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Covid-19: Impact Analysis on the Indian Economy, International Tax and Transfer Pricing



Karnik Gulati

Through this paper, the author has mainly analysed the impact of Covid-19 on the Indian economy, international taxation, and transfer pricing aspects. The author has refrained himself, as much as possible, to talk about numbers as those, in his opinion, usually depict a rosier picture than the ground reality.

1. Introduction

Covid-19, as we all know, has been a curse to the mankind. While we all wished for the year 2020 to end soon, to make a fresh start to our handicapped lifestyle, work style, etc., but little did we know that the year 2021 will be even more challenging due to subsequent wave hitting some countries.

India did reasonably well last year in controlling the spread of pandemic by imposing a strict two-month lockdown from end of March 2020 to end of May 2020. Of course, that came at a huge cost as it impacted the businesses in numerous ways, including disruption in supply chain, reduced logistical activities, demand and supply risk, change in consumer preferences, restricted access to markets, management and people impact, liquidity challenges, impact on brand value, etc. It also impacted the people physically, mentally, and economically as quite a few lost their loved ones, lost their income source – in form of losses in business leading to shut down, or job losses.

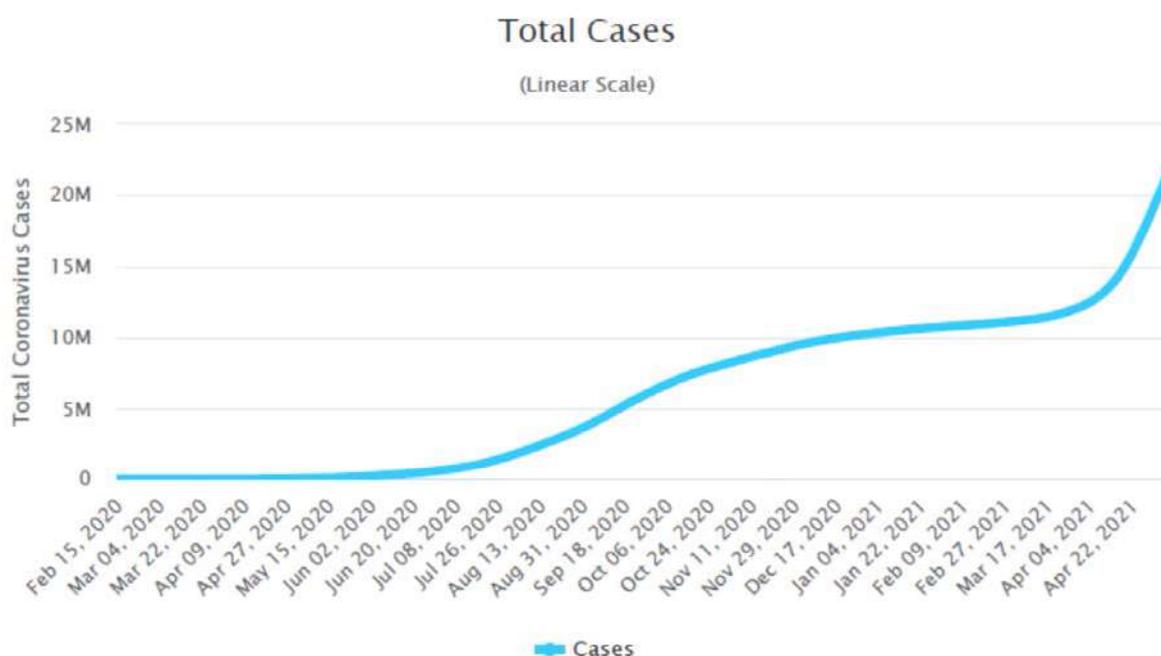
India, being a developing country, with a huge population, had challenges unique to itself. It was a dilemma of lives vs. livelihood for the government, but with little choice left, the restrictions were gradually eased with adequate safety instructions to ensure that the economy gets back on its feet. The economy did show few signs of recovery (at least on paper), mostly a V-shaped one, with a hope of reinvigorating it once again, but all of this was short-lived. Little did we know or, rather, had an inkling – but conveniently chose to ignore – the possibility of subsequent wave of the virus – this time even more venomous.

It all started again somewhere in the month of March this year when the cases rose rapidly, and it was in the month of April that the things started to get out of control. This compelled state governments to take their own calls – the Central government chose not to interfere this time. Whether that was the right way to deal with it or not is another story for another time. Nonetheless, this led India to surpass Brazil in second most cases in the world behind the USA. The total Covid-19 cases in India as on 8 May 2021 stands at 21.89 million¹. A pictorial representation² of sudden spike in cases is as under:

¹ <https://www.worldometers.info/coronavirus/country/india/>

² <https://www.worldometers.info/coronavirus/country/india/>

Figure 1: Covid-19 cases progression in India



2. Impact of pandemic – Globally and on India

The impact of the pandemic has been global and the fact that it has not yet subsided only makes it difficult to predict the actual impact it will have on the lives and livelihoods of the people and, the consequential impact on the world economy. The world economy was already reeling under pressure due to multiple macro factors including trade tensions between various countries and this pandemic has only made the matters worse.

2.1 Global Impact³

The pandemic has raised unprecedented challenges on a global scale due to global lockdown for a decent period in the year 2020. This brought the world economy to halt during that period. The cumulative loss to global GDP over 2020 and 2021 is estimated at around USD 9 trillion. The rebound in global activity has, however, been uneven and subdued since the beginning of second half of the year 2020 due to resurgence in Covid-19 cases in some countries.

Going forward, an effective vaccination campaign, restoration of consumer and business confidence as well as continued monetary and fiscal support are expected to lift the global output by 4.5 – 5.5 percent in 2021. Downside risks to this forecast include the possibility of mutant strains, delays in vaccine procurement and distribution, disruptive effects on potential output from the pandemic, and financial stress triggered by high debt levels and weak growth.

2.2 Impact on India

The fiscal deficit for the financial year (FY) 2020-21, which was originally estimated⁴ at 3.5 percent of GDP while presenting the Union Budget 2020-21, was revised⁵ to 9.5 percent of GDP during this year's Union Budget. This admission of higher fiscal deficit is commendable and gives a ray of hope that the government is open to look beyond the numbers this time and focus on the long-term growth

³ Volume 2 of the Economic Survey 2020-21 (Chapter - 01). Accessible at <https://www.indiabudget.gov.in/economicsurvey>

⁴ Union Budget 2020-21. Accessible at <https://www.indiabudget.gov.in>

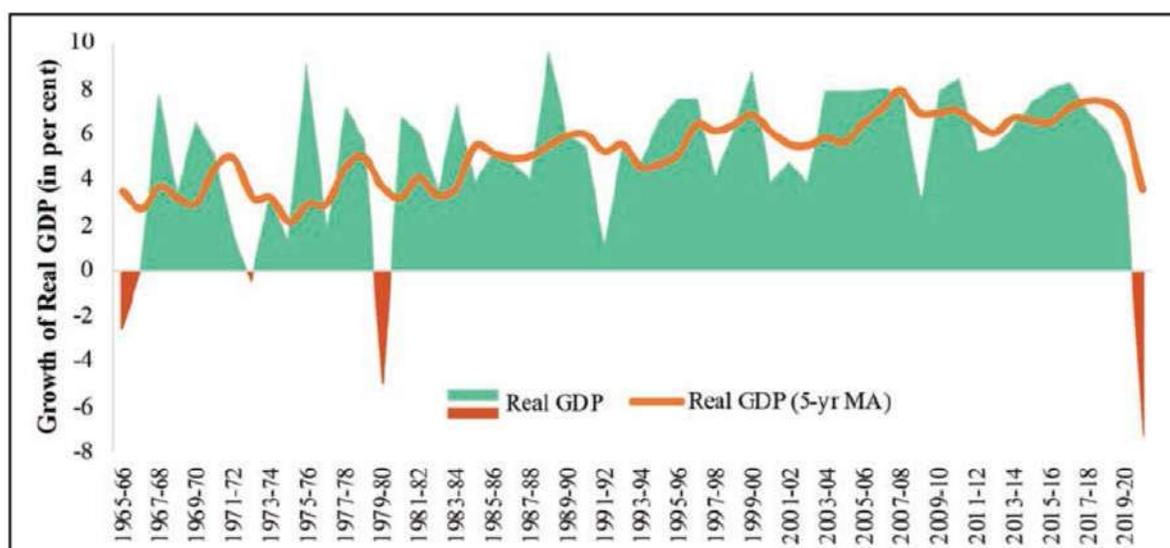
⁵ Union Budget 2021-22. Accessible at <https://www.indiabudget.gov.in>

prospects of the Indian economy. It only shows the maturity with which the government is willing to deal with this extraordinary situation. After all, everyone knows that having an ideal scenario of having zero or no fiscal deficit is only a delusion; that state of Nirvana – if we may call it – is very hard, if not impossible, to achieve. Interestingly, the Economic Survey 2021⁶ highlights what the eminent French Economist, Olivier Blanchard, explained during his presidential address to the American Economic Association⁷, i.e., fiscal deficit is not at all harmful – and is, in fact, good in the long term – if the real rate of interest is less than the real growth rate of the economy.

