April, 2020

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Pandemic Legal intelligence

International Tax Perspective - Part II

Place of Effective Management - Corporate Tax Residency

Legal intelligence Series - COVID | XXX

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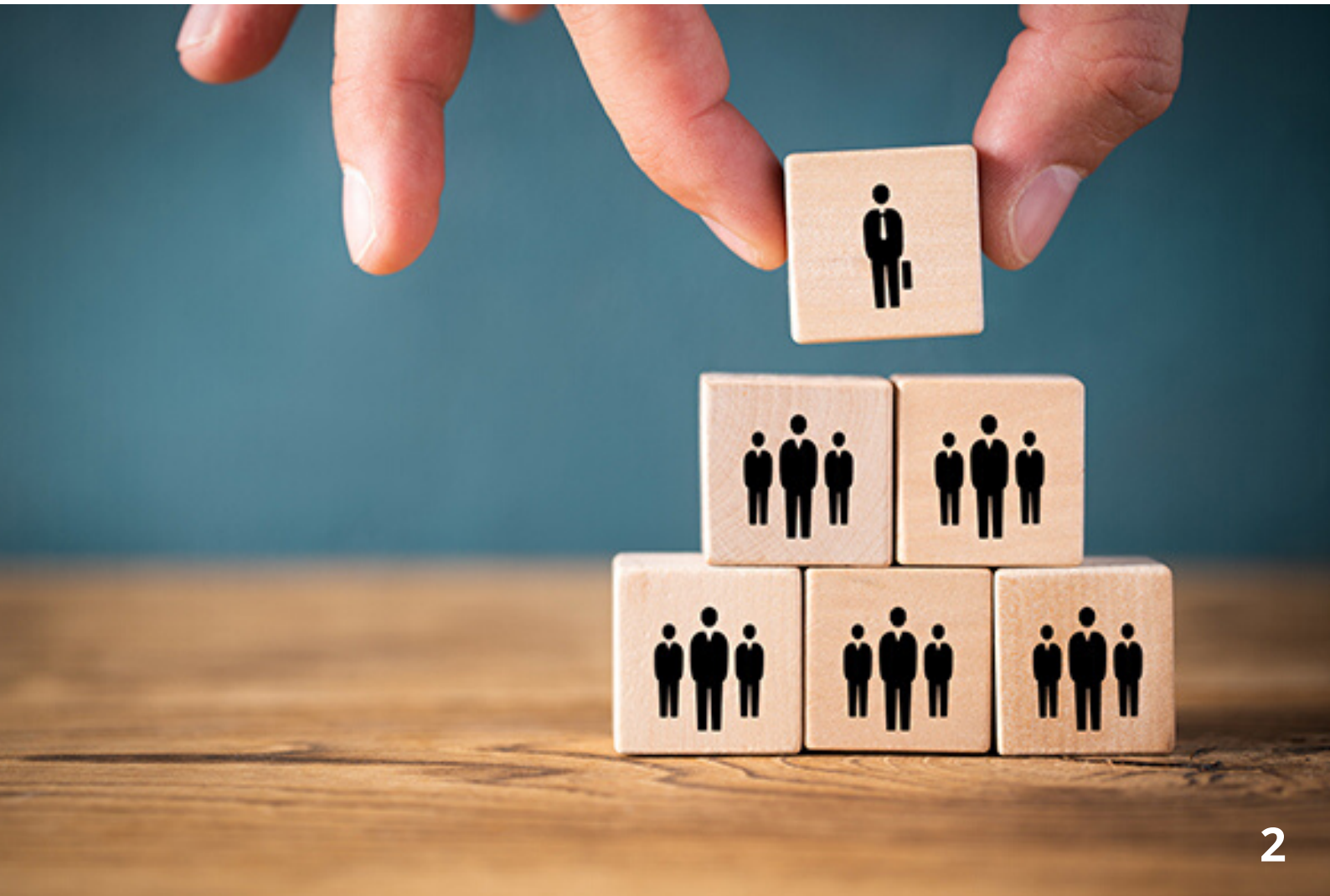
Introduction

Businesses are currently dealing with a multitude of issues as a result of the measures taken to stop the global spread of the COVID-19. One aspect that might not currently feature at the top of the list is the **maintenance of corporate tax residency**.

This has the potential to fall through the cracks when faced with bigger and more urgent issues. But it is an issue on which tax and legal teams needs to address over the coming weeks and months.

Corporate tax residency dictates where a company will be taxed on its worldwide profits (subject to any exemptions).

A company is generally tax resident in the country where it is incorporated or where it has its 'Place of Effective Management' ("POEM")



