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by Elizabeth J. Stevens

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Where the Money Is: Tax and Worker Mobility

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In this article, Stevens argues that remote and mobile work presents interpretative challenges for taxpayers and policy challenges for governments under bilateral tax treaties and U.S. tax rules.

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Tax policymakers globally — including the U.S. Congress, European Commission, OECD inclusive framework on base erosion and profit shifting, and, to a lesser degree, the U.N. Committee of Tax Experts — have devoted enormous effort in the last 30 years to chasing a particular kind of mobile income: intangibles income.

The existing international tax architecture was designed around labor and capital, which could for the most part be readily tied to particular taxing jurisdictions based on their physical locations. Intangible assets weren't irrelevant by any means, but they didn't assume a dominant role in corporate income generation until the 1990s.

Since that inflection point, the rise of intangibles, digitalization, and related economic forces have contributed to the generation of staggering corporate profits. And thanks to rules like the U.S. cost-sharing regulations and check-the-box entity classification regime, structures like the double Irish (with or without the Dutch sandwich), and other arbitrage opportunities, those staggering profits largely accumulated in jurisdictions that had far more palm trees than corporate employees, and where they were subject to no or light taxation, on the premise that the intangible assets that generated the profits were located there.

Enter BEPS, pillars 1 and 2, and innumerable efforts at the domestic level to recapture — and tax — the income from those intangibles.

For example, in 2017 the United States enacted section 965. Referred to as the repatriation tax, section 965 brought the no- or low-taxed income that had been realized by subsidiaries of U.S. multinationals into the U.S. tax base and applied a nominal tax to it.

Section 965 dealt with the past. Prospectively, the global intangible low-taxed income regime taxes most of that income on a current basis in the hands of the shareholder.[1]

From a U.S. perspective, those changes largely succeeded in capturing income from mobile intangibles, or at least a proxy for it.

That income may escape the trap. Corporate taxpayers and their advisers are infinitely creative. But while the whole world has been focused on multinationals' mobile intangibles income, tax policymakers may have failed to observe Sutton's law: Individual income tax and related levies, not corporate income tax, are where the money is — and workers have started to go mobile, too.[2]

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[1] *See generally* section 951A.

[2] When asked why he robbed banks, midcentury U.S. bank robber Willie Sutton allegedly responded: "Because that's where the money is."

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I. The Stakes

Among OECD members, corporate income tax accounts for only about 10 percent of overall tax revenue. Personal income tax and social security contributions account for nearly half the tax revenue pie.[3]

The United States may or may not be representative of the OECD as a whole, but it publishes extensive data. For the fiscal year ending October 31, 2019, corporate income tax accounted for only about 7 percent of U.S. federal revenue. Individual income tax accounted for 50 percent, with employment and self-employment tax making up another 36 percent.[4] In the individual income tax revenue bucket, tax on high earners represents a surprisingly large chunk: For calendar year 2019, the top 1 percent of individual taxpayers — those with adjusted gross income exceeding about $550,000 for the year — paid about 40 percent of total individual income tax.[5] Setting aside the period discrepancy, those two data points imply that the top 1 percent of individual earners accounted for about 20 percent of the U.S. federal government's revenue for 2019.

Those high-earning individuals are the most likely to go mobile. Whether they are self-employed crypto traders or coders for companies offering partial or complete remote work post-pandemic, highly skilled professionals are on the move. Many employees, independent contractors, and business owners can now work from anywhere much or all of the time.

In one sense, that phenomenon is simply a scaled version of the traveling salesman fact pattern. One could argue, however, that there is a material factual difference — and that there should accordingly be a legal difference — between a company's sending an employee to work in another jurisdiction and choosing not to fire the employee for moving, or moving around, amid a skilled labor crunch.

Even if one adopts the view that worker mobility is not a new phenomenon, the tax policy landscape has changed in the past several years in ways that put far more weight on how one resolves the tax issues the phenomenon raises. Setting aside pillar 1 for the moment, the OECD inclusive framework has addressed mobile intangibles in part by decreeing that the profits associated with them should be taxed where the people are — specifically, the people who develop, enhance, maintain, protect, and exploit the intangibles (known as the DEMPE functions), and particularly the people who control the risks associated with those functions.[6] If those people spend ski season in Switzerland, springtime in Paris, summer in Ibiza, and autumn in New York, where should the profit be taxed?

