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INSIGHT: Accidental Residents, Impermanent Establishments—Help for Those Who Can Only Phone Home




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Stay at home orders, drastic reductions in available travel options, and fears of contracting Covid-19 have caused many international travelers to become stranded in the United States starting in February.

WELCOME GUIDANCE FOR THOSE STRANDED BY THE PANDEMIC

Unexpectedly prolonged U.S. stays by such travelers raised questions of potential U.S. taxable presence for themselves and their employers—questions commendably addressed by Treasury and the IRS. In two revenue procedures and one set of FAQs, the government provided welcome practical guidance that should limit the U.S. tax impact of only being able to phone home.

We focus here on the FAQs, which address when a company may become subject to U.S. tax due to the prolonged U.S. presence of its employees under the U.S. trade or business and U.S. permanent establishment (PE) standards. Following a summary of the guidance provided in the FAQs, we identify five action items for potentially affected companies, and conclude by providing suggestions for expanding the initial guidance, including in ways that may be particularly relevant for U.S.-based multinationals.

THE FAQS AND NEW REVENUE PROCEDURES

Foreign corporations and nonresident alien individuals are subject to U.S. net basis tax on income effectively connected with a U.S. trade or business. The similar—but generally higher—U.S. PE standard applies to foreign persons that qualify for the benefits of a tax treaty between their country of residence and the U.S. In both cases, the threshold determination of whether the foreign person has a U.S. trade or business or PE depends on the extent and nature of the activities they conduct within the U.S., including activities conducted by a foreign corporation through its employees or agents. The presence of individuals in the U.S. also determines their status as U.S. taxable residents in their own right under a largely mechanical test that counts days of ''physical presence'' in the U.S.

Thus, when pandemic-related travel disruptions left many nonresidents stranded in the U.S., such periods of unplanned U.S. presence could have led to significant U.S. tax consequences by causing a company to have a U.S. trade or business or PE based on the activities of its stranded employees. As a further consequence, this unanticipated presence could also cause those employees to become U.S. taxable residents based on their extended period of physical presence in the U.S. Further, while the potential for accidental U.S. residence might be most obvious for non-U.S. based companies, U.S. multinationals could also find themselves affected if substantial activities related to their foreign subsidiaries were to be conducted in the U.S. due to the pandemic's impact on foreign travel.

Treasury and the IRS are to be applauded for acting with alacrity to issue guidance that ameliorates in a sensible way the most pressing issues presented by these circumstances. Of greatest relevance to companies facing taxable presence issues, the FAQs state that, in determining whether a taxpayer has a U.S. trade or business or PE, services or other activities performed by an ''individual temporarily present in the United States''

during the ''COVID-19 Emergency Period'' will not be taken into account if the activities would not have been performed in the U.S. *but for* ''COVID-19 Emergency Travel Disruptions.'' This rule is driven by three key definitions:

■ An ''individual temporarily present in the United States'' means a nonresident alien, or a U.S. citizen or lawful permanent resident who had a tax home outside the U.S. in 2019 and reasonably expects to have a tax home outside the U.S. in 2020. The individual must have been present in the U.S. between Feb. 1, 2020 and April 1, 2020.

■ The ''COVID-19 Emergency Period'' means an uninterrupted 60-day period, which may be selected by the foreign taxpayer, beginning on or after Feb. 1, 2020, and on or before April 1, 2020. Thus, depending on the start date selected by the foreign taxpayer, the COVID-19 Emergency Period could be any 60-day period falling within the four-month window between Feb. 1 and May 31, 2020.

■ ''COVID-19 Emergency Travel Disruptions'' refer to canceled flights and disruptions in other forms of transportation, shelter-in-place orders, quarantines, and border closures, and individuals feeling unsafe traveling during the COVID-19 Emergency due to recommendations to implement social distancing and limit exposure to public spaces.

By potentially disregarding 60 days of U.S. activity between Feb. 1 and May 31, the FAQs make it less likely that a company with employees stranded in the U.S. would have a U.S. trade or business or PE during this period.