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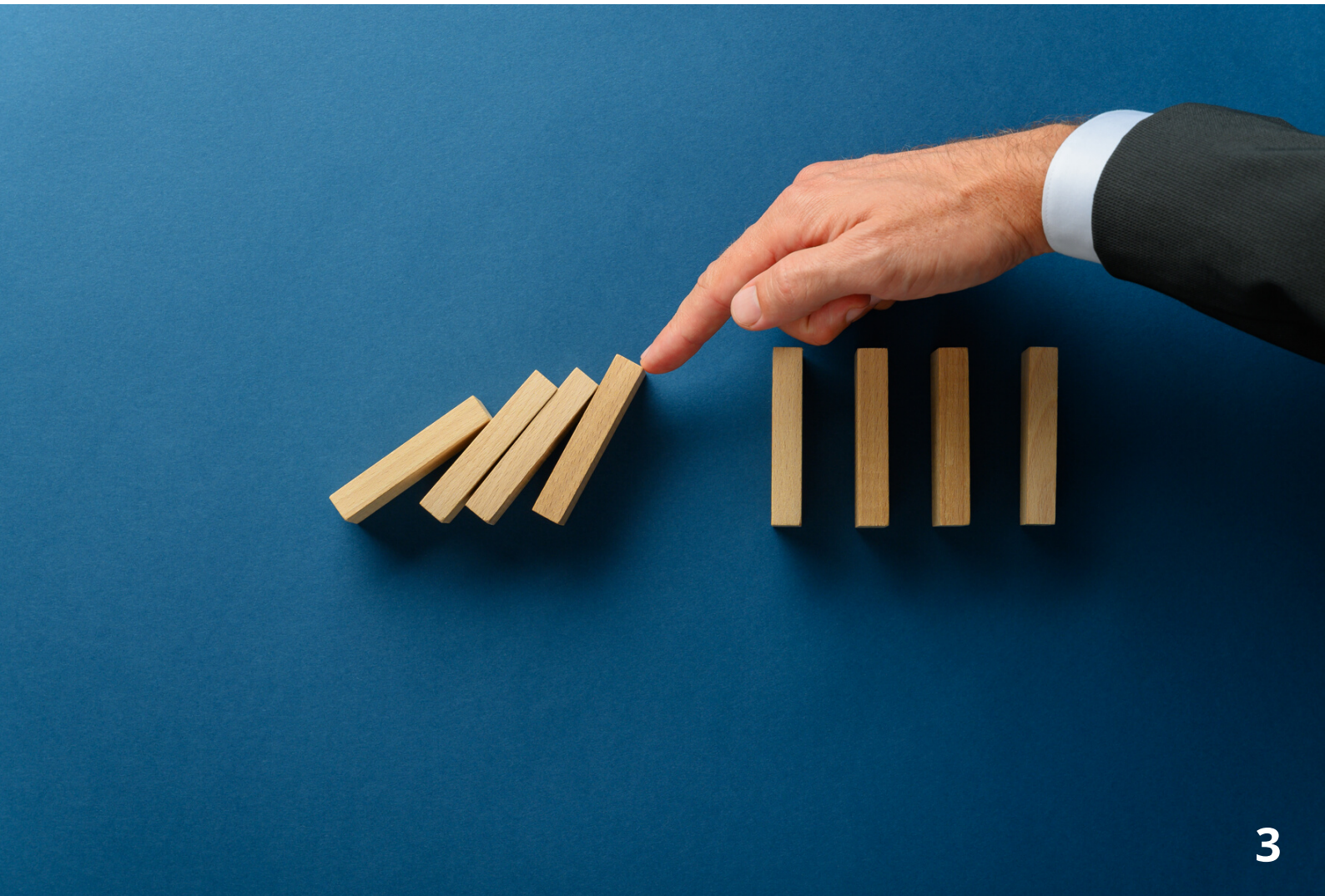
What is Place of Effective Management ("POEM")?

The OECD MC has defined POEM as :

The place where key management and commercial decisions that are necessary for the conduct of the business as a whole are in substance made and that all relevant facts must be examined to determine POEM.

POEM has being recognized in India by amendment in section 6(3) of Income tax Act, 1961 under finance act, 2015, which states that a company is said to be resident in India in any previous year, if it is an Indian company, or its place of effective management in that year is in India.

POEM is an internationally recognized residency concept adopted in tie-breaker rule of Indian treaties as also adopted in many jurisdictions.



Creation of Place of Effective Management

OCED Guidelines, 2020 has shown its view on the COVID-19 crisis that it 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.

The concern is that such a change may have as a consequence in company's residence under relevant domestic laws and affect the country where a company is regarded as a resident for tax treaty purposes.

It seems that the current pandemic situation might not create any changes to an entity's residence status under a tax treaty as a temporary change in location of the the directors, or chef officers is an extraordinary and temporary situation due to the COVID-19 crisis and such change of location should not trigger a change in residency of corporates in view of tie breaker rule.

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Key factors determining POEM

Producing the results that is required or intended, in reality, although not officially intended, the term “effective” should be understood in sense of "real".

Key management and commercial decisions should mean decisions which are concerned with broader strategic and policy decisions and tend to be made by members of the Senior Management / Key Management personnel's.

Senior Management Personnel's ("SMPs") / Key Management Personnel's ("KMPs") means the top level executives / employees of a company who are generally responsible for taking the key Management and Commercial decisions for the Company.