The fiscal deficit for FY 2021-22 is pegged at 6.8 percent (budget estimates) of GDP⁸. Given the current situation in India – with the sudden spike in cases and fatalities – the fiscal deficit of FY 2021-22 may also need an upward revision. But that should not bother the government much as long as the money is being allocated for the right cause and on projects of utmost importance.

National Statistical Office (NSO) has estimated a contraction of real GDP by 7.7 per cent in 2020-21 as compared to a growth of 4.2 per cent in 2019-20. This is the fourth contraction in India's GDP since 1960-61. Trend in India's real GDP growth is presented below⁹:

Figure 2: Trend in India's Real GDP Growth



Source: NSO

Even the tax-to-GDP ratio of India has been nosediving in the recent years and has hit a 10-year low of 9.88 percent in financial year 2020. India is way behind OECD members in terms of the tax-GDP ratio — an average of 34 per cent.¹⁰ The ratio does not seem to improve, at least, anytime soon since, inter alia, the impact of the pandemic continues to subsist with no clarity until when shall it continue.

⁶Volume 1 of the Economic Survey 2020-21 (Chapter - 02; page no. 43). Accessible at <https://www.indiabudget.gov.in/economicsurvey>

⁷ <https://www.aeaweb.org/webcasts/2019/aea-presidential-address-public-debt-and-low-interest-rates> [Last accessed on 24 April 2021]

⁸ Union Budget 2021-22. Accessible at <https://www.indiabudget.gov.in>

⁹ Volume 2 of the Economic Survey 2020-21 (Chapter - 01). Accessible at <https://www.indiabudget.gov.in/economicsurvey>

¹⁰ https://www.business-standard.com/article/economy-policy/india-s-tax-to-gdp-ratio-plunges-to-a-decade-low-of-9-88-in-fy20-120060801629_1.html

3. India's response in combatting with the pandemic

India, so far, has done very little, or rather negligible, in terms of providing relief measures to compensate the economic disruption caused by the pandemic. A so-called mega stimulus package of USD 266.67 billion¹¹ was announced during the March 2020-May 2020 period which roughly works out to be 10 percent of India's GDP.¹² Most of it had no real benefit but only that it was, as always, packaged really well. The stimulus largely failed to soften the blow as it focused mainly on providing liquidity and collateral-free credit for small businesses with no actual money in their hands. The package gave a step-motherly treatment to various industries including aviation, hospitality, and tourism.

Given the magnitude of humanitarian and economic disaster in India, the government should not worry about fiscal deficit numbers at this stage. Yes, the Union Budget 2021-22 announcement clearly signify the change in attitude, with a clear focus on growth and creating demand right now instead of the widening fiscal deficit. However, a successful implementation of these intentions is equally important especially when this government has had a dismal record when it comes to actual implementation.

Going by the reports¹³, another economic stimulus package is on the cards and we hope that this time the package will dole out some actual liquidity in the hands of the citizens. Apart from this, the vaccination drive is also expected to bring some respite to the people and the economy consequently. From 1 May 2021, the vaccination drive has been extended to the age group of 18-45 years, but the actual implementation is yet to be seen and a lot will depend on that. So far, it has been disappointing.

4. International Tax and Transfer Pricing specific issues

While the countries are still grappling with a challenge of taxing the digital businesses in absence of any tangible physical presence, plethora of other unrelated issues came along with the spread of Covid-19. The exact impact that Covid-19 will have on taxation aspects will only be known as we progress and come across unique situations. However, there are few issues which are foreseeable at this stage on the international taxation and transfer pricing front. Both the issues have been dealt in detail below.

4.1 International tax issues

Due to the travel and other restrictions imposed by the respective governments during a major part of the year 2020 – which, of course, continues till date in some of the cities, states, and countries – human capital was handicapped and was forced to stay wherever they were. Few voluntarily moved back to their native place for various reasons including personal safety, forced movement to take care of their loved ones, etc. depending on the travel restrictions.

This handicap has led to various challenges for individuals at a personal level regarding taxability of the employment income. On the other hand, the businesses feared permanent establishment (PE) implications due to temporary dislocation of their key employees taking strategic decisions, or agents entering into contracts on behalf of the principal, etc.

Some of the major issues have been discussed as under along with case studies.

¹¹ INR 200 billion converted into USD at an exchange rate of 1 USD = INR 75 (rounded off)

¹² <https://www.theweek.in/news/biz-tech/2020/05/12/how-does-modis-economic-package-compare-to-spending-by-other-countries.html>

¹³ <https://www.hindustantimes.com/business/government-weighs-stimulus-as-virus-surges-101618428630090.html>

4.1.1. Creation of potential permanent establishment (PE)

a. Home (Fixed Place) PE

Overview

The dislocation of people from their usual place of work could create numerous issues, including risk of creating fixed place PE at home, since now the employment is being exercised from respective homes of the employees.

Definition of Fixed Place PE

PE means a fixed place of business through which the business of an enterprise is wholly or partly carried on¹⁴.

While the existence of fixed place PE is a fact specific exercise, the essential conditions to test its existence include:

- **Place of business test** – Business must be conducted through such place. Existence of physical location is important.
- **Disposal test**¹⁵ – Such place should be at the disposal of the enterprise (employer, in this case). There should be some ability to exercise right or dominion or control. 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. If it used on a continuous basis, the story could be different, i.e., if it is an organisation's requirement for an employee to work-from-home then the situation could be different.

Example – Where an organization decides to implement work from home policy which requires employees to only visit office in rare instances and, as a result, implements hot desking system¹⁶, the risk of home PE will increase. Please see scenario 3 in case study 1 below.

- **Permanence test** – There should be a certain degree of permanency. Such place should be on a regular basis and not occasionally. Should be available for sufficiently long period of time. Intent as well as actual conduct to be seen.
- **Business activity test** – Activities performed through the fixed place of business must be of a business character.

The above conditions are required to be satisfied cumulatively.

Case study 1

Now let us take an example with some variations to check if these conditions could trigger in this Covid scenario. Assume Mr. A used to work (before Covid-19 restrictions) in country A since 5 years for an organization located there. Due to Covid-19 situation, he decided to move back to his native place in country B to be with his aged parents. Now let us take different scenarios in terms of possibility and willingness of Mr. A to return to country A and resume with his old working style of physically attending office every day.

¹⁴ Paragraph 1 of art. 5 (Permanent Establishment) of the OECD model tax convention 2017

¹⁵ Paragraph 18 and 19 of the commentary on art. 5 of the OECD model tax convention 2017

¹⁶ Hot desking is an office organization system which involves multiple workers using a single physical workstation or surface during different time periods. [Source: https://en.wikipedia.org/wiki/Hot_desking]

Scenario 1: Mr. A is willing to move back to country A but travel restrictions are preventing him to do so.

Scenario 2: The travel restrictions are lifted in both the countries but Mr. A is himself down with Covid and, hence, it is impossible for him to even step out of his house in country B.

Scenario 3: Travel restrictions lifted in both countries and Mr. A is fit to travel to country A and resume his normal work schedule of physically attending office. However, as a cost cutting measure and for employee’s safety, Mr. A’s employer has announced work from home policy which does not require Mr. A to stay in country B anymore.

Tabulated below¹⁷ are different scenarios assumed above to check if any of the four pre-conditions for existence of fixed place PE can be triggered.

Table 1: Different scenarios for case study 1

Condition	Scenario 1	Scenario 2	Scenario 3
Place of business test	Yes	Yes	Yes
Disposal test	No	No	Possible
Permanence test	No	No	Possible
Business activity test	Yes	Yes	Yes

Author’s view

In the above example, the place of business test gets satisfied in all scenarios because Mr. A is carrying out his employer’s work, located in country A, in country B. Furthermore, the business activity test may also get satisfied depending on the nature of work the employees carries out in the source state.

Now let us move on to the two most important tests in this case: disposal test and permanence test. In scenarios 1 and 2, both the tests, disposal test and permanence tests will not get satisfied, since Mr. A is working in country B only for a temporary period and, that too, not because his employer requires him to do so, but because of travel and other restrictions or health issues.

