Agency, *Rättslig vägledning, Inkomstskatt, Skatteavtal* (8 May 2020). It can be observed that this statement, to some extent, is in conflict with other Position Statements from 2015, *supra* n. 55.



February 2021, a clarification was given that the home office in the situation described is not regarded as a PE unless it becomes the “new norm over time”.<sup>57</sup> Even if the home office ultimately fulfils the criteria of permanence, a case-by-case analysis must be conducted in respect of the criterion of “being at the disposal of”.

In April 2021, the Board of Advanced ruling decided that a PE did not exist when an employed shareholder in a foreign company started to work from a home office in Sweden. Although the employee stayed in Sweden for more than 6 months, he was determined to go back to the main office abroad as soon as the COVID-19 pandemic allowed. The Board found that the home office was not at the disposal of the employer.<sup>58</sup>

Finally, in May 2022, the Position Statement made by the Tax Agency in 2015 was replaced with a new Position Statement.<sup>59</sup> The new Statement is in more conformity with the 2017 version of the Commentaries to the OECD Model and will lead to fewer home office PEs in Sweden than before. The Tax Agency takes the view that if the foreign employer requires (either explicitly or implicitly) that the employee should work from home, a PE might arise since the prerequisite “a place at disposal” for the employer might be fulfilled. In addition, if the requirement is implicit, one also has to determine whether there are any advantages for the employer if the employee is working from Sweden. Several examples are provided in the Statement. However, if the employee is working from home on their own initiative and an office is provided elsewhere, no PE will arise. The same outcome is reached if the work from home is due to restrictions or recommendations from the government.

In domestic law, there are possibilities to give fringe benefits to the employees in different situations, for example, when going on business trips. In this regard, the concept of “place of employment” or “work place” (*tjänsteställe*) is of importance.<sup>60</sup> Consequently, and in contrast to a PE, there are several advantages to having the place of employment in the home since it facilitates several fringe benefits. The discussion arose during the pandemic as to whether employees working from home could have their place of employment at home. The position taken by the Tax Agency is

57. Tax Agency, <https://www4.skatteverket.se/rattsligvagledning/edition/2021.1/2971.html#h-Coronakrisens-inverkan-pa-forekomsten-av-fast-driftstalle> (accessed 12 Feb. 2021).

58. SE: Board of Advanced Rulings, SRN 72-20/D (9 Apr. 2021).

59. SE: Tax Agency, Position Statement, *När medför en anställds arbete i hemmet att ett utländskt företag får fast driftställe?*, dnr 8-1677220 (13 May 2022).

60. Ch. 12, para. 8 IL.

that the place of employment should not change due to the pandemic. For the future, it has taken the position that, although employees may choose where to work, the place of employment is the place where the employer has an established workspace. The only exception would be if there is a contract between the employee and employer that the home of the employee should be the place of employment. In that case, the employee has to work at least 50% of his work time from home.<sup>61</sup> This author would argue that the Position Statement, to some extent, is in conflict with the paragraph in the IL. According to the first sentence of chapter 12(8) of the IL, the place of employment is where the taxpayer performs the main part of their work. There is no indication that this must be at the workspace of the employer. However, this author understands the pragmatic interpretation of the law made by the Tax Agency. Whether it will hold in a court is to be seen.

### 29.3.3. Dependent agency PE

The OECD approach is that an employee who concludes contracts on behalf of the enterprise while temporarily working from home does not constitute a dependent agent PE, according to article 5(5). This opinion assumes that the employee did not conclude contracts prior to the COVID-19 crisis.<sup>62</sup> As mentioned previously, the Swedish PE rule is similar to that of the OECD with regard to the dependent PE rule. In the aforementioned ruling by the Board of Advance rulings in 2021, the Board decided that the dependent agent rule did not apply since it was held that the employee did not use this competence.<sup>63</sup> In the future, if employees start to work remotely on a more voluntary and ad hoc basis, most important to determine will be whether they fulfil the time criterion and use the dependent agent competence habitually.<sup>64</sup>

In contrast to the OECD Model, according to the interpretation of domestic law made by the Swedish Tax Agency, a self-employed person cannot trigger a dependent agency PE. The rationale behind this interpretation is that, according to domestic law, a self-employed person cannot give themselves a right to conclude a contract since the business they carry on is not a legal person. However, in the same Position Statement, the Tax Agency states that according to tax treaties, a Swedish self-employed person may constitute

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61. SE: Tax Agency, Position Statement, *Tjänsteställe för anställda som själv kan välja att arbeta på andra platser än sin arbetsplats*, dnr. 8-1283049 (6 Dec. 2021).

62. First OECD Report, *supra* n. 6, at paras. 2.4-2.12.

63. SRN 72-20/D (9 Apr. 2021).

64. Similar to the Second OECD Report, *supra* n. 7, at paras. 23-24.

a PE in the other contracting state, depending on the domestic law of that state.<sup>65</sup>

#### 29.3.4. Construction sites

In contrast to the OECD Model, a construction site in Sweden will be deemed to exist at the 6-month threshold. In its tax treaties, Sweden often uses a 183-days rule in this regard.<sup>66</sup> The question of interruptions in the calculation of time has not been discussed by the law enforcers in Sweden.

However, in HFD 2019 ref. 36,<sup>67</sup> the SAC dealt with the construction PE rule in the Poland-Sweden Income Tax Treaty (2004), which, in turn, follows the OECD Model, and the 12-month period is used. The question in the case was whether a 4.5-month break could be considered when calculating the 12-month period for establishing a construction PE. The SAC based its ruling on the 2017 version of the Commentary on the OECD Model and stated that, since the break in the case at hand did not match any of the examples listed in the Commentary of breaks that should be considered when calculating the 12-month period, it should not be considered. This resulted in the Polish company being assessed as not having a PE in Sweden.<sup>68</sup>

#### 29.3.5. Concluding comments

If a PE is located in Sweden, it will have several consequences. First, the company (employer) will be liable to tax in Sweden (*see* section 29.1.3.). Second, it will affect the applicability of the 183-days rule (*see* section 29.5.1.). Third, liability to pay social security contributions will be widened (*see* section 29.1.4.).

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65. Tax Agency, Position Statement, *Kan en enskild näringsidkare vara beroende representant för sin enskilda näringsverksamhet så att fast driftställe uppkommer?*, dnr 131 2536936-13/111 (24 Apr. 2013).

66. Cejje & Wendleby, *supra* n. 37, at sec. 6.1.

67. *See* SE: SAC, 28 June 2019, HFD 2019 ref. 36.

68. *See also* the advance ruling case SE: SAC, 6 Dec. 2013, HFD 2013 not. 78 (4890-13), Case Law IBFD, which concerned the question of whether a computer server could constitute a PE. The SAC stated that this depends on the circumstances in the individual case assessed. In the case at hand, the SAC considered that it lacked sufficient information on the circumstances to deliver an advance ruling on the issue.

With regard to the obligation for employers to withhold preliminary tax on wages to employees, the main rule is that this should be done if the salary is taxable according to the IL.<sup>69</sup> In this regard, the foreign employer with a PE is regarded as a Swedish employer. In addition, a foreign employer without a PE in Sweden is obliged to withhold tax on the salaries of the employees. However, in these situations, the withholding is only obliged if the work is performed in Sweden.<sup>70</sup> The same applies if the economic employer is a Swedish company (*see* section 29.5.1.).

## **29.4. Physical presence according to articles 15(1) and (17) of the OECD Model**

### **29.4.1. Income of employment: The importance of physical presence**

As mentioned in section 29.1.2., physical presence is important as one decisive factor to establish unlimited tax liability (habitual abode). Concerning employment income, it is of great importance when it comes to the application of tax treaties. In HFD 2012 ref. 18, the SAC has interpreted article 15(1) of the Nordic Income and Capital Tax Treaty (1996) (NTT). The court found that the term “exercised” requires a physical presence in the source state in order to apply.

Several questions concerning article 15 were highlighted during the COVID-19 pandemic. Some of these dealt with remuneration related to not performing actual work or inactivity (layoffs, short-term layoffs, etc.).<sup>71</sup> Some of these situations were addressed by the Tax Agency, which felt the urge to make two clarifications concerning article 15(1) of the tax treaties.<sup>72</sup> The first clarification was about remuneration paid when a person was exempted from work during a notice period. The position taken by the Tax Agency, inspired by the Commentaries of the OECD, was that the income should be considered derived from the state where the employee should have performed their work if they had done so during the notice period.<sup>73</sup> In the same clarification, it is held that severance payments as a main rule,

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69. Ch. 10, sec. 2 SFL.

70. Ch. 10, sec. 6, first sentence SFL.

71. For description of the different measures taken by the Swedish Parliament, *see* Cejje, *supra* n. 8, at sec. 5.

72. Tax Agency, [https://www4.skatteverket.se/rattsligvagledning/edition/2021.18/2981.html#update\\_20210305115638](https://www4.skatteverket.se/rattsligvagledning/edition/2021.18/2981.html#update_20210305115638) (24 and 29 Mar. 2021) (accessed 3 Apr. 2022).

73. Para. 2.6 *OECD Model: Commentary on Article 15* (2017).

unless the circumstances indicate otherwise, are to be allocated to the state where the employee was physical present during the last 12 months.<sup>74</sup> The second clarification made by the Tax Agency regarded deferred payments (for example, bonuses or extra holiday payments<sup>75</sup>). According to the Tax Agency, these are taxable in the state in which the work was being performed when earned, regardless of when the payment is made.<sup>76</sup>

The clarifications made during the pandemic are, to some extent, inspired by a status quo approach, though – to some extent – they do not emphasize the physical presence as important as in previous statements. In an older Position Statement (2008), the Tax Agency held that remuneration paid by a private employer in Germany to a person living in Sweden could, according to article 15(1), be taxed based on physical presence and source taxation, even though that person was not performing any work.<sup>77</sup> However, the clarifications made during the pandemic basically follow the Commentaries to the OECD Model and can be explained by the different type of income to which they relate.<sup>78</sup> In essence, the approach taken by the Tax Agency and the SAC seems to follow the OECD approach. There are no rules available to take the pandemic into account in this regard.

#### 29.4.2. Resident taxpayers heading home to Sweden due to the pandemic

Physical presence is also decisive when exemption rules in domestic law are applied. Concerning taxpayers unlimited liable to tax in Sweden, two rules in domestic law may apply when such persons are conducting work in a foreign jurisdiction (the 6-month rule and the 1-year rule). When applicable, the foreign income is exempted from Swedish income tax.<sup>79</sup> Both these rules are based on the fact that the taxpayer is working abroad for a specific time period. If the time period is not fulfilled – e.g. the taxpayer returns to Sweden – the income will be taxed in Sweden.

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74. See similarly para. 2.7 *OECD Model: Commentary on Article 15* (2017).

75. According to Swedish law, an employee gets extra holiday payments when on holiday. See SE: Semesterlag (1977:480) secs. 7-8 and 16.

76. See similarly para. 2.2 *OECD Model: Commentary on Article 15* (2017).

77. SE: SKV Position Statement, *Hur ska man, enligt intern rätt och skatteavtal, se på ersättning från arbetsgivare för arbetsbefriad tid?*, dnr. 131 529672-08/111 (20 Sept. 2008).

78. All in all, it seems also to follow the approach taken in the Second OECD Report, *supra* n. 7, at paras. 49-52.

79. Ch. 3, sec. 9 IL. For a more in-depth explanation of the rules, see Cejje, *supra* n. 8, at sec. 2.2.2.

Yet, there is a safety valve (*säkerhetsventil*) in the law, which enables the taxpayer to demand that the income would still be exempted if the reason for their return is due to circumstances beyond their control and, thus, taxation would be unreasonable.<sup>80</sup> During the pandemic, the Tax Agency clarified in its Legal Guidance that the pandemic could be regarded as such circumstance and that the safety valve might be applicable.<sup>81</sup> The examples given in the Legal Guidance assume that the taxpayer has already spent more than half of the time planned in the foreign jurisdiction. However, despite this clarification, questions remain. For example, would it still be unreasonable to tax the employee if they returned to Sweden after 2.5 months instead of 6 months?<sup>82</sup>

### 29.4.3. Remote work from abroad (i.e. teleworking)

Remote work comes in different shapes and forms. It can be workers who are stranded in the host state or persons who start to work remotely on a voluntary basis. As mentioned in the introduction of this chapter, remote work has increased and will to some extent continue to be more common than before the pandemic. Returning to the scenario mentioned in section 29.3.1. in which the employee starts to work remotely from their summer house in Spain (i.e. workcation), from a tax treaty perspective, the situation will be possible to solve – regardless if the employee is doing this on their own initiative or if they are, in fact, posted to the employer’s office in Spain.<sup>83</sup>

Compared to social security, the problem of taxation is less complex. From a social security perspective, the main rule in the EU Regulation is that the employee is insured in the state where they conduct the work (*lex loci laboris*).<sup>84</sup> Similar to tax treaties, the physical presence is of importance. However, in contrast to tax treaties, the purpose of the social security system is to be covered by one system at a given time. To make this easier to apply, rules exist for posted workers and those who simultaneously and normally work in two or more states. However, these rules do not apply if the employee starts to work from a foreign jurisdiction on a voluntary and occasional basis. In these situations, the physical presence prevails, and a shift in applicable social security system and social insurance affiliation

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80. Ch. 3, sec. 13 IL.

81. Tax Agency’s Legal Guidance (*Rättslig vägledning*) of 5 May 2020.

82. For a more in-depth explanation, see Cejje, *supra* n. 8, at sec. 2.2.3.

83. See also Second OECD Report, *supra* n. 7, at paras. 59-63.

84. The physical presence of the employee is decisive; see ECJ, 27 Sept. 2012, case C-137/11 *Partena*, EU:C:2012:593.

should in fact be made. Here, further simplicity is required, and an adjustment of the EU Regulation ought to take place for those employees who – with the consent of their employers – can work remotely from other jurisdictions. To include a threshold would probably be the easiest way to adapt the Regulation to the new ways of working.

In April 2022, the SAC delivered a judgment regarding social security affiliation.<sup>85</sup> In the case, a Swedish employee (A) had worked remotely from South Africa for a few years. The employer withheld taxes and paid contributions in Sweden. The problem arose when A wanted to receive work-related benefits from the social security system in Sweden. The National Insurance Office held, according to the letter of the law, that these benefits could only be earned by work performed in Sweden (or if the EU Regulation stipulated). The SAC took a more pragmatic view, interpreting the “work performed in Sweden” extensively including not only where the work was physically performed but also that the employer was Swedish; in which country the employee was hired; the employer’s business in Sweden; and the character of the work performed. The interpretation made by the SAC was based on the preparatory work of the legislation.<sup>86</sup>

#### 29.4.4. Income of artists, influencers, etc.

Similar to article 15(1), article 17 of the OECD Model relies on the physical presence of the taxpayer when allocating the taxing right to the income. In contrast to article 15, the problems caused by the pandemic have not been dealt with by the law enforcers in Sweden. However, based on the aforesaid (*see* section 29.4.1.) and the fact that article 17 of the OECD Model often is followed in the concluding of Swedish tax treaties,<sup>87</sup> the location of the performer (similar to physical presence of the employee) is the determining factor. This would possibly mean that if an artist or sportsperson rehearses in one state and performs in another state, the latter state would have the right to tax the income (unless the person is paid also for rehearsal time etc.).<sup>88</sup> Similarly, if they live-stream from one state, this state would probably argue to have the right to tax.

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85. SE: SAC HFD, 13 Apr. 2022, case nr. 2329-21.

86. SE: Governmental bill. (prop.) 1998/99:119 p. 103 ff.

87. *See* Cejic & Wendleby, *supra* n. 37, at sec. 18.

88. *Cf.* para. 9.1 *OECD Model: Commentary on Article 17* (2017).

## 29.5. Article 15(2) and (3) of the OECD Model

### 29.5.1. The 183-days rule

With its starting point as article 15(2) of the OECD Model, Sweden has implemented its own 183-days rule in the domestic law addressing non-resident individuals.<sup>89</sup> Up to 2020, Sweden used a formal interpretation of the employer concept in this context. From 1 January 2021, an economic employer concept is adopted. However, the rule as such has not been altered; thus, it has been supplemented with an exemption for the “hire of labour”. If the situation is covered by the rule on hire of labour to Sweden, the 183-days rule is not applicable since the economic employer is regarded to be the Swedish company (or similar). Hence, the income is taxable in Sweden.<sup>90</sup> Yet, a work-related visit to Sweden of no more than 15 workdays in a row or maximum of 45 workdays in a calendar year will not be regarded as “hire of labour” and, hence, the employee will not be taxed in Sweden.<sup>91</sup>

Let us examine the situation of a person who is covered by the 183-days rule in domestic law as well as a tax treaty and is stranded in Sweden due to the pandemic. In previous research, the author of this chapter has argued that the exemption mentioned in the OECD Commentaries (article 15(5)) ought to be interpreted to cover this situation, disregarding the extra days spent in the country; accordingly, the taxpayer ought to continue to be covered by the 183-days rule.<sup>92</sup> A similar interpretation has been made by the OECD in its second report.<sup>93</sup> However, the opinion of the Swedish Tax Agency is not to extend the exemption this far and only the taxpayers’ own sick days are disregarded.<sup>94</sup> In addition, by using a strict interpretation of black letter law, the Tax Agency also argue that the taxpayer might become unlimited liable to tax in these situations (based on habitual abode).<sup>95</sup>

Due to this strict interpretation of the rules, the question of how the days are calculated is quite important. When it comes to the question of habitual

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89. Sec. 6a SINK.

90. For a more in-depth description, *see* Cejje, *supra* n. 8, at sec. 2.2.4.

91. Sec. 6a SINK; in this regard, only workdays are counted.

92. Cejje, *supra* n. 6, at sec. 3.4.2.

93. Second OECD Report, *supra* n. 7, at paras. 53-56.

94. On the contrary, in tax treaty interpretation, Sweden follows the approach taken that sick days in the end of a 183-day period, preventing the taxpayer from leaving Sweden, will however not be counted. *See* Tax Agency’s website; *Questions and Answers section, 183-day rule and Covid-19*, available at <https://www.skatteverket.se/privat/skatter/coronainformationforprivatpersoner.4.1c68351d170ce5545272ce3.html> (accessed 23 Apr. 2022).

95. *Id.*



abode, no real guidance is given. Concerning the 183-days rule, all days are included, i.e. Saturdays, Sundays and days of arrival and departure.<sup>96</sup> Any 12-month period can be used. However, in regard of the 15/45 workdays, the calendar year is used. As mentioned previously, basically all days are counted according to domestic law. In the Swedish tax treaties, different periods are used (12 months, calendar year, etc.).

### 29.5.2. Employees working in international traffic

From the previously analysis, it is quite clear that the physical presence of the employee is of importance when applying articles 15(1) and 15(2). In contrast, article 15(3), on employees working in international traffic, does not take the physical presence of the taxpayer into account. The rationale is that it would be too difficult due to the mobile nature of the work. Instead, article 15(3) allocates the taxing right to the resident state of the employee. However, prior to 2017, the taxing right was allocated to the state where the PoEM of the enterprise was situated. For a long time, many of the Swedish tax treaties have allocated taxing rights also to the resident state.<sup>97</sup> In addition, according to the NTT,<sup>98</sup> income of a Swedish employee of Scandinavian Airlines is taxable only in Sweden.<sup>99</sup> Due to the increase of mobility of work, the question if the resident principle should prevail over physical presence in the future will be addressed in section 29.8.

## 29.6. Frontier workers

Frontier workers, i.e. workers who live in one state and work in another, are rather common within the Nordic countries. If government subsidies are paid to frontier workers via the employers, the same view is taken as described in section 29.4.1. Commuting is most common between Sweden and Denmark. Approximately 19,000 individuals commuted from Sweden to Denmark on a daily basis prior to the pandemic and a few thousand in the opposite direction. The number of commuters decreased during the pandemic and has continued to do so.

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96. SE: Government bill. (prop.) 1989/90:47, p. 22.

97. Cejte & Wendleby, *supra* n. 37, at sec. 16.1.

98. *Convention between the Nordic Countries for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital* (23 Sept. 1996), Treaties & Models IBFD.

99. Id. See also the reservation made by Sweden in para. 15 *OECD Model: Commentary on Article 15* (2017).

According to the NTT, frontier workers living in Sweden and working in Denmark for a private employer would be taxed only in Denmark. In this case, Sweden would be their resident state and both states would be able to tax the income according to article 15(1). According to article 25(6b) of the NTT, Sweden would exempt the income from tax. As a result, tax would be paid only in Denmark. The same goes for social security contributions according to the EU Regulation.<sup>100</sup> Even though the usual mismatch in payment of taxes and social security contributions<sup>101</sup> is solved in this case (both are paid in Denmark), other problems do occur. The outcome is problematic from a Swedish budgetary perspective since Sweden has a rather generous social security benefit system based on residency<sup>102</sup> and also provides for free schooling and so forth, which are financed by taxes. However, due to this imbalance, Sweden and Denmark have signed the Öresund Treaty (2003).<sup>103</sup> This treaty includes a compensation regime, making Denmark (in the previous situation) transfer some tax revenue to Sweden. However, the compensation regime has been strongly criticized in legal doctrine as being unfair.<sup>104</sup> In addition, the Öresund Treaty states that work carried out in the home of the taxpayer may be considered work performed in the state of employment.<sup>105</sup> The same goes for work carried out on business trips, etc.<sup>106</sup> This extended possibility to tax is only applicable if the work performed in the state of employment (Denmark in this case) is at least half of the work time during a 3-month period. If the Öresund Treaty is not applicable, then the main rules in the NTT will apply, and Sweden can tax the income from work performed in Sweden (article 15(1)).

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100. EU Regulation, *supra* n. 39.

101. As a main rule, taxes are usually paid in the resident state and contributions in the source state, which often is referred to as a discoordination or mismatch.

102. See SE: Social Security Insurance Code (2010:110), ch. 5.

103. NTT, appendix 4 Öresund Treaty; and SE: *Lag (2004:639) om ändring i lagen (1996:1512) om dubbelbeskattningsavtal mellan de nordiska länderna*; see also Government bill (prop.) 2003/04:149. For an in-depth analysis, see M. Dahlberg & A.S. Önder, *Taxation of Cross-Border Employment Income and Tax Revenue Sharing in the Öresund Region*, 69 Bull. Intl. Taxn. 1, pp. 29-36 (2015), Journal Articles & Opinion Pieces IBFD; and Y. Lind, *Crossing a Border – A Comparative Tax Law Study on Consequences of Cross-Border Working in the Öresund and Meuse-Rhine Regions* pp. 170-174 (Jure 2017).

104. Dahlberg & Önder, *id.*, at pp. 31-33; Lind, *id.*, at pp. 172-173; Cejic, *supra* n. 6, at pp. 188-189; and T. Persson & C. Schwartz, *ESS in the Öresund Region – Taxation in Cross-Border Situations*, in *Big Science and the Law* pp. 227-257 (U. Maunsbach & A. Hilling eds., Ex Tuto Publishing 2021).

105. The Swedish Tax Agency has issued a Position Statement concerning the interpretation of art. 1 of the Öresund Treaty. The Statement provides that time on sick leave or vacation is regarded as work performed in the source state. Some other clarifications are given in the Statement; see SE: *Tolkning av artikel 1 i 2003 års avtal mellan Sverige och Danmark om vissa skattefrågor*, dnr 131 134135-17/111 (7 Apr. 2017).

106. See also Dahlberg & Önder, *supra* n. 103, at p. 31.

During the pandemic, many Swedish frontier workers were prevented from commuting to Denmark and, thus, worked from home offices in Sweden. Due to this, the Tax Agency made a clarification stating that the 3-month rule was still applicable and that if employees could not work more than 50% in Denmark during this period, they would be taxed in Sweden on the income rendered when working from home. Clarifications were also made on how to calculate the 3-month period. Normally, the Tax Agency uses calendar months, but during the pandemic, it also accepted a day-by-day calculation similar to the model used in Denmark.<sup>107</sup>

An additional problem is the fact that social security contributions are also paid in Denmark. The Öresund Treaty does not cover the loss of social security contributions.<sup>108</sup> When frontier workers start to work from home in Sweden, the EU Regulation stipulates that the social security system of Sweden may apply instead of the Danish system. However, the National Insurance Offices (*Försäkkingskassan* and *Udbetaling Danmark*) made an agreement that the pandemic should not affect social security; no changes would be made in respect of where the individual was insured, meaning that the Danish system would still apply.<sup>109</sup> Conversely, this pragmatic view is, as indicated previously, not taken by the Swedish Tax Agency. The rationale of the Tax Agency's approach will be discussed in the next section.

## **29.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)**

As indicated throughout this chapter, the Swedish Tax Agency has taken a rather formal view on the rules applicable and has found very few situations in which the pandemic has influenced its application of the law. For example, it has been held that if a person stays for 190 days in Sweden, they will become unlimited liable to tax in Sweden (habitual abode), regardless of the reason for the stay. In addition, the physical presence has been of

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107. See SE: Tax Agency's Position Statement, *Tolkning av artikel 1 i 2003 års avtal mellan Sverige och Danmark om vissa skattefrågor*, dnr 131 134135-17/111 (7 Apr. 2017); and Tax Agency's, COVID-19-related information for private individuals, *Coronapandemin och ett ökat antal arbetsdagar i hemlandet för svenska Öresundspendlare*, available at <https://www.skatteverket.se/privat/skatter/coronainformationforprivatpersoner/corona-pandeminochettokatantalarbetsdagarihemlandetforsvenskaoresundspendlare.4.109dcbe71721adafd251920.html> (accessed 23 Apr. 2022).

108. The social security contributions in Sweden are normally 31.42% which, in fact, leads to a great revenue loss for the state.

109. Cejje, *supra* n. 6, at sec. 3.2.4.

importance also in regard to the application of tax treaties when employees are working remotely from their homes in cross-border situations, as well as the day-to-day calculation of days present in Sweden for frontier workers and the applicable Öresund Treaty.

This formal approach can be explained by the importance put on the principle of legality (*nullum tributum sine lege*) in the Swedish tax context and Constitution.<sup>110</sup> Even though the principle holds that the Tax Agency cannot levy tax in the absence of a tax rule, the converse also holds, i.e. if there is a rule stating tax liability, the Tax Agency needs to levy the tax.<sup>111</sup> Only if there are explicit exemptions for levying the tax in the code can an exception be made. Such exception is found in chapter 3, section 13 of the IL (the safety valve). In this regard, the Tax Agency has made use of the possibility to apply this exception during the pandemic (*see* section 29.4.2.).

Furthermore, it is interesting to note that the Swedish National Insurance Office has taken a more relaxed view in trying not to change the social security system for affected individuals when prevented from travelling during the pandemic. In section 29.6., the example of Sweden and Denmark was given. In addition, the Swedish National Insurance Office has made a more general applicable statement on its website. If a person is prevented from traveling to their work state due to closed borders and the COVID-19 pandemic, as long as they keep their employment, the social insurance affiliation will not change. This exemption lasted until 30 June 2022.<sup>112</sup>

An explanation might, at first sight, be that the principle of legality is not as strong for social security as for tax law – the National Insurance Office is rather providing for benefits than levying contributions. On the one hand, the Tax Agency does levy contributions based on the decision of the National Insurance Agency, and contributions are considered to be taxes in the Constitution.<sup>113</sup> Accordingly, these pragmatic paths taken by the National Insurance Office could, from a domestic perspective, be questioned (*see* section 29.8.2.). On the other hand, during the COVID-19 outbreak, the

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110. SE: *Regeringsformen* (1974:152) [Instrument of Governance] ch. 8, sec. 2 and ch. 2, sec. 10(2). *See also* A. Hultqvist, *Legalitetsprincipen vid inkomstbeskattningen* (Juristförlaget 1995).