II. Potential Problems

A simple (and stylized) example illustrates the income tax issues raised by worker mobility.[7]

ABC Corp. is a pandemic baby, formed in March 2020 in Country X during lockdown. Its founders recruited bored coders and built a business connectivity platform that they marketed on a software as a service model from the start. The founders set up a small office in X's capital city, but ABC's employees have always worked mostly or fully remotely. In late 2021 the founders recruited a renowned CEO who accepted the job because she thought their low-overhead model represented the future. Now that travel restrictions have eased, ABC has leaned into that model by adopting a work-from-anywhere policy.

The weather in X could be better — and is, in fact, much better — across the border in Country Y. After ABC's policy announcement, employee E, a national of X, books an Airbnb in Y, packs up her laptop, and heads to the airport.

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[3] OECD, "The Global Revenue Statistics Database," at 7 (undated).

[4] Office of Management and Budget Historical Tables, "Table 2.1, Receipts by Source: 1934-2027" (undated).

[5] IRS Statistics of Income, "All Individual Returns Excluding Dependents Classified by Tax Percentile — Early Release," Table 4.1 (undated).

[6] *See* OECD, "Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations," at paras. 6.43-6.58 (2022); *see also* paras. 1.60-1.70 (discussing the allocation of risk to the party that controls, and has the financial capacity to bear, those risks).

[7] Worker mobility undoubtedly has implications for indirect taxes and other levies as well, but analysis of those topics is beyond the scope of this article.

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That fact pattern raises at least five buckets of income tax issues, most of which are treaty issues[8]:

- residency;
- taxation of employment income;
- permanent establishment;
- profit attribution; and
- local taxes and compliance.

When the COVID-19 pandemic struck, the OECD secretariat released guidance on the interpretation of some of the relevant treaty provisions, observing that COVID-19 and public health measures taken in response were temporary, exigent, and non-ordinary course. It counseled that tax treaty provisions should be applied to pandemic fact patterns with those considerations in mind. (A 2021 update to that guidance catalogs similarly themed guidance in various jurisdictions.)

The premise of that guidance was that people were moving around, working from home, and potentially getting stuck on the "wrong" sides of borders not by choice but because of emergency travel restrictions and other public health measures. As the secretariat cautioned in the updated guidance, a deeper evaluation would be required if fact patterns initially driven by COVID-19 exigencies were to persist over the longer term. Pandemic restrictions have now eased almost everywhere, and employees are relocating temporarily or semi-permanently by choice.

A. Residency

Our example implicates (at least) E's residency. E is a national of X. Whether or not she was tax resident there before her move, her tax residence may change as a result of her travel to Y to work.

Assume that X and Y have signed and ratified an income tax treaty that tracks the 2017 OECD model.[9] First and foremost, E's residency is a domestic law question in both X and Y. Where E is liable for tax based on domicile, residence, or a similar criterion could depend on her nationality or on how many days during the year she spends in each jurisdiction.

Suppose that for 2022, E would be subject to comprehensive residence-basis income taxation in both X and Y under their respective domestic laws. To apply the treaty tiebreaker provision, we would need to know the location of E's permanent home. What was her living situation in X? How long was E's original Airbnb booking in Y, and did she stay there for the duration of her travels? If she moved around, did she settle in one place for any longer period? The OECD model commentary assures us that even a rented apartment or room can qualify as a permanent home if the dwelling is available to the taxpayer at all times.

Another relevant question involves E's role at ABC. The answer matters if, for example, E is ABC's CEO and chairs the board of directors. If E spends enough of the year in Y, her presence there could effect a change in ABC's place of effective management, and so potentially in its residency, too.[10]

B. Taxing Employment Income

Whatever her residency, E should be concerned with the possibility of double taxation of her employment income.[11] This is again first a domestic law question. If E's salary would be taxable in only one country, she has no need to rely on the treaty. However, if both countries want to tax E's salary, model article 15 recognizes a taxing right for Y, which X's taxing right might trump based on how much time E spends in Y and whether her activities there create a PE for ABC.

If E's salary is taxable in Y, and she continues to make contributions to an X pension scheme during her stay there, Y might not allow E a deduction for those contributions. The OECD

[8] For further discussion of the treaty issues raised by cross-border employment situations arising from the COVID-19 pandemic, see John L. Harrington, "When Workers Permanently Establish Themselves at Home," 49 *Tax Mgmt. Int'l J.* 10 (Oct. 2, 2020).

[9] Here, article 4 on residency is relevant.

