TIE-BREAKER RULES
&
MOVING BEYOND PHYSICAL RESIDENCY

CA Prerna Peshori

RESIDENCE CONCEPT – FOR INDIVIDUALS

- Denotes personal connection
- Residence, domicile, citizenship are they same?
  - US citizens are residents of US
  - UK domiciled are residents of UK
- Tests for residency
  - Time spent in the country – No of days test
  - Connections with a particular country
    - centre of vital interest, permanent home, habitual abode (Australia, Netherlands, Germany or France)
    - Close relations with country – Canada or Netherlands
    - place of employment (France, Japan, NZ)

  - Citizenship test (US)
  - Generally leads to world-wide taxation (except for countries following territorial system of taxation)

RESIDENCY IN INDIA – FOR INDIVIDUALS

- No of days test
- 2 kinds of residents – Ordinary & not ordinary
- >182 days during the PY or
- 60 days during the PY AND 365 days in the 4 PPY
- **Exception: 60 days replaced to 120 days**
  - Indian citizen or PIO coming on visit to India having TI (from other than foreign sources) > Rs. 15 Lakhs
- **Exception: 60 days replaced to 182 days**
  - For Indian citizen going outside India for employment or member of crew of Indian ship
  - Indian citizen or PIO coming on visit to India
- New concept of deemed residency – Indian citizen not liable to tax in any country & having TI (from other than foreign sources) > Rs. 15 Lakhs

RESIDENCY IN INDIA – FOR INDIVIDUALS

- Additional Test for establishing ordinary residency
- Resident in 2/10 PPY AND
- Presence of > 730 days in 7 PPY

ROR	World-wide income taxable in India
RNOR	Income accruing or arising in India except if business controlled in or profession set-up in India
NR	Income accruing or arising in India

DUAL RESIDENCY FOR INDIVIDUALS

- Article 4 of the Tax treaty refers to the domestic tax law of each country for the purpose of determining the residency
- Therefore, application of the domestic tax laws could result in dual residency
- Tie-breaker rule under the tax treaty provides priority ordering list in order to determine which state should be considered as ultimate residence country
- Tie-breaker is based on greater connection with a particular state

RESIDENCE UNDER THE TAX TREATIES

- Treaty applies only when person is resident of either or both Contracting States
- Article 4 attempts to resolve conflict of dual residency
- Refers to residency under domestic tax laws
- Tie-breaker for individual
  - Permanent Home
  - Centre of Vital Interest
  - Habitual Abode
  - Nationality
  - MAP
- Tie-breaker for corporates
  - POEM
  - MAP post MLI

MEANING OF THE TERMS

- Permanent Home
  - For longer period of time
  - Rented or owned
  - individual has arranged to have the dwelling available to him at all times continuously, and not occasionally for the purpose of a stay
- Centre of Vital Interest
  - Family and social relations
  - Occupations
  - Political, cultural
  - Place of business
- Habitual abode
  - Where he is customarily or usually residing
  - frequency, duration and regularity of stays that are part of the settled routine of an individual's life

JUDICIAL DECISIONS

- Where taxpayer lived in Thailand for employment purposes and also in Australia where he maintained his family, since taxpayer sustained his and his family's expenses/living from his employment in Thailand, taxpayer's personal and economic relations was closer to Thailand, Primary judge had correctly regarded taxpayer to be a resident of Thailand [2020] 121 taxmann.com 59 (FC-Australia)
- A husband and wife are dual residents of Italy and Switzerland.Their main home is in Switzerland, and they run a commercial operation in that country. They are also entered in the registry of Italians registered abroad (AIRE). They also own real estate in Italy and shareholdings in Italian resident companies. The Italian Supreme Court holds that their CVI is Italy, and they are therefore treated as Italian residents for the purposes of the Italy-Netherlands Income and Capital Tax Treaty