111. R. Pålsson, *Konstitutionell skatterätt* p. 93 (Iustus 2018).

112. SE: National Insurance Office, [https://www.forsakringskassan.se/privatpers/resa\\_arbeta\\_studera\\_eller\\_fa\\_vard\\_utomlands/arbeta\\_utomlands/arbeta\\_i\\_flera\\_lander\\_inom\\_eu\\_ees\\_eller\\_i\\_schweiz](https://www.forsakringskassan.se/privatpers/resa_arbeta_studera_eller_fa_vard_utomlands/arbeta_utomlands/arbeta_i_flera_lander_inom_eu_ees_eller_i_schweiz) (accessed 26 Apr. 2022).

113. K. Cejje, *Inkomstskatter och Socialavgifter - två metoder att beskatta löneinkomster* pp. 270-272 (Norstedts juridik 2020); Pålsson, *supra* n. 111, at p. 23, SE: case RÅ 1983 1:85, RÅ 1986 ref. 158 and RÅ 1996 ref. 5.

European Union provided some guidelines concerning the exercise of the free movement of workers and social security.<sup>114</sup> This may be one explanation for the different approaches.

## 29.8. The future of the mobility of work: A need for adjusting the existing treaty rules?

### 29.8.1. Introduction

The nexus and fair taxation for corporate taxes has been discussed by the international tax community for years. During the pandemic, it became clear that the tax base for employment income is mobile, similar to companies. Concepts such as WFA, digital nomads, gig-economy, workcation, WFH and remote work (teleworking) have become more familiar and are widely understood and made available to many.

If these employees use their work laptops cross-border, new questions arise. In this contribution, a Swedish perspective is taken, with its main focus on the interpretation and application of domestic law and tax treaties during the pandemic. The output shows that the Tax Agency interprets the law according to its wording, and few exceptions for more pragmatic or ad hoc solutions exist. Both prior and during the pandemic, several scholars have claimed that the tax base for employment income and the principles of tax liability (nexus) for the employees might need to be changed, due to the increase of mobility.<sup>115</sup> If the physical presence of the employee should still be crucial, different questions of evidence need to be solved. Should persons be taxed based on which server they are using (easily manipulated), geo-localization technologies<sup>116</sup> or where a stamp in their passport is issued?

In this section, a *de lege ferenda* perspective is taken, and a few general comments are made with the purpose of contributing to further discussion

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114. Communication from the Commission, *Guidelines concerning the exercise of the free movement of workers during COVID-19 outbreak* 2020/C 1021/03; and ELA, *Impact of teleworking during the COVID-19 pandemic on the applicable social security* (July 2021).

115. S.V. Kostić, *OECD/UN/International – In Search of the Digital Nomad – Rethinking the Taxation of Employment Income under Tax Treaties*, 11 *World Tax J.* 2 (2019), *Journal Articles & Opinion Pieces IBFD*; Beretta, *supra* n. 5; H. Niesten, *Revising the Fiscal and Social Security Landscape of International Teleworkers in the Digital Age*, 49 *Intertax* 2, pp. 120-143 (2021); Tjernberg, *supra* n. 5; Cejic, *supra* n. 3; and C. Schwartz, *Taxation of Remote Workers – Is the Allocation of Taxation Rights in Line with the Benefit Principle?*, 15 *World Tax J.* 4 (2023), *Journal Articles & Opinion Pieces IBFD*.

116. For a description how this could work, see Beretta, *id.*, at p. 111.

on this topic. Unfortunately, no overarching, perfect solution is proposed. However, the author of this chapter finds it very satisfactory that these questions and matters are being discussed and is very much looking forward to future similar discussions and conferences.

### 29.8.2. The principle of legality and flexibility in situations of force majeure

In this contribution, the conclusion has been made that the Swedish Tax Agency, in contrast to the Swedish National Insurance Office, did not change the interpretation and application of the rules based on the fact that the pandemic can be regarded as force majeure or an extraordinary event of a special kind, in which people were forced to change their working patterns. Hence, the view taken by the Tax Agency can be explained by the strong influence of the principle of legality in this area.

Since the principle of legality is found in the Swedish Constitution, it is somewhat difficult to argue that this position ought to be changed. However, one could discuss whether a new rule in tax laws or treaties should be enacted that would make it possible to *not* levy taxes in situations of force majeure or extraordinary times – as long as it is for the benefit of the taxpayer. As mentioned previously, the principle of legality in the Swedish Constitution is phrased in the positive (no tax without law). It is not phrased as now interpreted, i.e. if there is a law – tax must be levied. Hence, there might be room for a force majeure clause.<sup>117</sup>

### 29.8.3. Improvements in current laws, treaties and application

If one reaches the conclusion that existing rules make sense and only minor changes should be made, a few improvements can be highlighted. Firstly, in regard to habitual abode as used in Sweden, more guidance from the legislator or SAC is needed to be able to provide foreseeability and certainty for the taxpayers and their employers. Secondly, regarding the same situation, the calculation of time spent in Sweden needs to be clarified. Above all, it would have been preferred if a more Commentary-coherent interpretation

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117. According to the opinion of this author, great cautiousness must be taken if this should be done, since the risk of misuse or misinterpretations possibly would occur. For the time being, this author does not argue for such article.

for situations of stranded workers due to force majeure situations would have been made by the Tax Agency during the pandemic. Thirdly, the EU Regulation on social security needs to be amended. One way to do this would be to include a tolerance rule for those employees who voluntarily, irregularly and ad hoc work remotely from different places in the union (workcation). Article 13(1) does not cover employees who do not *normally* pursue activities in two or more states. Article 12(1) only covers posted workers and not employees voluntarily choosing to work from elsewhere.<sup>118</sup>

#### 29.8.4. Time for change?

The author of this chapter would argue that it is time for change, or that at least an in-depth discussion needs to take place in regard of remote work. Accordingly, several different solutions are already presented by other scholars, and further solutions will most likely be put on the table in the near future!

Today, physical presence is of importance. A first option would be to keep this decisive factor and perhaps make a clearer and stricter physical presence test, combined with geo-localization technologies.<sup>119</sup> A second option would be to give the state of the PoEM/situs of the employer the taxing rights for the employees' wages, etc., which is similar to article 19(1)(a) of the OECD Model. If one chose to give the source state (residency of the employer) the taxing right, this could be made in combination with a compensation regime for the residence state and/or a tolerance rule in situations of remote work.<sup>120</sup> Alternatively, the residence of the employee could be given even more importance, similar to article 15(3) of the OECD Model. This third option could also be combined with a compensation regime, but this time in favour of the source state. A fourth option would be to reverse the path and turn back to citizenship as a decisive factor. All these suggestions have both advantages and disadvantages.<sup>121</sup>

Without analysing all these solutions in depth, the author of this chapter would argue that since social security contributions and taxes are both

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118. EU Regulation, *supra* n. 39; and sec. 29.4.3.

119. See Beretta, *supra* n. 5, at pp. 107-111.

120. See sec. 6 Öresund Treaty; and Niesten, *supra* n. 115, at pp. 139-143.

121. Beretta, *supra* n. 5; Niesten, *supra* n. 115; and Kostić, *supra* n. 115.

important sources for state revenue,<sup>122</sup> and mismatches<sup>123</sup> – when levying them – cause great administrative burdens for the taxpayers, it would be interesting to analyse whether they can be coordinated to a greater extent than today.<sup>124</sup> Based on all the differences, especially regarding social security law – to be successful, there will probably not be a one-fits-all solution.

For example, the legislators will probably have to differentiate, between different types of remote workers, for example, a person working for a few weeks from their summer house in Spain, a frontier worker working from home a few days a week or a digital nomad (highly mobile person). One way forward in these discussions would be to coordinate taxes and contributions to the same state; introduce a threshold (in days) for highly mobile people; and discuss the possibility of introducing compensation regimes. In addition, one can also discuss if the other state should be able to tax the income on a lower tax rate, similar to the treaty articles on passive income (articles 10 and 11 of the OECD Model). Whichever solutions are chosen, the underlying purpose must be to ease the administrative burdens for taxpayers. The author is looking forward to discussing these questions in forthcoming research.<sup>125</sup>

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122. In Sweden, social security contributions are the greatest source of income for state finance; see Cejje, *supra* n. 113, at p. 22; and Government bill (prop.) 2018/19:1, pp. 89-90.

123. In this context, “mismatches” means that taxes are levied in one country and contributions in the other country.

124. F. Pennings & M. Weerepas, *Towards a convergence of coordination in social security and tax law?*, 15 EC Tax Review 4, pp. 215-225 (2006); B. Spiegel et al., *Analytical report 2014: The relationship between social security coordinating and taxation law* (European Commission 2015); M. Weerepas, *Tax and social security contribution, a word of difference?*, 2018 NTJ 1, pp.18-30 (2018); and J. Tepperova et al., *Tax and Social Security: EU perspective* pp. 1-6 (KPMG 2018).

125. See research grant, *supra* n. 1.



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## Chapter 30

### The Impact of Tax Treaties on International Mobility of Work in Switzerland

Tabea Lorenz and Peter Hongler

#### 30.1. Mobility of work and domestic tax law

##### 30.1.1. Exit tax for individuals

As Switzerland does not tax capital gains on private movable assets,<sup>1</sup> there is also no need for a comprehensive exit tax. Only in the case of a self-employed person will business assets be taxed upon leaving Switzerland as, in the moment of the relocation, the tax liability ends in Switzerland.<sup>2</sup> However, these cases are very rare and, as a consequence, there is no particular debate regarding whether the stay abroad of an individual (potentially also triggered by the pandemic) might trigger exit taxation in Switzerland.

##### 30.1.2. Exit tax for corporations

If the place of effective management of a corporate taxpayer has shifted to another country, this triggers exit tax consequences in Switzerland.<sup>3</sup> Moreover, since 1 January 2020, Switzerland has had a comprehensive exit tax provision, i.e. not only covering the relocation of place of effective management but also the transfer of assets, business operations and functions abroad.<sup>4</sup> In simplified terms, a transfer of the place of effective management means that hidden reserves will be subject to corporate income tax (including goodwill).<sup>5</sup> This is true both if the seat still remains in Switzerland but also if the seat is shifted abroad. However, if only the place of effective management is transferred and the seat remains in Switzerland, this does not

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1. CH: *Bundesgesetz über die direkte Bundessteuer* [Federal Direct Tax Act (FDTA)], 1990, art. 16(3) (amended 2022), Primary Sources IBFD.

2. Art. 8 (2) FDTA 1990 (amended 2022).

3. Art. 61b (1)1 FDTA 1990 (amended 2022).

4. Art. 61b FDTA 1990 (amended 2022).

5. See art. 61b FDTA 1990 (amended 2022).

yet trigger domestic withholding tax on the retained earnings in Switzerland but only corporate income tax.<sup>6</sup>

In practice, the discussion of an exit tax due to a change of the place of effective management has so far been of limited relevance. One reason might be that companies proactively aim at a tax residency in Switzerland. There are, however, quite a number of cases in which the authorities claimed that the place of effective management of a company is in Switzerland and not, as argued, abroad. These cases relate to traditional offshore structures.<sup>7</sup> As far as it can be observed, there was no specific discussion in relation to changed circumstances (i.e. a transfer of the place of management) during the pandemic.

### 30.1.3. Substance requirements

Switzerland has no specific substance requirement in its domestic tax code. This means that even a company without any substance shall be subject to an unlimited corporate income tax liability in Switzerland if its seat is in Switzerland. However, the substance requirement is of particular interest in cross-border situations in which a Swiss-based company is owned by a foreign company and the foreign company wants to apply a tax treaty in order to reduce the dividend withholding tax liability in Switzerland.<sup>8</sup> In this case, taxpayers often ask for an up-front tax ruling to confirm that a foreign person is indeed the beneficial owner of dividends paid by a Swiss company and that such a person shall be able to apply the tax treaty in order to receive a full or partial refund of the Swiss dividend withholding tax. These tax rulings contain, in general, a rather detailed description of the substance in the state of the recipient company (e.g. information about office premises, personnel, etc.). Therefore, in the case that there is a change in the substance as outlined in the ruling, this would question the validity of the tax ruling.<sup>9</sup>

However, during the pandemic, the Swiss authorities, in general, were rather reluctant to seriously take into consideration changes in the fact pattern triggered by the pandemic. Therefore, as far as it can be observed, no specific

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6. CH: *Bundesgesetz über die Verrechnungssteuer (Verrechnungssteuergesetz)* [Withholding Tax Act (WTA)], 1965, art. 4(2) (amended 2022), Primary Sources IBFD, *e contrario*.

7. See e.g. CH: BGer [Federal Supreme Court], 16 May 2013, 2C\_1086/2012, 2C\_1087/2012.

8. The withholding tax is levied in particular on dividends paid by domestic taxpayers and interests on bonds of domestic borrowers (*see* art. 4 WTA 1965).

9. This is based on the good faith principle in art. 9 of the Swiss Federal Constitution.

rulings have been revoked by the authorities just due to the fact that a taxpayer did not follow the fact pattern disclosed in a tax ruling.<sup>10</sup>

#### 30.1.4. Are the substance requirements based upon premises still appropriate?

One particular feature of the Swiss tax system is the federal institutional structure within Switzerland. (Corporate) Income taxes are levied at the federal, cantonal and municipal level. This requires that clear rules are followed on how to define tax liabilities if more than one canton is involved. For instance, in an intercantonal situation, a company is subject to corporate income taxation only in the canton where its seat or place of effective management is unless it has a permanent establishment or it owns real estate in another canton.

Therefore, the term “place of effective management” is also of interest in mere intercantonal conflict situations.<sup>11</sup> Here, recent developments show that this triggers difficulties in an age of significant mobility and decentralized business models. Therefore, in many instances, it is far from clear where the place of effective management really is, and some tax authorities have started to question whether the seat and place of effective management are at the same place. It could be assumed, therefore, that the seat has again gained some importance in disputed situations as it could serve as a default criterion in the sense that, if the determination of the place of effective management is difficult, the tax liability is in the canton where the seat prevails. However, this development cannot be detected in the case law of the Swiss Federal Supreme Court. The opposite seems true, so the seat has lost some importance according to recent case law.<sup>12</sup> Moreover, the authorities assume that, in certain cases, even the place of residence of the main shareholder and/or board members is relevant.<sup>13</sup> This is in particular true

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10. Tax rulings, however, are not publicly available.

11. The legal terms are not identical, but there is a significant overlap also in the case law of the Swiss Federal Supreme Court.

12. See, in particular, CH: Federal Supreme Court, 1 Feb. 2019, 2C\_627/2017. There is a dogmatic dispute on whether the seat shall, in principle, be a decisive factor unless the seat is only used in a fictitious form (e.g. in the case of a letter box company) or whether the place of effective management is always decisive (see, for details, P. Locher, *Zum Hauptsteuerdomizil juristischer Personen im interkantonalen Verhältnis*, StR, p. 270 et seq. (2020)). There are some persuasive arguments in favour of the former opinion.

13. For further details, see M.R. Jung, *Hauptsteuerdomizil juristischer Personen: International und interkantonal*, Expert Focus, p. 251 et seq. (2017).

for an enterprise that does not require a lot of substance such as investment or holding companies.

### 30.1.5. Social security agreements

European coordination law<sup>14</sup> applicable to Switzerland regulates which social security system is applicable to employees living and working in different EU Member States. As a general rule, employees are subject to the social security laws of one EU Member State only. Employees are normally subject to the social security laws of the state in which they are physically performing their work. There are, however, certain exceptions to this principle. For instance, frontier workers who work a significant part (i.e. at least 25%) in their country of residence will be subject to the social security laws of the country of residence and not the country where the main place of work is located.

Due to COVID-19 pandemic measures, the Member States of the European Union agreed to apply a more flexible approach to the social security coordination rules for the duration of the pandemic. As a consequence, Switzerland came to an understanding that the international social security rules between the countries should be interpreted flexibly and consequently not lead to a change in the social security regime of frontier workers increasingly working from home due to the measurements of the COVID-19 pandemic. For employees residing in one EU Member State (or Switzerland) and working in another EU Member State (or Switzerland), this means that they remain subject to the social security system in the country where their employer is located even if they work from home for more than 25% of the time. The members of the European Union Administrative Commission for the Coordination of National Social Security Systems agreed on 14 June 2022 to extend this flexible application of the subordination rules until the end of 2022. The flexible application of the subordination rules will also be extended accordingly within the framework of the Agreement on the Free Movement of Persons (AFMP) and the European Free Trade Association

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14. Regulation (EC) No 883/2004 of the European parliament and of the council of 29 April 2004 on the coordination of social security systems (SR 0.831.109.268.1); Regulation (EC) No 987/2009 of the European parliament and of the council of 16 September 2009 laying down the procedure for implementing Regulation (EC) No 883/2004 on the coordination of social security systems (SR 0.831.109.268.11). For further information, see Swiss Federal Social Insurance Office, *Social security agreements and standard-setting conventions*, available at <https://www.bsv.admin.ch/bsv/en/home/social-insurance/int/points-of-reference-and-agreements/sozialversicherungsabkommen.html> (accessed 3 Aug. 2022).

Convention and will thus apply to Switzerland.<sup>15</sup> The subordination rules are also to be designed or interpreted from 1 January 2023 in such a way that a certain extent of telework can be carried out in the country of residence without changing the responsibility in the area of social security. The concrete implementation will be prepared in the coming months at the European level and between Switzerland and its neighbouring countries.<sup>16</sup>

## 30.2. Residence, tiebreaker rules and mobility of work: Individuals and entities

### 30.2.1. Interpretation of article 4(1) and (2) of the OECD Model

As far as it can be observed, there have been no specific decisions on the impact of increased mobility concerning the interpretation of article 4(1) of the OECD Model. Therefore, the following focus will be on article 4(2) of the OECD Model on the terms “centre of vital interests”. According to the case law of the Swiss Federal Supreme Court, all objective elements that are useful for determining the centre of vital interest of a person need to be considered for the application of the tiebreaker rule.<sup>17</sup> Therefore, according to the court, it is not possible to freely choose the place of residence. According to the Swiss Federal Supreme Court, the entire environment (i.e. professional but also family life) needs to be considered.<sup>18</sup> However, it is of no decisive importance where the formal place of domicile is of a person, i.e. where the documents are.<sup>19</sup> The court has developed a certain practice on a case-by-case basis that is highly influenced by its case law in intercantonal situations.<sup>20</sup> For instance, in the case of a married couple, it is assumed that the personal link to the family home is closer than to the workplace.<sup>21</sup>

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15. For further information, see Swiss Federal Social Insurance Office, *Neue Vereinbarung ab dem 1. Juli 2023: Kein Zuständigkeitswechsel im Bereich der Sozialversicherungen bei Telearbeit unter 50% in bestimmten Staaten*, available at <https://www.bsv.admin.ch/bsv/de/home/sozialversicherungen/int/grundlagen-und-abkommen/telearbeit.html> (accessed 3 Aug. 2022).

16. For further information, see id.

17. CH: Federal Supreme Court, 7 Apr. 2017, 2C\_128/2016, 2C\_130/2016, cons. 4.2 (with further references).

18. See CH: Federal Supreme Court, 6 Dec. 2010, 2C\_397/2010, cons. 2.4.2.

19. CH: Federal Supreme Court, 17 Oct. 2005, BGE 132 I 29, cons. 4.1.

20. See section 30.2.2.

21. CH: Federal Supreme Court, 10 Mar. 2019, 2C\_473/2018, cons. 5.3.1.

### 30.2.2. The impact of a mobile lifestyle on the application of the tiebreaker

There is not a lot of case law available on the application of the tiebreaker rule in Switzerland.<sup>22</sup> However, there are dozens of judgments available on the question of where the centre of vital interest is in intercantonal situations as this is also the key criteria for determining tax residency within Switzerland. If a person is subject to unlimited taxation in two cantons, the canton to which the taxpayer has a closer connection prevails.<sup>23</sup> The courts use several proxies to develop a certain standardized approach towards determining tax residency. In order to do so, the courts differentiate between several categories.<sup>24</sup> For instance, there is the assumption that married couples have, in general, a closer link to the family home than to the workplace, or single taxpayers who do not have regular contact to other family members are, in general, resident at the place where they work. Moreover, there is specific case law for employees in a management position, for persons with two alternative domiciles, and for employees who only work during a tourist season, and there is also a specific practice also for persons who stay in a different canton for specific purposes (e.g. staying in a mental institution or a health resort). There are dozens of judgments of the Swiss Federal Supreme Court on how and in what circumstances a person falls under which category. Moreover, the court then defines where such persons should have their closest connections and therefore which canton is competent to tax the person as a resident canton.

Recent years have led to a rethinking about the allocation of some of these cases due to new lifestyles. The most obvious example is employees in a management position. There, the traditional argument was that the connection to the working place is so significant that it should prevail over the domicile (i.e. where the family lives). However, as managers of very large enterprises can also work from home, this is not persuasive anymore. Nevertheless, the case law of the Swiss Federal Supreme Court has not yet changed.

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22. See e.g. in the last years CH: Federal Supreme Court, 2C\_128/2016, 2C\_1066/2017, 2C\_480/2019, 2C\_473/2018.

23. See e.g. CH: Federal Supreme Court, 17 Oct. 2005, BGE 132 I 29.

24. For instance, see with many references, M. Zweifel & S. Hunziker, *Interkantionales Steuerrecht in Kommentar zum Schweizerischen Steuerrecht*, sec. 6 (M. Zweifel, M. Beusch & D. de Vries Reilingh eds., Helbling Lichtenhahn Verlag 2021).

### 30.3. Permanent establishments and mobility of work

#### 30.3.1. Home office as a permanent establishment

In inbound situations, Switzerland does not know a dependent agent permanent establishment. Therefore, the focus in the following is on the permanent establishment definition in article 5(1) of the OECD Model. For a home office to qualify as a permanent establishment according to article 5 of the OECD Model, the following requirements need to be fulfilled.

Firstly, the establishment must be permanent. Switzerland has quite a restrictive position on the question of when an establishment is “permanent”. For instance, the cantonal tax court of Solothurn requires a minimum of 6 months for an establishment to be considered permanent.<sup>25</sup> However, even if the home office is used for a longer period, it is not automatically considered to be a permanent location if the employee uses it only from time to time. However, a strong argument in favour of a permanent home office is a contractual obligation of the employee to work from home during specific days (e.g. Monday and Tuesday).<sup>26</sup> A second important question is whether the place of business is at the disposal of the employer. Here, the key question is whether the fact that the employee may have disposal over the home office also means that the employer has the right to have disposal over the home office. There is no specific case law available in Switzerland in this regard.<sup>27</sup> However, as argued by Vogelsang, due to the fact that Switzerland, in general, applies the permanent establishment threshold in a restrictive form, it can be assumed that the right to dispose would be attributed to the employer only in very specific circumstances.<sup>28</sup> This would occur, for instance, if there is a contractual obligation to use the home office as a working space and the employer compensates the employee for the additional costs. Therefore, Switzerland is quite reluctant to assume that a home office creates a permanent establishment. Third, of course, the activity shall not be exempted from the permanent establishment definition according to article 5(4) of the OECD Model.

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25. CH: Tax Court Solothurn, 4 July 2011, SGSTA.2010.90, BST.2010.87, cons. 4.2.

26. For more details, see M. Vogelsang, *Home-Office-Betriebsstätten während und nach der COVID-19-Pandemie*, p. 176, IFF Forum für Steuerrecht (2021).

27. See, from a civil law perspective, however, CH: Federal Supreme Court, 23 Apr. 2019, 2A\_533/2018.

28. M. Vogelsang, *supra* n. 26, at p. 176.

### 30.3.2. Impact of the pandemic

There are no specific publications of the authorities on the application of the permanent establishment threshold in international situations with particular regard to the pandemic. However, in general, the mere fact that the employee was forced to work from home during the pandemic shall not be sufficient to create a permanent establishment as, in particular, the home office is not considered to be at the disposal of the employer.<sup>29</sup> Of course, if the employee continues to work from home after the pandemic, the situation needs to be reassessed.

### 30.3.3. The current discussion

In intercantonal circumstances, the Swiss Tax Conference (a body with representatives of all cantonal and federal tax authorities) has published an analysis of the impact of teleworking.<sup>30</sup> The authorities have clearly stated that working from home shall not create a permanent establishment. Even in decentralized business models in which the employees are obligated to work from home, a permanent establishment shall not exist. Therefore, this is in line with the restrictive understanding of a permanent establishment in international situations. This is a strong sign that the Swiss authorities (but also scholars)<sup>31</sup> are very reluctant to lower the permanent establishment threshold and assume that a home office could create a permanent establishment.

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29. Therefore, this is generally in line with the opinion of the OECD (*see* OECD, *OECD Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis* (3 Apr. 2020); and OECD, *Updated guidance on tax treaties and the impact of the COVID-19 pandemic*, (21 Jan. 2021)).

30. Schweizerische Steuerkonferenz, *Analyse zu den Auswirkungen von Telearbeit auf die interkantonale Steuerauscheidung von Unternehmen*, sec. 3.1 (SSK 2022).

31. *See* e.g. Vogelsang, *supra* n. 26, at p. 172 et seq.



## 30.4. Physical presence according to articles 15(1) and 17 of the OECD Model

### 30.4.1. General remarks

Employees without a tax domicile or abode in Switzerland are subject to limited tax liability if they pursue gainful employment in Switzerland.<sup>32</sup> A withholding tax procedure applies, which means that the Swiss employer must withhold the tax due when the employment salary is paid and remit it periodically to the competent Swiss tax authority.

In its earlier case law, the Swiss Federal Supreme Court interpreted the predecessor provision of article 5(1)(a) of the Federal Direct Tax Act (FDTA) to the effect that, although all economic connecting factors of the activity must be in Switzerland, the physical presence of the employee in Switzerland was not mandatory.<sup>33</sup> In 2011, however, the Swiss Federal Supreme Court changed this case law and stated, among other things, that article 5(1)(a) of the FDTA must be interpreted literally.<sup>34</sup> As a result, the taxation of employees without a tax domicile or abode in Switzerland presupposes that the work that is decisive for the accrual of the entitlement to remuneration is physically carried out in Switzerland. This therefore corresponds to the relevant requirement of article 15(1) of the OECD Model. An employee's home office abroad for a Swiss employer therefore does not, in principle, give rise to a (limited) tax liability in Switzerland. Whether an employee is forced to stay and work at a certain place abroad (e.g. due to travel restrictions or public health measures) or whether they do so on a voluntary basis is basically irrelevant to the question of subjective tax liability under currently applicable Swiss domestic tax law.

A special case is the taxation of restricted employee options as the law provides for pro rata taxation in Switzerland if the employee moved abroad during the vesting period. The income realized by the employee is taxed in Switzerland on a pro rata temporis basis (ratio of days resident in Switzerland to days resident abroad).<sup>35</sup> Furthermore, Swiss domestic tax law provides exemptions from a physical presence in Switzerland for

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32. See art. 5(1)(a) DBG 1990: "Individuals without a tax domicile or abode in Switzerland shall be subject to taxation on the basis of economic affiliation if they: a. pursue gainful activity in Switzerland."

33. CH: Federal Supreme Court, 2 Dec. 1988, 2A.83/1988, ASA 59 p. 471 cons. 4b; CH: Federal Supreme Court, 29 Jan. 1996, 2A.47/1995, ASA 65[1996/97] p. 822, cons. 2b.