Moving to scenario 3, since the travel restrictions have been lifted and there is no extraordinary reason for Mr. A to stay back in country B, the disposal test and permanence test may get satisfied because now Mr. A’s employer voluntarily wants its employees to work-from-home due to whatever reasons. Therefore, the place of disposal test and permanency test may get triggered, thereby, creating PE of Mr. A’s employer in country B. However, this may require consideration of all the facts and circumstances before concluding whether employer of Mr. A will have fixed place PE in country A.

In a nutshell, all that matters is the circumstances in which Mr. A is staying back in country B, i.e., if it is a forced stay due to prevailing restrictions on travel, etc., it will usually not lead to creation of fixed place PE. On the other hand, if Mr. A, due to his employer’s directions of following work-from-home policy stays back in country B, assuming all other conditions are also met, it is highly likely that it will lead to creation of fixed place PE in country B.

¹⁷ ‘Yes’ means condition satisfied, ‘No’ means condition not satisfied, ‘Possible’ means further examination of facts and circumstances required.

b. Dependent Agency PE

Overview

The dislocation of people from their usual place of work could also create risk of creating dependent agency PE (DAPE) for employees working from jurisdictions other than where their employer is located.

Definition of DAPE¹⁸

Where a person is acting in a contracting state (read it as country B) on behalf of an enterprise (read it as Mr. A's employer) and, in doing so, Mr. A either:

- 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 (read it as Mr. A's employer),

Other conditions prescribed to trigger existence of DAPE are not relevant for this analysis and have, therefore, not been discussed at all. Needless to mention that the activities carried out by the employee or agent should not be of preparatory or auxiliary in nature as prescribed under paragraph 4 of article 5 of the OECD Model Tax Convention 2017.

Therefore, habitual conclusion of contracts or habitual principal role (leading to the conclusion of contracts without material modification by Mr. A's employer) by employees or dependent agents create a risk of creating a DAPE in source jurisdiction (country B, in this case).

Case study 2

Assuming same facts as in case study 1.

Author's view

In scenarios 1 and 2, it will be important to evaluate whether the employee performs these activities (actual conclusion of contracts or play a principal role in conclusion of contracts) 'habitually'. The presence of an employee must be more than transitory¹⁹. Furthermore, the extent and frequency of activity will also play a crucial role in deciding the 'habitually' condition²⁰.

In scenario 3, it is more likely than not that the habitually condition will get triggered if Mr. A continues to stay in country B and, inter alia, the 'habitual' condition is met.

c. Construction PE

Overview

Due to the Covid-19 pandemic, construction activities have taken a hit due to temporary suspension of work at sites and there is a dilemma on the treatment of period during which the site remained suspended due to Covid-19 restrictions. As per the OECD²¹, the temporary period of disruption ought not to be excluded while calculating the prescribed thresholds. It is upto the respective jurisdictions to decide what does 'temporary disruption' mean.

Definition of Construction PE

¹⁸ Paragraph 5 of art. 5 (Permanent Establishment) of the OECD model tax convention 2017

¹⁹ Paragraph 98 of the commentary on art. 5 of the OECD model tax convention 2017

²⁰ Paragraph 98 of the commentary on art. 5 of the OECD model tax convention 2017

²¹ Paragraph 55 of the commentary on art. 5 of the OECD model tax convention 2017

Ideally, a construction or building or installation site is considered as PE in source jurisdiction upon crossing a prescribed threshold. The threshold varies from tax treaty to tax treaty. However, OECD has prescribed the threshold to be more than twelve months whereas UN prescribes the threshold to be more than six months.

Author's view

This may lead to disputes as each jurisdiction will have its own interpretation as to what constitutes temporary disruption. However, in author's view, the pandemic was something extraordinary, and extraordinary situations require extraordinary measures and, therefore, the period of disruption due to this pandemic should not be included while calculating the prescribed threshold for triggering existence of construction PE.

Furthermore, it will be interesting to see how the tax authorities around the world deal with cases wherein the workforce at a particular construction site is halved, due to which the period in source jurisdiction has doubled than the actual time it would have normally taken them to finish the work. In such cases, the onus would be upon the taxpayer, carrying out work in the source jurisdiction, to substantiate that the sole reason of exceeding the prescribed threshold was that due to the pandemic the workforce was halved.

Risk mitigation announcements made by the tax authorities around the world w.r.t. PE exposure are tabulated below:²²

Table 2: Announcements w.r.t. PE exposure

S. No.	Country	Announcement made	Notification applicability	Author's Remarks
1	Australia ²³	No PE in Australia if it meets all the following: → No PE existed prior to impact of Covid-19 → No changes in company's circumstances → Unplanned presence of employees is only temporary due to the pandemic	Applicable until 30 June 2021.	No clarity on DAPE and construction PE.
2	Austria ²⁴	For Home PE If relocation due to the pandemic, it is a force majeure event. However, work in the home office should not become a norm. Home office in	Based on Author's research, this circular was valid until 19 July 2020 Subsequent	Based on Austria's announcement, it may consider PE to exist in case of scenario 3 in case study 1 discussed earlier.

²² https://read.oecd-ilibrary.org/view/?ref=1060_1060114-o54bvc1ga2&title=Updated-guidance-on-tax-treaties-and-the-impact-of-the-COVID-19-pandemic

²³ <https://www.ato.gov.au/business/international-tax-for-business/working-out-your-residency/>. [Last accessed on 24 April 2021]

²⁴ [https://findok.bmf.gv.at/findok?execution=e1s1/Info zur Anwendung und Auslegung von Doppelbesteuerungsabkommen im Zusammenhang mit der COVID-19 Pandemie - Findok Internet \(bmf.gv.at\)](https://findok.bmf.gv.at/findok?execution=e1s1/Info+zur+Anwendung+und+Auslegung+von+Doppelbesteuerungsabkommen+im+Zusammenhang+mit+der+COVID-19+Pandemie+-+Findok+Internet+(bmf.gv.at)) (Please convert it into English, if required) [Last accessed on 24 April 2021]

S. No.	Country	Announcement made	Notification applicability	Author's Remarks
		<p>such cases will not be at disposal of office. In addition, the employer provides an office which in normal circumstances is available to its employees.</p> <p>For Construction PE</p> <p>Temporary interruptions of construction sites due to the pandemic should in principle not lead to a suspension of days spent in source jurisdiction for calculating the prescribed threshold.</p>	circular could not be found by the Author.	<p>Please exercise caution while interpreting the exceptions as on today.</p> <p>No clarity on DAPE.</p>
3	Canada ²⁵	<p>For Home PE</p> <p>No PE if employment duties performed in Canada solely due to travel restrictions in force.</p> <p>For DAPE</p> <p>No DAPE if concluding contracts in Canada on behalf of the non-resident entity, while the travel restrictions are in force, provided that such activities are limited to that period and would not have been performed in Canada but for the travel restrictions.</p>	The relief has been extended multiple times. The last update was released on 1 April 2021.	No clarity on construction PE.
4	Germany ²⁶	<p>For Construction PE</p> <p>Interruption period will not be counted for the prescribed threshold provided that:</p>	Author could not independently verify the notification.	No clarity on Home PE and DAPE.

²⁵ <https://www.canada.ca/en/revenue-agency/campaigns/covid-19-update/guidance-international-income-tax-issues.html> [Last accessed on 24 April 2021]

²⁶ https://read.oecd-ilibrary.org/view/?ref=1060_1060114-o54bvc1ga2&title=Updated-guidance-on-tax-treaties-and-the-impact-of-the-COVID-19-pandemic

S. No.	Country	Announcement made	Notification applicability	Author's Remarks
		<p>→ duration of the interruption is at least two weeks;</p> <p>→ site workers have been withdrawn from the construction site or have left it;</p> <p>→ relevant income will be taxed in the jurisdiction of residence of the enterprise or its personnel.</p>		
5	Greece ²⁷	<p>For Home PE</p> <p>No PE if employment duties performed in Greece solely due to travel restrictions in force.</p> <p>For DAPE</p> <p>No DAPE solely because an agent is concluding contracts in Greece (i.e., their home jurisdiction) on its behalf or is stranded in Greece, provided that such person did not habitually conclude contracts on behalf of the non-resident entity in Greece before the Covid-19 outbreak. It is a matter of fact and degree as to whether that habitual condition is met.</p> <p>For Construction PE</p> <p>Such temporary disruption period will not be excluded.</p>	For periods preceding 18 March 2020 and following 15 June 2020, it shall be assessed whether such restrictions were in place. Author is not aware if the relaxation has been extended beyond 15 June 2020.	Greece has gone with the OECD interpretation of including the temporary suspension period in case of construction PE irrespective that the suspension was due to extraordinary event in the form of the pandemic.