JUDICIAL DECISIONS

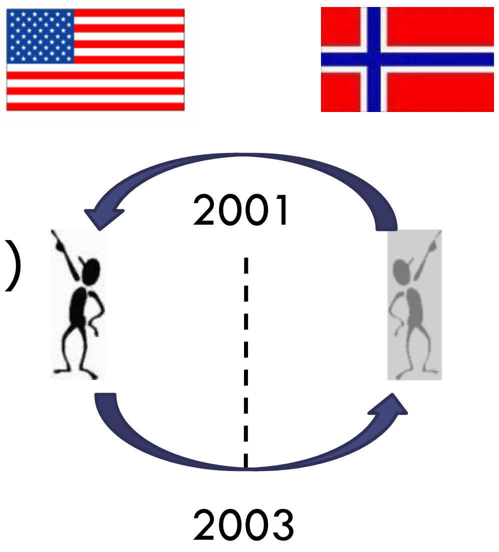
- The taxpayer lived with his wife and son in the Netherlands.[358] He was a director and shareholder of a Dutch company. He sold his house to his son, but continued to occupy the premises and also paid the utility bills for the house. The telephone account was in the name of the Dutch company of which he was a director and shareholder. Furthermore, he had bank accounts and health insurance in the Netherlands. The taxpayer had applied for residency in Spain, where he owned (jointly with his wife) a holiday home. He was issued an identity card by a Spanish municipal authority, where he also had bank accounts. The holiday home had limited power supply, and the telephone was rarely used. The Supreme Court agreed with the finding of the Court of Appeal that the taxpayer was resident in the Netherlands. The fact that he had sold his house to his son in the Netherlands did not change anything, as he had continued to have the house at his disposal as his permanent home and had paid a significant amount towards the maintenance of the house. Accordingly, the Supreme Court found that his personal and economic ties with the Netherlands were closer than those with Spain.

- The taxpayer owned a house in the United Kingdom, which she shared with her husband. Due to health reasons, she also lived in Spain, where she rented an apartment. Her husband remained in the United Kingdom, and she spent a significant part of her time there with him. She also returned to the United Kingdom to care for her father who was very ill, and then, later, for her mother. The taxpayer was also herself in receipt of disability payments from the UK government. She had several UK bank accounts (some jointly owned with her husband) and UK credit cards, all registered to her address in the United Kingdom. She was entered on the UK electoral roll. She also had a bank account in Spain, which she held jointly with her husband. She was also a director of a Spain-resident company, owned by her husband. She received no remuneration for her role, but carried out certain managerial and administrative functions for the company. The UK First-Tier Tribunal found that the taxpayer’s CVI was the United Kingdom.

PERMANENT HOME

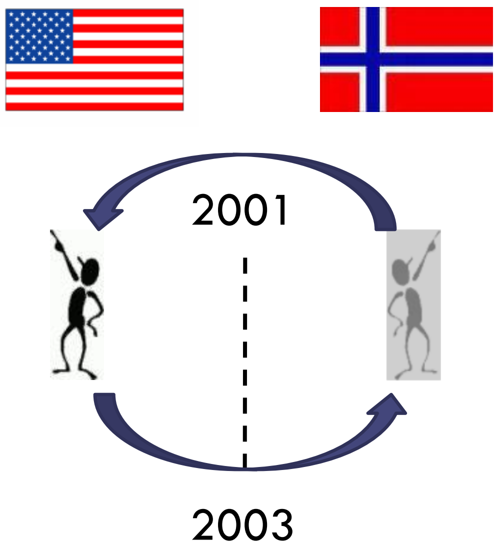
NOREGSHØGSTERETT (NOR), 24.4.2008, HR-2008-00727-A

- Norwegian moves to U.S. for 2 ½ years
- He rents apartment in U.S.
- Rents out Norwegian apartment during absence (non-terminable)
- Resident in US according to US domestic law
- Resident in Norway according to Norwegian domestic law
- Where is taxpayer resident for treaty purposes during period at issue?