34. See CH: Federal Supreme Court, 25 Mar. 2011, BGE 137 II 246.

35. See arts. 17d and 97a DBG 1990.

activities on ships or aircrafts<sup>36</sup> as well as members of the administration or management of legal entities with their registered office or permanent establishment in Switzerland.<sup>37</sup>

#### 30.4.2. Income from employment (article 15 of the OECD Model) versus other income (article 21 of the OECD Model)

It can be seen from the context of the OECD Model that all compensation paid as remuneration for employment can be subsumed under article 15 of the OECD Model. The OECD Model Commentary also states that, according to the understanding of the member states, benefits in kind for employment are also covered by the term “salaries, wages and other similar remuneration”.<sup>38</sup> This understanding thus corresponds, in principle, to that of “income from employment” under Swiss tax law,<sup>39</sup> which is why the interpretation may generally also be based on this provided there is no contradiction with the context of the agreement.<sup>40</sup> The Swiss Federal Supreme Court has already stated in this context that the “salaries, wages and other similar remuneration” that originate from employment are to be interpreted according to domestic Swiss law according to the prevailing doctrine in this country and that an autonomous interpretation is not necessary.<sup>41</sup> Swiss domestic tax law provides in article 17(1) of the FDTA that all income from employment, including ancillary income, is taxable. Furthermore, substitute income paid out by the employer due to accident or illness is also part of the taxable salary.

However, according to the case law of the Swiss Federal Supreme Court, the scope of application of article 15 of the OECD Model does not include, for example, the taxation of a payment that the employee received from their employer after termination of their employment relationship in return

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36. See art. 5(1)f DBG 1990.

37. See art. 5(1)b DBG 1990.

38. See OECD Model Tax Convention on Income and on Capital: Commentary on Article 15, para. 2.1 (27 Nov. 2017), Treaties & Models IBFD.

39. For more details, see P. Locher, *Kommentar zum DBG, Bundesgesetz über die direkte Bundessteuer, I. Teil*, art. 17 m.no. 17 et seq. (Verlag für Recht und Gesellschaft AG 2019).

40. For more details, see S. Dürr, *Kommentar zum internationalen Steuerrecht*, art. 15 OECD-MA, art. 15 m.no. 20 (Helbing Lichtenhahn Verlag 2015); and D.M. da Silva, *Der Begriff des Arbeitgebers gemäss Art. 15 Abs. 2 lit. B OECD-MA im internationalen Steuerrecht der Schweiz* p. 85 et. Seq. (Stämpfli Verlag AG, 2019).

41. See CH: Federal Supreme Court, 10 Feb. 2017, BGE 143 II 257, cons. 6.4.

for compliance with a non-competition clause. The Swiss Federal Supreme Court subsumed such a payment under article 21 of the OECD Model because no consideration in the form of work had been provided for the payment.<sup>42</sup> Likewise, according to the Swiss Federal Supreme Court, a severance payment received by an employee for leaving early is not considered as remuneration for work performed within the meaning of article 15(1) of the OECD Model but rather “other income” within the meaning of article 21(1) of the OECD Model.<sup>43</sup> Taking this case law into account, it can therefore be assumed that a Swiss court would subsume severance payments to international employees under article 21 of the OECD Model regardless of whether the activity was previously carried out in a home office in the state of residence. Therefore, the state of residence would acquire exclusive taxing rights on such payments.

### 30.4.3. Entertainers and sportspersons

The prevailing view is that only income that is directly related to a personally exercised activity in public is covered by article 17(1) of the OECD Model.<sup>44</sup> Only in the case of such performance-related income is taxation justified under article 17(1) of the OECD Model because, as the Swiss Federal Supreme Court points out, the performance-related nature of the concept of an artist or sportsperson corresponds to the performance-related nature of the remuneration.<sup>45</sup> In the same decision of the Swiss Federal Supreme Court in 2008, it was ruled that compensation paid for training sessions does not fall within the scope of article 17(1) of the OECD Model as training sessions do not take place in front of an audience. As far as can be seen, there were no specific discussions regarding changed circumstances during the pandemic.

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42. See CH: Federal Supreme Court, 9 May 2012, 2C\_604/2011.

43. See CH: Federal Supreme Court, 10 Feb. 2017, BGE 143 II 257, cons. 7.

44. See OECD Model Tax Convention on Income and on Capital: Commentary on Article 17, para. 9 (23 Nov. 2017), Treaties & Models IBFD; and see, for more details, T. Graf & H. Christoffel, *Kommentar zum internationalen Steuerrecht*, art. 17 m. no. 67 (Helbing Lichtenhahn Verlag 2015).

45. See CH: Federal Supreme Court, 6 May 2008, 2C\_276/2007, cons. 5.3.

## 30.5. Article 15(2) and (3) of the OECD Model

### 30.5.1. The 183-day rule

In an analogy to the OECD Commentary,<sup>46</sup> the Swiss tax authorities also base the determination of the days of stay on physical presence.<sup>47</sup> Home office days in the state of residence thus do not count as days of stay within the meaning of the 183-day rule. As far as can be seen, there were no specific discussions regarding changed circumstances during the pandemic.

## 30.6. Frontier workers

### 30.6.1. General remarks

Since the AFMP<sup>48</sup> entered into force in 2002, the number of frontier workers<sup>49</sup> in Switzerland has more than doubled. At the end of March 2022, the number of frontier workers in Switzerland with cross-border commuter permits (permit G) amounted to around 365,000.<sup>50</sup> The frontier workers thus represent around 7% of the Swiss workforce. More than half of all frontier workers resided in France (55.7%). Likewise, large proportions resided in Italy (23.6%) and Germany (17.4%). Furthermore, less than 2.5% came from Austria and Liechtenstein, while 0.8% came from other countries.

### 30.6.2. Agreements with neighbouring countries

#### 30.6.2.1. Overview

The OECD Model does not rule on frontier workers.<sup>51</sup> Switzerland has regulated the tax treatment of frontier workers bilaterally with all five

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46. See para. 5 OECD Model: Commentary on Article 15.

47. For more details, see Dürr, *supra* n. 40, at art. 15, m. no. 31.

48. Concluded on 21 June 1999, SR 0.142.112.681.

49. In this national report, the terms “frontier workers”, “cross-border workers” and “commuters” are used synonymously.

50. Swiss Federal Statistical Office, Cross-border Commuters Statistics in 1<sup>st</sup> quarter 2022, available at <https://www.bfs.admin.ch/bfs/en/home/statistics/work-income/employment-working-hours/economically-active-population/cross-border-commuters.html> (accessed 3 Aug. 2022).

51. See para. 10 OECD Model: Commentary on Article 15: “It should be noted that no special rules regarding the taxation of income of frontier workers [...] are included as it

neighbouring countries.<sup>52</sup> In principle, the income of frontier workers in Switzerland is subject to Swiss taxation. An exception applies to frontier workers from Liechtenstein and, in some cases, from France, as this income is not subject to taxation in Switzerland. The tax treaties with Austria, Germany and Liechtenstein directly address the fiscal regime of frontier workers. Differently, France and Italy signed specific agreements with Switzerland, apart from DTAs. The following paragraphs aim to summarize the current status of the specific provisions for frontier workers.

### 30.6.2.2. Austria

Until 2007, the Austria-Switzerland Income and Capital Tax Treaty (1974)<sup>53</sup> encompassed the fiscal treatment of frontier workers in article 15(4). The provision provided that the main right of taxation was assigned to the state of residence, but the source state was allowed to withhold a tax of 3% on frontier workers' employment income. In 2007, this cross-border commuter regulation was repealed,<sup>54</sup> and the current tax treaty between Austria and Switzerland does not contain a cross-border commuter regulation. The so-called place of work principle applies under article 15(1) of the tax treaty. Simultaneously with the abolition of the cross-border commuter regulation, Switzerland undertook in the Final Protocol to the tax treaty to make a compensation payment of 12.5% of the tax revenue of persons who are resident in Austria and taxed in Switzerland in accordance with article 15(1) of the treaty.<sup>55</sup> Furthermore, the Final Protocol of the tax treaty expressly provides that a bilateral fiscal equalization will be evaluated when the frontier workers' flow changes.

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would be more suitable for the problems created by local conditions to be solved directly between States concerned.”

52. For more details, see F. Amadeo, *Commuters and remote working*, Jusletter, p. 10 et seq. (2022).

53. Agreement between the Swiss Confederation and the Republic of Austria for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital (concluded 30 Jan. 1974, SR 0.672.916.31).

54. See art. III of the Amending Protocol of 21 March 2006, AS 2007 1253, BB1 2006 5155.

55. See para. 4 of the Final Protocol to the Austria-Switzerland Income and Capital Tax Treaty (1974).

### 30.6.2.3. France

Switzerland and France have signed a specific agreement on the taxation of the employment income of frontier workers<sup>56</sup> that forms an integral part of the France-Switzerland Income and Capital Tax Treaty (1966).<sup>57</sup> Accordingly, the exclusive right of taxation belongs to the state of residence. In return, the source jurisdiction shall receive 4.5% of the total amount of the annual gross remuneration as a compensation fee.<sup>58</sup> This agreement grants frontier workers the maintenance of their status if they do not return home up to 45 days per year. However, such rules only apply to the cantons of Basel-Land, Basel-Stadt, Bern, Jura, Neuchâtel, Solothurn, Valais and Vaud.

Regarding frontier workers with a place of work in the canton of Geneva, a special agreement has been signed between the canton of Geneva and France according to which the place-of-work principle pursuant to article 17 of the tax treaty between France and Switzerland applies.<sup>59</sup> In return, the canton of Geneva pays an annual amount of 3.5% of the gross wages paid to frontier workers residing in the departments of Ain and Haute-Savoie.

### 30.6.2.4. Germany

Article 15a(2) of the Germany-Switzerland Income and Capital Tax Treaty (1971)<sup>60</sup> defines a frontier worker as an employee who is resident in one contracting state and working in the other jurisdiction but regularly returns to their domicile. The requirement to return home may be waived without losing the frontier worker status if the worker does not return home for a maximum of 60 days per year “due to his working activity”. The competent

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56. See Agreement between the Swiss Federal Council and the Government of the French Republic on the Taxation of the Employment Income of Frontier Workers (concluded on 11 Apr. 1983, SR 649.810).

57. See art. 17(4) of the Agreement between the Swiss Confederation and France for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital and the Prevention of Tax Evasion and Avoidance (concluded on 9 Sept. 1966, SR 0.672.934.91).

58. See art. 2 of the Agreement between the Swiss Federal Council and the Government of the French Republic on the Taxation of the Employment Income of Frontier Workers (concluded on 11 Apr. 1983, SR 649.810).

59. Agreement of 29 January 1973 between the Swiss Federal Council (acting on behalf of the Republic and Canton of Geneva) and the Government of the French Republic on financial compensation for frontier workers working in Geneva (concluded on 29 Jan. 1973).

60. Agreement between the Federal Republic of Germany and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital (concluded 11 Aug. 1971, SR 0.672.913.62).

authorities have agreed that working days on which a frontier worker spends the whole day at the place of residence are not considered non-return days within the meaning of article 15a(2) of the tax treaty.<sup>61</sup> According to article 15a(1), the state of residence has the main taxing right on income from employment of frontier workers. The source jurisdiction shall apply up to 4.5% withholding tax on this latter.

### 30.6.2.5. Liechtenstein

The Liechtenstein-Switzerland Income and Capital Tax Treaty (2015)<sup>62</sup> provides in article 15(4) that income earned by frontier workers may only be taxed in the state of residence. Switzerland may therefore not levy any withholding tax on frontier workers resident in Liechtenstein. Frontier worker status ceases to apply if the person does not return to their place of residence for work-related reasons on more than 45 working days after the end of work in a calendar year.<sup>63</sup> The competent authorities have explicitly agreed that working days in which the employee works at their place of residence (home office days) do not count as non-return days.<sup>64</sup> Home office days can lead to the loss of the frontier worker status if the employee thereby no longer regularly commutes to their residence. In 2009, the Swiss Federal Supreme Court decided on the old tax treaty between Liechtenstein and Switzerland for which the concept of a frontier worker does not require that the employee returns to their place of residence every working day without exception; a regular return is sufficient. The court has ruled that an employee who commutes to their place of work 60% of the working days

61. Consultation Agreement on the Agreement of 11 August 1971 between the Federal Republic of Germany and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital (DTA-CH/D) concerning full-day working days spent at the place of residence by frontier workers on the application of the frontier worker rule in Article 15a DTA-CH/D (concluded 15/18 July 2022).

62. Agreement between the Swiss Confederation and the Principality of Liechtenstein for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital (concluded 10 July 2015, SR 0.672.951.43).

63. See para. 5© of the Protocol to Article 15(4) of the Liechtenstein-Switzerland Income and Capital Tax Treaty (2015); Mutual Agreement on the Agreement of 10 July 2015 between the Swiss Confederation and the Principality of Liechtenstein for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital concerning the application of article 15(4) of the Liechtenstein-Switzerland Income and Capital Tax Treaty (2015) (concluded 14 Nov. 2016).

64. Mutual Agreement on the Agreement of 10 July 2015 between the Swiss Confederation and the Principality of Liechtenstein for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital concerning the application of article 15(4) of the Liechtenstein-Switzerland Income and Capital Tax Treaty (2015) (concluded 14 Nov. 2016), ch. 2.

and works 40% at their place of residence is still to be considered a frontier worker.<sup>65</sup>

#### 30.6.2.6. Italy

Switzerland and Italy have signed a specific agreement on the taxation of the employment income of frontier workers<sup>66</sup> that forms an integral part of the Italy-Switzerland Income and Capital Tax Treaty (1976).<sup>67</sup> As an exception to general tax rules, this agreement grants exclusive taxing rights on income from dependent employment to Switzerland as a source jurisdiction. Therefore, Swiss employers apply a withholding tax on Italian frontier workers' salaries, and the cantons of Graubünden, Ticino and Valais must pay a compensation fee to the Italian municipalities located within 20 kilometres of the Swiss borders.<sup>68</sup>

In December 2020, Switzerland and Italy signed a new agreement on frontier workers repealing the old agreement from 1974. Under this new agreement, the source jurisdiction, usually Switzerland, keeps limited taxing rights on income from private employment. This share cannot exceed 80% of the applicable withholding tax. The residence country, usually Italy, has full right to tax its resident frontier workers but must grant a tax credit. Furthermore, the new agreement introduces a written definition of a frontier worker and a threshold of 45 days per year during which the frontier worker may derogate to the daily back home requirement. The date of entry into force of the new agreement was 1 January 2024. Although the new agreement was signed in December 2020, i.e. during the pandemic, it does not contain any provisions related to employees working from a home office. However, a clause in the new agreement provides for regular reviews and possible adjustments in relation to telework.<sup>69</sup>

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65. CH: Federal Supreme Court, 1 Oct. 2009, 2C\_215/2009, cons. 4.

66. See Agreement on cross-border workers signed between Switzerland and Italy (concluded on 3 Oct. 1974, SR 0.642.045.43).

67. See art. 15(4) of the Agreement between the Swiss Confederation and the Italian Republic for the Avoidance of Double Taxation and for the Regulation of Certain Other Questions in the Field of Taxes on Income and on Capital (concluded on 9 Mar. 1976, SR 0.672.945.41).

68. For more details, see Amaddeo, *supra* n. 52, at pp. 14 et seq.

69. See para. 3 of the Additional Protocol.



### 30.6.3. Employees working from a home office

In summary, no tax treaty with a neighbouring country of Switzerland contains a provision on the tax treatment of cross-border commuters working from a home office. The pandemic has led to great legal uncertainties in Switzerland about the taxation of frontier workers. Since the daily home return is an essential requirement of the definition of a cross-border worker under the tax treaties, frontier workers that must remain in either the source or residence state because of the pandemic can no longer qualify as cross-border workers. Therefore, after the expiry of the mutual agreements, the following will apply in principle: if a cross-border commuter works from home, the daily back home criterion doesn't apply, and they can no longer be defined as a frontier worker. Accordingly, article 15 of the OECD Model applies and, due to the lack of physical presence at the usual place of work, the employee must be taxed in their state of residence, and the source jurisdiction cannot levy a tax on income from employment. Whether an employee is forced to work from home or whether they do so on a voluntary basis is irrelevant to the question of tax liability under currently applicable Swiss tax treaties.

## **30.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)**

### 30.7.1. General remarks

Switzerland has concluded provisional mutual agreements with neighbouring countries on the taxation of international home office employees. The special rules prevent the COVID-19 pandemic from leading to an interim shift in the taxation of international employees. Specifically, the existing tax treaties will continue to apply as before as long as the COVID-19 exemptions are in effect.

### 30.7.2. Mutual agreements with neighbouring countries

On the basis of article 26(3) of the Germany-Switzerland Income and Capital Tax Treaty (1971), Switzerland and Germany signed a mutual

agreement following OECD recommendations.<sup>70</sup> They agreed to apply that the days spent working from a home office due to COVID-19 pandemic measures as well as days spent at home without performing work activities but with continued pay will be deemed as being spent in the source state. This means that Switzerland may continue to levy a withholding tax of 4.5% of the gross wages of cross-border commuters in relation to Germany that Germany credits accordingly. The period during which a cross-border worker is affected by COVID-19 measures is not considered when examining the number of days that may not be exceeded to retain cross-border worker status. The agreement was terminated by mutual consent and expired 30 June 2022.

On 22 October 2020, Switzerland and Liechtenstein signed a mutual agreement (under article 26 of the Liechtenstein-Switzerland Income and Capital Tax Treaty (2015)) keeping the status quo ante.<sup>71</sup> The agreement stipulates that the employer must issue a confirmation to the cross-border commuters about the period of time during which the employee performed their activity in the state of residence due to the pandemic. This is to ensure that the cross-border worker status is not lost by exceeding the 45 days. The agreement is intended to prevent Switzerland from claiming a right of taxation for the gainful activity carried out in Switzerland due to the loss of cross-border commuter status. If the cross-border commuter regulation does not apply, the factual fiction that the employee is working at the usual place of work applies provided that they can prove that their wages are taxed at this place. The mutual agreement was terminated as of 31 March 2022.

Switzerland and France signed a mutual agreement on the basis of article 27(3) of the France-Switzerland Income and Capital Tax Treaty (1966).<sup>72</sup> Following the OECD recommendations, no changes in the allocation of taxing rights would have been made. All days spent in the residence state through remote working due to Covid-19 must be considered as time spent

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70. Mutual Agreement on Cross-Border Workers signed between Switzerland and Germany (concluded on 11 June 2020), available at <https://www.estv.admin.ch/dam/estv/de/dokumente/international/laender/int-laender-de-dba-kv-covid-19-de.pdf.download.pdf/int-laender-de-dba-kv-covid-19-de.pdf> (accessed 3 Aug. 2022).

71. Mutual Agreement on cross-border workers between Switzerland and the Principality of Liechtenstein (concluded on 20 Oct. 2020), available at <https://www.estv.admin.ch/dam/estv/de/dokumente/international/laender/int-laender-fl-dba-20201020-verstaendigungsvereinbarung-de.pdf.download.pdf/int-laender-fl-dba-20201020-verstaendigungsvereinbarung-de.pdf> (accessed 3 Aug. 2022).

72. Mutual Agreement on cross-border workers between Switzerland and France (concluded 13 May 2020), available at <https://www.estv.admin.ch/dam/estv/de/dokumente/international/laender/int-laender-fr-dba-kv-coronavirus-de.pdf.download.pdf/int-laender-fr-dba-kv-coronavirus-de.pdf> (accessed 3 Aug. 2022).

in the source state. The agreement has been extended through a series of extensions and will remain in force until 31 October 2022.

In June 2020, Switzerland and Italy signed a mutual agreement.<sup>73</sup> This agreement provides, for the first time, a written definition of a frontier worker within Swiss-Italian tax agreements. The agreement stipulates that the days that the frontier worker works from home due to COVID-19 are deemed to have been spent in the source state. This agreement has been tacitly extended and will remain in force at least as long as the emergency status is declared until 31 October 2022.

During the COVID-19 pandemic, no mutual agreement occurred between Switzerland and Austria.

### 30.7.3. Special rule by the tax authorities of the canton of Zurich

In spring 2020, the tax authorities of the canton of Zurich ruled that working days spent by employees resident abroad in their home offices due to the pandemic would be subject to Swiss withholding tax.<sup>74</sup> Therefore, the special regulations, as they have been concluded with the countries that Switzerland has mutual agreements with, should also represent the rule for international workers from other countries with which no mutual agreements have been concluded. This rule was published as a notice on the homepage of the tax authorities of the canton of Zurich and can be qualified as an administrative ordinance. Administrative ordinances are generally not addressed to the general public but are a general-abstract directive from the superior authority to its subordinate authorities. Although the courts are, in principle, not bound by these administrative ordinances, in practice, the courts rarely deviate from them.<sup>75</sup>

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73. Mutual Agreement on cross-border workers between Switzerland and Italy (concluded 18/19 June 2020), available at <https://www.estv.admin.ch/dam/estv/de/dokumente/international/laender/int-laender-it-dba-aa-20220722-de.pdf.download.pdf/int-laender-it-dba-aa-20220722-de.pdf> (accessed on 3 Aug. 2022).

74. Kantonales Steueramt Zürich, *Quellenbesteuerung von Arbeitnehmenden mit Ansässigkeit im Ausland, die wegen der Coronakrise im Home Office arbeiten* (28. Apr. 2020), available at <https://www.zh.ch/de/news-uebersicht/mitteilungen/2020/steuern-finanzen/steuern/quellenbesteuerung-von-arbeitnehmenden-mit-ansaessigkeit-im-ausl.html> (accessed 3 Aug. 2022).

75. For more details, see M. Reich, *Steuerrecht* p. 40 et. seq. (Schulthess 2020).

However, this legal interpretation violates both the Swiss tax treaty regulations and Switzerland's domestic tax law. In the meantime, however, the canton of Zurich has abandoned this unlawful practice.<sup>76</sup> In relation to countries with which no mutual agreement has been concluded, the rules according to the applicable tax treaties therefore apply. As a rule, COVID-19-related home office days are therefore to be treated as working days abroad for withholding tax purposes.

### 30.8. The future of the mobility of work: A need for adjusting the existing treaty rules?

#### 30.8.1. Do existing tax treaty rules still make sense – assessment guidelines?

To assess the question of whether tax treaty rules still make sense, various assessment guidelines or principles could be of relevance:

- *practicability and effectiveness*: obviously, if a rule is not at all applicable due to too much complexity, it makes sense to change the rule. However, countries are very much used to applying articles 4 and 5 but also article 15 of the OECD Model. There is currently no obvious need to change these rules to make them effective. Of course, the attribution of taxing rights according to the days physically spent in other jurisdictions (i.e. article 15(1) of the OECD Model) is complex and triggers compliance costs. The rules are, however, not ineffective and do indeed work in practice. At least this reflects the authors' subjective experience;
- *efficiency*: another assessment criterion would be how efficient these rules are and whether they trigger any harmful distortions. However, as it has been shown in another instance, certain reluctance is necessary to use efficiency arguments in international tax policy.<sup>77</sup> Therefore, the current rules might distort people's decisions, e.g. to physically work

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76. See Kantonales Steueramt Zürich, *Quellenbesteuerung von im Ausland ansässigen Arbeitnehmenden, die wegen der Coronakrise im Home Office arbeiten* (12 Jan. 2021), retrieved at <https://www.zh.ch/de/news-uebersicht/mitteilungen/2021/steuern-finanzen/steuern/quellenbesteuerung-von-im-ausland-ansaessigen-arbeitnehmen---d.html> (accessed 3 Aug. 2022).

77. For more details, see P. Hongler, *Justice in International Tax Law* p. 416 et seq. (IBFD 2019), Books IBFD.

- in another state or not, however, inefficiencies are not as harmful in an international environment as they are in a domestic sphere;<sup>78</sup> and
- *justice*: the question of whether current allocation rules are just or whether they need to be changed in order to achieve a fairer international tax regime is obviously challenging and goes beyond the present report. There are some design principles that are valid from a normative perspective. For instance, the benefit principle and the source principle do indeed have a normative content both as a justification to tax and a limitation to tax principles.<sup>79</sup> This means that a jurisdiction should indeed have a taxing right if income was created within its territory and/or by obtaining benefits from the jurisdiction. This needs to be considered in the following.

### 30.8.2. Which tax treaty rules should be changed by Switzerland – some general remarks

Switzerland, in general terms, follows the OECD Model with respect to the most important clauses relevant for the purpose of the present country report (articles 4, 5 and 15 of the OECD Model). There are some minor deviations in the treaty practice of Switzerland.<sup>80</sup> Therefore, in the following, only changes to the articles in the OECD Model are assumed and changes to the “Swiss model” which is, by the way, not publicly available, are not particularly addressed.

### 30.8.3. Changing article 15 of the OECD Model?

#### 30.8.3.1. In general

Interestingly, there has recently been a renewal of the academic debate about how to allocate taxing powers between the cantons in particular with respect to employment income.<sup>81</sup> Such a debate triggered by the allocation of taxing rights in intercantonal situations might also be of relevance for

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78. The main argument is that efficiency as a normative goal is based on utilitarianism as the underlying rationale, however, utilitarianism is difficult to uphold at an international level where no distributive mechanisms exist.

79. For more details, see Hongler, *supra* n. 78, at p. 436 et seq. (source principle) and p. 447 (benefit principle).

80. See P. Hongler, *IBFD Global Tax Treaty Commentary* (IBFD 2021), Books IBFD.

81. See, in particular, F. Mauchle, *Die Verteilung von Erwerbseinkünften im interkantonalen Steuerrecht unter Berücksichtigung des Finanzausgleichs* p. 1 et seq. (Stämpfli 2021), Books IBFD.

the international tax regime. In an intercantonal scenario, the resident state, however, currently has an exclusive taxing right. This is important to note.

One way of achieving a sustainable allocation of taxing powers between different bodies is to reflect the benefits received by the employees in an intercantonal scenario following the benefit principle. Similar arguments have been brought forward in order to achieve justice concerning the allocation of tax rights in the international sphere.<sup>82</sup> Interestingly, in an intercantonal environment, there have been economic studies to demonstrate the additional governmental costs triggered by each commuting employee in an intercantonal scenario and, therefore, the benefits obtained at the workplace.<sup>83</sup> The results are that annual fiscal costs of between CHF 2,510 and CHF 9,039 are triggered per commuting employee.<sup>84</sup> This shows that the fact that a person is commuting from their home to this workplace triggers significant costs for the canton of work, and this seems to justify non-exclusive taxation in the canton of work.

Obviously, it is highly difficult to estimate the actual benefits received from both jurisdictions involved. Mauchle, for instance, assumes that fair allocation based on an overall benefit principle would mean a 2:1 allocation between the resident canton and the source canton (i.e. where the work is rendered).<sup>85</sup> This means that the resident canton shall have the right to tax two thirds of the salary whereas the source canton only one third. Such rule would apply notwithstanding where the work is physically exercised.

However, it should not be forgotten that a fair allocation of taxing powers within Switzerland cannot be transposed *mutatis mutandis* to the international sphere. This is particularly because two states (compared to two cantons) do not belong to the same basic structure, and potential disadvantages through an allocation of taxing rights cannot be offset by other means (e.g. through a fiscal transfer system).<sup>86</sup> There should be reluctance at aiming at a perfect allocation of taxing rights in an international sphere. For instance, if the objective is allocating tax rights based on the benefit principle or the source principle in perfect pieces, this can also have negative distributive impacts. As it was developed in detail at another instance, value creation or

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82. M. Valta, *Das Internationale Steuerrecht zwischen Effizienz, Gerechtigkeit und Entwicklungshilfe* (Mohr Siebeck 2014), Books IBFD.

83. See, with further references, Mauchle, *supra* n. 82, at p. 136 et seq.

84. See, with further details, Mauchle, *supra* n. 82, at p. 149.

85. He mainly refers to the costs mentioned in the previous paragraph and an average salary in Switzerland (for details, see Mauchle, *supra* n. 82, at p. 299 et seq.). Of course, he also considers other elements such as fiscal transfers between the cantons.