²⁷ https://aade.gr/sites/default/files/2020-07/E2113_2020.pdf (English version not available)

S. No.	Country	Announcement made	Notification applicability	Author's Remarks
6	Ireland ²⁸	<p>For Home PE and DAPE</p> <p>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.</p> <p>The individual and the company should maintain a record of the facts and circumstances of the bona fide relevant presence in Ireland, or outside Ireland, for production to Irish Revenue if evidence that such presence resulted from Covid-related travel restrictions is requested.</p>	Updated as on 13 April 2021.	No clarity on construction PE.
7	New Zealand ²⁹	<p>For Home PE and DAPE</p> <p>No PE if individuals are stranded in New Zealand due to the pandemic.</p>	Not specifically mentioned on the website.	No clarity on construction PE.
8	The United Kingdom ³⁰	<p>For Home PE</p> <p>A non-resident company will not have a UK fixed place of business PE after a short period of time as a degree of permanence is required.</p> <p>For DAPE</p>	Not specifically mentioned on the website.	The UK, similar to Greece, has also gone with the OECD interpretation of including the temporary suspension period in case of construction PE irrespective that the suspension was due to

²⁸ <https://www.revenue.ie/en/corporate/communications/covid19/compliance-with-certain-reporting-and-filing-obligations.aspx> [Last accessed on 24 April 2021]

²⁹ <https://www.ird.govt.nz/covid-19/international/tax-residency> [Last accessed on 24 April 2021]

³⁰ <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm261010> [Last accessed on 24 April 2021]

S. No.	Country	Announcement made	Notification applicability	Author's Remarks
		<p>Whilst the habitual conclusion of contracts in the UK would also create a DAPE, it is a matter of fact and degree as to whether that habitual condition is met.</p> <p>For Construction PE</p> <p>Temporary period of interruption will not be excluded to compute the prescribed threshold.</p>		<p>extraordinary event in the form of the pandemic.</p>
9	The Unites States of America ³¹	The announcement simply states that a period of upto 60 consecutive calendar days between 1 Feb 2020 to 1 April 2020 will be excluded considering the pandemic.	The website was last updated on 12 June 2020.	It is surprising that the USA has given an upper limit of only 60 days. This, in Author's opinion, means that if one is stuck for above 60 days, the excess days will be considered irrespective that was due to the pandemic-related restrictions.

4.1.2. Dual residency for individuals and non-individuals

The OECD and UN model tax conventions 2017³² leave it to the domestic tax laws of the respective contracting jurisdictions to determine the residential status of individuals and other than individuals. It further provides tiebreaker test to determine the residential status if the stakeholder, by virtue of the respective domestic tax laws of contracting jurisdictions, obtains residency of both the jurisdictions.

In case of individuals, the tiebreaker is resolved based on hierarchy of tests including test of permanent home, center of vital interests, habitual abode, nationality. Even if such tests do not lead to a conclusion, then it is upto the competent authorities of the contracting jurisdictions to decide as per Mutual Agreement Procedure (MAP), as provided under article 25 of the OECD and UN model tax conventions 2017.

In case of non-individuals, the tiebreaker is resolved by MAP³³. However, while deciding that the non-individual is resident of which jurisdiction, factors like 'place of effective management' (PoEM), place of incorporation or establishment, etc. will have to be considered.

³¹ <https://www.irs.gov/newsroom/faqs-for-nonresident-alien-individuals-and-foreign-businesses-with-employees-or-agents-impacted-by-covid-19-emergency-travel-disruptions>. [Last accessed on 24 April 2021]

³² Respective art. 4 of OECD and UN model tax convention 2017

³³ Paragraph 3 of art. 4 (Resident) of the OECD model tax convention 2017

Having said that, it is pertinent to note that the 2014 version of the OECD model tax convention, in article 4, provides that in case of a dual residency of non-individuals (read it as corporates, for this paper), the PoEM will decide the residential status of the corporate. Therefore, most of the treaties that exist today provide PoEM test to resolve the dual residency issue for corporates. However, with the multilateral convention (MLI)³⁴ being implemented by most countries, the MAP solution³⁵, as provided in the OECD model tax convention 2017, may get replaced therein.

A noteworthy point in the last sentence of paragraph 3 of article 4 of the OECD model tax convention 2017 is that it provides that in the absence of a determination by the competent authorities, the dual-resident person shall not be entitled to any relief or exemption under the Convention except to the extent and in such manner as may be agreed upon by the competent authorities. Therefore, unless the competent authorities of the contracting jurisdictions reach an agreement in deciding which jurisdiction get the right to tax the taxpayer, as its resident, through MAP, it will be treated as resident of both the jurisdictions. This, of course, is unfair for the taxpayers but let us leave this argument here for another day.

a. Issues for individuals

In case of determination of residential status of individuals, most of the jurisdictions apply the test of cumulative physical presence (number of days test) in the relevant financial year. Therefore, in such cases, it is quite possible to attain residency of more than one jurisdiction due to relocation due to the Covid-19 pandemic. Of course, one can say that this issue can be easily resolved by the hierarchy-based tiebreaker test discussed above. It certainly can be, but only if the facts are straightforward. There could be cases where it eventually has to be resolved by using MAP which, in itself, is a very time-consuming procedure.

Risk mitigation announcements made by the tax authorities around the world w.r.t. dual residency issues for individuals are tabulated below:³⁶

Table 3: Announcements w.r.t. dual residency for individuals

S. No.	Country	Announcement made	Notification applicability	Author's Remarks
1	Australia ³⁷	Foreign resident temporarily in Australia for some weeks or months due to Covid-19, will not become an Australian resident for tax purposes if: →usually live overseas permanently →intend to return there as soon as they can.	Last updated on 29 October 2020 as per the ATO website.	-

³⁴ <https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf>

³⁵ Art. 4 (Dual Resident Entities) of the MLI

³⁶ https://read.oecd-ilibrary.org/view/?ref=1060_1060114-o54bvc1ga2&title=Updated-guidance-on-tax-treaties-and-the-impact-of-the-COVID-19-pandemic

³⁷ <https://www.ato.gov.au/General/COVID-19/Support-for-individuals-and-employees/Residency-and-source-of-income/#ChangeoftaxresidencyduetoCOVID19> [Last accessed on 8 May 2021]

S. No.	Country	Announcement made	Notification applicability	Author's Remarks
2	Canada ³⁸	The guidance provides for domestic residence test which comprises a “facts and circumstances test” and a “days of presence test”. Any stay in Canada due to travel restrictions to be ignored for determining the residency status.	Relief applies until the earlier of the date of lifting of the travel restrictions and 31 December 2021.	-
3	Finland ³⁹	Pandemic does not affect the way the Finnish tax authorities determine an individual taxpayer's residence under Finnish law or under tax treaties.	The relevant website was last updated on 10 December 2020.	That is a pretty bold statement from Finland. It not only talks about its domestic law but also its tax treaties. This could have wide ramifications.
4	France ⁴⁰	Pandemic does not affect the way the French tax authorities determine an individual taxpayer's residence under French law or under tax treaties.	The relevant website was last updated on 23 March 2021.	That is a pretty bold statement from Finland. It not only talks about its domestic law but also its tax treaties. This could have wide ramifications.
5	Greece ⁴¹	For the period 18 March-15 June 2020, any days spent in Greece due to travel restrictions will be ignored.	Author is not aware if the relaxation has been extended beyond 15 June 2020.	-
6	India	India has issued two circulars in this respect so far. The first one was issued on 8 May 2020 ⁴² for FY 2019-20 which says “days spent in India during March 2020 can be disregarded for the purposes of applying the domestic residency rules. The days that may be disregarded depends on the circumstances of the	Applicable for FY 2019-20 and FY 2020-21.	The first circular was clear to exclude stranded days while calculating the number of days present in India. However, the second circular is mainly concerned with double non-taxation as it is based on the premise that all countries have physical presence test instead of considering the fact that some countries also have additional factors

³⁸ <https://www.canada.ca/en/revenue-agency/campaigns/covid-19-update/guidance-international-income-tax-issues.html> [Last accessed on 8 May 2021]

³⁹ <https://www.vero.fi/en/detailed-guidance/statements/82178/effects-of-the-coronavirus-pandemic-on-taxes-on-income-received-under-an-employment-contract-in-a-foreign-country-the-six-month-rule-and-forces-majeures2/> [Last accessed on 8 May 2021]

⁴⁰ <https://www.impots.gouv.fr/portail/international-particulier/residence-fiscale-et-confinement-crise-covid> [Last accessed on 8 May 2021]

⁴¹ https://aade.gr/sites/default/files/2020-07/E2113_2020.pdf (English version not available)

⁴² https://www.incometaxindia.gov.in/communications/circular/circular_no_11_2020.pdf