PERMANENT HOME
NOREGSHØGSTERETT (NOR), 24.4.2008, HR-2008-00727-A

- Person ✓
- Resident ✓
- Tie-breaker: Art. 4 (2) OECD Model
- Subpara. (a): “permanent home”
- OECD Commentary, Art. 4 paras. 12-14



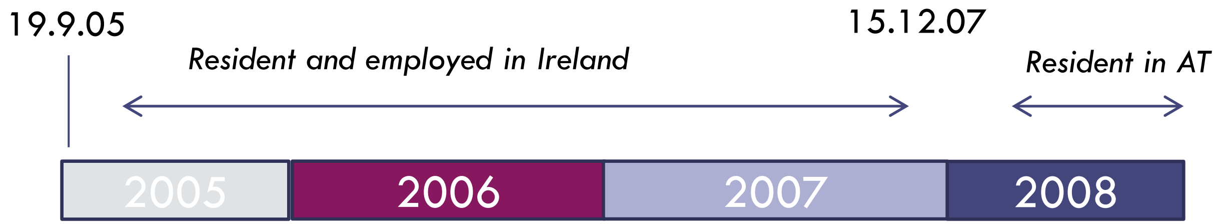
→ **U.S. apartment = permanent home**

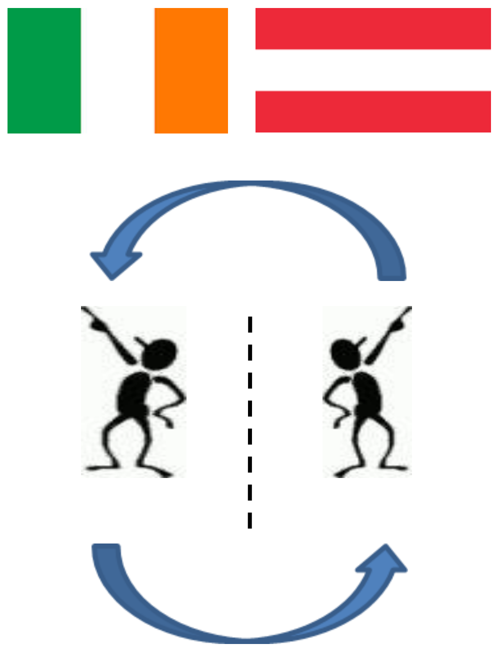
→ **Norwegian apartment ≠ permanent home**

→ **For treaty purposes, taxpayer is to be considered resident of the U.S.**

CENTRE OF VITAL INTERESTS

VWGH (AT) 25.07.2013, 2011/15/0193





- Unemployed national of AT, moves to Ireland for job in 2005, returns to AT in 2007.
- No wife or kids
- Retains house in AT, but disconnects phone, tv, internet
- Quits volunteer work at fire brigade
- Friends and colleagues in IRE, parents in AT
- Registered cars in Ireland and AT
- Registered as resident of Ireland and AT

CENTRE OF VITAL INTERESTS
VWGH (AT) 25.07.2013, 2011/15/0193

- centre of vital interests“?
- Personal relations over economic relations
- Colleagues / roommates:
- no personal relations
- Analysis over longer period of time, not per tax year
- Critique?
- Time frame to be analysed
- In dubio pro patria

- Pro Ireland
- 2-year employment
- Rental home
- Cars registered in Ireland

- Pro Austria
- Parents
- Retention of home
- Car registered in Austria
- Member of voluntary fire brigade

GIG/SHARING ECONOMY

- Emergence of crowd-work and work-on-demand apps
- Labour as a service – freelancer.com, Upwork.com, Fiverr
- Work-on-demand apps – Uber, Ola
- Digital Nomadism
  - Estonia launched digital nomad visa
  - Caribbean countries issued nomad digital residence
- Individuals having family in one country, working in more than 2 countries, staying in 3rd country, home in 4th country, working on a cruise….several residency states
- Tie-breaker has physical presence requirement in each of the tests
- Need to move away from physical residency

MOVING BEYOND PHYSICAL RESIDENCY

NEW WORK MODELS

- Home office & Teleworking
- Labour as service through crowd working platforms
- Gig/sharing economy
- Decentralised work force
- Digital nomadism
- Recently, many low tax countries like UAE , UK , Spain , Cyprus etc. are offering citizenship/ residency programs to the skilled individuals which aids them to lower their taxes
- In 2020, wealthy Indians again topped the list of those making enquiries for such residency/citizenship programmes
- Such kind of emigration schemes coupled with digitalisation assists HNIs to avoid their taxes in several countries by relocating in low tax jurisdictions, thereby resulting in personal Income-tax (PIT) avoidance.

