The Impact of COVID-19 in the International Tax Sphere

By Patrick McCormick

COVID-19's overarching impact on daily life cannot be overstated; like every industry, tax has been effected, with changes in functional considerations and compliance requirements. For multinationals (either U.S.-based taxpayers with foreign activities or foreign taxpayers with U.S. , tax considerations resulting from COVID-19 in some respects mirror those for exclusively domestic taxpayers (for example, whether tax return filing deadlines are changed); others are more distinct (an example being whether relocated workers create permanent establishment concerns).

This article details how COVID-19 tax relief impacts multinational taxpayers, as well as special tax considerations for multinationals resulting from COVID-19. As referenced within the article, guidance related to COVD-19 is evolving, with continuous guidance both from the Service and foreign taxing authorities.

2019 Filing Requirements.

On March 18, 2020, the Internal Revenue Service issued Notice 2020-18, providing initial COVID-19 relief; Notice 2020-18, issued on April 6, 2020, superseded the relief provided in Notice 2020-17. Under Notice 2020-18, taxpayers with federal income tax payments or returns originally due April 15, 2020 received automatic postponement until July 15, 2020.

For April 15 taxpayers required to file international information returns, Notice 2020-18 relief was largely curative, with most information return deadlines (i.e. any filed with a taxpayer's income tax return) automatically extended as well. Significant 2019 gaps still remained after Notice 2020-18 in the multinational context – nonresidents with June 15 deadlines were given no relief, and some information filing requirements – specifically, Forms 3520 and 3520-A – were unaffected by the Notice's terms.

Notice 2020-18 was augmented significantly by Notice 2020-23, released on April 9, 2020. Per Notice 2020-23, any taxpayer (whether domestic or foreign) with a tax payment or tax filing obligation due between April 1, 2020 and July 15, 2020 are automatically postponed until July 15, 2020. Relief granted under Notice 2020-23 explicitly includes Form 3520; taxpayers with installment payments due under Section 965(h) also receive an extension. Given their inclusion within the designated relief timeframe, June 15 filers are provided an extension (whether filing on June 15 based on residence outside the United States or by virtue of nonresident alien classification).

Non-2019 Compliance Effects.

Most compliance relief for multinationals comes from application of relief available for all taxpayers. As an example, nonresident individuals required to file United States tax returns generally are required to file by June 15. However, nonresidents with income subject to United States wage withholding (wages for personal services performed in the United States) must file by April 15. *See* 26 C.F.R. § 1.1441-4(b)(1); Rev. Rul. 92-106.

Nonresident are subject to the same rules for tax refunds as residents – claims for refund must be filed by the later of three years from filing of the return or two years from tax payment. 26 U.S.C. § 6511(a). While nonresidents are far from the lone taxpayers who file amended returns to claim refunds, they nonetheless are more likely to amend returns (given complexity of United States tax rules applicable to them, and lack of familiarity with American tax creating a greater likelihood that returns will initially be completed suboptimally).

Notice 2020-23 provides relief to taxpayers whose Sec. 6511 filing deadlines fall within the April 1-July 15, 2020 covered period (primarily impacting taxpayers' 2016 tax filings). Section III.C of Notice 2020-23 provides an automatic extension of time until July 15, 2020 for "specified time-sensitive actions" (amendments of tax returns, filing petitions with Tax Court, and associated taxpayer actions).

Importantly, Service notices to date have not addressed how individuals forced to stay within the United States involuntarily (i.e. through travel restrictions) will be treated for tax residency purposes. Statutorily, an individual may be classified as a United States resident for income tax purposes if she spends at least 31 days in the current year in the United States and the sum of her days spent in the United States in the last three years exceeds 183, after use of applicable multipliers. *See* 26 U.S.C. § 7701(b)(3). Extended unanticipated stays in the United States increase the likelihood of the substantial presence test being met. Exceptions to the test apply and can be utilized to combat tax residency classification; these exceptions may ultimately be the most feasible option to avoid residency, given the inherent difficulty with tailoring a new residency exception specific to COVID-19.

Permanent Establishment Concerns.

Likely the most-discussed consideration in the multinational context has been risk that displaced workers will create tax nexus in new jurisdictions. As brief background, nonresident business entities are subject to United States tax on (1) fixed or determinable income sourced to the United States ("FDAP income") and (2) income effectively connected to the nonresident's "United States trade or business". *See* 26 U.S.C. § 871; 26 U.S.C. § 881. The latter is a more expansive category – incorporating both FDAP income and income items falling outside the FDAP category (capital gains associated with the trade or business, inventory items, and certain foreign-sourced income). Id.

United States trade or business assessment focuses on whether a nonresident is engaged in United States activities which are regular, continuous, and substantial. *See* U.S. v. Balanovski, 236 F.2d 298 (2d Cir. 1956); U.S. v. Northumberland Insurance Company, 521 F.Supp. 70 (DNJ 1981). Where a nonresident business is based in a country with which the United States maintains a tax treaty, evaluation shifts (typically) to whether business profits are attributable to a United States permanent establishment. *See* United States Model Income Tax Convention, Arts. 5 and 7.

Permanent establishments normally must have distinct physical aspects; offices are explicitly included within the permanent establishment concept. *See* United States Model Income Tax Convention, Art. 5; OECD Model Treaty Commentary. Permanent

establishments can be mere space at the disposal of a nonresident business; however, some geographic location or place is required. Id. Mere availability of physical space in a jurisdiction is normally insufficient for a permanent establishment; however, where physical space is utilized (either directly or indirectly) to generate significant income for a business enterprise, risk of a permanent establishment results from that physical space. Id.

Risk of permanent establishment/trade or business creation from relocated employees centers upon use of new office space within the United States. Whether office space is sufficient to constitute a permanent establishment/trade or business is fact-specific; where this level of connection exists, United States tax scope expands significantly. An office will not automatically create overarching tax; a United States office of a nonresident business enterprise will not create a permanent establishment where only auxiliary or preparatory activities occur in the United States. Elevation of standards in this context between a "trade or business" and "permanent establishment" are noteworthy, given the permanence requirement associated with the latter.

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