US OUTBOUND

KPMG in the US

Mark Martin and Thomas Bettge

COVID-19 and dislocated employees: DEMPE and risk control considerations

Mark Martin and Thomas Bettge of KPMG in the US address the transfer pricing implications of employees working outside their normal business jurisdictions during the COVID-19 pandemic.

As the COVID-19 pandemic persists, with many companies adopting new work from home models, employees may find themselves performing their duties in jurisdictions other than those in which they worked prior to the outbreak. This may occur when employees who live in one jurisdiction and ordinarily commute to another, now perform all their work from the jurisdiction of their residence, or when employees who were travelling during the pandemic are unable to return home or advised not to do so.

These dislocated employees pose a number of tax issues at both the individual and the corporate level, including tax residency and permanent establishment (PE) determinations. A number of countries have released guidance on these issues. In the United States, Rev. Proc. 2020-20 provides relief for certain foreign individuals who might otherwise be considered US tax residents as a result of a COVID-19-induced stay in the US, and the IRS has released a set of frequently asked questions addressing residency and PE issues for businesses. Similarly, the OECD Secretariat has released guidance on tax treaty issues relating to dislocated employees.

However, to our knowledge, neither the OECD nor any country has yet released guidance on how dislocated employees are treated for transfer pricing purposes. Over the past several years, the OECD's base erosion and profit shifting (BEPS) initiative has introduced increased scrutiny of substance into transfer pricing analyses. Under transfer pricing principles developed as part of the BEPS project, the development, enhancement, maintenance, protection, and exploitation (DEMPE) functions performed by members of a controlled group are taken into consideration when allocating returns related to intangible property. Similarly, entities must actually exercise control over risks in order to earn returns associated with those risks. Companies' transfer pricing therefore depends on having employees performing these functions in the jurisdictions to which the associated returns are allocated.

Many of those employees currently find themselves working outside their normal jurisdictions, leaving their employers to determine whether their DEMPE and risk-related transfer pricing remains accurate. Countries and organisations such as the OECD should consider providing guidance and assistance on this issue in order to reduce uncertainty and administrative burdens. Where countries have provided safe harbours, such as the US safe harbours with respect to residency and PE issues, consideration should be given to extending them to cover transfer pricing issues, though care should be taken to ensure that the relief provided is effective and not constrained by artificial limitations.

In the meantime, existing guidance on PEs may be helpful for addressing the consequences of dislocated employees for transfer pricing and substance. This guidance provides valuable insight into how tax authorities are approaching similar issues, and thus may serve as a blueprint for taxpayers grappling with uncertainty around DEMPE and control of risk. However, transfer pricing issues present some different policy concerns, and it is important to recognise that these issues may not be resolved in the same manner as PE issues, or may not be resolved at all, leading to the prospect of double taxation. To guard against potential disputes, taxpayers should document where their dislocated employees are working, why, and for how long, and the functions those employees are responsible for performing, and should continue to consider these substance-based issues as matters develop.

KPMG US

T: +1 713 319 3976 and +1 713 319 2173

E: mrmartin@kpmg.com and tbettge@kpmg.com