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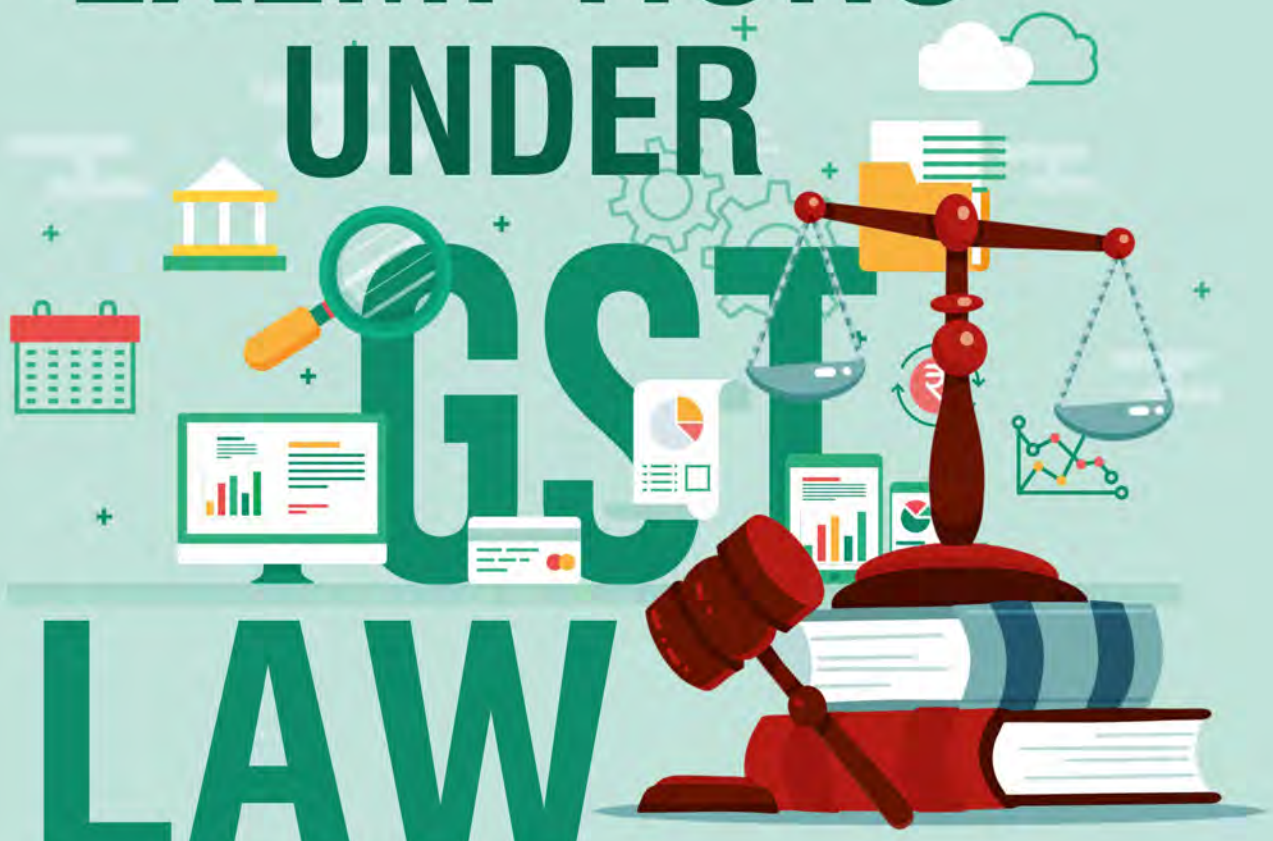

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HOT SPOT

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Analysing 'Work From Home Scenario' from Tax & PE/Poem Perspective

Introduction

The COVID-19 pandemic has transformed the manner of working. 'Work from home' – which was occasionally implemented – has become the new norm. The COVID-19 induced travel restrictions meant that homes were transitioned into offices on an immediate basis, especially for employees working in non-manufacturing establishments. Going forward, for some sectors (such as services sector, consultancy, back-office work, etc.), this may become the new way of delivering services. Hybrid models of work (some days in office and 'work from home' on other days) seem to be the future.