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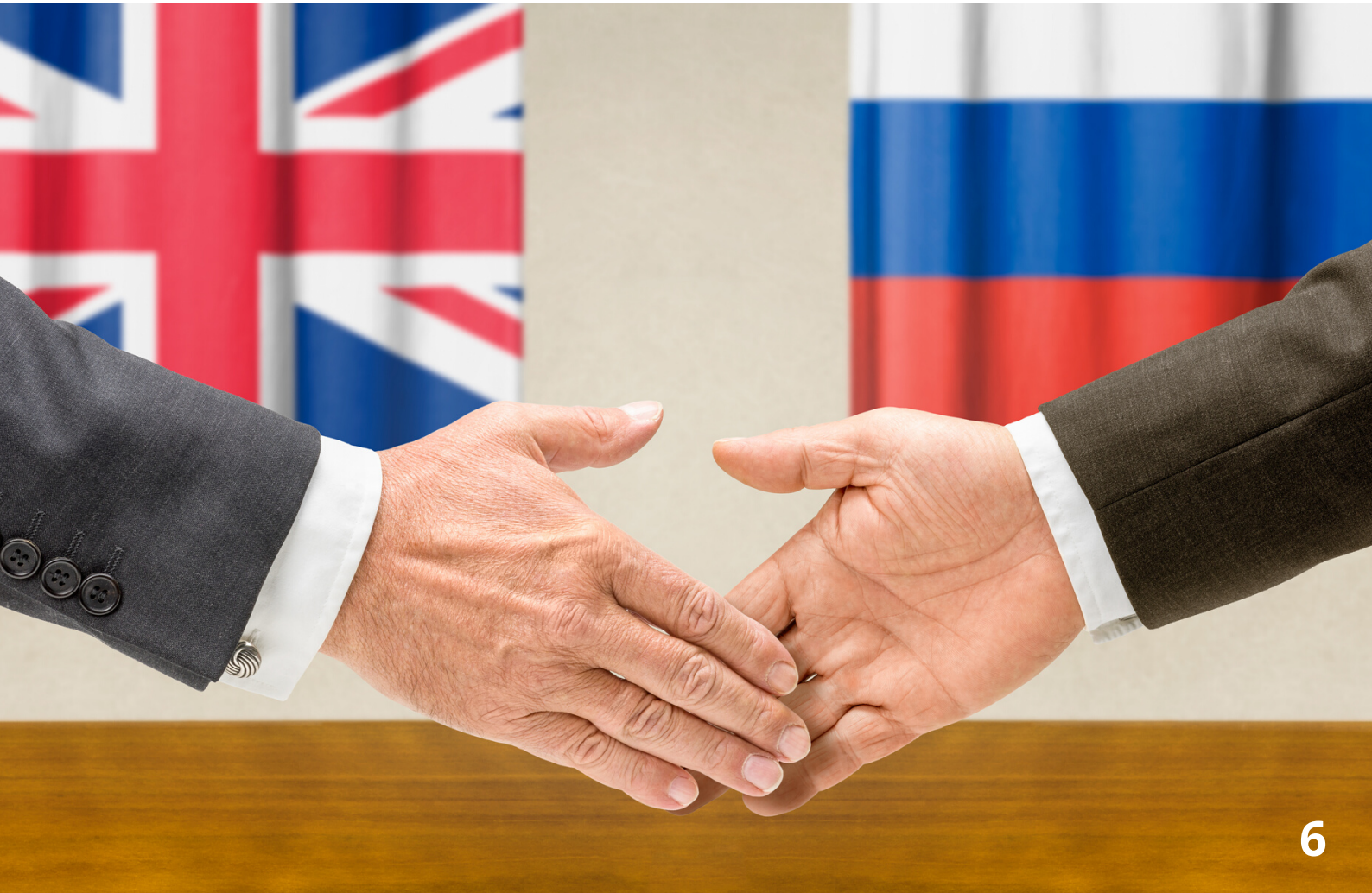
Dual Residency

COVID-19 may trigger an issue of double residency i.e. the company gets considered having its Place of effective management at two different countries simultaneously in their domestic laws.

Tie-breaker rules are included in tax-treaties to help to determine, which country has the right to tax an individual as the country of residence in case the individual qualifies as a resident (for tax purposes) under the domestic laws of both countries.

During this extraordinary situation tax treaties between two countries provides for tie breaker rules to determine the double residence of an entity, ensuring that the entity is resident in only one of the country.



Tie Breaker Rules - Way to determine Dual Residency

As per recent OECD Guidelines, 2020 ;

If the treaty contains a provision like the 2017 OECD Model tie-breaker rule, competent authorities deal with the dual residency issue on a case-by-case basis by mutual agreement. This determination will take into consideration all of the facts and circumstances over the determination period.

In particular, paragraph 24.1 of the OECD Commentary on Article 4 illustrates the range of factors that the competent authorities are expected to take into consideration to make their determination.

In situations where the treaty contains the pre-2017 OECD Model tie-breaker 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.