[10] Some countries assert residence-based taxing jurisdiction over corporations based on place of management. *See, e.g.*, India's Income Tax Act, 1961, section 6(3)(ii) (providing that a company will be considered a tax resident of India for any tax year in which its place of effective management, defined as "a place where key management and commercial decisions that are necessary for the conduct of business of an entity as a whole are, in substance made," is in India).

[11] Here, model article 15 addressing the taxation of employment income is relevant.

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model does not address those kinds of pension issues, but some treaties do.

C. Permanent Establishment

Whereas residency and the taxation of employment income are issues primarily for the employee, whether E creates a Country Y PE for ABC is primarily an issue for the employer. Once again, the analysis begins with domestic law: If E's activities in Y, together with any other Country Y activities of ABC, do not surpass the threshold for local taxation of her employer's profits in Y, ABC need not look to the treaty.

Whether ABC has a fixed place of business in Y through which its business is wholly or partly carried on — and therefore a PE[12] — depends on how long E spends in Y. The OECD model commentary offers no bright lines. How long is long enough to create a PE depends on the facts and circumstances, but in all events, E's time spent matters.

A second critical fact for the PE analysis is E's work location while in Y. In 2011 and 2012, pre-BEPS, an OECD working party published two discussion drafts addressing a smattering of PE topics, including whether an employee's home office could be a PE of her nonresident employer.[13] At the time, the only real controversy surrounded whether that kind of guidance was really needed, with the October 2012 draft noting that some delegates "questioned whether the issue had practical relevance."[14] Fortunately, other delegates were more prescient: The working party's recommended changes to the OECD model commentary were incorporated in 2017 and have proven extremely practically relevant.

Two new paragraphs on home offices prescribe a facts and circumstances analysis and point to two factors as critical. Whether the carrying on of business activities in the employee's home is intermittent or incidental, as opposed to regular and continuous, matters. It also matters whether the employer has in effect required the employee to use his home to carry on its business.[15] On that point, the commentary offers an example in which a cross-frontier worker chooses to perform most of his work from his home in one state rather than from the office made available to him in the other state. It says that in that case, the home office is likely not a PE.

In general, the creation of a fixed-place PE requires that the fixed location be at the disposal of the nonresident employer, such that the employer has the effective power to use that location.[16] According to the commentary, that condition is satisfied if one enterprise "is allowed to use a specific location that belongs to another enterprise . . . and performs its business activities at that location on a continuous basis for an extended period of time." Analogously, the commentary says a home office used continuously for carrying on business activities for an enterprise that has required the employee to use that location for work "(e.g., by not providing an office to an employee in circumstances where the nature of the employment clearly requires an office) . . . may be considered to be at the disposal of the enterprise."[17]

Returning to our example, suppose that while in Country Y, E generally works on the terrace of her Airbnb, soaking up the sunshine. Could E's Airbnb potentially be a PE of ABC? The company allowed E to work remotely but did not require her to do so, let alone from Y. ABC has a small office in Country X, but its employees have always been partially or wholly remote. Query whether ABC makes an office available to E in X. And query, too, whether E's work requires an

[12] As defined in model article 5.

[13] OECD, "Interpretation and Application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention: 12 October 2011 to 10 February 2012" (Oct. 12, 2011); and "Interpretation and Application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention: 12 October 2011 to 10 February 2012" (Oct. 19, 2012).

[14] *See also* Lee A. Sheppard, "BEPS and EU Progress Report," *Tax Notes Int'l*, June 27, 2016, p. 1215 (noting that "some of the 2012 issues were made redundant by BEPS or were silly to begin with" and predicting that "the next generation of European salesmen will be working from their tiny apartments and their mothers' tiny houses").

[15] *See* OECD commentary on model article 5, paras. 18-19.

[16] *Id*. at para. 12.

[17] *Id*. at para. 18. *See also* 2021 updated OECD guidance on treaties and COVID-19, at para. 17 ("If an individual continues to work from home after the cessation of the public health measures imposed or recommended by government, the home office may be considered to have [a] certain degree of permanence. However, that change alone will not necessarily result in the home office giving rise to a fixed place of business PE. A further examination of the facts and circumstances will be required to determine whether the home office is now at the disposal of the enterprise following this permanent change to the individual's working arrangements.").

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office, given that she can work anywhere from her laptop. One might also ask whether ABC reimburses any of the costs associated with E's de facto home office — or whether it would reimburse E if she were to rent a coworking space after finding herself sunburned from all that work outdoors and realizing her Airbnb lacks air conditioning.