While WFH (a commonly used expression for 'work from home') ensured that work never stopped and that economy/ trade continued to operate (in safer environments) albeit in a limited way, one must not lose sight of the income-tax issues and concerns that the multinational enterprises (MNEs) and their personnel may have to face due to WFH. WFH meant that people were able to work from places/ countries other than their normal place of work. This notional collapse of global borders forced people to stay where they were prior to the travel restrictions. Such involuntary stay can lead to unwanted tax concerns for MNEs and such people. MNEs may have to face challenges on account of permanent establishment (PE) exposure due to remote working by its personnel, and such stranded personnel may get trapped in issues like dual residency, etc.

In this article, the authors have discussed such challenges and the aspects which need to be considered in this regard by MNEs and stranded employees, global guidance available on the subject, India's response to income-tax issues arising due to COVID-19 induced travel restrictions.

Aspects to be considered by MNEs in WFH scenario

MNEs should keep in mind following aspects in WFH scenario:

- ***Relevant PE considerations***: There can be several types of PEs – fixed place PE, construction PE, service PE, agency PE, etc. depending on the nature of activities carried out by MNE in the source state, the application of relevant tax treaty, and also the applicability of the recently introduced multilateral instrument (MLI).

Thus, one needs to look at the relevant tax treaty while examining if the thresholds/criteria for creation of a PE are met. From the perspective of WFH, following are the PE considerations that need to be kept in mind:

- *Fixed Place PE:* It means a fixed place of business through which the business of an enterprise is wholly or partly carried on. A fixed place PE of MNE can be said to be in India if (i) there exists a physical place of business; (ii) such place of business is at the disposal of MNE; (iii) such place of business is at a fixed place with certain degree of permanence (ie not of a purely temporary nature); and (iv) core business activity of MNE is carried out through such fixed place of business. Paragraph 12 of Article 5 of the Organisation for Economic Co-operation and Development's (OECD) Model Tax Convention on Income and on Capital (2017) (OECD Commentary) provides that whether a location may be considered to be at the disposal of an enterprise will depend on that enterprise having the **effective power to use that location as well as the extent of the presence of the enterprise at that location and the activities that it performs there**. In this regard, attention is invited to the decision of Hon'ble Supreme Court of India in ***Formula One World Championship Ltd vs. CIT [2017] 394 ITR 80 (SC)*** wherein it was held that the place would be treated as 'at the disposal' of the enterprise when the enterprise has right to use the said place and has control thereupon, and it is not necessary that the premises are owned or even rented by the enterprise. The court further noted that duration/ period for which the place is at disposal is immaterial (in the instant case, it was around 3 weeks) and what would matter is the full access/ control over that place. In this regard, much would depend upon the nature/ business of the taxpayer, facts and circumstances of the case.

  Paragraphs 18 and 19 of Article 5 of the OECD Commentary contains crucial observation with respect to home office. Paragraph 18 states that when a home office is used on a continuous basis for carrying on business activities for an enterprise and it is clear that the enterprise has required the individual to use that location to carry on the enterprise's business (e.g., by not providing an office to an employee where the nature of employment clearly requires an office), the home office may be considered to be at the disposal of the enterprise. For ease of reference, the relevant paragraph is reproduced below:

  "18…Whether or not a home office constitutes a location at the disposal of the enterprise will depend on the facts and circumstances of each case. In many cases, the carrying on of business activities at the home of an individual (e.g., an employee) will be so intermittent or incidental

that the home will not be considered to be a location at the disposal of the enterprise. ***Where, however, a home office is used on a continuous basis for carrying on business activities for an enterprise and it is clear from the facts and circumstances that the enterprise has required the individual to use that location to carry on the enterprise's business (e.g. by not providing an office to an employee in circumstances where the nature of the employment clearly requires an office), the home office may be considered to be at the disposal of the enterprise."***

Similarly, Paragraph 19 with respect to cross frontier worker states as below:

19… ***Where, however, a cross-frontier worker performs most of his work from his home situated in one State rather than from the office made available to him in the other State, one should not consider that the home is at the disposal of the enterprise because the enterprise did not require that the home be used for its business activities.*** *It should be noted, however, that since the vast majority of employees reside in a State where their employer has at its disposal one or more places of business to which these employees report, the question of whether or not a home office constitutes a location at the disposal of an enterprise will rarely be a practical issue. Also,* ***the activities carried on at a home office will often be merely auxiliary and will therefore fall within the exception of paragraph 4.***

Thus, an employee doing WFH may result in creation of fixed place PE for his employer company in following circumstances:

- Employer has required the employee to do WFH.
- Employer has business interest in employee carrying out work through WFH basis.
- Core business operations are carried out by an employee from WFH mode.
- Employer pays his employee towards use of home office and/ or provides office equipment to his employee at home.
- Home office of the employee is registered as a place of business of employer.
- Activities of the WFH employee do not fall within the ambit of 'auxiliary or preparatory' services.

o ***Agency PE***: If a person resident in India represents or acts on behalf of MNE, his presence in India may be regarded as presence of such

MNE in India and could trigger establishment of a PE in India of that MNE. Agency PE of MNE in India can be said to be triggered when the following conditions are satisfied:

— Such person is dependent on MNE;

— Such person acts on behalf of MNE;

— Such person habitually concludes contracts or habitually plays the principal role leading to the conclusion of contracts on behalf of such MNE.

Thus, an employee doing WFH may result in creation of an agency PE for his employer company in following circumstances:

— Employee has the authority to conclude contracts or plays principal role leading to the conclusion of contracts on behalf of his employer.

— Activities of the WFH employee do not fall within the ambit of 'auxiliary or preparatory' services.

o ***Service PE***: If an MNE renders services in India through employees or other personnel and if the duration of such services in India exceeds a threshold limit provided under the relevant tax treaty, it may result in creation of a service PE of such MNE in India. Paragraph 151 of Article 5 of the OECD Commentary states that for service PE to arise, services must be provided to a third party (and not to the taxpayer itself). Further Paragraph 152 of Article 5 of the OECD Commentary states that service PE applies to services that are performed in a state by a foreign enterprise. Whether or not the relevant services are furnished to a resident of the state does not matter; what matters is that the services are performed in the state through an individual present in that state.

Thus, employee doing WFH may result in creation of service PE for his employer company if such services are rendered to third parties for a period exceeding service PE threshold criteria and the services performed by employee do not fall within the ambit of 'auxiliary or preparatory' services. In this regard, useful reference can be made to the decision of Delhi High Court in ***U.A.E. Exchange Centre Ltd vs. UOI [2009] 313 ITR 94***[1] wherein the Hon'ble court held inter alia that activities which are subsidiary or in aid or support of the main activity would fall within the ambit of 'auxiliary or preparatory' services.

1. This decision has been affirmed by the Hon'ble Supreme Court in the case of *Union of India vs. U.A.E. Exchange Centre Ltd [2020] 425 ITR 30.*

- ***Consequences of PE in India:*** Once it is established that an MNE has a PE in India, following consequences may arise:
  - *Business income*: Profits of the MNE that are attributable to such PE will be taxed as 'business income' in accordance with the relevant tax treaty.
  - *Filing of Indian income tax return:* The MNE will be required to file tax return in India and offer to tax such business income earned by it during the relevant financial year (FY).
  - *Tax deduction (TDS) obligations:* It will be required to withhold tax on salary income of its foreign employees under Section 192 of the Income-tax Act, 1961, deduct tax at source on expenses (such as under Sections 194J, 194C, etc.).
  - *Situation where senior executives of MNEs are stuck/ stranded in India*: Under the Indian tax law, a foreign company can be treated as a resident in India for tax purposes if its place of effective management (POEM) in the relevant FY was in India. POEM is defined to mean a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance, made. Thus, a situation may arise where senior executives of MNE are stuck in India due to COVID-19 related travel restrictions and business decisions are thus made from India. The question that arises then is whether such a scenario can result in the POEM of the MNE to be in India during that FY. Reference can be made to the guidance issued by the OECD (discussed below) wherein it has been stated that all relevant facts and circumstances should be examined to determine the 'usual' and 'ordinary' POEM, and not only those that pertain to an exceptional period such as the COVID-19 pandemic. While only time will tell as to how this issue will evolve under the income-tax jurisprudence, one hopes that a fair/ pragmatic approach is adopted by the tax administration in examining whether forceful presence of senior executives will result in establishment of the POEM of an MNE in India especially given the fact that such stay was by force (ie involuntary) due to travel restrictions imposed in India in these unprecedented times of COVID-19.

Some relevant aspects to be considered by individuals in WFH scenario

Individuals should keep in mind the following aspects in a WFH scenario:

- ***Examination of residential status:*** Under the Indian income tax law, an individual's tax residency is determined by his physical stay in India during the FY (1 April to 31 March) as well as his stay in the preceding years. Many other jurisdictions have similar physical presence thresholds to determine tax residency.