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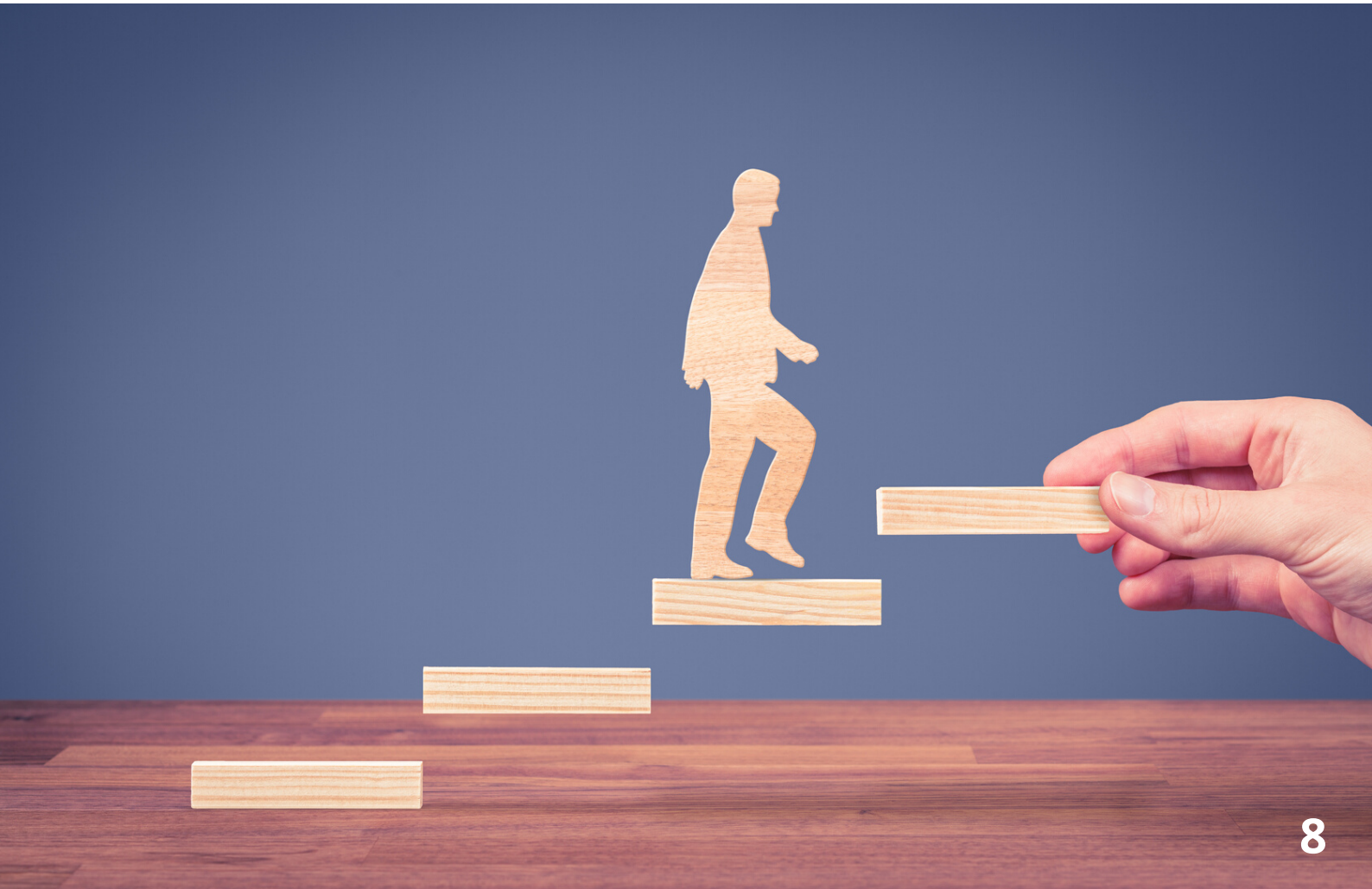
Continuing need for Local Country Guidance

The OECD Analysis recognizes that the threshold presence required by domestic law to register for tax purposes may be lower than under tax treaties, and tax registration requirements may be triggered under local law.

There also are taxes that are not covered by treaties, including sub-national taxes (e.g., state and local income taxes) and indirect taxes such as sales tax or value-added taxes.

Tax administrations are encouraged by the OECD to provide guidance that would minimize or eliminate unduly burdensome compliance requirements for taxpayers during the COVID-19 crisis.

To this end, certain jurisdictions have issued guidance on to COVID-19 providing various relaxation to the foreign companies in view of COVID-19.