THE IMPACT OF DIGITALISATION ON PERSONAL INCOME TAXES

- Digitalisation has effect on not only CIT but PIT as well
- Human capital has become highly mobile ~ most countries tax systems are based on premise of immobile PIT base
- Traditionally, businesses have hired their staff in the same jurisdiction where they have operations. Generally, therefore, employees resided – and paid PIT in the same jurisdiction as the business paid CIT
  - This reality is, however, set to change as remote working quickly spreads.
- Golden passport schemes, citizenship by investment schemes indicates race to bottom for PIT
- Increased PIT competition with characteristics similar to the race that has been taking place for many years in CIT
- Labour laws were designed considering full time & continuous employment based on direct relationship with employer
  - Divide between self-employed & employed getting narrower

ARTICLE 15 – EMPLOYMENT INCOME

- Article 15 of the Tax Treaties deals with employment income
- Exclusive right to residence state of employee
- Unless the employment exercised in source state
- Even if employment exercised in source state, if 3 conditions are fulfilled, it would still be exclusively taxed in residence state (i.e. connections of the employee with the source state are weak):
  - Employee present in source state for less than 183 days
  - Remuneration not paid by resident employer of the source country
  - Remuneration not borne by PE of the employer in source state
- Article 15 requires physical presence - Is physical presence really required for employees?
- Linking the place of employment with employees physical presence is problematic for internationally mobile workforce

PHYSICAL PRESENCE REQUIREMENT EMBEDDED IN ARTICLE 15

- Article 15 requires physical presence as a proxy for distributing taxing rights between residence and source countries
  - 183 days rule
  - Exercise of employment in the other state
- OECD Model Commentary

“the application of this method [days of physical presence] is straightforward as the individual is either present in a country or he is not.”

- OECD model commentary also provides that “ a resident of a Contracting State who derived remuneration in respect of employment from sources in the other state could not be taxed in the other state merely because results of his work were exercised in the other state”

SELF-EMPLOYMENT INCOME

- OECD Model Article 7 deals with service income as well
  - Article 14 deleted from OECD Model in 2000
- UN Model Article 14 deals with Income of Independent Personnel Services
- Taxability only in residence state unless there is fixed base regularly available in source state for the purpose of performing activities.
- Unlike PE, fixed base not defined.
- Fixed base regularly available requires some physical presence
  - Regularly available not defined
- Shared desk, shared laptop, shared wifi from co-working space – is it fixed base?
- Individual accessing e-residency program of country – does he has fixed base?
- Activity carried out by freelancer through website within minutes – does he has fixed base?
- Article 12A of UN Model on FTS

SELF-EMPLOYMENT INCOME

- Danish lawyer emigrated from Denmark with his family but continued to use his Danish law office address as postal address, use the website and email address of his former lawyer's office. The Danish tax authorities excluded the possibility that the emigrating individual would have Fixed base in Denmark since he had no fixed base available in Denmark.
- In Dudney case, the Tax Court of Canada held that computer consultant did not have fixed base at a Canadian company's premises where he was assigned an office, despite he using it for 300 days in a year as he could use office during the regular business hours and the office changed at the company's discretion.
- Italian lower-tier court held that a TV Columnist did not have fixed base in Italy since he needed prior approval from local TV company studio.

BLURRING LINE BETWEEN EMPLOYEES & SELF-EMPLOYED

- Contract of service vs contract for service
- Individuals providing services on aggregator platforms - Independent contractors or employees?
  - UK SC – drivers are workers instead of independent contractors
- Article 14 applies to professional services.
- The term employment not defined by OECD.
  - OECD Commentary provides that countries either adopt formal contractual relationship test or substance over form test
  - Substance over form – i) whether employee's activities constitute an integral part of the employers business activity & ii) whether the employer bears the risk for the result of the employee's activities
  - OECD addresses economic vs. legal employer but does not address who is employee at first place
- Whether there is employment relationship depends on responsibilities, risks and functions of the employer vis-a-viz employee