  There have been many occasions where non-resident Indians came to India (as their usual practice) prior to the

COVID-19 outbreak, to manage their family affairs and investments, and because of the COVID-19 outbreak and countrywide lockdown imposed in India, their Indian stay (for testing whether they have become 'resident' for Indian income tax purpose) has crossed the threshold number of days of 182 days (say in FY 2019–20 or in FY 2020-21). This is critical from a tax perspective because if one becomes a resident, the scope of his income which can be taxed in India widens besides application of the reporting requirements. Under the Indian tax law, resident individuals are required to pay tax on their global income whereas non-resident individuals are required to pay tax only on Indian-sourced income.

- ***Filing of tax return in India:*** Such individuals will need to file their return of income in India if they meet the prescribed threshold required for filing return of income in India.

- ***Jurisprudence on involuntary physical presence in India:*** While the Indian tax law does not carve out the period of involuntary stay in the determination of tax residency status, there has been a Delhi High Court ruling in the case of ***CIT vs. Suresh Nanda [2015] 375 ITR 172 (Delhi)*** which in view of the facts of that case held that the period of involuntary/forced stay in India was to be excluded to compute the period of stay in India *since the passport of the taxpayer was wrongly impounded by the authorities for a period of time making it impossible for the taxpayer to leave the country to maintain his non-resident status*. It was a peculiar case and having regard to that situation, the high court held that such involuntary/ forced stay must be excluded. The court further remarked that this case is based on its own peculiar facts and should not be treated as a precedent and that each case will have to be examined on its own merits in light of the facts and circumstances leading to 'involuntary' stay, if any, in India. We believe that forced stay in India of individuals stranded here due to COVID-19 related travel restrictions ought to be regarded as 'involuntary'. This is because individuals were not able to travel in view of government's travel restriction related guidelines/ advisory.

  Thus, an individual (primarily being a non-resident who becomes a resident in India due to COVID-19 restrictions) can take an argument in view of the aforesaid Delhi High Court ruling that his stay in India was mainly on account of lockdown restrictions imposed by the government to prevent the spread of COVID-19 virus and thus the same was involuntary. Hence, such number of days during which the lockdown restrictions were imposed should be excluded while determining his residential status. This argument will become even stronger with respect to those individuals who have maintained their non-residential status in India for quite some time (say for 5 - 7 FYs) and considering other aspects like (a) such stay was forced/ not on account of their own volition; (b) their center of vital interests/ habitual abode etc. lies in a foreign country. Even in the absence of this Delhi High Court ruling, on the first principle also, one can justifiably contend that the period of stay in India

on account of the lockdown restrictions should be excluded while determining the residential status given the fact that (a) the stay was forced due to lockdown restrictions imposed by the government; (b) assurance was given by the government that a circular excluding the period of stay for FY 2020-21 will be issued separately upon normalization of international flights.

Government measures with respect to tax residency

From the perspective of addressing challenges of tax residency for stranded individuals, the government of India had issued the following circulars/ press release:

- ***Circular number 11 of 2020 dated 8 May 2020 (FY 2019-20 Circular):*** For the purpose of determining the tax residential status for FY 2019-20, FY 2019-20 Circular provided relief to individuals who had come to India on a visit before 22 March 2020. This circular had categorised such individuals into three broad categories and provided corresponding relief to them as under:

Categories	*Relief provided*
Category 1: Individual who was unable to leave India on or before 31 March 2020	Period of stay in India from 22 March 2020 to 31 March 2020 will be excluded for determining residential status
Category 2: Individual who has been quarantined in India due to COVID-19 on or after 1 March 2020 and (i) has departed on an evacuation flight on or before 31 March 2020; or (ii) has been unable to leave India on or before 31 March 2020	Period of stay in India from the beginning of his quarantine to the date of his departure or 31 March 2020, as the case may be (i.e. depending on (i) or (ii)), will be excluded for determining residential status
Category 3: Individual departed on an evacuation flight on or before 31 March 2020	Period of stay in India from 22 March 2020 to date of departure will be excluded for determining residential status

- ***Press release dated 9 May 2020 (Press Release):*** The Press Release issued by the government stated that as the lockdown continues during FY 2020-21 and it is not yet clear as to when the international flight operations would resume, a circular excluding the period of stay of these individuals up to the date of normalisation of international flight operations for determination of the residential status for FY 2020-21, will be issued after flights resume. Thus, for all practical purposes, the Press Release read like a commitment/ public assurance from the government/ Central Board of Direct Taxes (CBDT) that similar exclusions would be provided for later year as well.