Revenue Procedure 2020-20, although of greatest relevance to individual taxpayers, also ties in with the FAQs' guidance. The revenue procedure provides a safe harbor in determining an individual's U.S. tax residency under the substantial presence test in tax code Section 7701(b)(3). Like the FAQs, the revenue procedure relies on the concept of a COVID-19 Emergency Period, allowing affected individuals to designate a 60-day period that is essentially excluded from the day count under the substantial presence test. The revenue procedure provides a somewhat clearer definition of the term ''COVID-19 Emergency Period,'' and thus may be helpful in interpreting the same term when used in the FAQ. In addition, in determining whether an individual is a nonresident who may qualify as ''temporarily present in the United States'' under the FAQ, the revenue procedure applies to determine nonresident status.

FIVE ACTION ITEMS FOR AFFECTED COMPANIES

1. *Choose a COVID-19 Emergency Period*

The FAQs allow a taxpayer to select any 60-day period within a four-month span as its COVID-19 Emergency Period. A single, continuous period must be chosen regardless of the particular days on which various employees were within the U.S. A number of factors may be relevant in choosing the period to be covered, including (i) when a company's employees were present in the U.S., (ii) which of those employees are non-U.S. citizens or residents and are thus eligible to be covered by the relief, (iii) what activities each employee performed while in the U.S., and (iv) when those activities were performed.

Note that employees who first traveled to the U.S. *after* April 1, and thus were not in the U.S. between Feb. 1 and April 1, are not covered by the relief, even though they may have been present during the 60-day period selected by the taxpayer. For example, if the taxpayer selects a 60-day period beginning on March 1, the activities performed by an employee that arrived in the U.S. on April 15 would not be covered by the relief provided by the FAQs, even though the employee was present in the U.S. during the taxpayer's 60-day period.

2. *Document That the Activities Would Not Have Been Performed in the U.S. 'But For' the Travel Disruptions*

Of note, Rev. Proc. 2020-20 and the FAQs have different approaches for determining if the conditions for relief have been satisfied. The revenue procedure adopts a presumption that a nonresident individual's presence in the U.S. during the chosen 60-day emergency period was attributable to the pandemic. By contrast, the FAQs apply a factual test, requiring the taxpayer to establish that the activities in question would not have been performed in the U.S. ''but for'' the travel disruptions caused by the Covid19 pandemic.

The FAQs do not include a filing requirement in order to apply the relief; however, there is a requirement to retain ''contemporaneous documentation.'' This includes documentation to establish the 60-day period selected as the COVID-19 Emergency Period. And, of potentially greater practical difficulty for companies, the FAQs also require documentation of facts establishing that ''but for'' the COVID-19 Emergency Travel Disruptions the relevant business activities would not have been undertaken in the U.S. The FAQs advise that those who seek to apply the relief extended by the FAQs should be prepared to provide this documentation ''upon request by the IRS.''

The guidance does not elaborate on what evidence will be sufficient to satisfy the standard, although affected companies may be comforted by the breadth of the definition of the COVID-19 Travel Disruptions. As defined in the FAQs, the term includes not only canceled flights, shelter-in-place orders, quarantines, and border closures, but also the fact that individuals ''may feel unsafe traveling during the COVID-19 Emergency due to recommendations to implement social distancing and limit exposure to public spaces.''

The breadth of this definition strongly suggests that the ''but for'' test should be satisfied by a showing that an employee who is not ordinarily a U.S. resident ended up working in the U.S. during the company's selected 60-day COVID-19 Emergency Period, without requiring the company to prove the impossibility of her working elsewhere, nor that the employee actually felt unsafe; widespread flight cancelations and empty flights and airports should sufficiently demonstrate that would-be travelers have generally felt unsafe about airplanes and airports during this period. Consider, for instance, the dramatic drop (roughly 95%) in the total number of air travelers logged by the U.S. Transportation Safety Administration on each day in April 2020 compared with the same day one year earlier.