86. Hongler, *supra* n. 78, at p. 406.

the source principle could be understood as a libertarian way of allocating income between several states.<sup>87</sup> It can even have contra distributive impact as rich states would benefit more from an allocation based on the criteria of value creation. In very general terms, a partial allocation of income to the state of work is persuasive following the logic of both the benefit and the source principles. Of course, another option would always be that the taxing rights are not allocated but rather transfer payments are made between the cantons depending on how many commuters there are in both directions. This is reflected, for example, in the compensation payments stipulated in the Final Protocol to the tax treaty between Switzerland and Austria.<sup>88</sup>

### 30.8.3.2. Simplification through new technologies

Certainly, technology would allow tracking the movements of persons to an extreme detail. One source would be the login data by mobile service providers but also the transactions of bank accounts as they would disclose the location of payments by debit or credit cards. Having access to such data would likely allow a government to track the days spent in the various jurisdictions in a rather comprehensive form. However, the information about the movement of a taxpayer is very sensitive and shall also be protected by the right to privacy, be it in the Swiss Constitution<sup>89</sup> or in the European Convention on Human Rights.<sup>90</sup> This needs to be further addressed. Therefore, the fact that new technologies allow easier tracking of human movement seems to justify the current allocation of taxing rights to physical presence as compliance costs for the application of article 15 of the OECD Model might be reduced.

### 30.8.3.3. Introducing a specific tax clause for daily commuters

A particular problem is triggered by daily commuters as there is currently no specific rule in the OECD Model. The underlying problem is that they are part of two basic structures, i.e. the resident and the source state. They also receive benefits both from the residence state and the source state. If it is assumed that the benefit principle has a normative value as an allocation but also as a limitation to tax principles, it should also be concluded that the place of work shall receive at least part (but also not all!) of the tax

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87. Hongler, *supra* n. 78, at p. 446.

88. See section 30.6.2.2.

89. CH: Federal Constitution, art. 8 (18. Apr. 1999).

90. Art. 13 European Convention on Human Rights (4. Nov. 1950).

revenue.<sup>91</sup> Moreover, specific provisions for commuters might also have the advantage of lower compliance costs as the assumption is that there is a daily commute.

Negotiations with the neighbouring countries, however, have shown that the various models have advantages and disadvantages. Moreover, the result of how a commuter provision is drafted highly depends on the negotiation power of the two states. For instance, the commuter provision with Liechtenstein allocates the tax right entirely to the resident state.<sup>92</sup> If there is an agreement on how much should be allocated to the working state (e.g. one third or half of the income), the second question is whether this shall be reflected in the allocation rule or whether a separate compensation clause is agreed upon by the states.

#### 30.8.4. Changing article 4 of the OECD Model?

The more decentralized entrepreneurial activities become, the more difficult it is to prove where the place of effective management is. This is important to consider both for tax authorities but also for taxpayers. Therefore, in an individual case, it might be extremely difficult to actually prove the place of effective management. The question arises of which state should prevail in such circumstances. It is the authors' understanding that it would be too simple to argue in favour of a "new" tiebreaker rule to solve the issue (e.g. the country where an enterprise has more employees – i.e. a more quantitative measure).

The reason is the following. The underlying problem with using article 4 of the OECD Model to determine the resident state is not so much to use a specific element such as the place of effective management but that the resident state in the current international tax regime has, in general, a taxing right for the residual income of a taxpayer, i.e. for everything that has not been taxed in the other state.

Therefore, instead of focusing on a redefinition of tiebreaker rules in an age of increased mobility, stronger source rules, for instance, by introducing a

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91. It is, therefore, surprising that, in intercantonal circumstances, the resident canton has an exclusive taxing power (Mauchle, *supra* n. 82, at p. 373 et seq.).

92. *Convention Between the Swiss Confederation and the Principality of Liechtenstein for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital Liechtenstein-Switzerland Income and Capital Tax Treaty* [unofficial translation], art. 15 (10 July 2015), Treaties & Models IBFD.



permanent establishment based on digital presence or significant economic presence would also relieve pressure on the tiebreaker rule. The same is true for the tiebreaker for individuals. There, there could be an argument in favour of a quantitative measure (e.g. days spent in one jurisdiction) as a tiebreaker. However, this would again not solve the issue of residual income taxation in the resident state.

### 30.8.5. Changing article 5 of the OECD Model?

The authors are not addressing whether the permanent establishment definition shall be changed. However, as it was outlined at another instance,<sup>93</sup> it seems odd that, in a highly integrated global economy, there is still reliance on a rather formal requirement of a fixed place of business as a corporate tax threshold in cross-border scenarios. There are various recommendations on how to change the permanent establishment definition. The focus would need to be particularly on some specific digital services, or applying a workforce presence permanent establishment<sup>94</sup> or a significant economic presence test.

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93. P. Hongler & P. Pistone, *Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy*, IBFD Working paper (2015).

94. S.V. Kostic, *A Plea for a Workforce Presence PE Concept in a Post-Covid Digitalized World*, 49 Intertax 10, p. 758 et seq (2021).



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## Chapter 31

### The Impact of Tax Treaties on International Mobility of Work in Ukraine

Svitlana Buriak

#### 31.1. Mobility of work and domestic tax law

##### 31.1.1. Introduction

During the time of the COVID-19 pandemic, “homework” became one of the most used expressions to describe the daily routine of people around the world. The International Labor Organisation (ILO) defined “homework” as “work carried out by a person, to be referred to as a homemaker, (i) in his home or in other premises of his choice other than the workplace of the employer; (ii) for remuneration; (iii) which results in a product or service as specified by the employer irrespective of who provides the equipment, materials, or other inputs used”.<sup>1</sup>

The 2-year period of adjusting to the new realities of homework inevitably triggered another phenomenon that is even more prevalent post-pandemic: the mobility of workers. The period of quarantine and isolation, interestingly enough, demonstrated how formal the current borders are between countries. The Internet enabled employees to return home to their families but continue working for foreign employers. Despite the pandemic appearing to be over, the trend for an increased mobility of work persists. Many people have reconsidered their value systems and the role of family, personal life and work-life balance within these systems. It made a strong impact on their new work habits and preferences. The mobility of workers during globalization and restrictions to mobility during the pandemic are two diametrically opposite phenomena. Yet, the period of the pandemic – during which many workers faced travel restrictions – shed light on the scale of inappropriateness of the “physical presence” criterion in the globalized world.

In international taxation of personal and corporate income, mobility of workers was one of the key challenges. The rules that have been linking

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1. ILO, *C177 – Home Work Convention*, 1996 (No. 177).

the tax jurisdiction to the physical place of performance of work both for personal and corporate income taxes are going through a conceptual crisis. The international tax community has been attempting to fix the existing law by implementing minor modifications and exceptions. Nevertheless, there are still no groundbreaking reforms on domestic or international levels to fundamentally change the system, which is not suitable for highly mobile workers.

This chapter will analyse the practical experience of Ukraine in dealing with the issues of workers' mobility for personal and corporate tax purposes. Among other questions, the discussion will focus on the regulatory responses of Ukraine to the mobility limitations of workers during the COVID-19 pandemic.

### 31.1.2. Tax residence of individuals: Mobility and travel restrictions

Concerning the residence of individuals, the mobility of workers can affect the taxpayer status of workers under Ukrainian legislation. Yet, the time spent by individuals in Ukraine is not the most relevant criterion to trigger worldwide taxation. The residency rules for individuals follow a similar approach, namely that of the 2017 OECD Model Tax Convention (OECD Model).

A person is considered to be a resident of Ukraine if he has a permanent home available to him.<sup>2</sup> If the person has two homes available in two different states, the person will be deemed a resident of Ukraine if he has a centre of vital interest there.<sup>3</sup> The centre of vital interest is considered to be the place where the person's family members live or where this person is legally registered as an entrepreneur. If it is not possible to reliably determine the place of residence based on only the information stated previously, the person is deemed a resident of Ukraine if he spends more than 183 days in the country.

The time spent by the residents of other countries in Ukraine because of travel restrictions, for example, during the COVID-19 pandemic, shall not affect the residence status to the extent that the permanent home and/or

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2. Art. 14.1.213 UA: Tax Code of Ukraine (last amended 9 Oct. 2022) [hereinafter Tax Code of Ukraine].

3. Id.

centre of vital interest is not in Ukraine. Since the residency rules boil down to the substance of a person's real connection to the jurisdiction, there was no need to adopt new measures because of the travel restrictions during the pandemic.

There could be also an opposite scenario in which a person who is a resident of Ukraine stays abroad for a longer period of time because of travel restrictions. The residency status would then depend on the domestic legislation of the state in which the person resides and the tax treaty between this country and Ukraine. Overall, the legislation requires Ukrainian tax residents to file a departure tax return if they leave Ukraine to live in another country.<sup>4</sup> A departure tax declaration is not the same as exit taxation. It aims only to settle the tax due based on an assessment issued by the tax authorities, but there is no additional departure fee or exit tax for individuals or companies when changing the residence.<sup>5</sup> Therefore, no exit tax would be due in Ukraine if the tax residence of the person had changed due to the travel restrictions.

### 31.1.3. Board members' mobility and corporate tax residency

The mobility of board members does not have any impact on the residency of the company that is registered in Ukraine. A legal person is considered to be a tax resident of Ukraine if the person, legal entity or branch of a foreign entity is registered in Ukraine.<sup>6</sup>

Interestingly enough, the place of effective management (PoEM) triggers the liability of foreign companies with board members operating in Ukraine, but there is no rule that a Ukrainian company with the PoEM in a foreign country might not be a resident of Ukraine.<sup>7</sup>

It could be assumed that the time spent by board members in Ukraine during the COVID-19 pandemic could affect the place of residence of foreign enterprises. The rules on determining the PoEM, indeed, contain a certain temporal criterion that is not yet well defined. Thus, the rule provides that

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4. KPMG, *Ukraine – Taxation of international executives* (July 2023), available at <https://assets.kpmg.com/content/dam/kpmg/xx/pdf/2023/01/TIES-Ukraine.pdf> (accessed 20 Mar. 2024).

5. PwC, *Ukraine – Individual Tax Administration* (30 June 2022), available at <https://taxsummaries.pwc.com/ukraine/individual/tax-administration> (accessed 11 Oct. 2022).

6. Art. 14.1.213(a) Tax Code of Ukraine.

7. Art. 133.1.5 Tax Code of Ukraine.

the PoEM of a foreign entity is deemed to be in Ukraine if the following criteria are fulfilled:

- the executive body's meetings are held *more regularly* in Ukraine than in any other country;
- managerial decisions and other current (operational) activities are carried on *mainly* from Ukraine; and
- the actual management of the activities of a foreign company is *mainly* carried out from Ukraine, regardless of the presence of persons possessing formal rights to do so.<sup>8</sup>

Therefore, travel restrictions can potentially affect the residency of the foreign entity whose board members reside in Ukraine even though, in practice, this rule is difficult to enforce.

During the COVID-19 pandemic, there was a moratorium in force on unscheduled tax audits and accrual of financial sanctions (e.g. fines and penalties) for violations of tax legislation. The reason for implementing the moratorium was to ease the economic and tax burden on taxpayers who already lost their income because of the pandemic. The relevant law has been in force since 18 May 2020. Consequently, even if the taxpayer had violated the provisions of tax legislation because of certain unpredictable conditions or regulatory restrictions during the pandemic (for example, a board member did not inform tax authorities about the change of the PoEM), no penalties would be applicable.

#### **31.1.4. Working from home: Substance requirements and permanent establishment**

Ukrainian legislation does not contain any substance rules with regard to the existence of sufficient workplaces for every employee of the company, either in anti-avoidance regulations or transfer pricing. Consequently, if all employees work from home and the company no longer has (sufficient) workplaces, there will be no tax consequences for the company. In the author's opinion, there is no need to ascribe any substance value to workplaces since the substance is represented by employees and their functions rather than the formal place from where the work is performed.

Nevertheless, when an individual works for a foreign company, the place of performance of work in the territory of Ukraine can trigger limited tax

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8. Art. 133.1.5 Tax Code of Ukraine.

liability for the foreign employer. Similar to the permanent establishment (PE) provision under the UN Model Tax Convention (UN Model), under Ukrainian legislation, provision of services by a non-resident (including consultancy services) through employees hired by him for such purposes amount to a PE if such activities meet the temporal threshold.<sup>9</sup> The activities have to be performed in Ukraine during the period of at least 183 days in any 12-month period. Yet, this provision is rarely enforced in practice since it is difficult to monitor this kind of work arrangement. If an employee works for a foreign company from Ukraine, it is almost certain that the employee will have a foreign bank account to which his monthly remuneration is transferred. Ukraine does not have access to such information. The only way for the Ukrainian tax administration to reveal such arrangements is the exchange of tax information with the country where the person is employed, which can be effective provided that the person files a tax return in Ukraine.

In 2014, the OECD developed the Common Reporting Standard (CRS), which is comprehensive for individuals and states and provides for prompt and sometimes instantaneous automatic exchange of information that will be available in a single database for any accountable person. Ukraine, as a member of the Secretariat of the Global Forum on Transparency and Exchange of Tax Information as well as a state that acceded to the 2004 Convention (a document ratified by the Verkhovna Rada and entered into force in 2009), has the opportunity to cooperate not only with the convention but also offshore territories.<sup>10</sup> For example, Denmark, the Netherlands and the United Kingdom have recently extended the convention to a number of territories with which it was previously impossible to share information. This list includes the British Virgin Islands, the Cayman Islands, Gibraltar and the Isle of Man.

The CRS obligates banks and other financial institutions (e.g. credit unions, microfinance institutions, investment institutions, certain types of insurance companies, brokers, securities depositories) to provide the following information to the tax authorities:

- for accounts of individuals of the participating countries, if the account holder is a tax resident of the jurisdiction from which the automatic exchange of information – the so-called accountable persons (reportable person); and

9. Art. 14.1.193(b) Tax Code of Ukraine.

10. UA: Ministry of Finance, *When the tax authorities find out the whole truth about Ukrainians' foreign accounts* (8 Feb. 2021), available at <https://minfin.com.ua/ua/2021/02/08/59753654/> (accessed 29 May 2022).

- for the accounts of companies, funds and trusts, if the company is controlled by one or more accountable persons or obtains income from passive sources (e.g. royalties, dividends, interest) or is controlled by the so-called passive non-financial entity (passive non-financial entity).<sup>11</sup>

Therefore, the recent developments on the exchange of bank information could facilitate the enforcement of the service PE provision for foreign entities.

### 31.1.5. Social security payments threshold and tax residency

Social security contributions are paid to the state budget by tax agents, legal entities or branches of foreign entities registered in Ukraine by self-entrepreneurs and any other entity or institution that relies on labour in Ukraine under an employment or other kinds of service agreements.<sup>12</sup> Overall, the social security contributions should be paid by both tax resident companies and non-resident entities if they employ labour in Ukraine to perform a business function. Yet, when an employee works for a foreign enterprise, it is difficult to monitor such an activity which, consequently, mean that the rules might not be enforced.

If a foreign resident works for a foreign entity from Ukraine, there is no obligation imposed on the company to pay a social security contribution provided that there is no PE of that company. However, if the worker becomes a tax resident of Ukraine due to having a permanent home available to him in Ukraine or the centre of vital interest if a home is available in two different countries, then the company will become liable for social contributions. The relevant definitions of “resident”, “non-resident” and “permanent establishment” in the law on contributions to the obligatory state social insurance are derived from the tax code. Hence, the treatment under social security law in Ukraine is aligned with the tax residence nexus.

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11. Id.

12. UA: Про збір та облік єдиного внеску на загальнообов’язкове державне соціальне страхування [Law of Ukraine On the collection and accounting of a contribution to the obligatory state social insurance] (last amended 10 Aug. 2022), art. 4.



## 31.2. Residence, tiebreaker rules and mobility of work: Individuals and entities

### 31.2.1. Mobility of work and treaty residence (article 4(1) of the OECD Model): Individuals

The residence rules under article 4(1) of the OECD Model contain several tests for individuals and legal entities. According to the provision, “the term ‘resident of a Contracting State’ means any person who, under the laws of that State, is liable to tax therein by reason of his *domicile, residence, place of management* or any other criterion of a similar nature” [emphasis added].<sup>13</sup> “Domicile” refers to the country where the taxpayer has a permanent home available to him; hence, “domicile” is a criterion used for the determination of the residence of individuals. The “place of effective management” is one of the possible residence criteria for legal entities.

Maintaining two permanent homes in different jurisdictions might not always be commercially viable for an individual compared to the hotel-like stays. “Domicile” as a residence test demonstrates the existence of a meaningful connection to the jurisdiction. The flexibility and mobility of workers does not decrease the effectiveness of this test since a commercially rational behaviour of a mobile worker does not entail maintaining a permanent home available to him in every country where his work is performed. Therefore, this criterion is preferred in Ukrainian legislation, as discussed in section 31.1.1.

Naturally, an individual can have several permanent homes available to him because of, for example, family members willing to host the individual on a permanent basis at any time. In this case, the tiebreaker rules of article 4(2) of the OECD Model induce considering where the taxpayer has his centre of vital interest. As mentioned in the previous section, under Ukrainian legislation, the centre of vital interest has to be determined considering where the person’s family members live or where this person is legally registered as an entrepreneur. Yet, the approaches to defining the “centre of vital interest” vary among different legal systems. Some jurisdictions attribute the focal value to the economic factors of the taxpayer’s centres of interest, such as place of employment or other type of economic engagement. Other countries ascribe major significance to personal ties, such as family members. Ukraine belongs to the second group of countries.

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13. *OECD Model Tax Convention on Income and on Capital* art. 4(1) (27 Nov. 2017), Treaties & Models IBFD.

The mobility and flexibility of workers in the last decade reached the point at which a person can have significant economic and personal ties in many countries, even if spending only 2 or 3 years in one country. For instance, in the European Union, freedom of movement of workers has completely erased the borders between Member States for EU citizens. Consequently, it is becoming more complicated to define the centre of vital interest of an individual for tax purposes due to more intertwined links to different countries and the disparities that exist in the legal systems concerning the concept of the centre of vital interest. The “location of family members” is also not the most optimal tiebreaker rule. It does not specify what family members are determinative for the test, e.g. parents, spouse, kids. This test can be abused by taxpayers and stimulate forum-shopping behaviour, for instance, when an unmarried taxpayer whose parents are from a low-tax country chooses to work in a high-tax jurisdiction.

### 31.2.2. Mobility of work and treaty residence (article 4(1) of the OECD Model): PoEM

With respect to legal entities, the determination of residence essentially depends on the domestic legislation of the contracting state. Yet, the PoEM test is frequently used as a benchmark also in domestic law. According to the OECD, the PoEM is the “place where the most senior person or group of persons make, in substance, the key management and commercial decisions that are necessary for the conduct of an entity’s business as a whole”. As mentioned previously, Ukrainian legislation contains a similar definition of the concept.

The mobility of labour, as well as COVID-related travel restrictions, play a significant role for applying the PoEM test to determine the residence state of the legal entity. PoEM presupposes decisions to be taken locally. This test appears to be ineffective or produces unsatisfactory outcomes in conditions of remote working, fly-in and fly-out management, COVID-19 travel restrictions or remote working as a new normal.<sup>14</sup> The pandemic made the reliance on information and communication technology solutions even stronger; it is the new normal for a board member to prefer having a call on Zoom, Teams or Skype to discuss important strategic decisions rather than wasting time flying to a different country for one meeting. It becomes

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14. S. Daniel, *Allocation of business profits to the jurisdiction of digital workers: nexus, transfer pricing rules (significant people functions), FA under BEFIT* (D. Weber ed., IBFD 2023), Books IBFD.

more difficult to spot the exact *place* of effective management when the decision-making happens “in the cloud”.<sup>15</sup> Therefore, the PoEM test has to envisage not only the physical location of the board meeting but also the substance of such activities.

The PoEM test in Ukraine applies only to foreign entities that might appear to be tax residents of Ukraine. If Ukraine and the European Union decide to take measures to harmonize the Ukrainian legislation with the EU law requirements, the application of the PoEM test only to non-residents can be perceived as unjustified discrimination.

There are several *risk* factors taken into account in the PoEM framework in Ukraine that are broader than those under the OECD or UN Models:<sup>16</sup>

- the following functions performed for the foreign entity in the territory of Ukraine:
  - making management decisions;
  - bank account management;
  - conducting accounting and/or management accounting of a foreign company; and
  - HR functions;
- the CEO or someone else in Ukraine has a power of attorney from a foreign company to sign contracts on its behalf;
- the office is branded or otherwise affiliated with a non-resident company;
- a non-resident company pays for the office where the management works; and
- employees (both CEOs and management personnel) have non-resident corporate e-mail accounts and use them to communicate with non-resident customers, partners or other related parties.

For foreign entities, it is important to be attentive to these risk factors and to restructure their activities if necessary or register as a tax resident of Ukraine.

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15. See OECD, *The Impact of the Communications Revolution on the Application Of “Place Of Effective Management” As A Tie Breaker Rule* (OECD 2021).

16. M. Yarova, *Who among IT specialist can be recognized as a PE of the foreign enterprise in 2022 and what are the consequences?*, Ain (30 Jan. 2022), available at <https://ain.ua/2022/01/31/kompanii-z-inozemnym-predstavnytctvom-naslidky/> (accessed 11 Oct. 2022).

### 31.3. Permanent establishments and mobility of work

The criterion of availability of a place to conduct business is fundamental to the analysis of whether a non-resident has a PE in Ukraine. Such a place can be any space that is available/used by a non-resident; it can be a home office or a coworking space.<sup>17</sup> Moreover, there are no requirements for a non-resident to have any rights to the premises (e.g. property, long-term lease) in which he operates. The very existence of constant availability of such a place for non-resident activities in it is enough.<sup>18</sup> Such an approach to the PE provision and its interpretation has been in force since 1 January 2021. However, the changes do not seem to reflect the lessons of the pandemic but the efforts of the legislator to align the domestic legislation with the OECD standards.

In order for a non-resident to have a permanent place of business, it is necessary to:

1. perform representative functions for the benefit of the non-resident in certain fixed premises;
2. have constant availability of such a place (premises) to perform these functions; and
3. have an awareness of the non-resident about the availability of such a place and the possibility of its use.

The last criterion is not mentioned in the OECD Guidelines. However, the practice of applying the rules illustrates the particular importance of the last factor.<sup>19</sup> With respect to the second requirement of the place to be *constantly* available, working from a flex office (such as coworking space) might not be sufficient to trigger a PE.

In addition, Ukrainian legislation extends the scope of a PE to a service PE and agency PE. The elements of these types of PEs are identical to the respective provisions of the UN and OECD Models correspondingly (section 31.1.3.).

In recent years, one of the most developed industries in Ukraine was the IT industry. IT is the fastest growing sector and has been among Europe's

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17. A. Vachnytska, *The indicators of permanent establishment of a non-resident in Ukraine*, Dmytrieva and Partners (21 Apr. 2021), available at <https://dmp.com.ua/news/4598/> (accessed 11 Oct. 2022).

18. Id.

19. Id.

most dynamically growing.<sup>20</sup> In 2021, the Ukrainian IT industry recorded a growth of 36% and remained strong and was the largest industry in the country during 2022 and 2023.<sup>21</sup> The majority of IT experts, as self-employed individuals or legal entities, perform work on a permanent basis for foreign companies from Ukraine. Due to very intense cross-border corporations of the Ukrainian IT sector with foreign partners, the changes to the legislations can affect IT experts the most. Foreign corporations used to outsource consultancy activities to Ukrainian IT specialists. With the adoption of a service PE and agency provision, some companies might be obligated to register a PE depending on the nature of the activities carried on by the specialists.

IT specialists are also often registered as self-entrepreneurs who independently enter into contracts with a foreign company (or through a Ukrainian affiliate company). However, amendments to the tax code indicate that such a sole proprietorship will not be considered a PE of a non-resident in Ukraine if it only operates as an independent counterparty for which such activity is independent and not limited to one client. It is quite easy to calculate the non-independence of a sole proprietor (or a group of sole proprietors). First, it is necessary to identify the center of distribution of foreign orders between sole proprietorships. The second is the identification of the coincidence in the sole proprietorship groups of the same customers.<sup>22</sup> At risk are also IT companies that:<sup>23</sup>

- have registered enterprises abroad and sign contracts with foreign customers on their behalf;
- do not have an office and employees in the country of registration of the enterprise;
- negotiate with clients from the Ukrainian office and exclusively sign agreed contracts with foreign companies; and

20. K. Vasyuk, *IT is Ukraine's fastest-growing sector. When the war is over, it will be the driver of our economy once again*, DigitalEurope (11 Mar. 2022), available at <https://www.digitaleurope.org/news/it-is-ukraines-fastest-growing-sector-when-the-war-is-over-it-will-be-the-driver-of-our-economy-once-again/#:~:text=Despite%20the%20ongoing%20conflict%2C%20in,increased%20from%20244%2C000%20to%20285%2C000> (accessed 11 Oct. 2022); O. Noyan, *Ukrainian IT industry continues to operate as war rages on*, Euractiv (21 Mar. 2022), available at <https://www.euractiv.com/section/digital/news/ukrainian-it-industry-continues-to-operate-as-war-rages-on/> (accessed 11 Oct. 2022); and BBC Future, *The growing IT sector in Ukraine*, available at <https://www.bbc.com/storyworks/future/ukraine-innovating-for-the-future/ukraines-dynamic-it-sector> (accessed 11 Oct. 2022).

21. K. Vasyuk, *Ukrainian IT Industry remain strong*, NUCC (1 Apr. 2022), available at <https://nucc.no/ukrainian-it-industry/> (accessed 11 Oct. 2022).

22. M. Grekov, *What tax risks arise for the IT business due to the "Law on CFC"*, Ain (8 Dec. 2020), available at <https://ain.ua/ru/2020/12/08/podatkovy-riziki-dlya-it-biznesu-cherez-zakon-pro-kik/> (accessed 11 Oct. 2022).

23. Id.

- fully or partially create products in Ukraine with employees of a Ukrainian company (usually a subsidiary or affiliate of the same foreign company) or freelancers (who are registered as sole proprietors but are actually employees because they work for a particular IT company).

The calculation of the profits attributed to the PE in practice is performed based on the turnover for each “sole proprietor” of such IT business. The tax rate for income of sole proprietors is 5% under the legislation of Ukraine, whereas the corporate income tax is 18%. The PE will have to pay the difference of 13%.<sup>24</sup> Thereby, Ukrainian legislation does not follow the Authorised OECD Approach and OECD Additional Guidelines on Attribution of Profits to a Permanent Establishment; also, Ukrainian legislation does not recognize that an additional income beyond the remuneration of an agent or employee has to be attributed to a PE. The qualification is that this affects the rate of the applicable tax, i.e. tax on employment income, tax on income of sole proprietor (different from the tax rate for income from employment) and corporate income tax.

There have been many policy discussions regarding the future of the PE concept. In the author’s view, the concept of a PE is overvalued in international taxation. It is a mere exemplification of how a multinational enterprise can carry on business in the source state but not an exhaustive list of the available modes. Yet, the decisive importance of the “recognized” PE forms leaves a lot of room for maneuver. Among the modern forms of business that are not covered by the PE are operating through an exclusive franchising or licensing agreement, dependent sole proprietors like IT experts or digital workers, among other forms.

The present PE concept absolutely unjustifiably extends the scope to cover dependent agents but not other dependent personnel in the source state. It is unclear why agency activities are more valuable than the activities, for example, of a dependent (economically affiliated) IT specialist who builds products that are worth millions in the source state.

The PE’s attention to purely formal criteria, such as the agreement form or the place from where the business is performed, overlooks the substance of activities. There might be an establishment in the jurisdiction without any substance there and an income-generating activity without any establishment.<sup>25</sup> Moreover, the PE concept includes only fixed places of businesses

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24. Id.