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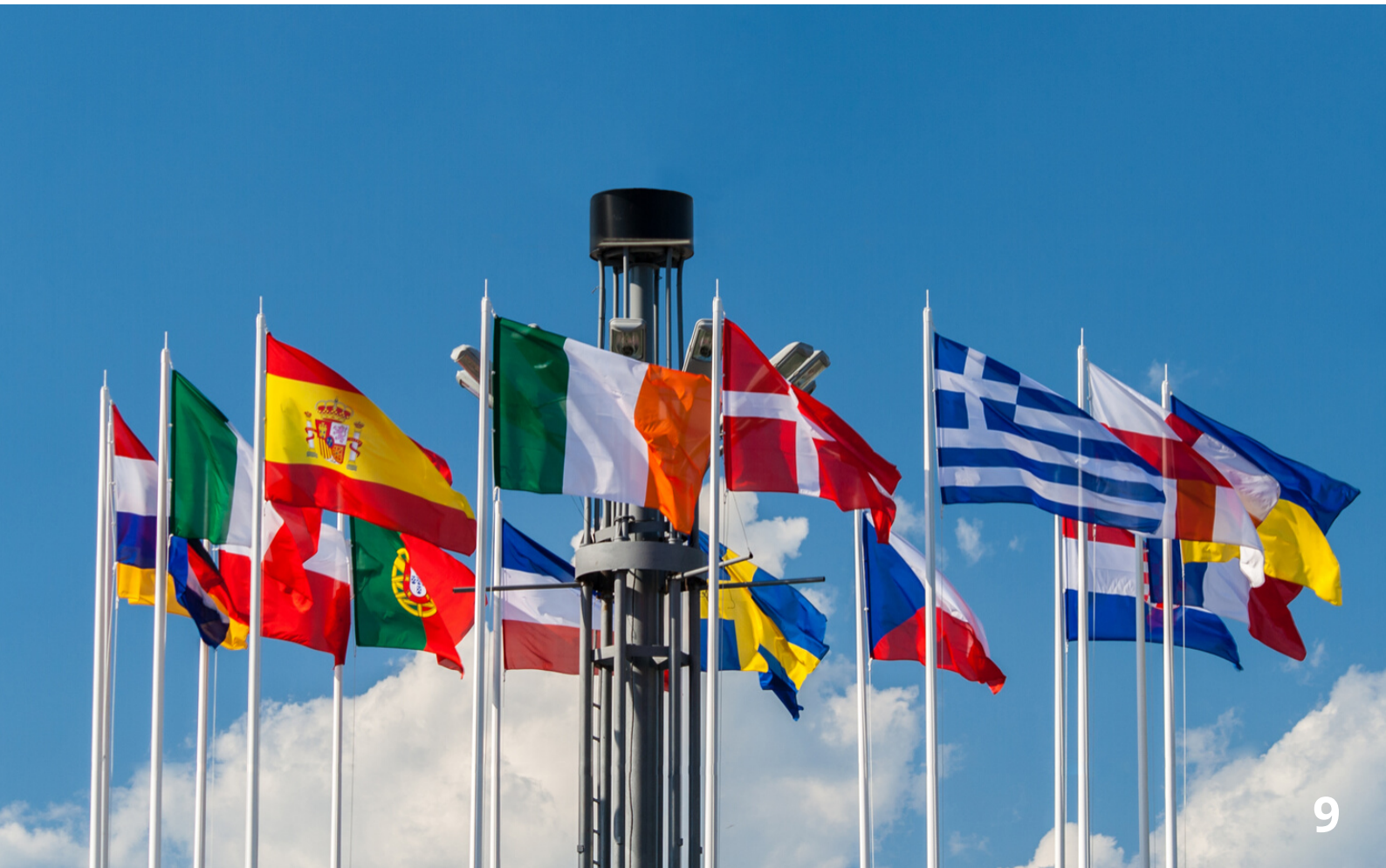
Irish Revenue

In light of the numerous travel restrictions and other measures imposed by countries arising from the COVID-19 outbreak, companies may need to consider how they conduct their business in the coming weeks and months in order to ensure that their corporate tax residency status is safeguarded.

On 23 March 2020, Irish Revenue released eBrief No. 046/20 to provide advice and information to taxpayers and their agents during the COVID-19 pandemic.

Irish Revenue has provided guidance on the topic of corporate tax residency and presence in or outside Ireland resulting from COVID-19 related travel restrictions

Irish Revenue have advised that, in the above scenarios, the relevant individual and company should both maintain records of the fact and circumstances of the bonafide presence in or outside Ireland (as the case may be) should Irish Revenue seek evidence that such presence in fact resulted from COVID-19 related travel restrictions.



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Her Majesty's Revenue and Customs (HMRC) - UK

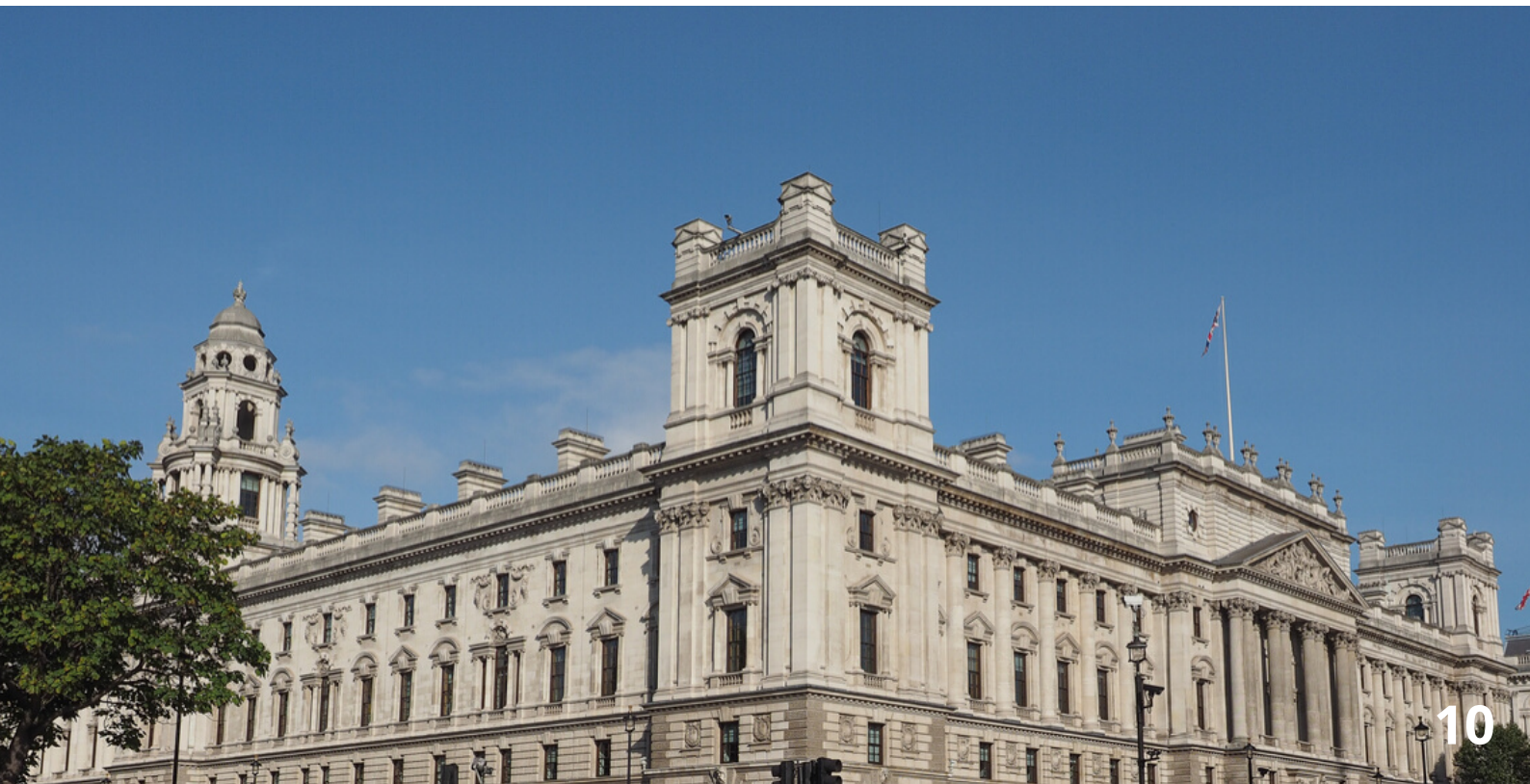
On 7 April, 2020, HMRC updated its published guidance to discuss the concern on Permanent Establishments in current pandemic era