3. *Consider Filing a Protective Return*

Foreign persons, including foreign corporations, may file protective U.S. tax returns even if they do not believe they were engaged in a U.S. trade or business for the tax year in question. Failure to file a U.S. tax return has a number of significant consequences for a taxpayer that is ultimately determined to have engaged in a U.S. trade or business. Although income effectively connected with a U.S. trade or business is subject to a net basis tax, taxpayers generally must have filed a U.S. tax return in order to claim deductions against the gross income that is subject to tax. Claiming relief from U.S. tax under a tax treaty similarly requires taxpayers to file a return. Moreover, if no return is filed, the IRS can assess tax at any time; by contrast, the general statute of limitations is three years from the filing of a return or six years in the case of a return that omits a substantial amount of gross income.

Protective returns are specifically provided for in regulations and preserve the ability to apply statutes of limitations, claim tax treaty-based relief, and claim deductions against any gross income later determined to be effectively connected with a U.S. trade or business. In light of the increased risk regarding U.S. trade or business determinations where additional activities were carried out within the U.S. due to travel disruptions from Covid-19, foreign corporations and other foreign persons that have not previously filed protective U.S. tax returns may wish to consider doing so for 2020. Taxpayers may opt to file protective returns even if they seek to rely on this newly announced relief in light of limitations and uncertainties surrounding that relief, in particular the limited 60-day time period it covers and the inability to ensure that the IRS will accept the taxpayer's assertion that the factual ''but for'' standard has been satisfied. Indeed, the FAQs anticipate the possibility of protective returns being filed and remind taxpayers of the availability of this avenue.

4. *Weigh the Costs and Benefits of Applying Relief*

Although not specifically referred to as an election, the guidance by its terms appears to provide that its relief is elective as the first answer in the FAQs states that a taxpayer ''may'' choose a 60-day COVID-19 Emergency Period. Thus, a company should be permitted to decline to select any such period, in which case all activities of employees and agents would be considered for purposes of U.S. trade or business and PE determinations.

Companies should therefore consider both the drawbacks and benefits from having a U.S. trade or business or PE before deciding whether to apply this relief. Companies that experience losses this year could potentially utilize a net operating loss associated with a U.S. trade or business to offset future U.S. income, subject to additional considerations, including under the Base Erosion and Anti-Abuse Tax (BEAT). In the case of a non-U.S. multinational that qualifies for the benefits of a tax treaty and is resident in a country with a higher tax rate than the U.S. rate, consider whether applying the relief in the FAQs could cause income that would have been earned by a U.S. PE, and subject to U.S. tax rates, instead to be subject to higher tax in the multinational's country of residence. A U.S. multinational may likewise prefer effectively connected income (ECI) treatment in the U.S. given the interaction of various provisions enacted as part of the Tax Cuts and Jobs Act of 2017.

For example, payments by a U.S. corporation to a related foreign person are generally not subject to BEAT if the payment is income effectively connected with a U.S. trade or business of the foreign recipient. Thus, including such amounts as ECI may help keep a taxpayer below the 3% BEAT threshold or, in the case of a taxpayer already subject to BEAT, may prevent the payment from being subject to the additional 10% tax imposed by BEAT.

5. *Consider Engagement With Treasury and IRS*

The relief announced in the FAQs may not cover all circumstances occasioned by Covid-19, and the travel disruptions recognized in the relief may continue far beyond the 60 days for which relief is granted. The FAQs recognize this, stating that the IRS will continue to monitor the Covid-19 pandemic and its impact on the ability of individuals to travel and ''may update these FAQs as appropriate.'' If companies find that their employees' ability to travel continues to be affected beyond the FAQs' 60-day period, it may be prudent to share that information with the government. In addition, regardless of the period of travel disruption that is ultimately recognized, there are other aspects of this initial guidance that may appropriately be broadened, as discussed below. These aspects of the rules, or other considerations pertinent to a company's specific factual circumstances, may be worth raising with Treasury and the IRS.

SUGGESTIONS FOR FURTHER RELIEF

The FAQs, and the two revenue procedures, represent an important step in avoiding inappropriate and potentially punitive consequences to companies and individuals at a time when Covid-19 poses unprecedented personal and business challenges. Taxpayers are rightly grateful for the acknowledgment of those challenges by Treasury and the IRS, and their demonstrated willingness to adopt creative solutions. We suggest that the government continue to build on this foundation, by addressing both evolving circumstances and additional issues that were not covered in the initial guidance.