- ***Circular number 2 of 2021 dated 3 March 2021 (Latest Circular):*** As there was no clarification from the CBDT regarding exclusions from period of stay of individuals for FY 2020-21 until almost the end of the FY 2020-21, various representations were made for clarity on this crucial aspect of residency determination which would have a huge impact on the tax positions of an individual. A petition was filed before the Hon'ble Supreme Court seeking clarity on this point. The Hon'ble Supreme Court took judicial note of the FY 2019-20 Circular which provided for exclusion of period of stay for FY 2019-20, and the continuing COVID-19 pandemic situation due to which individuals were stranded because of the country-wide lockdown. It accordingly directed[2] the petitioner to approach CBDT by filing a representation. CBDT was directed to consider such representation in 3 weeks of receipt.

  Subsequently, the Latest Circular was issued by the CBDT wherein no relief/ allowance for exclusion of days was given despite the assurance in the Press Release. The Latest Circular inter alia stated as below:

  - *Short stay will not result in Indian residency:* The Latest Circular provided that a short stay would not result in Indian residency as generally one would need to stay for 182 days or more to become a resident in India.

  - *Possibilities of double non-residency in case of general relaxation:* The Latest Circular stated that most of the countries have the condition of stay for 182 days or more for determining residency. Thus, a person in most situations will be resident in only one country since there are 365 days in a year. Accordingly, if a general relaxation for the stay period of 182 days is provided, there may be cases of double non-residency. In such situation, a person may not become a tax resident in any country in FY 2020-21 even after staying for more than 182 days or more in India resulting in double non-taxation and non-payment of tax in any country.

  - *Use of tie breaker rule as provided under the relevant tax treaty:* Tie breaker rules (as provided under the relevant tax treaty) were referred in the Latest Circular to state that the tie breaker test may come to the rescue of certain individuals. It was further stated that even if an individual becomes resident of India due to exceptional circumstances, he will most likely become 'not ordinarily resident' in India and hence his foreign-sourced income will not be taxable in India unless it is derived from business controlled in or profession set up in India. The Latest Circular has, however, ignored a situation where an income is not taxed in other

2. *Gaurav Baid vs. UOI & Ors [TS-62-SC-2021]*

country (such as UAE which does not levy tax on income earned by individuals) and thus the tie breaker may not even be used in such cases. In such cases, reporting requirements in India (such as filing of income tax return etc.) as discussed above may become applicable.

- *Taxability of employment income:* CBDT referred to the article relating to employment income 'Dependent Personal Services' as provided under the relevant tax treaty which provides that such employment income would be taxable in India only if the prescribed thresholds as provided under the relevant tax treaty are met.
- *Tax credit:* The Latest Circular stated that a person treated as an Indian resident will be eligible to claim for taxes paid (if any) in another country as per provisions of relevant tax treaty and hence there would be no double taxation.
- *Information sought by CBDT*: In case there are taxpayers who are likely to suffer double taxation, an option was given to them to provide all requisite details in a prescribed form (Form NR) by 31 March 2021. On receipt of such details, the CBDT would consider providing a general relaxation or relaxation in a specific matter (on a case-to-case basis) as it deems fit.

Pertinently, certain taxpayers have challenged the Latest Circular before the Hon'ble Supreme Court by way of filing a writ petition[3]. The taxpayers have sought a review of the Latest Circular and appropriate directions from the Hon'ble Supreme Court for exclusion of forced/ involuntary stay for FY 2020-21 on account of COVID-19 lock down restrictions in India etc.

OECD's updated guidance dated 21 January 2021 on tax treaties and the impact of COVID-19 pandemic

On a global front, providing some hope to such a category of taxpayers, OECD has issued an updated guidance document dated 21 January 2021 on the issues related to creation of PEs, tax residency status of individual and foreign companies etc. in view of the COVID-19 pandemic (OECD Guidance). The same are discussed below:

- ***OECD Guidance on concerns relating to creation of PE:*** In the OECD Guidance, with respect to PE exposure, OECD has stated as below:
  - *Regarding fixed place PE:* Individuals teleworking from home (i.e. the home office) as a public health measure imposed or recommended by at least one of the governments of the jurisdictions involved to prevent the spread of the COVID-19 virus would not create a fixed place of business PE for the business/employer.