In relation to whether the presence of employees or directors in the UK could result in foreign companies becoming UK tax resident, certain guidelines are issued such as:

If a company is considered dual-resident (i.e. in the UK and another country) then a Double Tax Treaty ("DTT") tie-breaker test would operate to settle this. There are two possible tie-breakers depending on the treaty.

Place of effective management (e.g. the UK-Germany DTT) – This test will require consideration of all facts and circumstances and a company's place of effective management can only be in one place at any one time.

Mutual agreement procedure ("MAP") – This will be the test adopted in many of the DTTs amended by the OECD Multilateral Instrument ("MLI"). Residence will be decided by mutual agreement between the two tax authorities concerned. Various factors will be taken into account by the tax authorities – however, importantly the outcome of such a procedure cannot be predicted.



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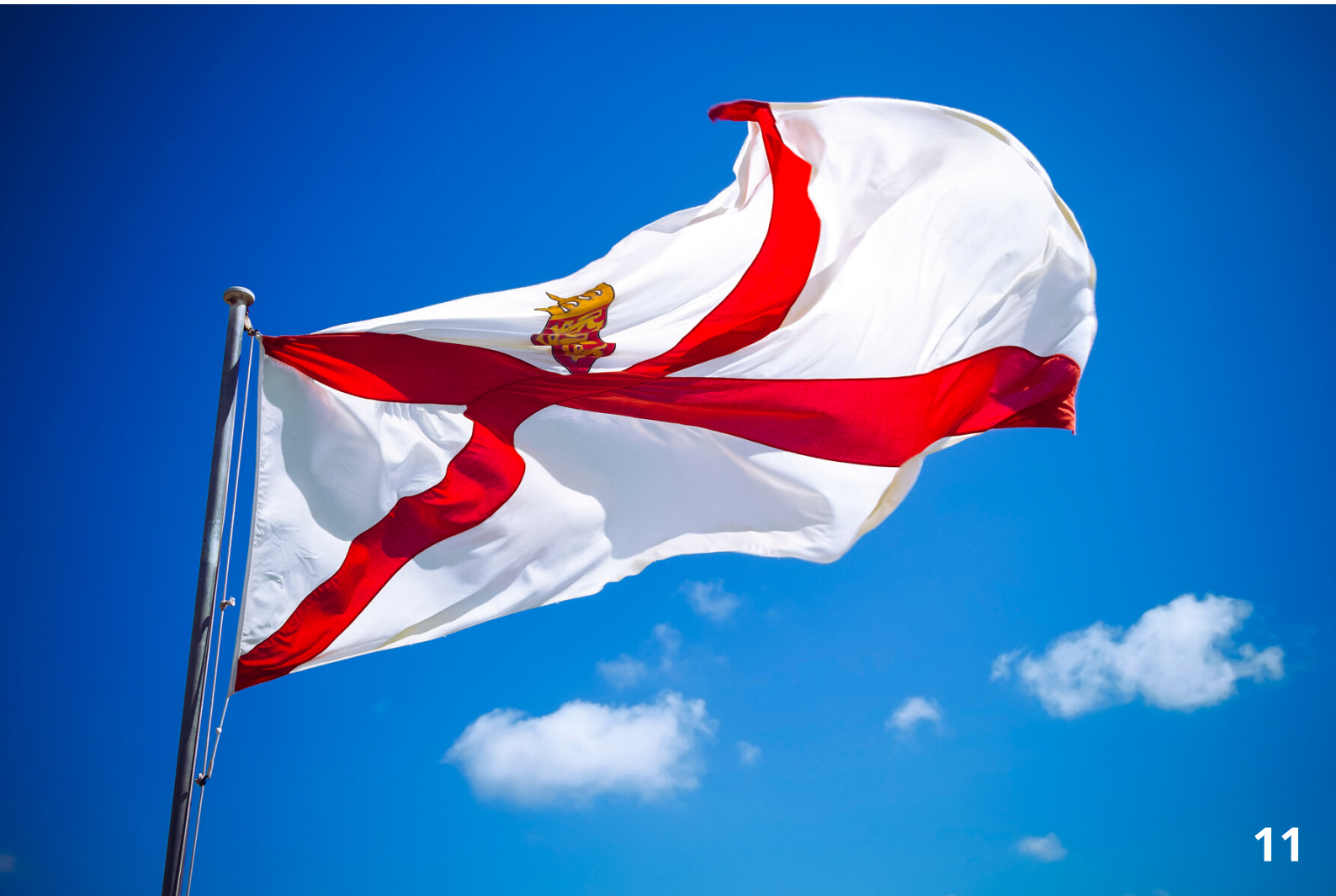
Tax residency – Jersey