First, as to evolving circumstances, the FAQs' commitment to continued monitoring of the effects of Covid-19 is particularly welcome. It is notable that any COVID-19 Emergency Period that began during the month of February would have expired before the end of April, yet it seems likely that many employees will continue to be affected by travel disruptions well into May, and possibly beyond. If so, the 60-day relief period announced in the FAQs should be extended to match the period in which individuals are actually restricted in their ability to travel safely.

However, identifying the end date of pandemic travel disruptions will be difficult, particularly given that the end date for particular individuals may be affected by conditions in their home countries as well as in the U.S. Thus, as an alternative solution we suggest that the government consider dispensing with the 60-day period al-

together. Such an approach would make sense given the FAQs' requirement that taxpayers in any event meet the factual ''but for'' standard to apply the relief.

The inherent inflexibility of any fixed period of time may be necessary in the context of Rev. Proc. 2020-20, which applies legal presumptions under the mechanical day count test of Section 7701(b)'s substantial presence test. Such precision, with the accompanying inflexibility, is not necessary here. In determining whether a foreign corporation has a U.S. trade or business or PE, the FAQs already limit the relief to activities that would not have been carried out within the U.S. ''but for'' COVID-19 Emergency Travel Disruptions.

Simply applying that factual test, without limiting relief to a particular number of days, would provide a more flexible approach that is best suited for the varying factual situations that have arisen from the pandemic and the variety of ways in which different companies and industries conduct their cross-border operations. This approach would also minimize the need for the government to revisit the guidance over time, and eliminate at least one source of uncertainty facing taxpayers as they try to sort out the best and safest ways to ''reopen'' in the coming months.

Turning to other categories of relief, we suggest that the government give further consideration to the circumstances that may confront U.S.-based multinationals that conduct most or all of their foreign operations through controlled foreign corporations (CFCs). These taxpayers may unexpectedly find that their CFCs are faced with U.S. trade or business or PE issues as a result of the pandemic. To the extent that this arises because non-U.S. based CFC employees find themselves stranded in the U.S., the FAQs will likely provide effective relief.

But the issue could also arise in relation to functions that are normally conducted outside the U.S. by U.S.-based executives, employees, and agents who frequently travel abroad. These functions could include attending board meetings, meeting with customers, signing contracts, and providing general managerial or technical services. If some of these activities are conducted remotely from the U.S. in 2020 due to pandemic-related travel restrictions, those U.S. activities could potentially give rise to a U.S. trade or business or PE.

In such a case, the FAQs' requirement that the employee or agent in question have neither U.S. citizenship nor a U.S. tax home would exclude the CFC from eligibility for relief to the extent that individuals who habitually split their time between U.S. and foreign offices have a tax home in the U.S. This despite the fact that the cause for these changes in the location of the activities is the same as those covered by the FAQs and the revenue procedures. Accordingly, we suggest that the relief provided under the FAQs would more accurately reflect the full extent of the effects of Covid-19 if the relief were extended to include individuals with U.S. tax homes who provide services to CFCs that would not have been conducted in the U.S. but for the COVID-19 Emergency Travel Disruptions.

Finally, the taxpayer community appreciates the prompt guidance issued in the form of the FAQs, but we suggest that, when time permits, publication of updated guidance in a more formal document (such as a revenue procedure) would be useful. This would provide an opportunity to clarify some of the issues identified above and would facilitate later citation to and retrieval of the guidance. Additionally, formal guidance could provide more specifics about the procedures for electing the relief, including whether contemporaneous documentation needs to be in place before year-end or before a return is filed, the time and manner for electing relief, and whether such election can be revoked at a later date.

CONCLUSION

The FAQs provide important relief for multinational groups whose employees have been stranded in the U.S. as a result of the Covid-19 pandemic. Treasury and the IRS deserve credit for addressing potential tax problems so quickly, and in a manner that gives appropriate priority to public health concerns by reducing the chances that individuals will feel pressured to travel for tax reasons at time when it is unsafe to do so. We hope that this triumvirate of guidance is a foundation for additional related relief as the problems presented by the pandemic become clearer over the coming months.

This column does not necessarily reflect the opinion of The Bureau of National Affairs, Inc. or its owners.

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