25. S. Buriak, *International taxation of business income in a globalized and digitalized economy: Towards recognizing new forms of ‘carrying on business’ and residual profits* (IBFD, forthcoming).

in a source state that are occupied by a corporation itself but not fixed places of business of others that can be an integral part of the enterprise's business. It has been repeatedly stated that such limitations were reasonable at the moment of creating the rules by the League of Nations, due to the fact that expansion through ownership over tangible assets was the only alternative to the arm's length stand-alone trade. In the modern economy, it is widely recognized that the PE concept has become somewhat outdated and requires specific tuning.<sup>26</sup>

In order to reflect economic and business developments, the wording of article 7 of the OECD Model could be modified as follows: "Profits from any business carried on by a resident of a Contracting State shall be taxable only in that State unless the resident carries on business in the other Contracting State [*including*] through a permanent establishment" [emphasis added]. The suggested wording would require the OECD to provide an autonomous definition of what amounts to "business" and "carrying on business" as well as to provide a commentary on the terms so as to develop a general test (not the list of activities). At the same time, the PE concept will remain relevant and strong for traditional ways of economic presence in the source state.

#### **31.4. Physical presence according to articles 15(1) and 17 of the OECD Model**

Article 15 of the OECD Model governs the distribution of taxing rights for employment income of a taxpayer.<sup>27</sup> The default rule of article 15 is that the country where the worker is resident is entitled to tax income from employment, unless the employment is exercised in the other contracting state. If the employment is exercised in the other contracting state, then the income from employment may be taxed there. In this case, the first state where the worker is a resident has to apply the credit or exemption method to eliminate double taxation.

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26. See, for example, R. Oliver, *Changing world leaves PE standing*, 10 International Tax Review 2, p. 17 (1999); A.J. Cockfield, *The rise of the OECD as an informal world tax organisation through national responses to E-commerce tax challenges*, 8 Yale JL & Tech., p. 136 (2015); and P. Hongler & P. Pistone, *Blueprints for a new PE nexus to tax business income in the era of the digital economy*, Talking Points (2015), Journal Articles & Opinion Pieces IBFD.

27. OECD, *Updated guidance on tax treaties and the impact of the COVID-19 pandemic* para. 46 (OECD 2021).

The place where the *employment is exercised* refers to the place “where the employee is physically present when performing the activities for which the employment income is paid”.<sup>28</sup>

The following scenarios can be subject to an analysis:

1. the tax resident of Ukraine works for a foreign entity physically present in Ukraine;
2. the tax resident of Ukraine works for a foreign entity physically performing work in the country where the entity is resident;
3. the non-resident of Ukraine works for a legal entity resident in Ukraine from abroad; and
4. the non-resident of Ukraine works for a legal entity resident in Ukraine physically performing his work from Ukraine.

If the person is tax resident of Ukraine (scenarios 1 and 2), then the tax code provides that any foreign income (including employment income from sources outside Ukraine) has to be included in the tax base in Ukraine.<sup>29</sup> The domestic law does not differentiate between scenarios 1 and 2. The main criterion for tax liability on employment income is personal tax residency of the taxpayer and not where the employment is physically exercised. These rules are, nevertheless, subject to the tax treaties to which Ukraine is the contracting state.

For instance, on 22 August 2018, Ukrainians state fiscal authorities were requested to provide a reasoned opinion regarding a citizen of Ukraine who had a single employer resident in Ukraine but who exercised employment in the territory of Belgium under the relevant agreement between the Ukrainian and Belgian companies.<sup>30</sup> Both Ukraine and Belgium could tax the income of the taxpayer according to their domestic legislation. The tax authorities informed the taxpayer that the provision of the tax treaty between Ukraine and Belgium is relevant in his case. The tax authorities relied on article 15 of the treaty, which is equal in substance to article 15 of the OECD Model.<sup>31</sup>

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28. Id., at para. 47.

29. A. Petryshak, *Working abroad: where taxes are paid and how to avoid double taxation*, Think Brave (25 May 2022), available at [https://biz.ligazakon.net/analitics/211453\\_robo-ta-za-kordonom-de-splachuyutsya-podatki-ta-yak-uniknuti-podvynogo-opodatkovannya](https://biz.ligazakon.net/analitics/211453_robo-ta-za-kordonom-de-splachuyutsya-podatki-ta-yak-uniknuti-podvynogo-opodatkovannya) (accessed 11 Oct. 2022); and arts. 14.1.55 and 163.1.3 Tax Code of Ukraine.

30. UA: Individual Tax Consultation by the Tax Authorities (22 Aug. 2018), № 3658 / K / 99-99-15-01-14 / IPK; and LigaZakon, *An employee of a Ukrainian enterprise performs work abroad: where income received is taxed* (30 Aug. 2018), available at [https://buh.ligazakon.net/news/179842\\_pratsvnik-ukranskogo-pdprimstva-vikonu-robotu-za-kor-donom-de-opodatkovuyutsya-otriman-dokhodi](https://buh.ligazakon.net/news/179842_pratsvnik-ukranskogo-pdprimstva-vikonu-robotu-za-kor-donom-de-opodatkovuyutsya-otriman-dokhodi) (accessed 11 Oct. 2022).

31. *Belg.-Ukr. Income and Capital Tax Treaty* (1996).



They interpreted article 15(1) of the treaty in the same way as the OECD Model, i.e. the employment is exercised in the place where a worker is physically located when performing his duty.<sup>32</sup> Under the circumstances of the case, Belgium was argued to have the primary right to tax the income of the Ukrainian resident.

In 2022, many Ukrainian citizens and tax residents who used to work for Ukrainian companies had to flee mostly to EU Member States because of the Russian invasion in Ukraine. This situation put mobility constraints on Ukrainian workers on a much greater scale than the COVID-19 pandemic. As of 24 May 2022, 6.6 million people have left Ukraine, and 2.1 million Ukrainians have returned to Ukraine.<sup>33</sup> As of November 2023, over 4.2 million people from Ukraine are registered in the European Union.<sup>34</sup> Many of these people continue working for Ukrainian legal entities from abroad. Ukraine has tax treaties with every EU Member State. Therefore, the change of the place where employment is exercised can lead to the allocation of the primary right to tax income from employment to EU Member States. Neither the domestic nor the international laws provide a solution regarding what has to be done in these circumstances.

Some industries, in particular the IT sector, prepared an official letter to the Prime Minister of Ukraine to address the risks of Ukrainian employees and self-entrepreneurs becoming tax residents in the host states.<sup>35</sup> The representative of the IT sector specified that tax residency risks create legal uncertainty and risks that may be the basis for imposition of penalties on Ukrainians. Even before the war, due to warnings in the media, also many Ukrainian companies (including in the field of IT) began relocating to other countries. Legislation in other countries often requires companies to register and pay taxes if their company is located in such a particular country or if the business is actually controlled or managed from within that country. Therefore, the relocation of workers can also trigger the change of residency of Ukrainian companies.

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32. LigaZakon, *An employee of a Ukrainian enterprise performs work abroad: where income received is taxed* (30 Aug. 2018), available at [https://buh.ligazakon.net/news/179842\\_pratsvnik-ukranskogo-pdprimstva-vikonu-robotu-za-kordonom-de-opodatkovuyutsya-otr-iman-dokhodi](https://buh.ligazakon.net/news/179842_pratsvnik-ukranskogo-pdprimstva-vikonu-robotu-za-kordonom-de-opodatkovuyutsya-otr-iman-dokhodi) (accessed 11 Oct. 2022).

33. BBC News, *How many Ukrainian refugees are there and where have they gone?* (4 July 2022), available at <https://www.bbc.com/news/world-60555472> (accessed 11 Oct. 2022).

34. EC, *Infographic - Refugees from Ukraine in the EU* (Nov. 2023), available at <https://www.consilium.europa.eu/en/infographics/ukraine-refugees-eu/> (accessed 20 Mar. 2024).

35. IT Ukraine Association, *on the necessity to save the tax residency of Ukrainian taxpayers during the war conflict* (10 May 2022), available at [https://bit.ly/Appeal\\_Text](https://bit.ly/Appeal_Text) (accessed 11 Oct. 2022).

This creates legal uncertainty, which encourages businesses to create new legal entities in the host country, resign contracts on their behalf and transfer payments abroad. That is why the IT sector emphasized the need to preserve the residence of Ukraine and prevent taxation in the host country. They called on European countries to take into consideration the following aspects and develop special rules to address the situation:

- it is critical that financial flows remain in Ukraine as they form the budget revenue, GDP, affect bank liquidity and add foreign exchange earnings;
- the centre of vital interests of displaced persons and companies should remain in Ukraine (the vast majority of displaced persons plan to return as soon as it becomes safe in Ukraine, as they feel part of Ukrainian society); and
- the economic base for income is the economy of Ukraine and not the economy of the country of temporary stay (displaced persons and companies, as a rule, work remotely for Ukrainian customers or exporting services so the formation of value added is not due to the economy of the host country).

The COVID-19 pandemic was also a force majeure situation when many workers became “stranded” because of travel restrictions. Ukrainian legislation did not contain any specific rules for foreigners who were “stranded” in Ukraine. The reason for this could be that the spread of the COVID-19 pandemic in Ukraine began much later than in other countries, i.e. closer to the autumn of 2020. Therefore, at the beginning of the pandemic, Ukraine was not closed and people could live in their home countries. Nevertheless, if some workers stayed in Ukraine during the lockdown, as the author mentioned earlier in this chapter, Ukraine implemented a moratorium for tax administrations for any tax inspections and tax fines in the period of the active phase of the pandemic.

When it comes to taxation of income of entertainers and sportspersons, under article 17 of the OECD Model, the state where the entertainer or sportspersons performs has the primary right to tax their income. The tax code of Ukraine contains the provision that non-residents who engage in cultural or sport activities in Ukraine and receive income from Ukraine are subject to income tax. The overall effective tax burden on income of artists and sportspersons is 15%<sup>36</sup> for the income of non-residents, of which 1.5% is earmarked tax for military needs. Cultural and sport services are also subject to a reduced VAT rate of 7%. The domestic legislation does not link

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36. Art. 141.4.2 Tax Code of Ukraine.

the obligation to pay income tax for non-resident artists and sportspersons to the place where they rehearse or train or perform publicly. It means that, even if the artist or athlete is supposed to perform their activities in the other contracting state but – due to travel restrictions and public health measures – is prevented from doing so, the payment will still be subject to a 15% tax rate since the activities are not performed in Ukraine. For example, the payment for a livestreamed concert would be an example of such a case. The place of performance is also the relevant factor for VAT purposes. These rules are, of course, subject to the tax treaties of Ukraine.

The legislation of Ukraine does not contain any specific provision for influencers. They can be subject to tax only if they register as self-entrepreneurs. Then, regular tax rules for resident taxpayers should apply to them. It is not clear whether it is possible to qualify an influencer as an artist under Ukrainian legislation. Therefore, influencers are subject to general tax provisions for the income of individuals. Yet, in practice, they rarely register themselves as self-entrepreneurs and their income is not covered.

### 31.5. Article 15(2) and (3) of the OECD Model

Paragraph 2 of article 15 of the OECD Model provides the following additional criteria of when the non-resident country where the worker exercises employment can be entitled to tax income from employment:<sup>37</sup>

- the employee is there for more than 183 days;
- the employer is a resident of the source jurisdiction; or
- the employer has a PE in the source jurisdiction that bears the remuneration.

Cross-border mobility of workers raises a number of tax compliance challenges. Having no border controls in the European Union, for example, makes it difficult for the authorities to control how many days a person spends in a certain country; it also might be difficult to control for the person himself. In addition, a taxpayer nowadays can be highly mobile between more than two countries and not meet the threshold of 183 days in any country. From the perspective of article 15, the taxpayer has to be liable to tax on income from employment only in the country where he is a tax resident. However, depending on a specific domestic residency provision, he may not

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37. OECD, *Updated guidance on tax treaties and the impact of the COVID-19 pandemic* para. 47 (OECD 2021).

meet the threshold of 183 days in any country, which might result in having no residence in any tax jurisdiction.

If the taxpayer is liable to tax in the country where the employment is exercised (other than his residence state), the employee has to file a tax return in his state of residence.<sup>38</sup> An additional disadvantage of cross-border mobility is that not all deductions might be available, and some tax benefits might potentially be lost.<sup>39</sup>

In Ukraine, documents confirming the stay of a non-resident individual in the customs territory of Ukraine for more than 183 calendar days are (i) a passport document and/or immigration card; (ii) a certificate from the border service; and (iii) documents on the basis of which he temporarily (permanently) resides in Ukraine.<sup>40</sup>

The residency for employers (legal entities) is determined based on the registration documents, PoEM or substance activities. Overall, having an office is not a determinative criterion for tax residency. Therefore, for example, home office as the recent mainstream mode of work should not affect the qualification of a tax resident of Ukraine under article 15(2)(b) of the OECD Model.

As discussed in section 31.1. of this chapter, the change of the PoEM could have consequences for the application of article 15(2). If the place where the person physically works is different from the place where he is resident and from the place where the employer is resident, then only the country of residence of the employee would have taxing rights. It must be pointed out that the PoEM test had no effect during the COVID-19 pandemic. The PoEM test for companies with the PoEM in Ukraine came into force only on 1 January 2022.<sup>41</sup>

The provisions on adopting a service and agent PE also came into force only on 1 January 2022. Now, these provisions have a definitive impact on article 15(2)(c) of the OECD Model. The scope of PE situations is broader

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38. EC Platform for Tax Good Governance, *Mobility of Workers* p. 5 (7 Oct. 2021).

39. Id.

40. UA: State Fiscal Service of Ukraine (10 Feb. 2016), № 1341 / M / 99-99-17-02-03-14, available at <https://www.pard.ua/uk/news/3952-dfsu-rozynyasnyuye-yaki-dokumenty-pidtvrdzhuyut/> (accessed 11 Oct. 2022).

41. O. Boboshko & N. Matvienko, 2021: *New registration fees to representatives of non-residents*, KPMG (2 Feb. 2022), available at <https://home.kpmg/ua/uk/home/media/press-releases/2021/02/2021-novi-reyestratsiyni-vymohy-do-predstavnytstv-nerezidentiv.html> (accessed 11 Oct. 2022).

now. It does not make a difference for the legislation whether a person performs agency or consultancy functions at a home office or in the office for PE purposes. The most relevant criterion is that the place should be habitually available for the worker.

During the pandemic, only the old version of the PE concept was in force. It contained a definitive list of what amounts to a fixed place of business, which included (i) office; (ii) factory; (iii) workshop; (iv) installation or construction for exploration of natural resources; (v) mine, oil/gas well, quarry or any other place of extraction of natural resources; (vi) warehouse or premises used for delivery of goods; and (vii) a server.<sup>42</sup>

There is no impact of economic ownership on Article 15, paragraph 2 OECD MC when it concerns Ukraine. Ukrainian legislation does not contain such a concept.

Overall, one of the ways to improve article 15 of the OECD Model – that later on can trigger the modifications of the legislation – could be to follow the approach of article 15(3) as a general rule for taxation of income from employment. Article 15(3) contains the exception to the general rule of article 15(1) for members of a regular complement of a ship or aircraft who can be taxed only in the resident state, disregarding where the work is performed. In the author's view, granting an exclusive taxing right to the country of residence has the advantage of simplifying the tax treatment of individuals in a highly mobile work environment. In principle, the place of performance of work is not relevant in a globalized world. A more relevant factor is when the person uses public benefits that must be financed through taxes. In this case, a proper test for the identification of residence through the centre of vital interest could closely align the residence state entitled to an exclusive right to tax income from employment and the state where the person has the closest social and family connection.

Yet, when considering the place where public benefits are used, the conflict between the residence state of the employer and the residence state of the employee arises. The residence state of the employer is the state that creates its workers' friendly environment, work places and a proper level of the economy to guarantee stable income from employees. On the other hand, the residence state of the employee offers a skilled workforce that can perform work.

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42. Art. 14.1.193 Tax Code of Ukraine.

All in all, the answer to the question of which state should be entitled to tax is a policy solution and the weighing of different factors. A shared taxing right appears to be a compromise between different countries, even if the cost is the complexity of compliance.

**31.6. Frontier workers**

Some tax treaties contain special frontier worker provisions. They replace the traditional sharing of taxing powers by a single collection of tax if the worker meets two requirements, i.e. he works in a frontier zone (spatial criterion) and returns home regularly/daily (temporal criterion). The provisions regulating frontier workers can be found in the tax treaties of many countries (Table 31.1.). The lack of harmonization of these rules on the domestic level can lead to disparities and discoordination between taxation and social security.

Table 31.1. Frontier workers in tax treaties or other agreements

|                          | Temporal:<br>Daily return | Geographical:<br>Frontier zone | Allocation rule                                                         |
|--------------------------|---------------------------|--------------------------------|-------------------------------------------------------------------------|
| Austria-Germany          | ✓                         | ✓                              | Residence state (exclusive)                                             |
| Austria-Italy            |                           | ✓                              | Residence state (exclusive)                                             |
| Austria-Lichtenstein     | ✓                         | ✓                              | Shared: 4% in employment state                                          |
| Belgium-France           |                           | ✓                              | Residence state (exclusive)                                             |
| France-Germany           | ✓                         | ✓                              | Residence state (exclusive)                                             |
| France-Italy             |                           | ✓                              | Residence state (exclusive)                                             |
| France-Spain             | ✓                         | ✓                              | Residence state (exclusive)                                             |
| France-Switzerland       | ✓                         |                                | Residence state (exclusive) – compensation of 4.5% for employment state |
| Germany-Switzerland      | ✓                         | ✓                              | Shared: 4.5% in employment state                                        |
| Italy-Austria            | ✓                         | ✓                              | Residence state (exclusive)                                             |
| Italy-France             | ✓                         | ✓                              | Residence state (exclusive)                                             |
| Italy-Switzerland        | ✓                         |                                | Employment state (80%)                                                  |
| Switzerland-Lichtenstein |                           |                                | Residence state (exclusive)                                             |
| Italy-San Marino         |                           |                                | Shared, final taxation for residence state                              |
| France-Spain             | ✓                         |                                | Residence state (exclusive)                                             |
| Sweden-Norway            |                           | ✓                              | Residence state (exclusive)                                             |

1. Source: IFA Milan Congress: Mobility of work – Plenary I – Part II: Personal income tax aspects.

The tax treaties of Ukraine with its neighbouring countries do not contain a specific distributive rule for frontier workers. Only the tax treaty with Poland contains a specific exception which specifies that wages and other similar remuneration received by a resident of one contracting state for employment or services carried out in the other contracting state shall not be taxable in that second state, if employment or services are provided by construction technicians on a construction site that constitutes a PE. Therefore, there is no experience in dealing with the avoidance of double taxation for frontier workers in Ukraine.

### **31.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)**

On 7 March 2020, the Verkhovna Rada of Ukraine adopted a number of laws aimed at preventing and combating the spread of the coronavirus disease (COVID-19) in Ukraine. Among them is the law that amended tax legislation to support taxpayers.<sup>43</sup>

The main changes introduced by the law in the field of taxation concerned the responsibility of taxpayers and penalties for violations of tax legislation. Any violations committed from 1 March to 31 May 2020 were disregarded, the penalty was not accrued or was subject to write-off. The liability could still arise only for the alienation of property that is in a tax lien without the consent of the tax authority or violation of accrual, declaration and payment of the VAT, excise tax and rent.

From 18 March to 31 May 2020, no tax audits were conducted. Ongoing and uncompleted inspections were temporarily suspended 31 until May 2020. Such suspension interrupted the term of the inspection and did not require the tax authority to take any additional decisions.

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43. UA: The Law of Ukraine as of 17 Mar. 2020, № 530-IX “On amendments to certain legislative acts of Ukraine aimed to prevent the occurrence and spread of coronavirus disease (COVID-19)” came into force on 17 Mar. 2020. The Law of Ukraine as of 17 Mar. 2020, № 533-IX “On Amendments to the Tax Code of Ukraine and other laws of Ukraine on support taxpayers for the duration of measures aimed to prevent the occurrence and spread of coronavirus disease (COVID-19)” came into force on 18 Mar. 2020, available at <https://tax.gov.ua/en/new-about-taxes--news-/print-413816.html> (accessed 11 Oct. 2022).

For the period from 18 March to 31 May 2020, the statute of limitations provided in the tax code of Ukraine was suspended.

The following persons were exempt from accrual and payment of social security taxes (although they could decide to pay) for the periods from 1 March to 31 March and from 1 April to 30 April 2020:

- private individuals, including those who opted for a simplified taxation system;
- persons who carried out independent professional activity (e.g. scientific, literary, artistic, artistic, educational or teaching, medical, legal practice); and
- members of a farm.

Employers, legal entities and sole proprietors who use the work of others were not exempt from accrual and payment of social security contributions during this period.

The act did not contain any provisions relevant for cross-border activities. The reason for this could be that individuals and tax entities were not obligated to report any changes during this period. It means that, even if travel restrictions resulted in a change of residency or in a PE in Ukraine, the tax administration took no actions in this regard.

Overall, the COVID-19 crisis and the war conflict in Ukraine have demonstrated that tax treaties should contain a clause for force majeure situations. It is definitely a relevant criterion for the application of tax treaty law whether a taxpayer decided voluntarily to work in a certain country or was forced to make such a decision.

### **31.8. The future of the mobility of work: A need for adjusting the existing treaty rules?**

#### **31.8.1. One-Stop Shop for wage tax withholding**

The high mobility of workers and the possibility to work remotely in today's business environment demands developing a simplified solution for the avoidance of double or even triple taxation on income from employment and sharing the taxing rights. Remote workers can cause wage tax withholding obligations in more than two countries. One of the potential solutions for this problem could be implementing a "one-stop-shop" approach that would require the country where the employer is resident to withhold tax on



the whole amount and distribute it to the tax administrations of other states entitled to the tax of the employee's business income.<sup>44</sup>

### 31.8.2. The qualification of dependent “self-entrepreneurs” for PE purposes

Another way to improve international tax is to recognize that “self-entrepreneurship” as a form of engaging the workforce in the source state can be abused. A rule similar to the dependent agent PE provision under article 5(5) of the OECD Model must be adopted to cover other functions performed by dependent personnel. An alternative solution would be to rely on the service PE provision of the UN Model that already contains a possibility to establish a PE in the source state, if the “personnel” of the taxpayer is engaged in furnishing services there or from there. The level of control and economic dependency over individuals who operate as “self-entrepreneurs” prevent their legal qualification as independent contractors. The limitation of the impact of the notion of economic dependency on the determination of the source state only to dependent agents under the model tax treaties is incoherent and unjustified.

### 31.8.3. A treaty provision for force majeure situations

The last 3 years demonstrated that a treaty provision for force majeure situations is a must-have. If a taxpayer chooses the physical place to perform work not based on his free will – but because of external circumstances of force majeure situations – then the tax treaties should not apply the same rules as in normal conditions. It would be critically important for the countries that faced force majeure circumstances to save stable tax revenue streams to cope with a crisis.

Moreover, there are principle-based justifications not to apply the regular rules in unpredictable force majeure conditions. In the author's opinion, the IT industry society of Ukraine summarized it in the best possible way:<sup>45</sup>

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44. IFA Milan Congress, *Mobility of work – Plenary I – Part II: Personal income tax aspects* (19-20 May 2022).

45. IT Ukraine Association, *supra* n. 35.

1. The centre of vital interests of displaced persons and companies remain in the state that they had to leave forcefully. The vast majority of displaced persons return to the place of vital interest as soon as it becomes safe in the country they leave or when it appears possible to return.

2. The economic base for the income of displaced people is normally the economy of their first resident state and not the economy of the country of a temporary stay. Displaced persons and companies, as a rule, work remotely for their home countries, so the formation of value added is not due to the economy of the host country. [Author's translation.]

In the author's view, the centre of vital interest cannot be changed because of forceful events, and the number of days spent does not represent the true economic attachment of a worker to the country where the worker is "stranded".

#### **31.8.4. Too much emphasis on the physical place of work performance: Ready for metaverse?**

Overall, the attention to the physical presence of the worker; the physical presence of work performance; taking strategic decisions; or the location of facilities does not appear to be the approach suitable for the present and future of the world. Many strategic meetings already happen in the virtual environment. Facebook recently announced the creation of a so-called metaverse – a virtual environment where the feeling of a live presence will be maximized. The world will gradually move farther away from any idea of a physical presence, and future-looking international tax law should take action in the same direction.

#### **31.8.5. International taxation among other legal disciplines**

Tax treaties do not provide exhaustive autonomous definitions for a number of legal terms, such as "business", "business profits", "carrying on business" (article 7 of the OECD Model), "participation in control" (article 9 of the OECD Model), "other personnel" (article 5 of the UN Model), etc. In this regard, tax treaties must derive the respective meaning of the terms from the domestic laws of the contracting states. Globalization affected not only international tax relations but also many other legal areas that are currently in the process of developing new legal forms of economic relations. The author believes that any international tax reform must take a comprehensive view on all legislative developments in other legal disciplines that are related to

addressing the globalized economy. Without considering the developments of other legal disciplines, newly proposed international tax reforms risk becoming outdated relatively quickly.



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## Chapter 32

### The Impact of Tax Treaties on International Mobility of Work in the United Kingdom

Dilpreet K. Dhanoa

#### 32.1. Mobility of work and domestic tax law

##### 32.1.1. The impact of COVID-19 on the UK economy and workplace

To say that the way we live, work, and operate has seen a dramatic turn in the last 2-3 years would be an understatement. Globally, no country was left untouched in the wake of the COVID-19 pandemic. The United Kingdom was particularly hard hit and, at the time of this writing, had 22,238,715 reported cases (resulting in 177,977 deaths).<sup>1</sup> Most institutions gathering data on the impact of COVID-19 usually recorded the United Kingdom in their “Top 10” of reported cases and deaths for the pandemic outbreak.<sup>2</sup> The UK Parliament launched an inquiry in July 2020, “Tax After Coronavirus”.<sup>3</sup> The introduction to that report noted:

The coronavirus crisis has generated one of the greatest shocks to the UK’s economy in the past 300 years. It has accelerated the UK’s public debt at the fastest rate ever seen in peacetime. After the crisis has passed, it will have exacerbated the long-term pressures on the public finances that are projected to see revenues and spending diverge indefinitely if no action is taken.<sup>4</sup>

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1. Worldometer, *Reported Cases and Deaths by Country or Territory*, available at <https://www.worldometers.info/coronavirus/#countries> (accessed 20 May 2022).

2. See, for example: CNN Health, *Tracking Covid-19’s global spread*, available at <https://edition.cnn.com/interactive/2020/health/coronavirus-maps-and-cases/> (accessed 23 May 2022); Our World in Data, *United Kingdom: Coronavirus Pandemic Country Profile*, available at <https://ourworldindata.org/coronavirus/country/united-kingdom> (accessed 22 May 2022); Financial Times, *Coronavirus tracked: see how your country compares*, available at <https://fig.ft.com/coronavirus-chart/?areas=eur&areas=usa&areas=zaf&areas=grc&areas=hun&areas=gbr&areasRegional=usny&areasRegional=usnh&areasRegional=uspr&areasRegional=usdc&areasRegional=usfl&areasRegional=usmi&cumulative=0&logScale=0&per100K=1&startDate=2021-06-01&values=deaths> (accessed 23 May 2022).

3. House of Commons Treasury Committee, *Tax after coronavirus*, Twelfth Report of Session 2019-21, p. 6 (24 Feb. 2021), available at <https://committees.parliament.uk/publications/4865/documents/50796/default/> (accessed 21 May 2022).

4. Id.

The report set out to examine what the major long-term pressures on the UK tax system are in the wake of the pandemic and whether those ought to be addressed through tax reform. In doing so, it considered which areas of the tax system are most in need of reform, what overall level of taxation the UK economy might bear and whether there might be a role for windfall taxes in a post-pandemic world.

