



# HONG KONG TAX ALERT

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## OECD COVID-19 analysis

### Summary

On 3 April, the OECD issued an analysis examining tax treaties and the impact of the COVID-19 crisis on cross-border workers. A number of key tax issues are addressed including the risk of a company creating a permanent establishment or taxable presence in a new jurisdiction and changes to the tax residence status of an individual as a result of key staff being forced to work in a location other than their normal place of work.

The OECD's guidance provides a pragmatic approach designed to prevent taxpayers facing unforeseen tax difficulties as a result of the unprecedented crisis. However, it is not without some limitations as the guidance primarily deals with the position under OECD-model treaties rather than liabilities that may arise under domestic law.

### Background

The OECD issued an analysis on 3 April examining tax treaties and the impact of the COVID-19 crisis. A number of potentially significant tax concerns may arise as a result of key staff being forced to work in a location other than their normal place of work. These include accidentally causing a company to be resident in a location other than intended, accidentally creating a permanent establishment or other taxable presence in a new jurisdiction and changes to the tax residence status of the individual concerned. The OECD analysis is helpful in this regard, setting out the view that COVID-19 measures are generally exceptional and should not normally impact on a company or individual's tax status under tax treaties in a particular jurisdiction. We note however, that construction projects appear to be an exception where delays as a result of the virus may result in a permanent establishment being created.

The OECD's guidance will be helpful for many taxpayers who have been concerned about the impact staff dislocation may have on their tax position. However, it is worth noting that it is only guidance, and is not binding, especially on the many jurisdictions in this region that are not OECD members. Further, the paper primarily deals with the position under OECD-model treaties rather than liabilities that might arise under domestic law. We note that a number of jurisdictions, such as the UK and Australia, have also issued their own guidance setting out the domestic law position and trust that other jurisdictions will take a similar approach, although taxpayers will need to monitor this on a case-by-case basis. Finally it is worth noting that, while the OECD generally encourages a position of maintaining the status quo ante, those taxpayers who were already sailing close to the wind in terms of maintaining their requisite presence for residence or substance purposes may find their positions have become more difficult.

### Detailed comments

#### 1. Permanent establishments

The OECD considers it unlikely that employees working from home in a different jurisdiction from that in which they habitually work would create a permanent establishment risk in the new location. As this situation is temporary and exceptional, it would not generally have the requisite degree of permanency to create a fixed place of business. In addition, carrying on intermittent business activities at home as a result of government directives does not put an employee's

home at the disposal of the enterprise. In general, for a home office to create a permanent establishment, an enterprise generally has to require that employee to use their home and for them to do so on a continuous basis. Where a separate place of employment is made available to the employee, the exceptional use of a home office is unlikely to be a fixed place of business.

Similarly, the functions exercised from home, even if they involve significant roles in the conclusion of contracts, are unlikely to be regarded as habitual. Where an employee is only working from home as a result of force majeure or government directives, any activities they undertake should not be regarded as habitual. However, the situation may be different where an individual was already habitually concluding contracts in their home country before the outbreak.

Finally, the OECD notes that any temporary break in construction projects as a result of the pandemic should be included in the duration of the project for the purposes of calculating whether there is a permanent establishment. This may mean that some projects originally slated to fall within the relevant *de minimis* limit in the treaty may now run over the limit and result in a taxable presence. Developers should review their situations in this regard.

## 2. Corporate residence

Similarly to the position on permanent establishment, the OECD is of the view that the temporary relocation of board members to a different location as a result of COVID-19 should not have an impact on a company's residence. It is worth noting on practical terms, however, that the strength of this analysis depends on which version of the treaty is in use. The most recent, 2017, version of the model convention settles cases of dual residency by mutual agreement between the authorities. The OECD commentary (Article 4, paragraph 24.1) gives a range of factors to be considered, including where board meetings are usually held, where the chief executive officer and other senior officials usually undertake their duties, where the company's headquarters are and where day-to-day management is usually carried on. The OECD is of the view that in most cases this should lead to no change of conclusion if senior executives are temporarily located abroad.

The pre-2017 model convention was more mechanical and requires jurisdictions to look at the company's place of effective management. All relevant factors must be considered. The OECD notes that some states interpreted the place of effective management as being ordinarily the place where the senior person or group of persons make management decisions. This implies some may have a different interpretation. So while the OECD's stance is clear, it appears there is still scope for some jurisdictions to take a different view.