3. *Gaurav Baid vs. CBDT & Ors (Writ Petition (Civil) No. 353 of 2021), Vikas Malu vs. CBDT & Ors (Writ Petition (Civil) No. 376 of 2021)* etc

- *Regarding agency PE:* The agent's activity in a jurisdiction should not be regarded as 'habitual' if they have exceptionally begun working at home in that jurisdiction as a public health measure imposed or recommended by at least one of the governments of the jurisdictions involved to prevent the spread of the COVID-19 virus and, therefore, would not constitute a dependent agent PE provided the person does not continue those activities after the public health measures cease to apply.
- *Regarding construction site PE*: A construction site PE would not be regarded as ceasing to exist when work in the site is 'temporarily' interrupted. The OECD Guidance, however, provides that the jurisdictions may consider certain periods where operations are prevented as a public health measure imposed or recommended by the government where the site is located to reduce the spread of the COVID-19 virus as a type of interruption that should be excluded from the calculation of time thresholds for construction site PEs.

- ***OECD Guidance on concerns relating to change of residence:*** With respect to concerns relating to change in residence, OECD has stated as below:
  - *Regarding change in location of board members/senior executives:* A temporary change in location of board members or other senior executives is an extraordinary and temporary situation due to COVID-19 pandemic and such change of location should not trigger a change in treaty residence. In case of dual residence of the companies, tie breaker rules as provided under the relevant tax treaty would come into play. All relevant facts and circumstances should be examined to determine the 'usual' and 'ordinary' POEM and not only those that pertain to an exceptional period such as the COVID-19 pandemic.
  - *Regarding change in the residence of the individuals:* As the COVID-19 pandemic is a period of major changes and an exceptional circumstance, tax administrations and competent authorities will have to consider a period where public health measures imposed or recommended by the government do not apply when assessing an individual's residence status. If, in the context of and as a result of the COVID-19 pandemic, an individual's temporary presence in a jurisdiction results in him becoming dual-resident, that individual's place of residence for the purposes of the tie-breaker included in the applicable treaty is unlikely to change, given that the tie-breaker provision requires consideration of factors that shall also be assessed in a more normal period. A dislocation because a person cannot travel back to their home jurisdiction due to a public health measure of one of the governments of the jurisdictions involved should not by itself impact the person's residence

status for purposes of the tax treaty. A different approach may be appropriate, however, if the change in circumstances continues when the COVID-19 restrictions are lifted.

- ***Concerns related to income from Employment:*** In the OECD Guidance, with respect to concerns relating to income from employment, OECD inter alia has stated as below:

  - Stranded worker exceeding his days of presence threshold due to travel restrictions: Where an employee is prevented from travelling because of COVID-19 public health measures of one of the governments involved and remains in a jurisdiction, it would be reasonable for a jurisdiction to disregard the additional days spent in that jurisdiction under such circumstances for the purposes of the 183 days' test in Article 15(2)(a) of the OECD Model.

Conclusion

Thus, MNEs and their stranded employees would need to keep the above aspects in view while evaluating any possible challenge from a PE perspective. Since WFH mode largely started from last year itself, it would be interesting to see how Indian courts will look at these arrangements from a tax standpoint especially in view of COVID-19 related challenges.

Pertinently, while there are no Indian precedents on concern relating to PE arising in a WFH scenario especially in light of the COVID-19 pandemic, lately, various foreign courts had occasions to examine this aspect. Although foreign court[4] rulings are not binding in nature, the principles laid down in these rulings will serve as a useful guiding material for the Indian courts in their adjudication.

Also, a sympathetic and reasonable approach would be required on the part of tax administration to be fair to taxpayers and to avoid unnecessary litigation in this regard.

(The views of the author(s) in this article are personal and do not constitute legal/professional advice of Khaitan & Co. For any further queries or follow up, please contact us at ergo@khaitanco.com).

4. H1 [TS-466-FC-2021(DEN)]: In this case, having regard to the facts and circumstances of the case, Danish Tax Council held that employee of the company compelled to work in Denmark due to COVID-19 did not constitute a PE of the company in Denmark under Danish-English DTAA.

   Sproger (UK Co.) [TS-303-FC-2021 (DEN)]: In this case, having regard to the facts and circumstances of the case, Danish Tax Council held that 'internal support work' by the employee from his home office in Denmark did not constitute PE of United Kingdom based employer in Denmark. Council further remarked that the employee performed his work from Denmark solely due to private circumstances.

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