The United Kingdom has traditionally worked closely with the OECD, and in a post-Brexit world, some academics have argued that the OECD could fill the policy vacuum left by the European Union.<sup>5</sup> As a result, this chapter will also consider the OECD's perspective alongside the United Kingdom's position in respect of mobility of work and tax. The opening paragraphs to the OECD's updated guidance issued on 21 January 2021 in respect of tax treaties and the impact of the coronavirus stated:

The impact of the coronavirus disease ("COVID-19") has been profound. The rapid spread of the virus has strained local medical infrastructures, led to restrictions on travel and social contact, and created unprecedented disruptions to the global economy.

During the pandemic period, many enterprises have faced curtailment of their operations, and have been forced to close offices and other business premises forcing those businesses to change how their business is conducted (e.g. working from home). In many jurisdiction, international travel was either suspended or severely restricted for a number of weeks leaving people stranded in jurisdictions where they might not otherwise be. This temporary dislocation of people can have tax consequences for those individuals and the businesses for which they work.<sup>6</sup>

As noted already, this chapter deals with questions arising in the world of taxation and mobility of work for the United Kingdom specifically. However, given the OECD's detailed work in respect of comparative studies and benchmarking that is often used as a mechanism to provoke change in institutions, policy, government expenditure and regulatory environments in its global members – including the United Kingdom – it would be remiss to not factor in the OECD's guidance. It has informed UK policy (whether

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5. R. Dunin-Wasowicz, *The OECD could reply the EU as a driver of UK public policy after Brexit*, LSE Blog (26 June 2017), available at <https://blogs.lse.ac.uk/brexit/2017/06/26/the-oecd-could-replace-the-eu-as-a-driver-of-uk-public-policy-after-brexit/> (accessed 21 May 2022). See also J. Morphet, *Beyond Brexit? How to assess the UK's future* (Bristol University Press 2017).

6. OECD, *Updated guidance on tax treaties and the impact of the COVID-19 pandemic* (21 Jan. 2021), OECD Policy Responses to Coronavirus (COVID-19), available at <https://www.oecd.org/coronavirus/policy-responses/updated-guidance-on-tax-treaties-and-the-impact-of-the-covid-19-pandemic-df42be07/> (accessed 22 May 2022).

as change to be implemented or a matter for policy consideration), for example, the permanent establishment guidance, and so this chapter will consider the wider guidance issued by the OECD Secretariat along with other policy documents issued following the pandemic.

### 32.1.2. UK labour market, COVID-19 impacts and fiscal packages

Invariably, there has been a significant impact on the labour market with some workers being disproportionately economically impacted by the COVID-19 pandemic.<sup>7</sup> A Parliamentary research paper looking into the impact of the coronavirus on the labour market noted, “[w]orkers who are from an ethnic minority group, young workers, low paid workers and disabled workers, have been most negatively economically impacted by the coronavirus.”<sup>8</sup>

For individuals who fall into those categories, it is often extraordinarily difficult to physically move the incidence of work, and the option of relocation is often unlikely. Taxation as a global system has not necessarily afforded respite for such individuals. While many office workers are able to find more of a flexible work-home arrangement, with people reporting longer hours working but often resulting in higher levels of happiness and productivity,<sup>9</sup> those most economically impacted by the coronavirus cannot often say the same. Such individuals include those in social care, public transport, education and health care.

For context, it is useful to consider how the lockdowns in the United Kingdom coupled with increasing international policy guidance led to the country undertaking a number of measures to try and protect workers and businesses from the hard-hitting impacts of the crisis.<sup>10</sup>

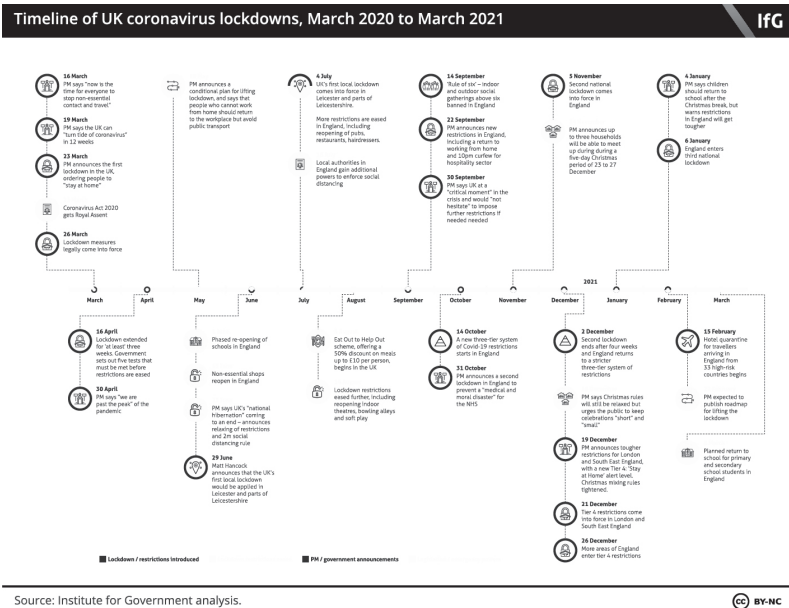
7. A. Powell, F.-D. Brigid & H. Clark, House of Commons Library Research Briefing Paper, *Coronavirus: Impact on the labour market*, p. 25 (9 Aug. 2022), available at <https://researchbriefings.files.parliament.uk/documents/CBP-8898/CBP-8898.pdf> (accessed 15 Sept. 2022).

8. *Id.*

9. The Economist, *The Rise of Working from Home* (8 Apr. 2021), available at <https://www.economist.com/special-report/2021/04/08/the-rise-of-working-from-home>.

10. Institute for Government, *Timeline of UK coronavirus lockdowns, March 2020 to March 2021*, available at <https://www.instituteforgovernment.org.uk/sites/default/files/timeline-lockdown-web.pdf>. *See also* <https://www.instituteforgovernment.org.uk/sites/default/files/timeline-coronavirus-lockdown-december-2021.pdf> (further details showing Mar. 2020-Dec. 2021 period).

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While the United Kingdom managed to put in place policy and legislative measures along with fiscal packages, one of the key concerns emerging from the 2020 inquiry were the long-term trends when “as a result of demographic pressures, the relationship between the tax base and Government spending changes dramatically.”<sup>11</sup> The role and mobility of work has had one of the biggest impacts and will undoubtedly continue to do so – and it is this topic that this chapter will explore in a post-pandemic world in the United Kingdom.

During the course of the pandemic, the United Kingdom’s revenue authority (His Majesty’s Revenue & Customs (HMRC)) issued guidance in respect of the challenges faced by employers and employees alike with respect to the principle of a permanent establishment.<sup>12</sup> It particularly addressed whether the presence of individuals in the United Kingdom, as a result of the pandemic, could establish a taxable permanent establishment for foreign companies for UK corporation tax purposes.

11. House of Commons Treasury Committee, *supra* n. 3, at p. 13.  
12. HMRC, *International Manual – HMRC Approach to UK Permanent Establishments in response to COVID-19 Pandemic* (INTM261010) (2 Apr. 2020), available at <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm261010> (accessed 12 Jun 2022).



### 32.1.3. UK tax residency as a matter of law

#### *Individuals*

The starting position in UK law is that individuals who are UK resident and UK domiciled (or deemed domiciled) are liable to be taxed on their worldwide income on an arising basis.<sup>13</sup> Both “residence” and “domicile” (including deemed domicile) are technical terms that have generated significant case law in the UK courts. The underlying principle is that those individuals with the strongest links to the United Kingdom should pay more tax than those whose connections may be weaker. The concepts of residence and domicile are used to assess and measure the strengths of an individual’s links with the United Kingdom and to then determine their UK tax position. As already noted, an individual who is both a UK resident and domiciled there will be considered to have the strongest links to the United Kingdom and will be subject to UK income tax on their worldwide income and gains. In contrast, an individual who is neither a UK resident nor domiciled there has the weakest links with the United Kingdom. Generally (and subject to anti-avoidance provisions), they are liable to income tax only on their UK-source income and to a capital gains tax only on gains realized on a disposal of UK residential property.

The tax year in the United Kingdom runs from 6 April of one year to 5 April of the following year for any given tax year.<sup>14</sup> Whether an individual is treated as a UK resident in that year is determined by the statutory residence test. This is not simply a day-counting exercise but is rather a series of tests that account for other factors such as previous residency, connections to the United Kingdom and the amount of time spent in the United Kingdom.

The number of days it takes to become a tax resident in the United Kingdom can vary. Generally, when an individual spends 183 days or more in the jurisdiction, they will usually be treated as a UK tax resident. However, it is also possible to become a UK tax resident if an individual spends 46, 91 or 120 days – depending on the number of “ties” that person has to the United Kingdom (for example, property ownership, family, etc.). In the wake of the pandemic, HMRC issued guidance that, when a person was required to remain temporarily in the United Kingdom due to COVID-19, it would likely be considered an “exceptional circumstance” and any days (up to a maximum of 60 days) would be disregarded.

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13. The arising basis of taxation means that an individual pays tax on their income and gains in the tax year in which those income and gains arise.

14. UK: Income Tax Act, 2007 (amended 2023), sec. 4, Primary Sources IBFD.

### *Companies*

The United Kingdom has adopted the approach that where the central management and control of a company actually abides is a question of fact with each case to be considered on its own specific factual matrix.<sup>15</sup> The general position under UK law<sup>16</sup> is that a foreign corporation is not treated as being a UK tax resident unless its central management and control are undertaken in the United Kingdom. What is meant by “central management and control” was set out in the judgment of Lord Loreburn in the case of *De Beers* (1906),<sup>17</sup> whereby he said:

a company resides for purposes of income tax where its real business is carried on. [...] I regard that as the true rule; and that the real business is carried on where the central management and control actually abides.

It remains to be considered whether the present case falls within that rule. This is a pure question of fact, to be determined, not according to the construction of this or that regulation or by-law, but upon a scrutiny of the course of business and trading.

With this as the starting point in law, following the pressure created by the pandemic and national lockdowns that forced employees and businesses to conduct their affairs in alternative locations, the question of what amounts as a company residence for the purposes of taxation invariably came to the fore. HMRC took the view that the existing legislation and guidance in relation to company residence “already provides flexibility to deal with changes in business activities necessitated by the response to the COVID-19 pandemic”.<sup>18</sup> Specifically, HMRC’s guidance set out that:

We do not consider that a company will necessarily become resident in the UK because a few board meetings are held here, or because some decisions are taken in the UK over a short period of time. HMRC guidance makes it clear that we will take a holistic view of the facts and circumstances of each case.

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15. HMRC, *International Manual – HMRC Approach to Company Residence in response to COVID-19 Pandemic* (INTM120185) (3 Apr. 2020), available at <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm120185> (accessed 12 Jun 2022).

16. See UK: Corporation Tax Act, 2010 (amended 2023), sec. 1141, Primary Sources IBFD, which notes that a company has a permanent establishment in a territory if, and only if, (i) it has a fixed place of business there through which the business of the company is wholly or partly carried on; or (ii) an agent acting on behalf of the company has and habitually exercises their authority to do business on behalf of the company.

17. UK: UKHL, 30 July 1906, *De Beers Consolidated Mines Ltd v. Howe* (*Surveyor of Taxes*) [1906] AC 455.

18. HMRC, *Internal Manual: International Manual – HMRC Approach to Company Residence in response to COVID-19 Pandemic* (INTM120185) (3 Apr. 2020), available at <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm120185> (accessed 12 Jun 2022).

Having said this, the issue of corporate economic substance is high on the agenda of tax authorities globally, and the United Kingdom is no exception. Tax residence and corporate economic substance are ultimately matters of fact. However, in circumstances where more than one jurisdiction claims primary taxing rights and a tax treaty applies, then the treaty will usually require consideration of where strategic decisions are undertaken. This will, in turn, assist in determining the territory of residence under the treaty.

## **32.2. Residence, tiebreaker rules and mobility of work: Individuals and entities**

### **32.2.1. The statutory residence test**

An individual will be treated as a UK resident if they meet one of the automatic UK tests<sup>19</sup> or the sufficient ties test.<sup>20</sup> The automatic ties tests<sup>21</sup> are set out in the following list:

- the first automatic test is, if an individual has spent 183 days or more in the United Kingdom in the relevant tax year, they will be considered to be a UK resident;
- the second automatic test is relevant if the individual has or had a home in the United Kingdom during all or part of the relevant tax year. The test is met if there is at least one period of 91 consecutive days (of which 30 must fall in the relevant tax year) where the individual has a home in the United Kingdom and spends a sufficient amount of time there or has no overseas home; and
- the third automatic test is when an individual works full-time in the United Kingdom for any period of 365 days with no significant break from UK work and all or part of the 365 day period falls within the tax year, more than 75% of the total number of days in the 365 day period when the individual did more than 3 hours of work and at least 1 day that is both in the 365 day period and in the tax year is a day in which the individual does more than 3 hours of work in the United Kingdom.

In the event that an individual does not meet any of the automatic ties tests, then they would consider applying the sufficient ties test with respect to

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19. UK: Finance Act, 2013, sch. 45, part 1, para. 5, Primary Sources IBFD.

20. Sch. 45, part 1, paras. 17-20 Finance Act 2013.

21. Sch. 45, part 1, para. 7 Finance Act 2013. *See also* HMRC, *Residence, Domicile and Remittance Basis Manual, Residence: The SRT: Automatic UK tests* (RDRM11300) (24 May 2022), available at <https://www.gov.uk/hmrc-internal-manuals/residence-domicile-and-remittance-basis/rdrm11300> (accessed 12 June 2022).

determining their UK residence status. This requires the individual to look at and consider their connections to the United Kingdom (their “ties”) and determine whether their ties in connection with the number of days spent in the United Kingdom are sufficient for them to be considered a UK resident for tax purposes for the relevant tax year.

The test comprises two separate sliding scales that use the UK days and the individual’s UK ties in the tax year. If an individual was not a UK resident in any of the 3 years prior to the year in question, they need to consider the following ties: family, accommodation, work and a 90-day tie. In the event an individual was a UK resident in 1 or more of the 3 years immediately preceding the year in question, then in addition to the ties noted, they will also need to consider if they have a country tie.<sup>22</sup> The sliding scale that applies to the tax year depends on the individual’s residence status in the previous 3 tax years.

### 32.2.2. The impact of the pandemic

Following the outbreak of the pandemic, HMRC made it clear that there would be modifications to the guidance (albeit on a temporary basis). As such, the following circumstances were considered “exceptional” and under the temporary guidance amended in the light of COVID-19, the following were disregarded for statutory residence test purposes:

- when an individual is quarantined or advised by a health professional or public health guidance to self-isolate in the United Kingdom as a result of the virus;
- when an individual finds themselves advised by official government advice not to travel from the United Kingdom as a result of the virus;
- when an individual is unable to leave the United Kingdom as a result of the closure of international borders; and
- when an individual is asked by their employer to return to the United Kingdom temporarily as a result of the virus.

Noting the United Kingdom’s position specifically, the OECD identified that guidance had been issued by the country on whether days spent in the United Kingdom could be disregarded for the purposes of determining residency as a result of exceptional circumstances. The United Kingdom’s legislation has detailed provisions regarding what should be considered

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22. HMRC, *Residence, Domicile and Remittance Basis Manual – Residence: The SRT: The ties test: Introduction* (24 May 2022), available at <https://www.gov.uk/hmrc-internal-manuals/residence-domicile-and-remittance-basis/rdrm11510> (accessed 12 June 2022).

when calculating and applying the statutory residence test.<sup>23</sup> One of the factors it considered is the number of days an individual spends in the United Kingdom. However, it is possible to exclude a maximum of 60 days spent in the United Kingdom in any tax year as a result of “exceptional circumstances”.

However, following the onset of the pandemic and national lockdowns, HMRC’s revised guidance on the test with respect to what amounted to “exceptional circumstances” was as follows:

Days spent in the UK may be ignored if the individual’s presence in the UK is due to exceptional circumstances beyond their control. This will usually only apply to events that occur while an individual is in the UK and which prevent them from leaving the UK.

Exceptional circumstances will normally apply where the individual has no choice concerning the time they spend in the UK, or in coming back to the UK. The situation must be beyond the individual’s control.

In its guidance, HMRC provided examples of circumstances that might amount to “exceptional circumstances” and those that would not (in HMRC’s view). One such example contrasting the circumstances and the approach taken to applying the law is set out below.

#### **Example 2(a)**

Henrik is working in the construction industry and lives in Germany. He has business interests in the UK and has spent 68 days working here in the current tax year. He is a lone parent and his children usually live in the family home in Germany with him.

Henrik sends Victoria, his 13 year-old daughter, for a 2 week holiday at a UK summer holiday camp. Whilst undertaking one of the activities she has an accident and is taken to hospital with a suspected major neck injury. Henrik immediately travels to the UK, to be with his daughter and arranges for her to be moved back to Germany as soon as possible. This happens 3 days after the incident. Victoria remains in hospital in Germany for a further 4 weeks.

The 3 days Henrik spends in the UK with his daughter arranging her transfer, after this potentially life threatening accident, would count as exceptional circumstances.

#### **Example 2(b)**

A similar judgement would be applied had Henrik and his daughter been in the UK when the accident had occurred. If Henrik stays with his daughter beyond

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23. See sch. 45, sec. 22 Finance Act 2013.

their planned return date, until she can be transferred back to Germany, the additional days where he is present at midnight would count as exceptional circumstances.

Had Henrik chosen not to arrange for his daughter to be transferred to a German hospital, and had elected to stay in the UK until she was released from hospital here, the additional time spent in the UK would not be considered as exceptional circumstances.

In order to be ignored as days spent in the UK, there must be exceptional circumstances beyond the control of the individual. In other words, the event or situation in question must be one over which the individual has no control or influence, and which cannot reasonably have been foreseen.

For example, if an individual is a passenger on a commercial aircraft that is forced to make an emergency landing in the UK, and there is no available onward flight to their original destination for 2 days afterwards. The 2 days that would otherwise count as time spent in the UK would be ignored due to exceptional circumstances.

While the examples are helpful to a degree, the guidance itself is generic and did not offer specific reassurance. However, HMRC went on to further revise its approach and made it clear that the following would always be considered as falling within the embrace of “exceptional circumstances”:

- when an individual is quarantined or advised by a health professional or public health guidance to self-isolate in the United Kingdom as a result of the virus;
- when an individual finds themselves advised by official government advice not to travel from the United Kingdom as a result of the virus;
- when an individual is unable to leave the United Kingdom as a result of the closure of international borders; or
- when an individual is asked by their employer to return to the United Kingdom temporarily as a result of the virus.<sup>24</sup>

These specific instances are certainly helpful in clarifying the position. Regarding tax treaties, HMRC’s guidance made it clear that treaty residence is determined using a series of tie breaker tests such as permanent home, centre of vital interests, habitual abode and nationality. It further went on to state that, even in circumstances where a person “may become resident in the UK under the statutory resident test, [their] residence under a treaty will

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24. HMRC, Residence, *Domicile and Remittance Basis Manual – Residence: The Statutory Residence Test (SRT): Main contents: Coronavirus (COVID-19)* (RDRM11005) (24 May 2022), available at <https://www.gov.uk/hmrc-internal-manuals/residence-domicile-and-remittance-basis/rdrm11005> (accessed 12 June 2022).

not change due to [their] temporary dislocation.”<sup>25</sup> In addition, no change was made to the employment article in the treaty.

### 32.3. Permanent establishments and mobility of work

The OECD’s guidance made it clear that “despite the complexity of the rules, and their application to a wide range of potentially affected individuals, it is unlikely that the COVID-19 situation will affect the treaty residence position”.<sup>26</sup>

There is no doubt that this was because, although the pandemic had hit some countries in a way like no other event had in recent years, tax treaties take an extraordinarily long time to negotiate and are often the result of significant and prolonged discussions between the relevant jurisdictions involved. Having said this, the OECD’s analysis on the matter is particularly illuminating with respect to the approach that governments during the pandemic should have adopted:

In general, a PE must have certain *degree of permanency* and be *at the disposal* of an enterprise in order for that place to be considered a fixed place of business through which the business of that enterprise is wholly or partly carried on. Paragraph 18 of the Commentary on Article 5 of the OECD Model explains that *even though part of the business of an enterprise may be carried on at a location such as an individual’s home office, that should not lead to the conclusion that that location is at the disposal of that enterprise simply because that location is used by an individual (e.g. an employee) who works for the enterprise. The carrying on of intermittent business activities at the home of an employee does not make that home a place at the disposal of the enterprise.* Also, for a home office to be a PE for an enterprise, it must be used on a continuous basis for carrying on business of an enterprise and the enterprise generally has to require the individual to use that location to carry on the enterprise’s business.

During the COVID-19 crisis, individuals who stay at home to work remotely are typically doing so as a result of government directives: it is force majeure not an enterprise’s requirement. Therefore, considering the extraordinary nature

25. HMRC, *Residence, Domicile and Remittance Basis Manual – Residence: The SRT: Annex D: International tax clarifications due to coronavirus (COVID19) – Q&A* (RDRM13410) (24 May 2022), available at <https://www.gov.uk/hmrc-internal-manuals/residence-domicile-and-remittance-basis/rdrm13410> (accessed 12 June 2022).

26. OECD, *OECD Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis*, para. 28 (3 Apr. 2020), available at [https://read.oecd-ilibrary.org/view/?ref=127\\_127237-vsdagpp2t3&title=OECD-Secretariat-analysis-of-tax-treaties-and-the-impact-of-the-COVID-19-Crisis](https://read.oecd-ilibrary.org/view/?ref=127_127237-vsdagpp2t3&title=OECD-Secretariat-analysis-of-tax-treaties-and-the-impact-of-the-COVID-19-Crisis) (accessed 18 May 2022).

of the COVID-19 crisis, and to the extent that it does not become the new norm over time, teleworking from home (i.e. the home office) would not create a PE for the business/employer, either because such activity lacks a sufficient degree of permanency or continuity or because, except through that one employee, the enterprise has no access or control over the home office. In addition, it provides an office which in normal circumstances is available to its employees.<sup>27</sup> [Emphasis added]

As noted previously, provision was made in HMRC's guidance with respect to the first automatic test and the number of days present in the United Kingdom during the pandemic.<sup>28</sup> With directors and other key decision-makers unable to leave the United Kingdom during national lockdowns along with very limited air travel, advice was given to companies to take care that any contingency plans put in place to ensure business operations could continue (wherever employees or directors may be working from) such that they did not have the effect of rendering the foreign entity becoming a UK tax resident.<sup>29</sup> Such guidance also included when to disregard the 3-hour rule of an individual working in the United Kingdom if:

- the day falls in the period beginning with 1 March 2020 and ending with 1 June 2020;
- on that day, the individual is in the United Kingdom carrying out specified COVID-19-related work; or
- the individual is resident in another country for tax purposes.<sup>30</sup>

Although HMRC took the view that the existing legislation and guidance in respect of company residence was sufficiently flexible for dealing with

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27. OECD, *id.*, at paras. 8-9.

28. See, generally, HMRC's guidance for various allowances made in respect of the statutory residence tests; and HMRC, *Residence, Domicile and Remittance Basis Manual: Residence: The SRT: Annex D: Contents* (RDRM13400) (24 May 2022), available at <https://www.gov.uk/hmrc-internal-manuals/residence-domicile-and-remittance-basis/rdrm13500> (accessed 12 June 2022).

29. See, for example, Simmons & Simmons LLP *COVID-19 – Corporate Residence and PE Issues* (8 Apr. 2020), available at <https://www.simmons-simmons.com/en/publications/ck8rfk14d1mcs0a82d3ez3jv7/covid-19---corporate-residence-and-pe-issues> (accessed 3 June 2022). See also BDO, *Corporate tax residence and COVID-19* (27 Apr. 2020), available at <https://www.bdo.co.uk/en-gb/insights/tax/corporate-international-tax/corporate-tax-residence-and-covid-19> (accessed 18 May 2022).

30. HMRC, *Residence, Domicile and Remittance Basis Manual – Residence: The SRT: Annex D: International tax clarifications due to coronavirus (COVID-19): Work tie* (RDRM13500) (24 May 2022). See also the relevant tables, available at <https://www.gov.uk/hmrc-internal-manuals/residence-domicile-and-remittance-basis/rdrm13500> (accessed 12 Jun 2022).



changes in business resulting from COVID-19,<sup>31</sup> there nonetheless laid a real risk that those who were key decision makers in companies along with employees stranded in the United Kingdom for extended periods of time could create a permanent establishment. To be a “fixed place” permanent establishment under a tax treaty, the relevant location must have a certain degree of permanency as well as being at the disposal of an enterprise. Therefore, an employee’s “home office” when working there during the pandemic and in response to it might likely have triggered the “exceptional circumstance” (under HMRC’s guidance) as arising (as opposed to this being a circumstance required by the employer). However, a certain degree of permanence may exist if an individual continued to work from home after the pandemic response measures were lifted.

In addition, from a company perspective, it becomes essential to look at “the pattern of decision taking over the life of the company and the relative importance of the decisions taken”<sup>32</sup> such that management should think carefully about discussions at board meetings and manage this accordingly. While it was generally considered that short-term decisions taken in the United Kingdom were unlikely to result in a company becoming a UK tax resident (under the “central management and control” test), it nonetheless prompts a close look at the fact pattern and for that to be monitored with some frequency. In addition, HMRC’s guidance made clear the following:

It is also worth noting that even if [central management and control] does abide in the UK, this does not necessarily mean that the company will be UK resident. If the company is also considered to be resident of another territory with which the UK has a Double Taxation Agreement (DTA), the corporate residence tie-breaker provisions of the DTA may result in the company being treated as non-UK resident. Most of the UK’s DTAs include a place of effective management (POEM) or a competent authority based tie-breaker.

POEM, like [central management and control], requires consideration of all the facts and circumstances. Unlike CMC however, the POEM can only be in one place at any one time. As such, even if CMC started to abide in the UK to a sufficient enough degree to result in UK residence under UK domestic law,

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31. HMRC, *International Manual – HMRC Approach to Company Residence in response to COVID-19 Pandemic* (INTM120185) (24 May 2022), available at <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm120185> (accessed 12 June 2022).

32. P. Gilliland & S. Pevsner, *COVID-19: HMRC Announces its Approach to Company Residence*, *Proskauer Tax Talks* (8 Apr. 2020), available at <https://www.proskauertaxtalks.com/2020/04/covid-19-hmrc-announces-its-approach-to-company-residence/> (accessed 17 May 2022).

it may be that after consideration of the activity in both territories, the POEM may be found to be in the other territory, and the company will therefore be treated as non-UK resident.<sup>33</sup>

There is a strong emphasis that existed in legislation and guidance prior to the pandemic that each case would be considered on its unique factual matrix alone with “central management and control” and “place of effective management” tests being used as tools and guides. No such cases appear to have been logged in the United Kingdom with respect to businesses having acquired a permanent establishment as a result of employees having been forced to remain in the United Kingdom. However, given that the United Kingdom is a common law jurisdiction, until this is tested in the courts, it remains to be seen whether the impact of the pandemic did convert any businesses into having permanent establishments in the United Kingdom.

### **32.4. Physical presence according to articles 15(1) and 17 of the OECD Model**

The OECD updated and revised its guidance in respect of article 15 (Income from Employment). It noted that, when a government subsidized the retention of employees on the company’s payroll during the pandemic, the income should properly be attributed to the place where the employment *used to be* exercised. In other words, but for the pandemic, national lockdowns and closing of international borders, this would occur where the employment would actually have been undertaken. The revised guidance went on to note that other employment income would normally be taxed where the employment was performed.<sup>34</sup>

This ties in with HMRC’s general position that an individual “can live abroad and still be a UK resident for tax”<sup>35</sup> (for example, if they were in the United Kingdom for more than 183 days in a tax year). In circumstances where an individual might be taxed twice, i.e. once on their UK income

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33. HMRC, *HMRC Approach to Company Residence in response to COVID-19 Pandemic* (INTM120185) 24 May 2022), available at <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm120185> (accessed 12 June 2022).

