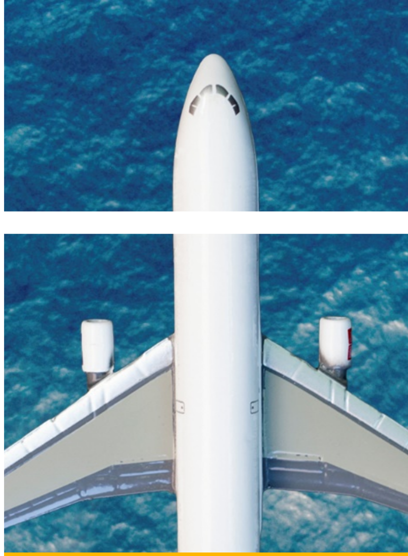

# Pandemic driven permanent establishment and tax residence concerns – Aviation Finance Focus

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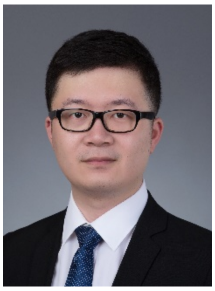

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## In brief

The outbreak of COVID-19 and the accompanying cross-border travel restrictions and quarantine requirements have had an unprecedented impact on the operations of business globally. Given the high level of mobility and the importance of travel in the aviation finance industry, such a change in business operations has created complicated commercial and tax challenges for many in the industry.

On 21 January 2021, the Organization for Economic Co-operation and Development ("OECD") published an update to their earlier April 2020 guidance on cross-border tax issues arising from the COVID-19 pandemic. In summary, this extends previously provided guidance, given the longevity of the crisis. The latest guidance conveys the key message that exceptional and temporary changes to work location or arrangements arising directly as a result of the COVID-19 pandemic should not by themselves result in the creation of a permanent establishment ("PE") or a change of tax resident status of a company or an individual.

However, the OECD guidance is merely a view on the interpretation of various treaty provisions which is not legally binding. Jurisdictions may adopt a different view of the relevant treaty provisions from those expressed by the OECD. In situations where tax treaties do not exist, the relevant jurisdictions' domestic tax rules may still apply. It should therefore be clear that it is important for aviation finance industry participants to assess their circumstances and to proactively monitor and manage such tax risks.

## In detail

Persistent restrictions on cross-border movement, quarantining, remote work arrangements – they are all playing havoc with workforce management and creating unfamiliar and complex tax challenges for every industry.

The potential tax issues associated with COVID-19 special work arrangements may be particularly pronounced for the aviation finance industry given the difficulties facing many parties in the industry right now. Such companies may be dealing with scenarios where dislocated top-level management and directors are making some of the most significant decisions their companies have ever faced from whatever location they happen to be based in. Commercially, that might be what needs to happen, but from a tax perspective, this has the potential to create a host of issues if not managed correctly. The actions may increase the risk of creating a PE or taxable presence in some jurisdictions and could even have an impact on the tax residence position of group companies in certain circumstances.

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## Permanent establishment risk

The OCED's guidance, as it relates to the potential PE issue described above, can be summarised as follows:

Fixed place PE: the exceptional and temporary change to work location as a COVID-19 public health measure imposed or recommended by at least one of the governments of the jurisdictions involved would not create a fixed place PE for the business or employer. If the employee continues to work from such exceptional or temporary work location after the cessation of the public health measures, the likelihood of constituting a PE will increase but thoughts should still be given to other criteria for a fixed place PE including whether the location is at the disposal of the business or employer.

Agency PE: The agent's activity in a jurisdiction should not be regarded as "habitual" if they have begun working at home in that jurisdiction on an exceptional basis as a result of a COVID-19 public health measure imposed or recommended by at least one of the governments of the jurisdictions involved and therefore, would not constitute a dependent agent PE, provided that the person does not continue those activities after the public health measures cease to apply.

The above OECD guidance provides a positive message that exceptional or temporary work arrangements as a direct result of COVID-19 should not by themselves lead to the creation of a PE. However, some terms are not explicitly defined (public health measures for one) which leaves key elements open to interpretation. Also, as noted, specific jurisdictions may take a different view on the interpretation of treaties and, for situations where there is not an applicable double tax treaty, domestic rules governing what constitutes a local taxable presence may still apply without concession.

Furthermore, companies should carefully assess whether their business activities or employees' unintended stay in a jurisdiction would trigger domestic tax reporting obligations, even though they may ultimately be able to claim a tax exemption under the applicable tax treaty.

## Corporate tax residence concerns

The view of the tax authorities in three jurisdictions on the tax residence of aircraft owning companies is key in most leasing structures:

- the intended jurisdiction of tax residence of the relevant asset owning company;
- the jurisdiction of the parent company or indeed any other jurisdiction where directors or key management staff happen to be based; and
- the lessee jurisdiction.

While relevant for the wider aviation finance industry, aircraft lessors, in particular, commonly have resident individuals of their parent jurisdictions as directors and/or in senior management positions for their overseas group companies. Such staff would typically fly to the leasing hub locations for management and board meetings where they would participate in the key strategic decision for those companies.

Across last year, and for much of the year ahead, many of those trips may not be possible. While it varies greatly based on the local substance each group has in the relevant leasing platform location, for some aircraft lessors, the periodic physical presence of those individuals is key in ensuring that they are regarded as tax resident in those locations. With that travel no longer possible, actions to mitigate the risks around tax residence may be required.