## 3. Cross-border workers

Where an employee lives in one jurisdiction but works in another, any employment-related income remains taxable in the first instance in the location where they used to work. This applies equally in the case of government subsidies during the COVID-19 crisis. According to the OECD's analysis, such subsidies most closely resemble termination payments which the OECD commentary attributes to the place where employment took place.

## 4. Individual residence

The OECD considers it unlikely that an individual's residence would be affected by the COVID-19 situation. They note that this is only the case where there is a treaty in place – absent a treaty, a simple “days-present” test may well result in residency and it would be a matter for the host country to determine what relief to grant. They note that the UK, Ireland and Australia have already done this.

They envisage two basic scenarios. One is a person stranded overseas having travelled on holiday or a short business trip. Assuming that person meets the domestic residence requirements of both jurisdictions, the normal tie breaker in the first instance would be where the individual had a permanent home, and that would almost always be their home country.

The second scenario is more complex, where someone who normally lives abroad and has residence there has returned to their previous jurisdiction of residence. In this case, they may have ties to the previous jurisdiction which makes the outcome of the tie-breakers less clear or potentially tip the balance from one place to another. However, ultimately the competent authorities would need to consider the habitual abode of the individual and the OECD's view is that this should be considered over a sufficiently long period of time. They consider it would be inappropriate to base it on an exceptional circumstance such as COVID-19.

### KPMG Observations

Overall, the OECD's analysis is to be welcomed as a pragmatic approach designed to prevent taxpayers facing unforeseen tax difficulties as a result of the crisis. For the most part, it recommends jurisdictions concluding that taxpayers retain the same tax profile as they had before the outbreak. Nonetheless, it does note some limitations to this approach:

- 1) It is only applicable where there is a double tax treaty in place; absent this, domestic law provisions may be much more stringent or less flexible than the standard treaty provisions. Hong Kong, in particular, does not have treaties with a number of significant locations, meaning that the existing low thresholds for carrying on business and the 60 day test for salaries tax may still apply.
- 2) Many treaties have variations from the OECD model convention.
- 3) Borderline cases may be placed in a more difficult position – while it is unlikely that a large company is going to face difficulties because its chief executive got stuck overseas on a business trip, individuals or companies with a less clear residential status still risk the effects of the virus tipping the balance. While the OECD discourages this, it will ultimately be down to the interpretation of the tax authorities concerned;
- 4) On a wider basis, the attitude of individual authorities is clearly going to be critical to how businesses are impacted. The OECD refers to several authorities which have already issued guidance on these matters under their domestic laws and it is hoped others will follow suit.
- 5) Not all taxes are covered by treaties, so state and provisional taxes or social security contributions may still require separate analysis.
- 6) Slightly out of kilter with the tone of the rest of the analysis, it appears that there may be a genuine impact on the taxability of construction projects as a result of the disruption of the virus.

Although not expressly mentioned by the analysis, the move to restrict the extent to which a permanent establishment may arise as a result of COVID-19 measures should also assist employees who are currently working outside their usual country of residence as it would generally give them 183 days' grace before their employment income became taxable overseas provided the employee continues to work solely for the benefit of an overseas employer and the cost of employment is borne overseas.

On the other hand, the OECD's guidance is premised on short, accidental presence. It does not cover what happens if the current situation were to extend for more than half a year, but parts of the analysis may be susceptible to challenge where the new arrangements are strictly speaking a matter of choice rather than enforced by law.

It's comments on cross-border workers are unlikely to be of practical help to anyone who normally works in Mainland China but is resident in Hong Kong and currently forced to work from Hong Kong. On a practical level, both sides are likely to regard themselves as having the right to tax the income and it is unlikely in view of this that a tax credit will be available for the double tax paid. While we hope the relevant authorities can come to a pragmatic view in light of the special circumstances, concerned individuals should consult their tax advisors.

While the guidance should provide a degree of reassurance for taxpayers during the disruption, it is important that taxpayers and their advisors work together to understand what their exposures might be, which are likely covered by treaties and what the approach of the relevant jurisdictions concerned will be. We would encourage the Hong Kong Inland Revenue Department to follow the lead of overseas authorities in issuing their own guidance on these issues confirming that Hong Kong would not seek to impose a tax charge, either under domestic law or a tax treaty, if a person has a taxable presence in Hong Kong only as a result of extraordinary measures resulting from COVID-19.

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