The Government of Jersey's Comptroller of Revenue has issued certain guidelines in line with HMRC :

Government of Jersey's Comptroller of Revenue has confirmed that where companies' operating practices have to be adjusted in response to the COVID-19 pandemic.

The Comptroller will not treat the company as having failed the economic substance test.

The Comptroller has also confirmed that such adjustments will not disturb the tax residence in Jersey of foreign registered companies, provided that the changes are temporary



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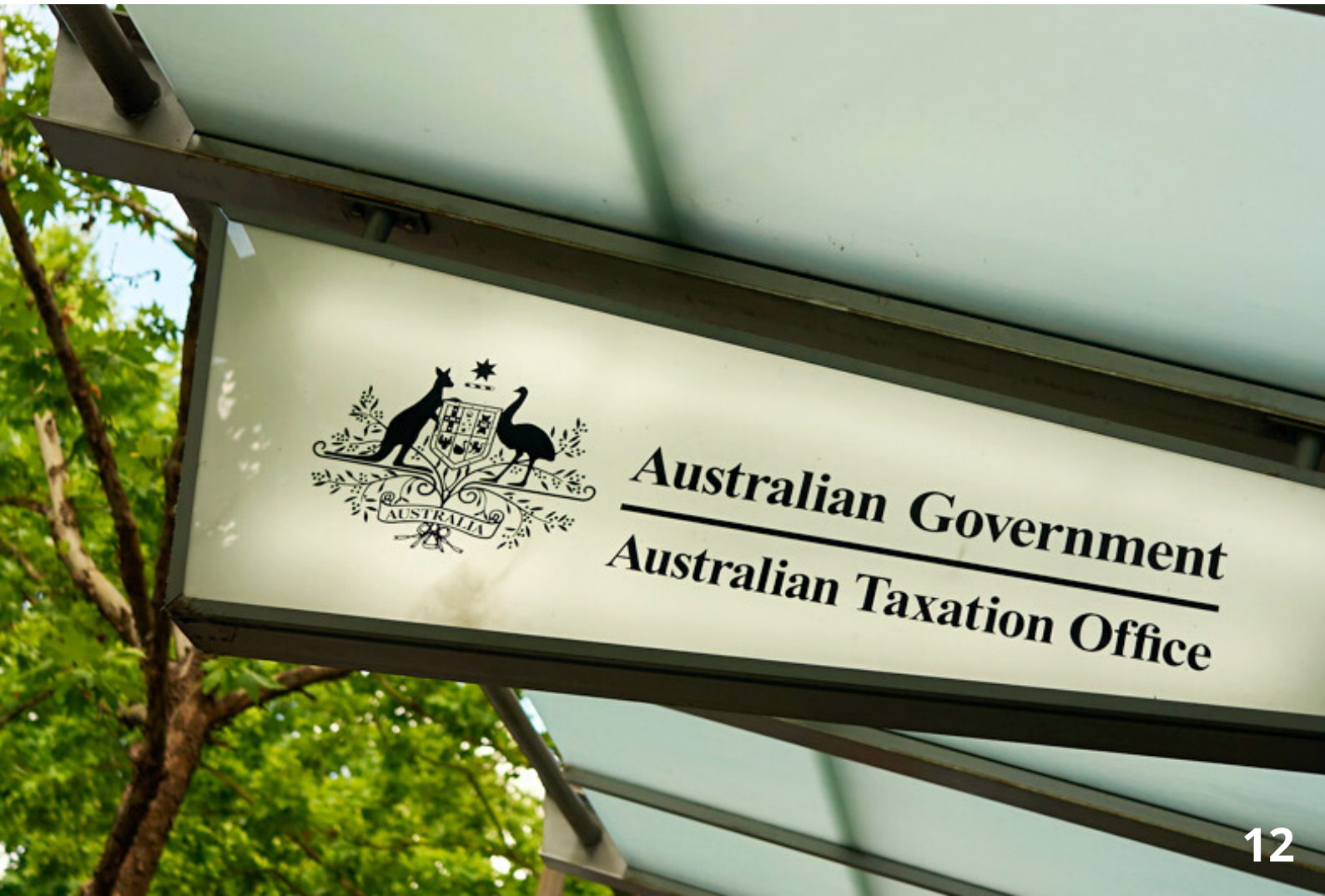
Australian Taxation Office ("ATO")

The Australian Taxation Office ("ATO") has issued frequently asked questions ("FAQs") to provide guidance on tax questions about the impact of COVID-19, including on Corporate residence :

A non-Australian incorporated company can be treated as resident in Australia if it carries on business in Australia and has its central management and control in Australia.