The OECD guidance also addresses certain circumstances in which there is a residence issue for an entity as a result of a temporary displacement of board members or other decision-making executives as a result of an extraordinary situation due to the COVID-19 pandemic. The general message is again positive, suggesting that any such circumstances should not lead to a change in an entity's tax treaty residence status. The guidance indicates that under the tie breaker rule in treaties, all relevant facts and circumstances should be considered to determine the "usual" and "ordinary" place of effective management and not only those facts and circumstances that pertain to an exceptional and temporary period.

Aircraft lessors and others may be able to argue that the change of their decision-making location is only temporary or exceptional. However, care should still be taken to assess the potential risk to the tax residence status of group companies and proper actions should be adopted proactively, adapted to the locations in question. The same limitations on the applicability of this guidance are relevant for residence as they are for PE considerations – the views expressed by the OECD are not binding on any country, the lack of a definition for certain key terms and the guidance's limited applicability to situations with a tax treaty in place.

## Other concerns

There are also some other concerns that could arise for certain aviation finance structures, including some industry specific issues. There may be certain concerns from a substance perspective in local leasing platform jurisdictions rules e.g. Hong Kong, Singapore or even Ireland in the context of maintaining trading status. Other concerns may be lease specific with certain leases, albeit a very limited number, including covenants that require varying degrees of activity and specific functions to be carried out in the location of the aircraft owning company.

While this article deals primarily with the corporate income tax considerations associated with dislocated employees, the tax residence of the individuals concerned could also be impacted and employer tax filing and payment obligations could arise if a dislocated individual begins to exercise their employment in a new host jurisdiction. Again, the OECD guidance expresses somewhat helpful views on the taxation of such income and administrative obligations but ultimately that may not eliminate obligations and liabilities triggered in particular countries.

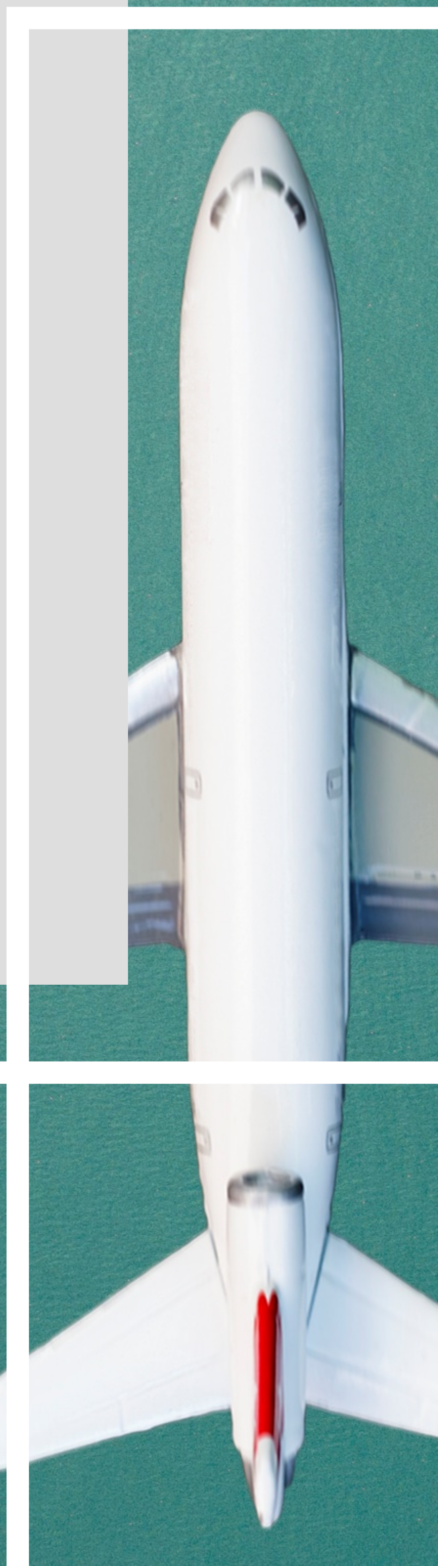
## Assessing and addressing the risks

There are concrete steps that aircraft lessors and others in the industry can take to mitigate the risks discussed and otherwise assess and adhere to any compliance requirements arising.

The starting point for any affected company should involve an assessment of their global presence and activities to identify any dislocated individuals and higher risk jurisdictions and leases. It may then involve moving on to renewing, or perhaps creating, operating guidelines aimed at managing risks factoring in the current mobility challenges.

Furthermore, close attention should be paid to any guidance issued by their local tax authorities in relation to tax issues associated with the COVID-19 pandemic and assess the impact of such guidance on their own business operations.

The OECD guidance is helpful as it provides an influential reference point for taxpayers and tax authorities alike. However, as mentioned above, it has its limitations and taxpayers would be wise not to be overly reliant on that guidance or hold expectations that tax authorities will be particularly lenient despite the circumstances being beyond their control.



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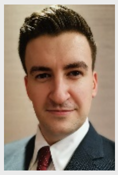

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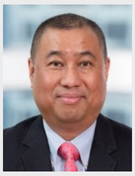

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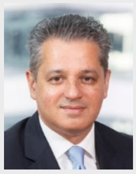

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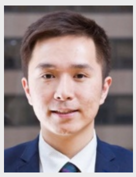

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