S. No.	Country	Announcement made	Notification applicability	Author's Remarks
		<p>restrictions imposed on the individual.”</p> <p>The second one was issued on 3 March 2021⁴³ for FY 2020-21 which mainly focuses on double non-taxation. It further provides that the taxpayers facing double taxation even after taking benefit of the relevant tax treaty, may apply in Form – NR (prescribed) by 31 March 2021.</p>		<p>considered for residency including citizenship, domicile, etc. Therefore, the government should give proper clarity for FY 2020-21 and FY 2021-22.</p>
7	Ireland ⁴⁴	<p>It provides for “force majeure” circumstances where an individual is prevented from leaving Ireland on his or her intended day of departure because of extraordinary natural occurrences.</p>	<p>The relevant website⁴⁵ was last updated on 13 April 2021.</p>	<p>Ireland has issued quite clear-cut guidelines in the source document along with examples.</p>
8	New Zealand ⁴⁶	<p>Domestic days of presence residency tests are not strictly applied where an individual is present in New Zealand or absent from New Zealand as a result of the Covid-19 pandemic if person leaves within a reasonable time after they are no longer practically restricted in doing so.</p> <p>New Zealand also issued guidance on the application of tax treaties and it notes that the residence tests in tax treaties are interpreted in a holistic and integrated</p>	<p>No specific date mentioned on the relevant website.</p>	-

⁴³ <https://www.incometaxindia.gov.in/news/residency-circular-02-of-2021.pdf>

⁴⁴ <https://www.revenue.ie/en/corporate/communications/documents/covid-19-statutory-residence-test.pdf> [Last accessed on 8 May 2021]

⁴⁵ <https://www.revenue.ie/en/corporate/communications/covid19/compliance-with-certain-reporting-and-filing-obligations.aspx> [Last accessed on 8 May 2021]

⁴⁶ <https://www.ird.govt.nz/covid-19/international/tax-residency>; <https://www.ird.govt.nz/covid-19/international/tax-treaties> [Last accessed on 8 May 2021]

S. No.	Country	Announcement made	Notification applicability	Author's Remarks
		manner and it is not expected that persons will be treated as resident under tax treaties just because of the current emergency conditions.		
9	The United Kingdom ⁴⁷	It prescribes that upto 60 days will be disregarded due to exceptional circumstances. It further provides that application of tiebreaker tests for residence included in treaties and noted that although a person may become resident in the UK under the statutory residence test, their residence under a treaty will not change due to a person's temporary dislocation	No specific date mentioned on the relevant website.	It is surprising that the UK has given an upper limit of only 60 days. This, in the Author's opinion, means that if one is stuck for above 60 days, the excess days will be considered irrespective that was due to the pandemic-related restrictions.
10	The United States of America ⁴⁸	Simply states that a period of upto 60 consecutive calendar days between 1 Feb 2020 to 1 April 2020 will be excluded considering the pandemic. Such period is left to be chosen by such individual.	No specific date mentioned on the relevant document.	It is surprising that the USA has given an upper limit of only 60 days. This, in the Author's opinion, means that if one is stuck for above 60 days, the excess days will be considered irrespective that was due to the pandemic-related restrictions.

b. Issues for non-individuals⁴⁹ including corporates

Covid-19 pandemic has raised concerns of potential change in the PoEM for companies due to relocation or inability of its key decision makers to travel to its usual place of business. PoEM is usually interpreted as ordinarily the place where the most senior person or group of persons (for example a board of directors) take the key management and commercial decisions necessary for the conduct of the company's business.⁵⁰

Risk mitigation announcements made by the tax authorities around the world w.r.t. dual residency issues for corporates are tabulated below:⁵¹

⁴⁷ <https://www.gov.uk/hmrc-internal-manuals/residence-domicile-and-remittance-basis/rdrm13200>; <https://www.gov.uk/hmrc-internal-manuals/residence-domicile-and-remittance-basis/rdrm13410> [Last accessed on 8 May 2021]

⁴⁸ <https://www.irs.gov/pub/irs-drop/rp-20-20.pdf> [Last accessed on 8 May 2021]

⁴⁹ For the purposes of this paper, the discussion under non-individual has been restricted to corporates only

⁵⁰ Paragraph 149 of the commentary on art. 29 of the OECD model tax convention 2017

⁵¹ https://read.oecd-ilibrary.org/view/?ref=1060_1060114-o54bvc1ga2&title=Updated-guidance-on-tax-treaties-and-the-impact-of-the-COVID-19-pandemic

Table 4: Announcements w.r.t. dual residency for corporates

S. No.	Country	Announcement made	Notification applicability
1	Australia ⁵²	If the only reason for holding board meetings in Australia or directors attending board meetings from Australia is because of the effects of Covid-19, then the Australian Tax Office will not apply compliance resources to determine if the company's central management and control is in Australia.	The relevant website was last updated on 3 February 2021.
2	Canada ⁵³	Application of the PoEM tiebreaker and noted that considering the extraordinary circumstances resulting from the travel restrictions, as an administrative matter, where a director of a corporation must participate in a board meeting from Canada because of the travel restrictions, the Canada Revenue Agency will not consider the corporation to become resident in Canada solely for that reason.	The relevant website was last updated on 27 April 2021.
3	Greece ⁵⁴	The PoEM of an entity will not be affected solely because the members of the team that make the key management and commercial decisions of an entity are temporarily located in a jurisdiction other than the one where the decisions are usually made, provided that such change is of temporary nature and due to exceptional circumstances. In any case, entities should maintain a record of facts and circumstances of the bona fide presence in a different jurisdiction as evidence that such presence resulted from Covid-19-related measures.	For periods preceding 18 March 2020 and following 15 June 2020, it shall be assessed whether such restrictions were in place. Author is not aware if the relaxation has been extended beyond 15 June 2020.
4	Ireland ⁵⁵	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.	No specific date mentioned on the relevant website.
5	New Zealand ⁵⁶	The guidance provides that the Covid-19 pandemic will not cause corporate	No specific date mentioned on the relevant website.

⁵² <https://www.ato.gov.au/business/international-tax-for-business/working-out-your-residency> [Last accessed on 8 May 2021]

⁵³ <https://www.canada.ca/en/revenue-agency/campaigns/covid-19-update/guidance-international-income-tax-issues.html> [Last accessed on 8 May 2021]

⁵⁴ https://aade.gr/sites/default/files/2020-07/E2113_2020.pdf (English version not available)

⁵⁵ <https://www.revenue.ie/en/corporate/communications/covid19/compliance-with-certain-reporting-and-filing-obligations.aspx> [Last accessed on 8 May 2021]

⁵⁶ <https://www.ird.govt.nz/covid-19/international/tax-residency> [Last accessed on 8 May 2021]

S. No.	Country	Announcement made	Notification applicability
		taxpayers to be tax resident in New Zealand because directors of a company are confined or stranded in New Zealand. The guidance further notes that the occasional exercise of control by the directors from New Zealand, for example through a board meeting, will not make the company tax resident in New Zealand.	
6	The United Kingdom ⁵⁷	They do not consider that a company will necessarily become resident in the UK (as a matter of domestic law or under the terms of a double tax treaty) because a few board meetings are held in the UK, or because some decisions are taken in the UK over a short period of time. A holistic view of the facts and circumstances of each case may be taken. Likewise, they do not believe that a company will necessarily become non-UK resident for UK tax purposes because a few board meetings are held, or some decisions are taken, outside the UK for a short period of time.	No specific date mentioned on the relevant website.
7	The United States of America ⁵⁸	Simply states that a period of upto 60 consecutive calendar days between 1 Feb 2020 to 1 April 2020 will be excluded considering the pandemic. Such period is left to be chosen by such individual.	No specific date mentioned on the relevant document.

4.1.3. Concerns related to income from employment/dependent personal services

Article 15 of the OECD and UN model tax convention 2017 governs the taxation of employment income, distributing the right to tax between the employee's jurisdiction of residence and the place where they perform their employment. Generally, the employment income is taxable in the residence jurisdiction of an individual unless the employment is exercised in other jurisdiction i.e., source jurisdiction⁵⁹.

⁵⁷ <https://www.gov.uk/hmrc-internal-manuals/international-manual/intml20185> [Last accessed on 13 May 2021]

⁵⁸ <https://www.irs.gov/pub/irs-drop/rp-20-20.pdf> [Last accessed on 13 May 2021]

⁵⁹ Paragraph 1 and 2 of art. 15 (Income from employment) of the OECD model tax convention 2017

However, the source jurisdiction gets the right to tax only in following cases:

- **Physical presence test:** Employee is physically present in the source jurisdiction for more than 183 days in any twelve-month period commencing or ending in the fiscal year concerned^{60,61}
- **Payer test:** Employer is a resident of the source jurisdiction
- **PE test:** Employer has a PE in source jurisdiction which bears the remuneration

Now, let us discuss the taxing rights in different situations.

a. Stranded workers

Assuming Mr. A is a resident of country A who goes on a temporary assignment to country B and gets stranded there due to travel restrictions, imposed by either or both countries. Further assume that the assignment was for fixed duration of 150 days (with a confirmed return ticket in hand), but he overstayed beyond the maximum threshold period of 183 days prescribed under the tax treaty between country A and country B. Let us see the treatment of overstaying period in different scenarios.