34. OECD, *OECD Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis* (3 Apr. 2020), para. 21, available at [https://read.oecd-ilibrary.org/view/?ref=127\\_127237-vsdagpp2t3&title=OECD-Secretariat-analysis-of-tax-treaties-and-the-impact-of-the-COVID-19-Crisis](https://read.oecd-ilibrary.org/view/?ref=127_127237-vsdagpp2t3&title=OECD-Secretariat-analysis-of-tax-treaties-and-the-impact-of-the-COVID-19-Crisis).

35. UK Government, *Tax on your UK income if you live abroad* (<https://www.gov.uk/tax-uk-income-live-abroad/uk-resident>).

by the country in which they are actually resident and once by the United Kingdom, if a tax treaty is in place, then the advice set out is either:

- to apply for partial or full relief before being taxed; or
- to apply for partial or full relief after being taxed.

HMRC's guidance (which existed pre-pandemic) notes that each tax treaty sets out the country in which to pay tax, the country to whom any relief application should be made and how much tax relief can be obtained. It further notes that, when the tax rates are different in the two jurisdictions, then the higher rate of tax is to be paid.<sup>36</sup>

The general rule and basis for apportionment under UK legislation with respect to earnings is as follows: "The extent to which general earnings are in respect of duties performed in the United Kingdom is to be determined under this Chapter on a *just and reasonable* basis. [emphasis added]"<sup>37</sup> For non-UK residents, the application of this provision determines the earnings that are taxable in the United Kingdom while, for Overseas Workday Relief, the provision determines the amount of earnings that are taxable on the arising basis and the amount that is taxable on the remittance basis.<sup>38</sup>

Following the impact of COVID-19, HMRC adjusted its position to reflect the difficulties faced by non-UK residents, noting that, in applying the "just and reasonable" test, any employment income earned while a person was "unexpectedly stuck in the UK" could be "justly and reasonably excluded if taxed in their home state".<sup>39</sup> However, it noted that:

Only the UK can establish any rights to tax the income for the period or periods the UK resident taxpayer spends in the UK, it is therefore reasonable for the UK to charge tax on its residents for work performed in the UK as no other state will have a claim to tax any earnings for such work.<sup>40</sup>

Specifically, the guidance went on to explain the position:<sup>41</sup>

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36. UK Government, *Tax on your UK income if you live abroad*, available at <https://www.gov.uk/tax-uk-income-live-abroad/uk-resident> (accessed 10 May 2022).

37. UK: Income Tax (Earnings and Pensions) Act, 2003, sec. 41ZA, Primary Sources IBFD.

38. HMRC, *Employment Income Manual – Appendix 5: COVID-19 considerations for non-residents and non-domiciled employees for 2020 to 2022* (EIM77045) (9 Jun 2022), available at <https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim77045> (accessed 12 June 2022).

39. Id.

40. Id.

41. UK Government, *supra* n. 36.

If you're a non-UK resident and were stuck in the UK because of coronavirus (COVID-19) between 5 April 2020 and 5 April 2022

You will not have to pay UK tax on employment income if you:

- earned it between the dates you intended to leave and when you left
- paid tax on it in your home country

Practical advice was set out noting that the individual must file a self-assessment tax return together with the appropriate prescribed form setting out the following information: dates they were stuck in the United Kingdom owing to the pandemic, what they earned in that time and confirmation that the individual paid tax on these earnings in another country.<sup>42</sup> In addition, HMRC's guidance made it clear that proof might be required that: the individual could not leave the United Kingdom when they intended to (evidenced, for example, with an NHS isolation note), the individual paid tax in another country on what they earned while stuck in the United Kingdom and/or they left the United Kingdom as soon as they reasonably could.<sup>43</sup> In the event such proof could not be adduced if asked for, HMRC's guidance contained the warning that UK tax might become due if an individual could not prove that they were unable to leave the United Kingdom and that they did not leave as soon as they could.

### **32.5. Article 15(2) and (3) of the OECD Model**

Taking the economic substance and income derived from employment a little further, it would be remiss not to consider how these paragraphs in the OECD Model interact with regimes that existed prior to the pandemic in the United Kingdom such as the diverted profits tax, which is a separate tax to corporation tax and charged at a higher rate. UK legislation<sup>44</sup> makes clear that a charge to the diverted profits tax can arise for an accounting period in one or more of the following three scenarios:

- a UK company uses entities or transactions that lack economic substance;
- a non-UK company uses entities or transactions that lack economic substance; and/or
- a non-UK company avoids creating a UK permanent establishment.

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42. Id.

43. Id.

44. UK: Finance Act, 2015 (amended 2017), secs. 77(2), 80 and 81, Primary Sources IBFD.

The diverted profits tax effectively seeks to:

[address] the erosion of the UK tax base by the diversion of profits that have been generated by UK economic activity. Profits which have been diverted from the UK are computed using the same principles which apply for corporation tax, including transfer pricing rules, except where the legislation requires them to be calculated by reference to the arrangements that it is just and reasonable to assume would have been made if tax on income had not been a consideration.<sup>45</sup>

HMRC has seen its diverted profits tax revenue increase during the COVID-19 pandemic due to an increase in profit shifting.<sup>46</sup> However, this was a trend that was only exacerbated by the pandemic, rather than fuelled by it. The United Kingdom's transfer pricing rules set out how transactions between connected parties are priced for tax purposes – including transactions between companies in the same group. As a result, the rules ensure that the United Kingdom is in a position to tax its share of the profits in accordance with the internationally recognized transfer pricing principle: the arm's length principle. HMRC challenges arrangements that do not allocate the right amount of profit (that is, the arm's length amount) to the United Kingdom. In the years from 2012/13 to 2017/18, HMRC secured approximately GBP 6.5 billion of additional tax via such challenges to the transfer pricing arrangements of multinationals.<sup>47</sup>

Accordingly, advance pricing agreements entered into with a tax authority will be underpinned by a set of critical assumptions that will need to be carefully reviewed and monitored following from any operational and/or financial adjustments as a result of circumstances created by the pandemic.

### 32.6. Frontier workers

The pandemic was not the only major event to have significantly impacted the United Kingdom in 2020-2021. The fallout from the Brexit referendum saw the United Kingdom's departure from Europe was drawn out and unclear with respect to the "new world" in which the United Kingdom would operate. In addition, the rise in the cost of living and subsequently the

45. HMRC, *International Manual: Diverted Profits Tax: Introduction and Overview: who is affected* (INTM489540) (16 May 2022), available at <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm489540> (accessed 12 June 2022).

46. L. Reeves, *UK companies increased profit shifting during the COVID-19 pandemic*, *International Tax Review* (5 May 2022).

47. HMRC, *Transfer Pricing and Diverted Profits Tax Statistics*, available at [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/729876/Transfer\\_Pricing\\_and\\_Diverted\\_Profits\\_Tax\\_statistics.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/729876/Transfer_Pricing_and_Diverted_Profits_Tax_statistics.pdf).

start of the Ukraine war in early 2022 have all combined to have significant impacts on the United Kingdom.

Prior to the Brexit transition period officially ending and in the midst of a second national lockdown, guidance was issued by the UK Home Office and UK Visas and Immigration (in September 2020). It concerned the frontier workers who wished to continue working in the United Kingdom. In the United Kingdom, frontier workers included EU citizens (including EEA and Swiss nationals) who are employed or self-employed in the United Kingdom but resident elsewhere.<sup>48</sup> To be eligible<sup>49</sup> for a frontier work permit prior to 1 January 2021, an individual had to demonstrate that: (i) they were commuting regularly to work in a country or countries where they do not live and (ii) that the countries where they were commuting to work were in the European Union or European Free Trade Association (EFTA).<sup>50</sup> Typically, frontier workers pay income tax via their employer but also make a declaration of all of their income in their home jurisdiction. Tax treaties seek to ensure that tax credits and reliefs can be applied such that taxation in the person's home jurisdiction is low or zero. However, working from home during the pandemic certainly complicated this for many around the globe. In the United Kingdom's case, this was coupled with its formal exit from the European Union.

The significance of the United Kingdom's departure from Europe cannot be understated. It has gone from being a part of a trading bloc in which it ascribed to the fundamental freedoms to acquiring a "third country" status. On 1 January 2021, entirely as a result of Brexit and following the end of the transition period, the United Kingdom switched to a new points-based immigration system. Frontier workers who wanted to commence working in the United Kingdom after this date were now required to apply for work authorization (under the new points-based system). Those individuals who had frontier worker status prior to this date were, in many cases, able to maintain that status. For UK citizens commuting and living in other EU/

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48. HM Government, *Frontier worker permit for EU citizens*, p. 2 (June 2021) available at [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/971527/Frontier\\_Workers\\_Leaflet.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/971527/Frontier_Workers_Leaflet.pdf).

49. UK Government, *Frontier workers in EU and EFTA countries* (23 June 2021), available at <https://www.gov.uk/guidance/frontier-workers-in-eu-and-efta-countries#who-is-a-frontier-worker> (accessed 16 May 2022).

50. The European Free Trade Association includes Iceland, Liechtenstein, Norway and Switzerland.

EFTA countries, consideration now has to be given on a country-by-country basis.<sup>51</sup>

In respect of frontier workers, it would appear that COVID-19 seemed to have less of an impact and consideration for the UK Government than Brexit. The only consideration given to frontier workers following the outbreak of the pandemic was in circumstances where a person was previously a frontier worker in the United Kingdom but, owing to travel restrictions, was unable to commute to the United Kingdom.<sup>52</sup>

### **32.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)**

The OECD published revised guidance in early 2021 on tax treaties and the impact of the pandemic<sup>53</sup> following travel restrictions and curtailment of business operations (including public health measures). The OECD's guidance sought to emphasize that it was seeking to promote measures that avoided double taxation but, conversely, its guidance could not be relied upon in instances of double non-taxation. It ultimately cited various examples of measures that countries across the world had chosen to adopt (or not adopt) and left it to each national tax authority to apply whichever approach it considered fit for its jurisdiction's purpose.

Despite the over-arching framework provided by the OECD and the practical guidance set out by HMRC, it is clear to see that displaced workers are a challenging landscape for tax authorities, employers and employees to navigate. "Tax authority guidance varies from one country to another and is regularly changing",<sup>54</sup> and the United Kingdom has found this to be a

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51. See country-by-country list set out at: UK Government, *Frontier workers in EU and EFTA countries* (23 June 2021), available at <https://www.gov.uk/guidance/frontier-workers-in-eu-and-efta-countries#who-is-a-frontier-worker>.

52. HM Government, *Frontier worker permit for EU citizens*, p. 3 (June 2021), available at [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/971527/Frontier\\_Workers\\_Leaflet.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/971527/Frontier_Workers_Leaflet.pdf).

53. OECD, *Updated guidance on tax treaties and the impact of the COVID-19 pandemic* (21 Jan. 2021), available at [https://read.oecd-ilibrary.org/view/?ref=1060\\_1060114-o54bvc1ga2&title=Updated-guidance-on-tax-treaties-and-the-impact-of-the-COVID-19-pandemic](https://read.oecd-ilibrary.org/view/?ref=1060_1060114-o54bvc1ga2&title=Updated-guidance-on-tax-treaties-and-the-impact-of-the-COVID-19-pandemic).

54. PwC, *United Kingdom: New HMRC and OECD guidance – time to review displaced workers*, p. 3 (29 Jan. 2021), available at <https://thesuite.pwc.com/media/11633/united-kingdom-new-hmrc-and-oecd-guidance-time-to-review-displaced-workers.pdf>.

tougher landscape to navigate with Brexit having also formalized (and thus the United Kingdom has had to renegotiate individual treaties with each Member State).

It is axiomatic to state that “COVID-19 has a continuing impact on where and how people are working, and countries are interpreting their laws and OECD guidance in different ways.”<sup>55</sup> Employees have a specific responsibility to ensure that their personal tax remains correctly assessed – comprising both their individual tax residence and also the wider tax impact of their COVID-19 displacement (even if only temporary). Even in circumstances where the UK displacement was very short, HMRC requested UK tax returns to be filed.

In keeping an eye on developments at the OECD, HMRC also continued to publish guidance – some of which remains in force and much of which had a limited time frame. One such example that fell in the latter category included guidance on COVID-19 considerations for non-residents and non-domiciled employees for 2020 to 2022.<sup>56</sup> The guidance was withdrawn on 6 April 2022. Specifically, the guidance related to various different groups of employees whose taxable earnings would have potentially been impacted following the pandemic travel restrictions.<sup>57</sup> Two groups that HMRC’s guidance was particularly focused on were, first, non-UK residents and, secondly, UK residents eligible for Overseas Workday Relief (*see* section 31.4.).

The United Kingdom has had a particularly stringent few years following its formal exit from the European Union, which has resulted in separate tax treaties having to be carried out with a whole host of states. The United Kingdom’s transition period ran until 11:00 p.m. on 31 December 2020. Until that time, most EU tax law continued to apply in the United Kingdom as though it were an EU Member State. The United Kingdom continued to be within the EU VAT regime, customs union and single market and, importantly, the UK courts continued to be able to make references to the European Court of Justice. Since officially leaving the European Union

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55. *Id.*, at p. 4.

56. HMRC, *Employment Income Manual – Appendix 5: COVID-19 considerations for non-residents and non-domiciled employees for 2020 to 2022* (EIM77045) (9 June 2022), available at <https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim77045> (accessed 12 June 2022).

57. HMRC, *Employment Income Manual – Appendix 5: COVID-19 considerations for non-residents and non-domiciled employees for 2020 to 2022* (EIM77045) (9 June 2022), available at <https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim77045> (accessed 12 June 2022).



(and exiting the transition period), the United Kingdom has entered into a new relationship with the European Union governed by the terms of the Trade and Cooperation Act – thus necessitating individual treaties to be negotiated with each EU Member State. The European Union Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises<sup>58</sup> is available to residents of the European Union and provides a complementary mechanism for mutual agreement procedure discussions. However, given the UK’s status as a “third country” for EU purposes (i.e. no longer a member), it is likely that it will have to look to the mutual agreement procedure article in any treaties agreed with EU Member States.

Most tax treaties include a mutual agreement procedure article that permits tax administrations to resolve double taxation issues via consultation and mutual agreement. Both HMRC’s Statement of Practice and guidance make it clear that:

MAP is a process which enables Competent Authorities of treaty partners to interact with the intention to resolve international tax disputes. The Competent Authorities are obliged to use their best endeavours to reach an agreement with a view to the avoidance of taxation which is not in accordance with the MAP article in the relevant tax treaty. In the UK, the Commissioners for HM Revenue and Customs (HMRC), or their authorised representatives, the UK Delegated Competent Authorities, have autonomy to enter into MAP agreements in accordance with the terms of the relevant tax treaty without being dependent on the approval or the direction of HMRC personnel directly involved with the adjustment at issue and without being influenced by policy considerations.<sup>59</sup>

The United Kingdom has one of the largest networks of tax treaties with more than 100 countries.<sup>60</sup> The aim of these treaties is primarily to eliminate double taxation of income or gains arising in one territory and paid to residents of another territory.<sup>61</sup> There exists a strong legal framework both in the United Kingdom’s treaties and in domestic legislation for the mutual

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58. 90/463/EEC: Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises - Final Act - Joint Declarations - Unilateral Declarations.

59. HMRC, *International Manual: Transfer Pricing: Methodologies: Mutual Agreement Procedure: Introduction to MAP* (INTM423010) (16 May 2022). <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm423010> (10 June 2022).

60. For a full and current list, see <https://www.gov.uk/government/collections/tax-treaties>.

61. PwC, *Individual – Foreign tax relief and tax treaties (United Kingdom)*, (30 Dec. 2021), available at <https://taxsummaries.pwc.com/united-kingdom/individual/foreign-tax-relief-and-tax-treaties#:~:text=The%20United%20Kingdom%20has%20one,to%20residents%20of%20another%20territory> (accessed 8 May 2022).

agreement procedure to be engaged in the United Kingdom, and HMRC has made it clear that:

Tax treaties seek to protect taxpayers from double taxation; provide for the appropriate allocation of taxing rights including in relation to profits from cross-border economic activities; and prevent fiscal discrimination by their signatories. The UK seeks to encourage and maintain an international consensus on the tax treatment of cross-border activity, and plays an important role in this field through its membership of the OECD. Like almost all tax treaties internationally, UK treaties follow the terms of the Model Convention in most respects and HMRC is guided in its interpretation of those tax treaties by the Commentaries on the Articles of the Model Convention.<sup>62</sup>

In other words, the mutual agreement procedure forms an important function by which HMRC and the other tax authorities it engages with can consult one another and resolve matters in relation to the application of their tax treaties. This has been recognized on numerous occasions by the UK courts (*see*, for example, the Supreme Court's decision in the case of *Fowler v Commissioners for Her Majesty's Revenue & Customs* [2020] UKSC 22).

The current reality is that mechanisms for cross-border enforcement and exchange of tax information exist through the network of tax treaties<sup>63</sup>. These treaties (as noted by some academics) are the proper place for such enforcement positions to be adopted as they have been agreed between specific sovereign nation states and provide a “constitutional framework for cross-border tax enforcement”.<sup>64</sup>

Yet, the desire for transparency (triggered in part by aggressive tax avoidance and evasion) combined with the Lockean theory of reciprocity<sup>65</sup> has fuelled several initiatives towards coming to alternative mechanisms of enforcement that “get around” the revenue rule. These include the general framework of mutual assistance, which encompasses exchange of information, assistance in the recovery of taxes and notification of liabilities<sup>66</sup> and, in particular, using international law or bilateral treaties as the vehicle to

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62. HMRC, *International Manual: Transfer Pricing: Methodologies: Mutual Agreement Procedure: Introduction to MAP* (INTM423010) (16 May 2022), available at <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm423010> (10 June 2022).

63. D.B. Debenham, *From the Revenue Rule to the Rule of The Revenuer: A Tale of Two Davids and Two Goliaths*, 56 Canadian Tax Journal 1, p. 6 (2008).

64. *Id.*

65. W.J. Kovatch, *Recognizing Foreign Tax Judgments: An Argument for the Revocation of the Revenue Rule*, 22 Journal of International Law 2, p. 281 (2000).

66. Baker et al., *International Assistance in the Collection of Taxes*, 65 Bulletin for International Taxation 4/5, p. 1 (2010), Journal Articles & Opinion Pieces IBFD.

override or circumvent the revenue rule. For example, the European Union has furthered this requirement through Recovery Directive (2010/24),<sup>67</sup> which requires mutual assistance from EU Member States with regards to recovery of claims relating to taxes, duties and other measures. The OECD has also sought to include a similar approach via article 27 of the OECD Model in order to facilitate the assistance and collection of taxes.

As noted by the Court of Appeal in *HM Revenue & Customs v. Ben Nevis (Holdings) Limited and another* (2013),<sup>68</sup> the revenue rule and support for it through cross-border assistance in collection of taxes via alternative international arrangements was that this “almost universal principle” concerning the proper ambit of the common law has been consistently recognized such that international agreements are required to depart from this established position specifically should they wish to do so. In a post-pandemic world, these mutually agreed procedures must be a more amenable way forward as opposed to pursuit through the courts.

### **32.8. The future of the mobility of work: A need for adjusting the existing treaty rules?**

For many years, tax treaties have provided a degree of protection to employees working on a short-term basis in countries other than their home countries. This was on the proviso that they were paid by their home location and their stay in their host location did not exceed 183 days (in the relevant period). There has been some argument that in “recent years more and more discussions involve the question which entity should be considered an ‘employer’ under the provisions of the double-tax treaties”.<sup>69</sup> Some argue that “covid-19 accelerated pre-existing trends”<sup>70</sup> such as discussions concerning which entity ought to properly be considered the “employer” for tax purposes. Yet, one of the key issues that came to bear in the wake of the pandemic was not of employers per se but displaced workers.

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67. Otherwise known as the Directive for Mutual Assistance in the Recovery of Duties (MARD).

68. UK: EWCA Civ, 23 May 2013, *HM Revenue & Customs v. Ben Nevis (Holdings) Limited and another* [2013] EWCA Civ 578, [6].

69. PwC, *A new kind of mobility – Economic employer approach in the CEE Region* (2013), available at [https://www.pwc.com/sk/en/publikacie/assets/2013/economic-employer-approach\\_cee.pdf](https://www.pwc.com/sk/en/publikacie/assets/2013/economic-employer-approach_cee.pdf) (accessed 8 May 2022)

70. The Economist, *supra* n. 9.

In addition, the process of digitization of the economy has also been significantly accelerated by the pandemic.<sup>71</sup> Despite slow moves being made towards hybrid and working models that are more flexible, most labour was still primarily carried out in person. “The pandemic has resulted in many behavioural shifts that could have a tax impact – amongst these are perceptions as to the need to carry out work in person.”<sup>72</sup> Following the trade-offs that the pandemic has forced businesses to consider around the world, there has been an inevitable impact on how and from where people choose to work. A question arises as to whether the existing tax treaty regime is truly fit for purpose in the post-pandemic world of 2022.

In response to considering tax policy in a post-pandemic world, the OECD issued further guidance in October 2021.<sup>73</sup> Some of the key points raised in respect of tax policy consideration for countries were:

- in adapting their tax policies to address structural challenges that countries face, they should put “growth, equity and sustainability on an equal footing”;
- tax policy has a central role in “enhancing equity” to address income and wealth distribution; and
- there is an acute need to “focus on domestic resource mobilisation” in developing countries (where tax revenues as a share of GDP were low prior to the pandemic).

Considering the impact of not only the pandemic but also Brexit, the increased cost of living and the Ukraine war, alongside the shift towards more hybrid models of working, the United Kingdom will need to continue to give active thought as to how its network of tax treaties can be developed to continue to attract business and investment without the risk of double taxation.

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71. R. de la Feria & G. Maffini, *The impact of digitalisation on personal income taxes*, 2021 British Tax Review 2, pp. 154-168 (2021).

72. Id.

73. OECD, *Tax and fiscal policies after the COVID-19 crisis* (14 Oct. 2021). <https://www.oecd.org/coronavirus/policy-responses/tax-and-fiscal-policies-after-the-covid-19-crisis-5a8f24c3/> (accessed 9 May 2022).

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## Chapter 33

### The Impact of Tax Treaties on International Mobility of Work in the United States

Doron Narotzki

#### 33.1. Mobility of work and domestic tax law

The COVID-19 pandemic has transformed numerous aspects of life in the United States. Several of the more noticeable changes have occurred in the relationship between employers and employees. Notably, there has been a dramatic increase of employees working remotely, whether from within the same state as their employer, from a different state to their employer or from outside the United States. During the COVID-19 pandemic, many employers learned that some of their employees had travelled to locations away from their normal work location. Some firms, including the accounting firm PwC, made the decision to allow employees to work permanently from any location they choose. Indeed, it seems that the phenomenon of working remotely is here to stay and has, in some ways, become the new norm. According to a survey conducted by the accounting firm KPMG, 64% of American employees would like their workplace to offer the option to work remotely.<sup>1</sup>

Working remotely raises a number of challenging tax considerations and issues for all those involved and, as a result, it is important for employers and employees to fully understand these risks and potential tax exposures. This report attempts to provide some answers and guidance in response to the questions and concerns that those working remotely may face, if they continue to perform their work remotely.

Pursuant to sections 7701(a)(30) and 7701(b) of the Internal Revenue Code (IRC), the United States imposes tax on the worldwide income of both citizens and residents regardless of the source from which that income is derived, while non-resident individuals are taxed only on their US-source income and income that is effectively connected with a US trade or business. Hence, unlike for corporations which follow the rule of place of incorporation for determining corporate residence, there are no adverse

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1. KPMG, *COVID-19 and the American Worker: Remarkably resilient with the right support* (KPMG 2020).

tax consequences for the corporation itself. If board members exercise their activities in a different jurisdiction from the residence state of the corporation,<sup>2</sup> they are subject to a lengthy and complex set of objective tests to determine their residence.<sup>3</sup> Individuals are classified as follows:

- lawful permanent residents for US immigration purposes (Green Card holders). Individuals who hold Green Cards but leave the United States for any reason and live abroad indefinitely or permanently are still classified and taxed as resident aliens until the Green Card is relinquished;<sup>4</sup>
- individuals who meet the “substantial presence test”. An individual meets the substantial presence test if they are present in the United States for at least 31 days in the current year and a combined total of 183 days during the current year and prior 2 years. For the purposes of the 183-day requirement, any part of a day the individual is present in the United States during the current calendar year counts as a full day, each day in the preceding year counts as one-third of a day and each day in the second preceding year counts as one-sixth of a day. Note that an individual who has less than 183 days of presence in the United States in the current tax year and who can establish a “tax home” in, and a “closer connection” to, another country for the entire year still may qualify as a non-resident alien, even if the 3-year, 183-day requirement is met. Note that some exceptions are available for certain students, teachers etc;<sup>5</sup> and
- newly arrived individuals in the United States, who may not satisfy the substantial presence test, may still be considered US residents if present in the United States for 31 consecutive days and at least 75% of the days in the year that begins from the first of those 31 consecutive days, and if they elect to be considered US residents.<sup>6</sup>

Nevertheless, the Internal Revenue Service (IRS) acknowledged that COVID-19 may have caused significant travel and related disruptions to some individuals who did not expect to be treated as US residents for federal tax purposes under the substantial presence test pursuant to Code Section 7701(b)(3). COVID-19 may, therefore, have impacted an individual’s qualifications for certain treaty benefits. Hence, the IRS offered a

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2. US: Internal Revenue Code of 1986, as amended, sec. 7701(a)(4) [hereinafter IRC].

3. I. Weinstock, *U.S. Tax Residency: Some Black-and-White Rules, Some Gray*, The CPA Journal (Mar. 2018).

4. Sec. 7701(b)(1)(i) IRC. It should be noted that Green Card holders are residents rather than citizens in tax treaties and, therefore, are subject to the tiebreaking rules in cases of dual residence. Citizens, on the other hand, are not subject to these tiebreaking rules, due to the saving clause.

5. Secs. 7701(b)(1)(ii) and 7701(b)(3) IRC.

6. Sec. 7701(b)(4) IRC.

temporary relief to the individual's residency rules described previously and issued Revenue Procedure (Rev. Proc.) 2020-20, which provides procedures for eligible individuals to claim the COVID-19 Medical Condition Travel Exception.<sup>7</sup>

Pursuant to Rev. Proc. 2020-20, individuals may apply the medical condition exception to exclude up to 60 days spent in the United States during a time period starting 1 February 2020 and after, and ending on or before 1 April 2020, with the specific starting date to be chosen by the eligible individuals. The Rev. Proc. also offers procedures for individuals to exclude those days of presence in order for them to claim tax treaty benefits with respect to dependent personal services income.

It is important to note that, although the reality of COVID-19 did not change dramatically during 2021, the application of Rev. Proc. 2020-20 was not extended beyond 2020. Despite this, the US Treasury Department did acknowledge that COVID-19 was still causing significant travel disruptions for individuals. For good policy reasoning, it can be argued that it would have been better if the IRS had issued an extension to allow individuals the same temporary relief it did in Rev. Proc. 2020-20.

The expatriation tax provisions (exit tax) pursuant to sections 877 and 877A of the IRC apply to US citizens who have renounced their citizenship and long-term residents (as defined in Section 877(e) of the IRC) who have ended their US resident status for federal tax purposes.

