

Second First??

Transfer Pricing Issues In Secondment of Personnel

By Patricia Gimbel Lewis

International short-term transfers of personnel among related entities are common and involve predictable, albeit complex, issues relating to *individual* income taxes, employee benefits, etc. Tax consequences from the broader *corporate* perspective often get little attention. Recent administrative guidance in Germany shines the spotlight on transfer pricing considerations, which are gaining particular interest as the IRS revises its transfer pricing regulations for services.

Corporate-level transfer pricing issues present intriguing theoretical issues that exhibit tension with the individual tax issues. Absent development of more uniform standards, it may be necessary to accept the fact-or-fiction of secondment before being able to effectively analyze the transfer pricing issues.

Definition and Example

Strictly speaking, secondment refers to the deployment of an individual from one related employer to another on a temporary basis, with eventual return to the first employer anticipated,¹ often referred to as the *loan* of an employee. A seconded individual does not change payrolls; instead, the receiving company reimburses the sending company for the individual's employment costs or pays some other type of fee or cost-plus arrangement.² (For simplicity, the discussion below refers to "corporate" consequences as meaning those of a business entity, regardless of its legal form.)

Here is a simple example: USCO, a U.S.-based multinational, uses an integrated computer network for ordering, tracking sales, etc. One of USCO's foreign subsidiaries (FORCO) needs an extra computer specialist to ensure it is using the system properly and to train some employees. USCO agrees to second Joe to FORCO for a year from USCO's large New York IT department. Joe stays on USCO's payroll and in USCO's various employee benefit programs, and FORCO agrees to reimburse USCO for the latter's \$150,000 employment costs with respect to Joe.

The transfer pricing status of secondment depends in the first instance on whether secondment is considered the provision of a service. After characterization comes quantification, as required by the pertinent transfer pricing regime.

A. Characterization

1. Is the arrangement a service contract or something else?

The first conundrum is whether USCO's secondment of Joe constitutes a provision of services from USCO to FORCO.³ If USCO had explicitly contracted with FORCO to provide computer consulting services for a year for \$150,000, common sense would view USCO as providing services to FORCO. That the consulting services were carried out by sending Joe to FORCO's premises for a year would not change that result.

What, if anything, differentiates such a service contract from a secondment arrangement? Possible tests are:

- a. **Is USCO providing a benefit to FORCO?** If this were the test, most secondments would effectively be service contracts.
- b. **Who is responsible for the services?** This approach would pivot on the bearing of financial and entrepreneurial risk — for example, the obligation to send others at no additional cost to correct or complete Joe's work.
- c. **What does the contract say?** For certain purposes, the transfer pricing regulations generally respect pre-existing contractual terms.⁴ Under this approach, secondments would seldom be service contracts.
- d. **Is there such a thing as a personnel "loan"?** If so, the transfer and repayment of the "principal" (whether considered the personnel or funds to pay them) would have no income tax consequences, though arguably a charge for use of the principal might be appropriate.
- e. **Does the result depend on the "common-law employee" test used for employment tax purposes under U.S. law?**⁵ This standard would suggest that if Joe remains under high-level review and control by USCO, the continuation of the nominal employer-employee relationship between Joe and USCO would be appropriate, but if Joe is sent to FORCO with no continuing oversight or legal control by USCO, the employment relationship would have terminated. If sufficient control is retained by USCO, however, to keep Joe its common-law employee within employment tax concepts (a key goal of secondment arrangements), a consistent view for income tax purposes would treat the transaction as the provision of a service.

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