Particulars	Scenario 1	Scenario 2	Scenario 3
Overstaying reason	Travel Restrictions	Suffering from Covid	Govt. recommendation to avoid unnecessary travel
Treatment of overstaying period	Ideally it should be excluded for calculating the prescribed threshold	Ideally it should be excluded for calculating the prescribed threshold	Debatable

Author's view

While it is more likely than not that the overstaying period is excluded in scenarios 1 and 2, but it is worth contemplating if the overstaying period in scenario 3 should also be excluded. The OECD, in its updated guidance⁶² on tax treaties, is of the opinion that the overstaying period in scenario 3 may not be excluded while calculating the prescribed threshold. However, in Author's opinion, the tax authorities should empathise with the taxpayers and evaluate such cases in a holistic manner considering the surrounding facts and circumstances. Having said that, since this scenario can also be misused by the taxpayers, it is pertinent for them to maintain adequate supporting documents to substantiate their claim of genuineness.

b. Work-from-home model for cross-border employees

Assuming Mr. A is a resident of country A where he works for an organization which is also a resident of country A. Due to the Covid-19 pandemic, given the nature of work, Mr. A's employer announced a permanent work-from-home policy. With this announcement, Mr. A decided to move back to his native place, country B, where he has his own home and family.

Until now, Mr. A was a tax resident of country A and his employment was exercised only in his residence jurisdiction, i.e., country A. However, once the work-from-home policy is

⁶⁰ This threshold is same in both OECD and UN model tax conventions 2017

⁶¹ This is a recommendatory threshold and varies from tax treaty to tax treaty. The tax treaties entered by India usually have a lower threshold.

⁶² https://read.oecd-ilibrary.org/view/?ref=1060_1060114-o54bvc1ga2&title=Updated-guidance-on-tax-treaties-and-the-impact-of-the-COVID-19-pandemic

implemented, Mr. A will now be exercising the employment from country B. In this case, once the prescribed threshold limit⁶³ is crossed, the entire employment income of Mr. A will be taxable in the source country, i.e., country B. This will lead in reduction of tax revenue of country A as it has agreed that, in such a scenario, the employment income will be taxable in the source jurisdiction. Furthermore, there will be some administrative challenges for Mr. A's employer once his income is subject to tax in country B as he might be required to withhold taxes in accordance with the domestic tax laws of country B.

Author's view

It is pertinent to note that this issue will only arise in the initial period until Mr. A becomes a tax resident of country B, by virtue of definition of resident in its domestic tax laws. Once Mr. A becomes a tax resident of country B (in subsequent years), the taxability will be governed by paragraph 1 of article 15.

c. Wage subsidies for cross-border employees unable to perform work due to pandemic

In some countries the government is bearing the payroll costs of employees since the employees are unable to perform their work at all, or unable to operate at full capacity, due to Covid-19 impact. In this case, the question arises whether this subsidy will be taxable by country A, where Mr. A was exercising his employment before the restrictions, or it will be taxable in country B, where Mr. A now exercises his employment due to the restrictions. As per the OECD updated guidance⁶⁴ on tax treaties, such subsidy will be taxable in country A, i.e., jurisdiction from where the employment used to be exercised.

Author's view

Such subsidies should continue to be taxed in the original jurisdiction i.e., employer jurisdiction where the employment used to be exercised. Therefore, the Author concurs with the view of OECD, in this regard.

Risk mitigation announcements made by the tax authorities around the world w.r.t. taxation of employment income is tabulated below:⁶⁵

Table 5: Announcements w.r.t. taxation of employment income

S. No.	Country	Announcement made	Notification applicability	Author's Remarks
1	Australia ⁶⁶	A non-resident who usually works overseas but instead performs that same employment in Australia as a result of Covid-19 will be treated as under: →Short-term (upto 3 months): Deemed not to have an Australian	Last updated on 29 October 2020 as per the ATO website.	No clarity on treatment of wage subsidies.

⁶³ Paragraph 2(a) of art. 15 (Income from employment) of the OECD model tax convention 2017

⁶⁴ https://read.oecd-ilibrary.org/view/?ref=1060_1060114-o54bvc1ga2&title=Updated-guidance-on-tax-treaties-and-the-impact-of-the-COVID-19-pandemic

⁶⁵ https://read.oecd-ilibrary.org/view/?ref=1060_1060114-o54bvc1ga2&title=Updated-guidance-on-tax-treaties-and-the-impact-of-the-COVID-19-pandemic

⁶⁶ <https://www.ato.gov.au/General/COVID-19/Support-for-individuals-and-employees/Residency-and-source-of-income/%23Sourceofemploymentincomereceivedwhileworki> [Last accessed on 13 May 2021]

S. No.	Country	Announcement made	Notification applicability	Author's Remarks
		source → Long-term (more than 3 months): Relevant facts and circumstances to be examined.		
2	Austria ⁶⁷	Governmental subsidy for a reduction in the working time of employees (of upto 100 per cent) that an employer pays forward to his employees is taxable in the jurisdiction in which the activity to which the subsidy relates would have been carried out as determined under a provision based on Art 15 OECD Model on the basis of the principle of causality. However, if a double tax treaty contains a separate provision for income from statutory social insurance or similar income, the guidance notes that a compensation for this type of subsidy is not within the scope of Art 15 OECD Model, but falls under the respective special provision of the double tax treaty, which – as a rule – assigns the taxation right to the state-of-fund.	No clarity from the respective website.	No clarity on stranded workers working remotely.
3	Canada ⁶⁸	Period upto 31 December 2020 will not be considered in calculation of physical presence test.	The relevant website was last updated on 27 April 2021.	

⁶⁷ <https://findok.bmf.gv.at/findok?execution=e100000s1&segmentId=4f45c5a9-4d31-4258-b0ed-367159caffee> [Last accessed on 13 May 2021]

⁶⁸ <https://www.canada.ca/en/revenue-agency/campaigns/covid-19-update/guidance-international-income-tax-issues.html> [Last accessed on 13 May 2021]

S. No.	Country	Announcement made	Notification applicability	Author's Remarks
4	Finland ⁶⁹	<p>Covid-19 pandemic does not affect the way the Finnish tax authorities determine how to interpret tax treaty articles on employment income.</p> <p>The same guidance outlines how domestic force majeure rules can result in days spent in Finland not counting for the purposes of Finland's domestic six-month rule where a Finland resident was assigned to work abroad but returns to Finland as a result of the Covid-19 pandemic.</p>	The relevant website was last updated on 10 September 2020.	<p>Both the statements in the same notification are contradictory.</p> <p>In case of determining residential status of individuals as well as non-individuals (as discussed above), they have clearly stated that Covid-19 will not impact the way they determine the residential status.</p>
5	Germany ⁷⁰	<p>It has concluded consultation agreements with certain countries like Austria, Belgium, France, Luxembourg, the Netherlands, Poland, and Switzerland to deem remote working to be carried out at a place had Covid-19 not been there. However, if this position is disadvantageous then a person has an option to be governed by tax treaty as it stands.</p>	Author could not independently verify the notification.	No clarity on how the German tax authorities will deal with situation arising with other than specific countries with which they have already entered into the consultation agreements.
6	Greece ⁷¹	<p>Wage subsidies will be governed by Article 15 OECD model tax convention and shall be taxed in the country where the employment was exercised before the pandemic.</p>	Author could not independently verify the notification.	No clarity on stranded workers working remotely.
7	Ireland ⁷²	<p>Irish Revenue will not seek to enforce Irish payroll obligations for</p>	The relevant website was last updated on	-

⁶⁹ <https://www.vero.fi/en/detailed-guidance/statements/82178/effects-of-the-coronavirus-pandemic-on-taxes-on-income-received-under-an-employment-contract-in-a-foreign-country-the-six-month-rule-and-forces-majeures2/> [Last accessed on 13 May 2021]

⁷⁰ <https://www.bundesfinanzministerium.de/Web/DE/Home/home.html> [Last accessed on 13 May 2021]

⁷¹ https://aade.gr/sites/default/files/2020-07/E2113_2020.pdf [Last accessed on 13 May 2021]