The FAQs state that if the only reason for holding board meetings in Australia or directors attending board meetings from Australia is because of impacts of COVID-19 (i.e., travel bans or the board deciding to halt international travel due to COVID-19),

Thus the above situation that by itself will not affect the company's residency status for Australian tax purposes.



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Conclusion

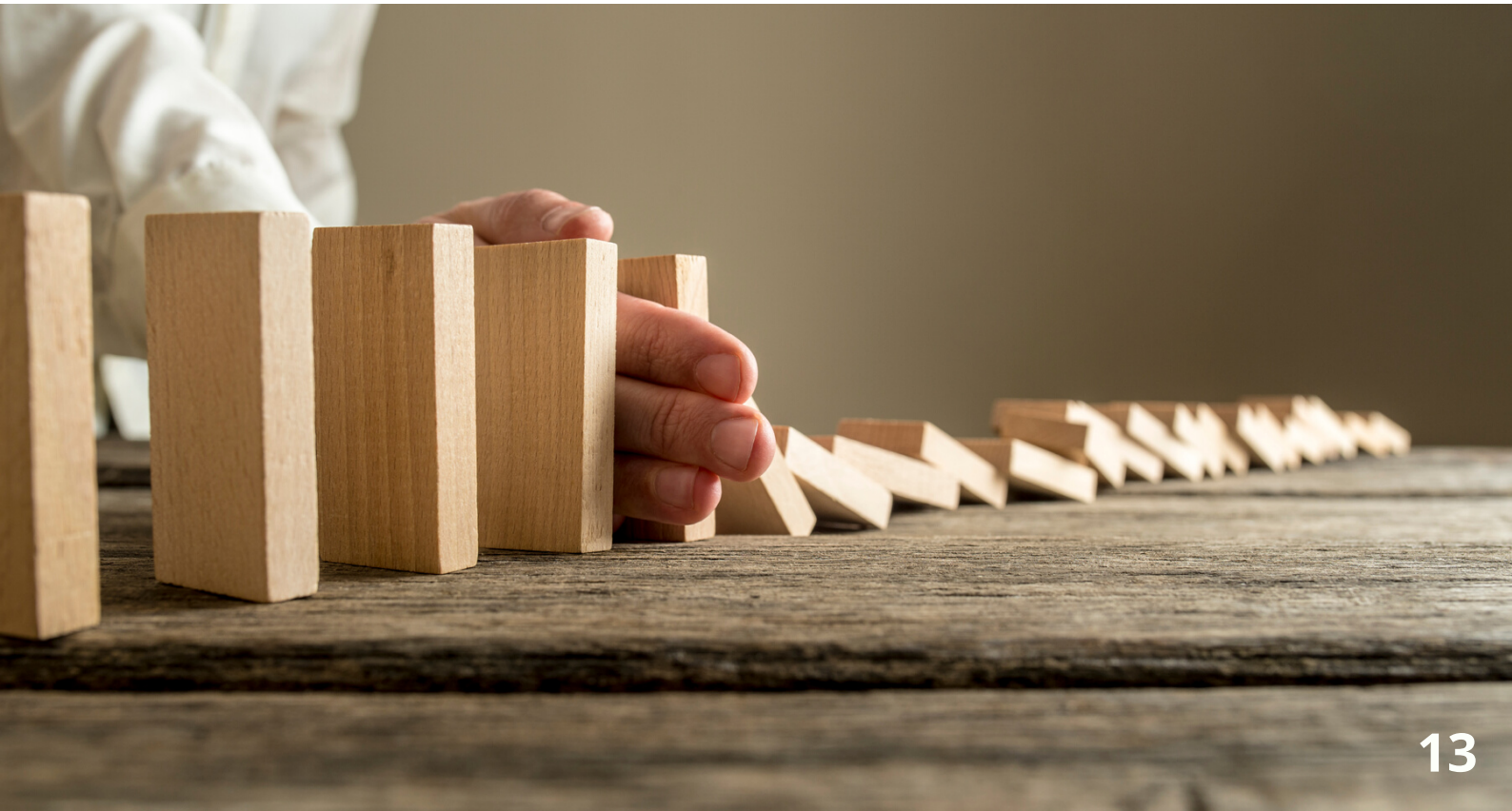
Authorities across the globe are rapidly employing short-term protective measures against the economic impacts of COVID-19. The efforts include measures support businesses and their employees.

The company must self-assess the location of its place of effective management. Where the treaty has a tie-breaker which depends on the agreement of the competent authorities of the two states.

The potential effect of the changes during the COVID-19 era could be a trigger of double residency, which, according to the OECD Secretariat, is a relatively rare case. Nonetheless, it is of the view that the tie-breaker rule in tax treaties would deal with this challenge.

Though the POEM, guidelines issued by the OECD and various other local government are clear on the aspect of corporate tax residency but time would be the essence to understand as to the applicability of these laws, and guidelines during COVID-19.

It is very crucial for companies to analysis and plan there tax structures to stand out in the present pandemic era.



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ABOUT US

AMLEGALS is a multi-specialised law firm. We would love to hear your views, queries, feedback and comments on **covid19@amlegals.com** or **rohit.lalwani@amlegals.com.**

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