JUDICIAL DECISIONS

- Mumbai ITAT holds that Uber India was not required to deduct tax in respect of payments made to drivers on behalf of Uber B.V. Explains that "*the role of UISPL is limited to act as a payment and collection service provider of Uber B.V. whereby the ride fare is collected by UISPL in its bank account on behalf of Uber B.V. and thereafter payments are made, on the instruction of Uber B.V., to Driver-Partners*.";
- Refers to Sec. 204(iii) and states that in the instant case assessee is not payer of money but only the remitter which is collected from the users on behalf of Uber B.V., as it entered into contract with driver-partners and not the assessee;
- Further refers to various clauses of agreement between Uber B.V. and driver-partners and Uber BV and Users to conclude that "*Uber B.V. is involved in rendering lead generation service to the Driver-Partner and transportation service is not provided by Uber B.V. or UISPL…The transportation service provided by the Driver-Partner to Users is a contract between them to which Uber B.V. is not a party…Therefore, it is clear that UISPL is not a part of the contract and no payment obligation is imposed either under the agreement with the Driver-Partner or under the agreement with the User*

JUDICIAL DECISIONS

- Chandigarh ITAT holds that no liability under Section 194C can be fastened on Assessee providing transport aggregator platform "Ola", acting as a mere intermediary, in respect of payments made to the Drivers
- ITAT observes: (i) roles of Assessee is limited to managing and operating the OLA app, facilitating the provision of transport services to be provided by the Driver to the Rider and payment collection through e-wallet on behalf of Driver, (ii) Driver is solely liable for any accident/ incident involving the vehicle, while providing taxi services, and the Assessee has been stated to be not liable for any such incident, (iii) the Assessee and the Driver are independent contractors and that their relationship is on a principal-to-principal basis, (iv) as per scope of services Assessee is merely an intermediary providing online marketplace services and that the OLA App is only a platform where the Driver is allowed to offer transportation services to the Rider, (v) Assessee does not own or in any way control the Vehicle used by the Driver for rendering transportation services to the Rider;
- Opines that "it is clear from the contracts between the assessee and the Driver and the assessee and Rider, all of whom are unrelated, that the underlying contract for transportation service is between the Driver and the Rider and that the assessee merely facilitates the entire process on its OLA App.";

IMPLICATIONS FOR THE EMPLOYER

- Home office as a PE of the employer
- OECD Guidance on tax implications due to Covid-19
  - exceptional and temporary change of the location where employees exercise their employment because of the COVID-19 pandemic, such as working from home, should not create new PEs for the employer.
  - The home should be at disposal of the foreign employer – whether employer requires employee to work from home
  - A home office may be a PE for an enterprise if it is used on a continuous basis for carrying on business of that enterprise and the enterprise generally has required the individual to use that location to carry on the enterprise's business.
  - enterprise has required the individual to use that location (e.g. by not providing an office to an employee in circumstances where the nature of the employment clearly requires an office), the home office may be considered to be at the disposal of the enterprise.

IMPLICATIONS FOR THE EMPLOYER

- Belgian Court excluded home office as PE as only part work from his home and was not obliged to do so under the employment contract
- Where salesperson performed presales activities from home, home office was held to constitute PE by Norwegian Court
- Swedish Supreme Administrative Court held that if a taxpayer’s business is conducted at the home of sole shareholder’s house, where it does not have any other place of business, it would constitute PE
- Danish Tax Council had held that sporadic work from home by MD, at his volition, not sufficient to constitute employer's PE as MD was not involved in prospecting sales/work for the Assessee
  - In another similar case, it again held that “No work aimed at customers is performed. The reason why the employee will perform his work from Denmark is solely due to private circumstances and therefore, home office would not constitute PE”
  - In another case, home office was held to constitute PE since the home office was listed as one of the place of employment in the employment contract and employee performed leading and supporting functions within sales and business development
- Austrian MOF issued note that whether home office would result in PE – attention should be paid to whether employee is required to perform his work from home for his employer and whether expenses for home office are claimed by employer or employee

IMPLICATIONS FOR THE EMPLOYER

- Guidance seems to suggest that home office can result in PE if the work is continuously carried from home and the employer requires employee to work from home, especially if employer provides the requisite equipment
- The activities of the employee should be related to core business of the employer and not preparatory and auxiliary in character.
- Challenges
  - Fragmentation of work amongst large no of employees
  - Remote working

NEED OF THE HOUR

- Moving away from physical presence requirement
- Redefining source & residency for the individual taxation
- Anti-abuse rule for PIT erosion