⁷² <https://www.revenue.ie/en/corporate/communications/covid19/compliance-with-certain-reporting-and-filing-obligations.aspx>. [Last accessed on 13 May 2021]

S. No.	Country	Announcement made	Notification applicability	Author's Remarks
		foreign employers in genuine cases where an employee was working abroad for a foreign entity prior to Covid-19 but relocates temporarily to Ireland during the Covid-19 period and performs duties for his or her foreign employer while in Ireland.	13 April 2021.	
8	New Zealand ⁷³	If the employee leaves or returns to their jurisdiction within a reasonable time after they are no longer practically restricted in travelling, then any extra days when the person was unable to leave (that are in addition to the 92 days) will be disregarded.	No specific date mentioned on the relevant website.	-
9	The United Kingdom ⁷⁴	A non-resident is not liable on employment income relating to employment exercised in the UK during a period of enforced stay due to the Covid-19 pandemic.	The relevant website was last updated on 16 March 2021.	-
10	The United States of America ⁷⁵	Simply states that a period of upto 60 consecutive calendar days between 1 Feb 2020 to 1 April 2020 will be excluded considering the pandemic. Such period is left to be chosen by such individual.	No specific date mentioned on the relevant website.	-

⁷³ <https://www.ird.govt.nz/covid-19/international/tax-residency> [Last accessed on 13 May 2021]

⁷⁴ <https://www.gov.uk/hmrc-internal-manuals/residence-domicile-and-remittance-basis/rdrm13410>; <https://www.gov.uk/tax-uk-income-live-abroad> [Last accessed on 13 May 2021]

⁷⁵ <https://www.irs.gov/pub/irs-drop/rp-20-20.pdf> [Last accessed on 13 May 2021]

4.1.4. Other potential international tax issues

Under the tax treaties, the article on elimination of double taxation – also known as article on foreign tax credit – contains a precondition to oblige the residence country to allow foreign tax credit to its residents for taxes paid by it in the source country. The precondition is that the source country should have levied the tax (if applicable) “in accordance with the provisions of the relevant treaty”. Therefore, given that different countries allow different relaxation measures due to Covid-19 pandemic which, in the opinion of the residence country, may not satisfy the “in accordance with” condition leading to denial of foreign tax credit.

4.2 Transfer pricing issues

Transfer Pricing, as we all know, is one of the specific anti-avoidance mechanisms which is followed in most of the countries. Transfer Pricing mechanism is useful to ensure that the transactions between related or associated entities are based on independent third-party terms and conditions.

Economic analysis, inter alia, plays a crucial role in any benchmarking analysis and the impact of the pandemic on transfer pricing analysis will need to be analysed with surgical precision. Remember, the benchmarking exercise for the impact period will not be the same as what most of us have been doing in the past. It will, inter alia, need more robust analysis especially in finding the right set of comparable companies and carrying out necessary economic adjustments.

Furthermore, the pandemic may impact the advanced pricing agreement (APA) terms like critical assumptions, financial projections, etc. and it will be crucial for the taxpayers and the revenue authorities to sit together and reach to an amicable solution well in advance.⁷⁶

4.2.1. Potential challenges for no risk or limited risk entities

Generally, the local entities perform limited functions with no or limited risk. Such entities are risk insulated with guaranteed margins and are usually used for captive consumption of a multinational business group.

Typical arrangements under this include cost-plus fixed margin arrangement or variable margin (arm’s length price-based) on sales arrangement.

During the interrupted period, under the cost-plus arrangement, the group companies may be tempted to renegotiate the margin percentage, or the cost-base considered for remuneration. However, it is a double whammy for the corporates, as the tax authorities of the local entity would want that there should be no renegotiation of terms whereas the tax authorities of the associated entities abroad may want that the taxpayer renegotiates the terms, similar to what it would have done had it transacted in an independent scenario.

On the other hand, under the variable-margin arrangement, the challenge would be to find suitable comparable companies. Assuming that the companies are functionally or qualitatively comparable to the local entity, they might be running into losses – like most of the taxpayers during the pandemic affected period – thereby leading to a negative margin range. Based on the practical experience with the tax authorities, the loss-making comparable companies are not looked upon favourably during the audit proceedings. Therefore, practically, it will be a tedious task for taxpayers to appropriately benchmark the underlying transactions.

⁷⁶ <https://www.taxsutra.com/tp/experts-corner/pandemic-covid-19-impact-apa-mechanism> [written by the Author himself in March 2020. This article was published on a subscription-based platform, pdf copy available on request] [Last accessed on 13 May 2021]

4.2.2. Potential challenges for entrepreneurial risk entities

Generally, they operate as any other business entity which bears all the associated risk and enjoys the corresponding rewards or assumes the corresponding losses. In short, their bottom-line is driven by market forces and, therefore, there are no guaranteed returns. These entities usually pay royalty or license fees to its associated entities abroad for using its trademark, know-how, technology, brand name, etc.

During the interrupted period, due to lower volume of sales or altogether no sales (depending on the industry in which one operates), a taxpayer may be incurring losses which may not be attributable to the transactions entered into with its associated entity. However, justifying this to the tax authorities may be a practical challenge. Economic adjustments including idle capacity adjustment, in form of inventory written off cost or salary cost paid to employees even when the production was halted due to restrictions imposed due to the pandemic, may need to be carried out. This, however, may invite attention of the tax authorities which may now carry out an in-depth analysis of royalty/license fee rate or the calculation mechanism of the royalty/license fee.

4.2.3. Potential challenges specific to intra-group payments

It has always been a practical challenge to satisfy the need-benefit-receipt test in case of intra-group service payments made by local entity to its associated entity abroad.

Issues like justification of cost allocation keys, justifying charge for strategic guidance received from global or regional headquarters, differentiating services warranting a charge from shareholder activity and justifying need for standby charges paid for obtaining on-call services will draw much more attention of the tax authorities and, due to squeezed bottom-line of the taxpayers, it is even more important for them to substantiate the same.

Author's view

From the taxpayers' perspective, one should focus on ex-ante approach over ex-post approach and also carry out economic adjustments and exhaustive comparability analysis. They should also maintain robust documentation to substantiate their claims. The taxpayers may also consider entering into the APA to achieve tax certainty in these uncertain times.

The OECD released "Guidance on the transfer pricing implications of the COVID-19 pandemic" on 18 December 2020⁷⁷ which broadly discusses on the following matters:

- Comparability analysis;
- Losses and allocation of Covid-19 specific costs;
- Government assistance programs; and
- Advanced Pricing Agreements (APA)

However, sadly there is no mention on the use of the sixth method or any other method which, in the Author's opinion, is much more flexible to deal with peculiar cases such as the pandemic. In fact, the recently released UN TP Manual⁷⁸, finds no mention of the pandemic impact at all. In the Author's opinion, this is the right time for the administrators (including the OECD, the UN and, more importantly, tax authorities of respective countries) to adopt a more flexible approach in benchmarking the intra-group transactions and encourage adopting method(s) other than the

⁷⁷ <https://www.oecd.org/tax/transfer-pricing/guidance-on-the-transfer-pricing-implications-of-the-covid-19-pandemic.htm>

⁷⁸ https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2021-04/TP_2021_final_web%20%281%29.pdf

originally prescribed five methods⁷⁹ of benchmarking. The Author wrote a detailed article on this highlighting why the sixth method deserves a chance at least during the interrupted period.⁸⁰ The Author, in fact, also suggested the same through emails to the relevant committee of the OECD and the UN both, but unfortunately the suggestions fell on deaf ears.

Furthermore, the tax authorities should come up with exhaustive guidance to deal with peculiar cases which one may witness when the audit of the impacted period comes up for scrutiny. Countries such as Australia, Canada, Singapore, The Netherlands, and The USA have already issued detailed guidance on transfer pricing implications of the Covid-19 pandemic. India, as usual, is yet to issue any guidance on this. Furthermore, it is high time that India also moves to concept of inter-quartile range rather than having its own 35th - 65th percentile range.

5. Potential after-effects of the pandemic and the way out

One certainly wishes to get rid of this pandemic soon and return to their normal routine in all respects. It is important for the government to accept the fact that the impact on the overall economy could be humongous, and it will take time for it to return to the pre-pandemic level.

It is important that the government treads this path carefully and avoid introducing any aggressive policy decisions to raise revenue collections. Going by the recent experiences, the Author fears that the common man may be unnecessarily harassed by raising existing tax rates or introducing new levies or further increase the fuel prices without any reason whatsoever. On the tax front, the Author fears that undue issues and consequently undue tax demands may follow to shore up the revenue coffers leading to tax terrorism.