According to section 7701(b)(6) of the IRC, a long-term resident ceases to be a lawfully permanent resident if:

- the individual's status of having been lawfully accorded the privilege of residing permanently in the United States as an immigrant in accordance with immigration laws has been revoked or has been administratively or judicially determined to have been abandoned;<sup>8</sup> or
- the individual<sup>9</sup>
  - commences to be treated as a resident of a foreign country under the provisions of a tax treaty between the United States and the foreign country,
  - does not waive the benefits of the treaty applicable to residents of the foreign country; and
  - notifies the IRS of such treatment on Forms 8833 and 8854.

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7. As described in sec. 4.01 Rev. Proc. 2020-20.

8. Sec. 7701(b)(6)(A) IRC.

9. Sec. 7701(b)(6)(B) IRC.

As a result, a US long-term resident who works and therefore stays in another country for a long period of time may risk the exit tax provision.<sup>10</sup>

In a situation in which an individual works from home in the United States for a foreign corporation there is a risk, under certain circumstances, that the individual's home will constitute a permanent establishment (PE) for the employer.

A non-resident, whether an individual or a corporation, is taxed in the same way as a US resident if “engaged in a trade or business” in the United States.<sup>11</sup> That is, they are taxed on the US source income that is “effectively connected” with that trade or business.<sup>12</sup> If the foreign corporation elects to be taxed pursuant to the provisions of a US income tax treaty, it will generally only be subject to US tax on its profits that are attributable to a US PE. Generally, the threshold for a foreign corporation engaged in a US trade or business is lower than those that would create a US PE.<sup>13</sup>

A non-resident is considered to be engaged in a US trade or business if its activities in the United States are “considerable... as well as continuous and regular,”<sup>14</sup> and the standard for determining the existence of a US trade or business is both qualitative and quantitative.<sup>15</sup> A non-resident employee working remotely in the United States as an agent presents the most difficult questions with regards to what constitutes a US trade or business. Such a

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10. Generally, sec. 877A IRC imposes a mark-to-market regime. Therefore, all property of a covered expatriate is deemed sold for its fair market value on the day before the expatriation date. Any gain arising from the deemed sale is taken into account for the tax year of the deemed sale, notwithstanding any other provisions of the IRC. Any loss from the deemed sale is taken into account for the tax year of the deemed sale, to the extent otherwise provided in the IRC, except that the wash sale rules of sec. 1091 IRC do not apply.

The amount that would otherwise be includible in gross income by reason of the deemed sale rule is reduced (but not to below zero) by USD 600,000, which amount is to be adjusted for inflation for calendar years after 2008 (the exclusion amount).

The amount of any gain or loss subsequently realized (i.e. pursuant to the disposition of property) will be adjusted for gain and loss taken into account under sec. 877A IRC mark-to-market regime, without regard to the exclusion amount. A taxpayer may elect to defer payment of tax attributable to property deemed sold.

11. Sec. 864(b) IRC.

12. Secs. 871(b) and 882 IRC.

13. Internal Revenue Service (IRS), *Creation of a PE through the Activities of Seconded Employees in the United States* (3 Sept. 2014), available at [https://www.irs.gov/pub/int\\_practice\\_units/TRE9450\\_06\\_02.pdf](https://www.irs.gov/pub/int_practice_units/TRE9450_06_02.pdf).

14. US: CCA, 17 July 1940, *Pinchot v. Commissioner*.

15. US: SC, 4 Dec. 1944, *Commissioner v. Scottish American Investment Co., Ltd.* “It is a matter of degree, based upon a quantitative and a qualitative analysis of the services performed, as to where the line of demarcation should be drawn.”



non-resident employee may very likely create a US trade or business for their employers.<sup>16</sup>

It is also important to know that the threshold for business activities in the United States in order to constitute a US trade or business is relatively low and, for example, selling inventory on a regular basis resulting from activities in the United States will meet this threshold.<sup>17</sup> Even if an employee working remotely in the United States is only demonstrating products and soliciting orders, the IRS may consider such activity enough to meet the threshold; in such a case, the employee would be considered to be engaged in a US trade or business, even if the foreign employer does not have a US office.<sup>18</sup>

US income tax treaties define a US PE as a fixed place of business in the United States through which a foreign corporation conducts its business. Generally, a foreign corporation will not be deemed to have a US PE if its activities in the United States are limited to preparatory or auxiliary activities. However, a foreign corporation may be considered to have a US PE if activities are undertaken on its behalf by a dependent agent who has the authority to sign contracts in the United States that are binding on the foreign corporation. Hence, assuming that a foreign corporation is taxed pursuant to a US income tax treaty, and that the employee working remotely in the United States is not an agent of the foreign corporation, the foreign corporation has a low risk of establishing a PE in the United States.

Worker classification is critical, as this is how an employer determines if it must withhold income taxes and pay social security, Medicare taxes and unemployment tax on wages paid to an employee.<sup>19</sup> Normally, employers do not have to withhold or pay any taxes on payments<sup>20</sup> to independent contractors.<sup>21</sup> The earnings of a person working as an independent contractor are subject to self-employment tax.<sup>22</sup>

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16. US: TC, 23 Apr. 1953, *Jan Casimir Lewenhaupt v. Commissioner of Internal Revenue*.

17. US: TC, 17 Jan. 1955, *Frank Handfield v. Commissioner of Internal Revenue*.

18. US: Rev. Rul. 56-165, 1956-1 C.B. 849, Primary Sources IBFD.

19. <https://www.irs.gov/businesses/small-businesses-self-employed/independent-contractor-self-employed-or-employee> (accessed 11 Mar. 2024). See also <https://www.irs.gov/businesses/small-businesses-self-employed/employee-common-law-employee> (accessed 11 Mar. 2024).

20. <https://www.irs.gov/businesses/small-businesses-self-employed/reporting-payments-to-independent-contractors> (accessed 11 Mar. 2024).

21. <https://www.irs.gov/businesses/small-businesses-self-employed/independent-contractor-defined> (11 Mar. 2024).

22. <https://www.irs.gov/taxtopics/tc554> (accessed 11 Mar. 2024).

Whether a worker or individual is considered to be an independent contractor or employee depends on the facts of their situation (facts and circumstances test). The general rule is that an individual is considered to be an independent contractor if the payer has the right to control or direct only the result of the work, but not how the work will be done and what will be done exactly.<sup>23</sup>

If a US corporation pays remote employees who work outside the United States, the wages of these employees are generally still subject to social security and Medicare tax. Some countries will impose a social security tax on the wages of remote employees. However, the United States has agreements with several countries, including Canada and France, to avoid this kind of double taxation.

In addition to the federal tax system in the United States, there is also the state tax system, which is, to some extent, different from one state to another. Working remotely or telecommuting also presents state tax considerations. While this report does not focus on state tax issues, a brief explanation is important in order to comprehend the US tax system as a whole.

Generally, with regard to state tax, there are two important questions to answer. First, does an employee working from home or telecommuting create a taxable nexus for the employer in that state? Second, which state has the taxing rights when an employee is working from home or telecommuting from an out-of-state location. The term “nexus” in the context of US state tax refers to the nature and regularity of interactions that an out-of-state corporation must establish in a state before it is subjected to that state’s tax laws and jurisdiction. A nexus is created by a taxpayer according to several factors: physical presence,<sup>24</sup> factor presence and economic presence.<sup>25</sup> The threshold to create a nexus is relatively low,<sup>26</sup> and states have indicated that the presence of one to six telecommuters, depending on the state, will give rise to an obligation to file a state income return for an out-of-state corporation.<sup>27</sup>

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23. <https://www.irs.gov/businesses/small-businesses-self-employed/independent-contractor-self-employed-or-employee> (accessed 11 Mar. 2024).

24. For instance, sales, property or payroll of a certain percentage or amount.

25. For instance, value or frequency of transactions in a state.

26. Following the US Supreme Court decision in *US: SC*, 21 June 2018, *South Dakota v. Wayfair*, states have adopted the “economic nexus factor presence standard”, which means states will claim taxpayer’s nexus if the sales, property or payroll in a specific state exceeds a certain monetary or transaction-based threshold.

27. <https://www.cpajournal.com/2021/07/16/tax-implications-of-covid-19-telecommuting-and-beyond/> (accessed 11 Mar. 2024).

### 33.2. Residence, tiebreaker rules and mobility of work: Individuals and entities

The United States has over 60 tax treaties with other contracting states.<sup>28</sup> Although US citizens and permanent residents are not permitted to use the provisions of a tax treaty to avoid the taxation of US source income, tax treaties may provide residents of contracting states with a reduced tax rate or sometimes even an exemption from US taxes on certain types of income they receive from sources within the United States. In addition, US residents and citizens may be taxed at a reduced tax rate or have an exemption from foreign taxes on certain types of income they receive from sources within the contracting state.

The United States has its own model treaty (US Model), which was last updated in 2016 and, prior to that, in 2006 and 1996. This model treaty serves as the US benchmark for every US tax treaty negotiation process. In the context of this report on the mobility of work, the differences with other model treaties are, for the most part, not significant or meaningful. When there are significant or meaningful differences, this report will address those specifically.

The residence analysis in the OECD Model Tax Convention on Income and on Capital (OECD Model) starts with the domestic law of the contracting state of which an individual claims to be a resident for tax treaty purposes.<sup>29</sup> An individual is not a resident of a contracting state for tax treaty purposes if that individual is taxed only on income sourced in that state or on business profits attributable to a PE within that state. An individual is a resident of a contracting state for treaty purposes if they are subject to tax on worldwide income under that contracting state's applicable domestic law. In general, the process for determining an individual's residency for tax treaty purposes is as follows:

- (1) analyse US residency claim, i.e. determine whether the individual is a US resident under US domestic law by determining whether the individual is a US citizen or a US resident alien under the lawful permanent resident, physical presence or first-year election tests;
- (2) analyse treaty country residency claim, i.e. determine whether the individual is a resident of a country that has a tax treaty with the United States; and

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28. <https://www.irs.gov/businesses/international-businesses/united-states-income-tax-treaties-a-to-z> (accessed 11 Mar. 2024).

29. *OECD Model Tax Convention on Income and on Capital*, art. 4(1) (21 Nov. 2017), Treaties & Models IBFD.

- (3) apply treaty's residency tiebreaker rules. If it is determined that an individual is a resident of both contracting states, then the treaty's residence tiebreaker rules apply.

Step (3) leads to the tiebreaker rules and tests, which are as follows:

- *Permanent home test.* A permanent home is one that is retained for permanent and continuous use;
- *Centre of vital interests test.* This test determines in which state the individual's personal and economic relations are closer, i.e. it assesses the location of the individual's personal, community and economic relations;
- *Habitual abode test.* An individual's habitual abode is located in the contracting state in which the individual has a greater presence during a calendar year. Although the length of time is not specified, the comparison must cover sufficient length of time and take into account the intervals at which the stays take place for it to be possible to determine where residence is habitual; and
- *Nationality test.* A national of a contracting state is an individual who is either a citizen or who possesses the nationality of that contracting state. An individual who is not a US citizen is unlikely to be defined as a US national under the tiebreaker rules in US tax treaties.

Non-resident alien individuals who perform services or other activities in the United States and foreign corporations who employ individuals or engage individuals as agents to perform services or other activities in the United States may be considered engaged in a US trade or business (USTB). If the individuals performing those services or other activities are temporarily in the United States solely due to COVID-19 travel disruptions, this may cause the non-resident alien or foreign corporation to become engaged in a USTB – which would not be the case if these individuals were not present in the United States. Generally, a non-resident alien or foreign corporation that is engaged in a USTB is taxable on its business income connected to that USTB.

If a US income tax treaty applies, however, the non-resident alien individual or foreign corporation generally will not be liable to federal tax on the income of its USTB (i.e. on its business profits) unless the business is wholly or partially conducted through a PE in the United States (the host country), such as an office or other fixed base, permanent location or a dependent agent.

A non-resident alien, foreign corporation or a partnership in which either is a partner (“affected person”) may choose an uninterrupted period of up to 60 calendar days, beginning on or after 1 February 2020 and ending on or before 1 April 2020 (the COVID-19 Emergency Period). During this period, services or other activities conducted in the United States will not be taken into account in determining whether the non-resident alien or foreign corporation is engaged in a USTB, provided that such activities were performed by one or more individuals temporarily present in the United States and which would not have been performed in the United States but for COVID-19 travel disruptions.

An “individual temporarily present in the United States” means an individual who was present in the United States on or after 1 February 2020 and on or before 1 April 2020, and who is either a non-resident alien, US citizen or lawful permanent resident who had a tax home (as defined in section 911(d)(3) of the IRC) outside the United States in 2019 and who reasonably expects to have a tax home outside the United States in 2020.

The IRS has determined that, during the COVID-19 Emergency Period,<sup>30</sup> services or other activities performed by a non-resident alien, foreign corporation or a partnership in which either partner is temporarily present in the United States will not be taken into account to determine whether the non-resident or foreign corporation has a PE, provided that the services or other activities of these individuals would not have occurred in the United States but for COVID-19 travel disruptions.<sup>31</sup>

The PE risk grows, however, when the remote working model ceases to be temporary and changes to a more permanent arrangement. In this case, a PE may be triggered in the remote-work location, and the employer may face potential double taxation, penalties and interest.

The threshold for a PE in many tax treaties applies to an “enterprise” of the other contracting state and generally means any activity that constitutes the carrying on of business.<sup>32</sup> The term “business” generally includes the performance of professional services and other activities of an independent

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30. Beginning on or after 1 Feb. 2020 and ending on or before 1 Apr. 2020.

31. IRS, *FAQs for Nonresident Alien Individuals and Foreign Businesses with Employees or Agents Impacted by COVID-19 Emergency Travel Disruptions* (updated 30 Jan. 2024), available at <https://www.irs.gov/newsroom/faqs-for-nonresident-alien-individuals-and-foreign-businesses-with-employees-or-agents-impacted-by-covid-19-emergency-travel-disruptions> (accessed 11 Mar. 2024).

32. Art. 3(1)(c) *OECD Model*.

character.<sup>33</sup> These two definitions clarify that income from the performance of professional services or other activities of an independent character comes under article 7 of the OECD Model (Business Profits) and not article 21 (Other Income). As a result, it is more likely than not that almost any economic activity by a resident of a treaty country creates an enterprise.<sup>34</sup> An enterprise, however, does not meet the threshold for taxation of its business profits in the other country pursuant to most tax treaties unless it is engaged in that country in a “business” from which it derives profits.<sup>35</sup> With the lack of definition in tax treaties for terms such as “being engaged in a trade or business” or “doing business”, and by virtue of the general clause contained in every income tax treaty, these terms will be interpreted according to the meaning they have in US domestic tax law. Hence, the term “business” is widely understood to have the same meaning as the IRC’s concept of “trade or business” as it applies to foreign taxpayers.<sup>36</sup> Therefore, if all the employees of a corporation work from home, and that corporation no longer has (sufficient) workplaces, the corporation will still probably meet the substance requirements to enjoy the tax treaty benefit.

It should be noted that, until a short time ago, before the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Sharing (MLI), article 4(3) of the OECD Model referred to “place of effective management”. The US Model does not refer to such a test and instead addresses the issue in article 4(3)(d), stating that if an individual is a national of both contracting states or of neither of them, the competent authorities of the contracting states should settle the question by mutual agreement. Often US tax treaty partners require US citizens and residents to provide them with a US residency certificate in order to claim any available and potential income tax treaty benefits, and/or certain other tax benefits, in those foreign countries. The IRS, upon formal request, provides this residency certification as Form 6166, a letter of US residency certification, and this meets the requirements for proving US residency.

### **33.3. Permanent establishments and mobility of work**

Pursuant to the IRC, a foreign company that carries on a trade or business in the United States is subject to tax the same way as US corporations

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33. Art. 3(1)(h) *OECD Model*.

34. The term “enterprise” extends to corporations, other business entities and individuals.

35. Art. 7(1) *OECD Model*.

36. US: TC, 15 Apr. 1958, *Herbert v. Commissioner*.

with respect to income effectively connected to its US trade or business. However, a foreign company that elects to be taxed under an applicable US income tax treaty will only be subject to US tax on its profits which are attributable to a US PE.

The exact forms and/or type of PE vary from one tax treaty to another, and reflect the negotiations between contracting states.<sup>37</sup> Nonetheless, the threshold for the taxation of business profits in the US Model (2016) is generally set relatively high, as historically the United States has always preferred, or leaned toward, taxation by county of residence rather than country of source.

The definition for PE in article 5(1) of both the OECD Model and the US Model states that a PE means a “fixed place of business.” The term “fixed place of business” is further developed under article 5(2). However, this does not necessarily help in the case of individuals who are working from home. Nonetheless, it is clear that the amount of time and the level and nature of activity are both relevant in determining whether a fixed place of business exists in the United States.<sup>38</sup> For instance, though engaging in just one horse race is a trade or business, the IRS agreed that a single race was not enough to meet the threshold for a PE,<sup>39</sup> while participating in several horse races may very well meet that threshold.<sup>40</sup> Therefore, it seems more likely than not that the permanent home office of an individual who works for a foreign company would meet the threshold for a PE if that individual also meets the requirement under article 5(5), i.e. they are acting on behalf of a foreign company and have, and habitually exercise, an authority to conclude contracts in the United States in the name of that foreign company. The circumstances in which a self-employed person triggers a dependent agent PE have been determined by the courts to depend on whether an agent was legal and economically independent.<sup>41</sup>

Paragraph 18 of the Commentary on Article 5 of the OECD Model<sup>42</sup> makes it clear that, even if part of a business is carried out or conducted in or through an individual’s home office, that fact alone does not necessarily mean that the home office is at the disposal of that individual’s employer.

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37. For instance, the income tax treaty between China and the United States sets the threshold for a PE much lower than the *US Model* (2016).

38. US: TC, *Consol. Premium Iron Ores Ltd. v. Comm’r of Internal Revenue*.

39. US: Rev. Rul. 58-63, 1958-1 C.B. 624, Primary Sources IBFD.

40. US: Rev. Rul. 60-249, 1960-2 C.B. 264, Primary Sources IBFD.

41. US: TC, 2 May 1995, *Taisei Fire & Marine Ins. Co. v. Comm’r of Internal Revenue*.

42. Art. 5(18) *OECD Model*.

A home office may be a PE if it is used on a continuous basis for carrying on the business of a corporation, and if that corporation has required the individual to use that location to carry on the enterprise's business. Although the US Model does not provide the same explanation with regards to home office, this analysis is consistent with US domestic tax laws.

Paragraph 2 of the Commentary on Article 7 to the US Model<sup>43</sup> provides an example that income from a transaction that is booked in a particular branch (or home office) will not be treated as attributable to that location if the sales and risk management functions that generate the income are performed in another location. Paragraph 2 of the Commentary on Article 7 to the US Model provides an example that a portion of the interest expense recorded on the books of the home office in one state may be deducted by a PE in the other if properly allocable thereto, and that the amount of expense that must be allowed as a deduction is determined by applying the arm's length principle.

It should be noted that the US Treasury did not issue any specific rules with regards to PEs and the specific and unique circumstances COVID-19 may have created with regards to them. Similarly, in a situation in which there were competing taxing rights as a result of employees working remotely in a different state during COVID-19,<sup>44</sup> the Supreme Court of the United States declined to hear the case, following the US Solicitor General's amicus brief that argued against the Supreme Court taking it up.<sup>45</sup>

With regards to digital nomads and US citizens, the place of residency is irrelevant. If a person is legally considered a US citizen and does not meet any of the exclusions, that person will have an obligation to file a US tax return and pay their tax liability.<sup>46</sup> If a digital nomad meets certain requirements, they may qualify for the foreign earned income exclusion (FEIE), the foreign housing exclusion and/or the foreign housing deduction. However, in order to claim these benefits, a taxpayer must have foreign-earned income, a tax home in a foreign country and also must be one of the following:

- a US citizen who is a bona fide resident of a foreign country for a period that includes an entire tax year;
- a US resident alien who is a citizen or national of a country with which the United States has an income tax treaty in effect and who is a bona

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43. Art. 7(2) *US Model*.

44. US: SC, 23 Oct. 2020, *New Hampshire v. Massachusetts*.

45. <https://www.scotusblog.com/case-files/cases/new-hampshire-v-massachusetts/> (accessed 11 Mar. 2024).

46. Form 1040, US Individual Tax Return.



- fide resident of that foreign country for an uninterrupted period that includes an entire tax year; or
- a US citizen or resident alien who is physically present in a foreign country for at least 330 full days during any period of 12 consecutive months.

If a digital nomad is a US citizen or a resident alien of the United States but lives abroad, they are still taxed on their worldwide income. However, they may qualify to exclude their foreign earnings from income up to an amount that is adjusted annually for inflation (USD 108,700 for 2021, USD 112,000 for 2022 and USD 120,000 for 2023), and also exclude or deduct certain foreign housing amounts.<sup>47</sup>

If a digital nomad is a non-resident in the United States, the situation becomes a little less clear or obvious. *Balanovski* (1955)<sup>48</sup> might be instructive, as a case in which an individual worked in the US for 8 months as an independent agent of the Argentinian government. The threshold to convince the court that a non-resident individual was engaged in a trade or business in the United States is very low.

### 33.4. Physical presence according to articles 15(1) and 17 of the OECD Model

Article 15 of the OECD Model and article 14 of the US Model state that income from employment should be taxable in the residence state unless the employment is exercised in the other contracting state, in which case it should be taxed there. For US federal tax purposes, if employment is exercised in the United States through a home office, it should be taxed by the United States. The home office will more likely than not be considered a PE, and the employee is engaged in a trade or business that is effectively connected with the conduct of the US trade or business.<sup>49</sup> In this regard, it does not make any difference if the home office is imposed by government measures.

With regards to the issue of artistes and athletes, article 17 of the OECD Model and article 16 of the US Model both take the same approach and

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47. <https://www.irs.gov/individuals/international-taxpayers/foreign-earned-income-exclusion> (accessed 11 Mar. 2024).

48. US: DC (SDNY), 19 May 1955, *United States v. Balanovski*, 131 F. Supp. 898.

49. Sec. 864(c) IRC.

strengthen the taxing right of the country of source. However, the US Model is slightly different to the OECD Model in that, under article 16(1), the US Model specifically exempts those artists and athletes who earn less than USD 30,000 “for the taxable year of the payment”.

Travel restrictions during COVID-19 made international travel more complicated. As a result, some employees were prevented from returning to their state of residence. Generally, the United States taxed those “stranded workers”. However, for purposes of the residency test, days that do not count towards the residency test include those on which a given individual was unable to leave the United States because of a medical condition and those on which an individual worked as a foreign government employee, teacher, student or professional athlete.<sup>50</sup>

The source rule for services such as performances and shows is straightforward. A non-resident providing services in the United States is deemed to be engaged in a trade or business in the United States and the compensation thereof is treated as effectively connected income, taxable under section 871(b) of the IRC. Compensation for services performed outside the United States is not subject to US taxation.<sup>51</sup>

In the situation of stranded workers who, due to travel restrictions, are prevented from returning to their state of residence or to the state in which they usually exercise their employment, the US generally offers a substantial presence test. An individual is not required to count days on which they were unable to leave the United States due to a medical condition.<sup>52</sup> Therefore, it is likely that if an individual was unable to leave the United States due to COVID-19, this same relief may be applicable.

### **33.5. Article 15(2) and (3) of the OECD Model**

Article 5(2) of the OECD Model and its equivalent in the US Model (article 14(2)) state that compensation derived by a resident of a contracting state from employment exercised in the other contracting state is taxable only in the first contracting state if the recipient has been present in the other contracting state for a period or periods not exceeding, in the aggregate, 183 days for all 12-month periods commencing or ending in the taxable

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50. Sec. 7701(b)(3)(D) IRC.

51. Treas. Reg. 1.861-4(b)

52. <https://www.irs.gov/individuals/international-taxpayers/substantial-presence-test> (accessed 11 Mar. 2024).

year concerned. Home office days in the state of residence are counted for the purpose of the 183-day rule. Moreover, if an employee has a home office, that office may be considered a PE if it meets the threshold of PE as discussed in section 33.3. Generally, if an individual continued to work from home even after the government ended the COVID-19 public health measures, their home office may be considered to have a certain degree of permanence. However, further analysis of all facts and circumstances is still needed in order to determine whether this constitutes a fixed place of business PE. If the home office is at the disposal of the corporation following the end of the COVID-19 public health measures, the likelihood of the home office meeting the threshold becomes significantly higher. However, it is very unlikely that in the case of individuals teleworking from home as a result of COVID-19 public health measure imposed by the US government, this would create a fixed place of business PE for the business/employer.

COVID-19 brought many changes to the way corporations and their employees operate in the United States. It seems that article 15 of the OECD Model can be improved through the inclusion of some reference to the now-common situation in which employees work from home and not from a formal office. An individual who is working from home in a different country does not use the infrastructure and services where the corporation is located. Hence, the taxing rights should be at least divided in a different way, so the country whose infrastructure and services are being used is appropriately compensated.

### **33.6. Frontier Workers**

The frontier worker situation in the United States differs to that between EU Member States. There are many frontier workers in the United States, from both Mexico and Canada. The provisions related to these frontier workers are settled only in domestic law and the trade agreement between the three states (the fairly new USMCA agreement, which was preceded by the NAFTA agreement) rather than the tax treaties. This basically exempts these frontier workers from the US residency substantial presence test.

### **33.7. Mobility of work and the justification and legal basis of COVID-19-based rules (consultations or mutual agreements)**

During the COVID-19 pandemic, Congress approved, and President Trump signed, the Coronavirus Aid, Relief, and Economic Security (CARES) Act, a massive tax-and-spending package intended to provide economic relief to address the impact of the COVID-19 pandemic. The CARES Act became law on 27 March 2020. However, the act did not include any rules applicable to tax treaties, directly or indirectly.

During the COVID-19 pandemic, the Canadian Revenue Agency issued guidance stating that certain US residents who typically work in Canada but are not usually present in Canada for more than 183 days and who, for this reason alone, are not taxable in Canada on their employment-derived income, may, due to travel restrictions, stay and work in Canada for an extended period of time. This guidance confirmed that, until the earliest of certain events occurs – for instance, when an employee returned or was able to return to their jurisdiction of residence – and only until 31 December 2020, those days would not be counted in the 183-day test in the US tax treaty with Canada.<sup>53</sup>

From a US federal income tax point of view, other than the temporary relief order given to individuals pursuant to Rev. Prov. 2020-20 (no longer applicable), which also applied to the application of tax treaties, the application of tax treaties to a taxpayer is irrelevant. This is the case whether an individual chose voluntarily to work in a certain country or was forced to make such a decision due to COVID-19 travel restrictions.

### **33.8. The future of the mobility of work: A need for adjusting the existing treaty rules?**

Some of the current US tax treaty rules, and even the US international tax source rules, seem to be outdated in situations such as a performance via Zoom to US viewers by an individual who is present in another country. The current rule of personal services will allow the performer to avoid US tax, even though the performance is only for US viewers. Moreover, there are hospitals in the United States that provide medical advice at night using

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53. <https://www.canada.ca/en/revenue-agency/campaigns/covid-19-update/guidance-international-income-tax-issues.html> (accessed 11 Mar. 2024).

doctors who are situated in Australia. The personal services rule is outdated because, at the time it was designed and implemented, the idea of such situations as those described was unimaginable; a reality in which personal services could be provided from different jurisdictions was not possible. COVID-19 not only made such examples possible, it also made them a common way of doing business and providing services. The author believes that the personal service rule should be revised to focus on the end point, meaning the place in which the services are actually being given. In the case of performances via Zoom or hospitals using doctors in Australia, the place of service is the United States. However, there is currently no discussion in the United States regarding the US tax treaty policy, and for political reasons it is also unlikely that such a discussion will occur in the near future.



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After 8 years at PwC, he received a proposal to lead the biggest group of companies in Moldova with entities specialized in real estate, hospitality, finance banking and media industries.

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