To ensure that this does not happen, the government should start planning about various mechanisms which it can implement to avoid this situation. Some of the mechanisms may include:

- **Doing away with setting revenue collection targets for field officers:** This has led to unproductivity and wastage of precious resources of the country in the form of cognitive resources, monetary resources, and the most important intangible resource that everyone has but often squanders – time. Consequently, the tax demands are raised only to meet unrealistic targets which, more often than not, get reversed at the appellate level.
- **Dedicated cells to deal with tax issues arising out of Covid-19 impact:** The government should be proactive to setup dedicated cells within the tax administration to deal with tax issues arising due to impact of Covid-19.
- **Clarity on PE implications and cross-border employment income:** As seen in the above sections, most of the major countries have already clearly spelt out the impact of Covid-19 on PE implications and cross-border employment. It is high time that India also comes out with clear set of guidance on the same to ensure that the stakeholders are not left in lurch due to uncertainty regarding tax implications.
- **Timely announcement of deadline extensions:** While the Central Board of Direct Taxes (CBDT) recently announced extension in some due dates, most of them relate to deadlines extension for revenue authorities to complete the audit scrutiny or issue notices. Furthermore, given the circumstances, it is suggested that the government should extend the deadlines well in advance rather than waiting for last week before extending the same. In the recent past, the

⁷⁹ Comparable Uncontrolled Price (CUP) Method, Resale Price Method (RPM), Cost Plus Method (CPM), Profit Split Method (PSM) and Transactional Net Margin Method (TNMM). Although these methods (nomenclature) are based on Indian Transfer Pricing Regulations but broadly the methods remain the same in principle even though they may be known by slightly different nomenclature.

⁸⁰ <https://news.bloombergtax.com/daily-tax-report-international/insight-covid-19-transfer-pricing-and-the-sixth-method> [Written by Author himself in June 2020]

due dates are extended only at the last minute after various industry bodies file applications. This, of course, is not limited for taxation aspects but all other relevant laws of the land.

- **Introduction of effective dispute prevention and resolution mechanism:** Effective dispute prevention and resolution mechanism should be introduced by India, in the form of mediation and arbitration, to avoid unnecessary and avoidable disputes arising due to Covid-19 impact. This will help the relevant stakeholders to save their precious monetary and cognitive resources on unnecessary and avoidable litigation. Mediation is long prevalent in some of the developed countries, and it is right time for India to introduce it. Furthermore, given that the place of effective management of corporates will most likely be determined by way of MAP, it is important that such issues are resolved expeditiously.
- **Liberalised tax recovery mechanisms:** One should surely pay due taxes and anyone who tries to circumvent the law should be punished. However, in these difficult times, the government may consider introducing equated monthly installment (EMI) scheme to lessen the burden on the taxpayers.

On the other hand, it is equally important for the businesses to keep in mind the following aspects:

- **Well-drafted formal written contractual agreements:** Most of the businesses were caught off guard by this pandemic as majority of the businesses do not have written contract with their vendors and customers. This led to numerous disputes regarding non-performance of contract due to potential impossibility of the desired act. Furthermore, even the businesses which had entered into formal written contractual agreements, either did not have any force majeure clause, or the same was not adequately drafted. Having said that, the written contract should always fall in line with the actual conduct of the transacting parties.
- **Robust documentation:** The taxpayers will need to pull up their socks and maintain robust documentation to substantiate the losses or lower profitability due to the pandemic. The typical response of the taxpayers while filing submissions before the tax authorities educating them about the ‘principle of consistency’ will no longer hold valid as the facts and circumstances will be substantially different in most cases.

6. Way forward

The need of the hour is to create more demand and that can only be done when there is enough liquidity in the market. Furthermore, it is also important for the government to empathize with the stakeholders at this hour while implementing new policy decisions and/or administering the existing policy decisions.

Some of the measures that can be taken to address the same are as under:

6.1. On the economy front

6.1.1. Easy access to capital

In these times, to propel the demand it is important that there is enough liquidity available in the market and that should be available at reasonable interest rates and without unnecessary compliance requirements.

6.1.2. Conscientious divestments

The government has been on divestments spree in the recent past, but one may exercise caution as public enterprises, at least the ones which are not sick or loss-making, need to be preserved from a long-term perspective. One cannot blindly sell all the public enterprises just because the government

needs money today. In fact, a meticulous planning is required to devise a divestment plan which should also focus on often ignored and underperforming state-owned entities. The government should identify all such state-owned entities and evaluate the root cause of the non-performance and take appropriate action of divesting in them.

6.1.3. Adopting austerity measures⁸¹

Austerity measures by the government officials to save precious public resources, both on revenue and spending front, will also help mobilise the resources in an efficient manner. This is a very important tool through which the limited available resources can be mobilized effectively and efficiently.

6.2. On the taxation front

6.2.1. Exploring new levy on super-rich

India should consider reviving the wealth tax and also impose a temporary Covid-19 cess on the super-rich. Reintroduction of the wealth tax will not only ensure more tax revenue to the government but also control the menace of black money which still exists, despite the demonetization back in year 2016. It will also enable the government to keep a tab on the disproportionate assets owned by the wealth-tax payers vis-à-vis the income tax returns filed by them.

Given that the Indian tax authorities have already employed artificial intelligence in administering the tax data, it will be easier for them to map the data disclosed under the wealth tax return vis-à-vis the returned income of such taxpayer for further investigation. In case the taxpayer is unable to substantiate, hefty fines and penalties should be imposed to keep a check on black money transactions and also generate the tax revenue. This will also help India in improving its already sluggish tax-to-GDP ratio which is expected to continue to head southwards. Having said that, it is important that there is no undue harassment of genuine taxpayers.

6.3. Looking beyond numbers

6.3.1. Health and medical infrastructure

Currently, our health and medical infrastructure is in dire straits, and it is a no-brainer that we need to prioritise it more than anything else. Currently, the infrastructure is inadequate to cater the population of 1.39 billion and counting. It is agonising to see that despite having the best brains in the medical world, we lag solely because of the lack of necessary infrastructure. To avoid this sorry state of affairs in the future, it is important that a much higher budget is allocated to this sector and also incentives are doled out to attract investors in this industry.

6.3.2. Improve the existing public information technology infrastructure

The current IT infrastructure of the government agencies is inadequate, as the websites do not function properly and, if at all they do, they are too slow to handle the traffic volumes. Given that India is moving towards faceless administration, it is even more important to provide seamless experience to the users.

6.3.3. Businesses to put technology at the forefront

⁸¹ The Author had voiced his opinion on adopting austerity measures rather than always resorting to imposing burden on common man (in form of new taxes or increasing the rate or scope of existing taxes) in his article dated 31 January 2020. Use the following link to access the same: <https://www.karnikgulati.com/spiraling-fiscal-deficit-time-to-adopt-some-austerity-measures/>

This pandemic has highlighted the importance of having the necessary information technology infrastructure and that one cannot sustain for long in any business without it. Of course, relatively bigger organisations already have adequate IT infrastructure to meet the challenges presented by cross country travel restrictions, intra-country movement or intra-city movement etc. However, it is important for small-to-medium businesses also to have adequate IT infrastructure in place. In some of the industries like manufacturing, it may not be feasible to implement complete work-from-home policy, but in most of the service industries, that is the only way forward.

6.3.4. Shared economy and gig economy

Businesses need to embrace the fundamental shift in how businesses are run. Businesses can now tap the right talent even across the world, without the need of having one physical present in the base country of operations. This will enable businesses to get the best talent and also, on the other hand, people to use their skills without any border restrictions.

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Karnik is an Associate Member of the Institute of Chartered Accountants of India. He also holds Baccalaureate Degree in Law (LL.B.) in addition to Advance Diploma in International Taxation (ADIT) from Chartered Institute of Taxation, London.

Karnik is presently associated with Coinmen Consultants LLP, New Delhi in their Tax & Regulatory Services. His areas of expertise include income tax advisory including international tax and TP matters, transaction advisory (inbound/outbound), FEMA advisory, dedicated consultancy for startups including assisting them finalising term sheets with investors, valuating the right funding instruments, etc. Karnik has previously worked with reputed firms including KPMG (New Delhi), T.P. Ostwal & Associates, Chartered Accountants (Mumbai) and Deloitte Haskins & Sells (New Delhi).

Karnik is also an active member of the International Taxation Committee of the Bombay Chartered Accountants' Society (BCAS). Karnik has been awarded twice with 'Certificate of Fellowship' presented by Professor Roy Rohatgi/Adv. Mukesh Butani on behalf of the Foundation for International Taxation, Mumbai for the year 2015 and 2019. Karnik also has a flair for writing and has authored various articles on international taxation and transfer pricing with Bloomberg, International Tax Review, etc.

“The difficulty lies not so much in developing new ideas as in escaping from old ones.”

John Maynard Keynes

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