A degree of permanence is necessary to the creation of a PE, and E's circumstances might not present it. Setting that condition aside, however, whether E's remote work location — an Airbnb, a coworking space, or some other fixed place — constitutes a PE of ABC will depend on whether that location should be considered at ABC's disposal. The commentary refers to whether the employer effectively requires or merely allows the employee to work from home but does not expressly consider the intermediate scenario, in which the employer facilitates the employee's remote work. The examples described above, in which the person who controls a premises permits the conduct of a company's business activities from that premises on an extended basis, suggest that E's Airbnb could constitute a PE of ABC if E remains there for a sufficiently long period and no space is set aside for her at ABC's offices in X.

Yet something about that conclusion rankles. The phrase "the effective power to use" implies a degree of control, and on the admittedly scant facts of our example, ABC appears to have no control over where E works. Indeed, the reader working from home may scoff at the notion that her employer exerts power over the home office, kitchen table, or sofa where she now spends at least three working days per week. Can a place be considered at the disposal of a nonresident employer when the employee controls where (and when) she works?

No matter where E works while in Country Y, that place will not be a PE of ABC if E's activities there are purely preparatory and auxiliary in character — a distinction that implicates E's role with the company.[18] If E is a sales representative or a software engineer, the exemption for preparatory and auxiliary activities is likely unavailable.[19] If E is in a support role, her presence in Y, alone, is unlikely to create an ABC PE there. However, E might not be the only ABC employee who likes sunshine and has an Airbnb account. If many other ABC employees simultaneously work remotely from Y, depending on their activities, the anti-fragmentation rule in the treaty could render the preparatory and auxiliary exception unavailable.[20]

E's role with ABC also matters for assessing agency PE risk.[21] Does she have contract authority, and regularly use it, such that Y law treats the resulting contracts as having been concluded there? Even if not, does E participate in the contracting process, and if so, how important is her role? If the conclusion of contracts in X (or elsewhere) directly results from E's activities in Y, then E has created a Country Y PE for her employer. If E is a software engineer, ABC probably has little or no agency PE risk, but if E is a sales representative, agency PE risk could be a problem.[22]

D. Profit Attribution

If E's presence in Country Y creates a PE, ABC must determine how much of its profit is properly attributable to that PE.[23] That is largely a transfer pricing question, determined by the functions, assets, and risks of ABC that are attributable to its PE in Y. E's activities, and those of any other ABC employees in Y, are critical to the answer. If E is one of only a handful of back-office employees

[18] Model article 5(4) provides that the term "permanent establishment" does not include "the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any . . . activity [that] . . . is of a preparatory or auxiliary character."

[19] *See, e.g.*, OECD model commentary on article 5, at paras. 59 ("The decisive criterion is whether the activity of the fixed place of business in itself forms an essential and significant part of the activity of the enterprise as a whole."), 71 (citing management and sales functions as unlikely to qualify as preparatory and auxiliary).

[20] The anti-fragmentation rule, which was added to the OECD model as article 5(4.1) as a result of BEPS action 7, has not been incorporated into all bilateral treaties (such as those to which the United States is a party) that otherwise generally follow the OECD model.

[21] The OECD model's agency PE provisions, as modified by BEPS action 7, are found at articles 5(5)-(6). Notably, the United States and some other jurisdictions have declined to incorporate the BEPS-related changes by omitting the italicized language in article 5(5), which reads in relevant part: "Where a person is acting in a Contracting State on behalf of an enterprise and, in doing so, habitually concludes contracts, *or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise*."

[22] *See* OECD model commentary on article 5, paras. 87-89.

[23] Here, model article 7 on the attribution of profit to a PE is relevant.

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working from Y, the net profit attributable to ABC's PE there is probably negligible.

But suppose that E is a software engineer who leads and has decision-making authority over an important component of ABC's platform. Under the post-BEPS OECD transfer pricing guidelines, applied by analogy here if X and Y follow the OECD's authorized approach to the attribution of profits to PEs, E's performance of DEMPE functions in Y could attract to that country some of the nonroutine profit generated by ABC's software platform.

E. Local Taxes and Compliance

E's work from Y could trigger various compliance obligations for E, ABC, or both under Y's domestic law. For example, E could be liable for (or ABC could be liable for remitting on E's behalf) social security or unemployment contributions or other social charges. Y law could require ABC to withhold and remit income or payroll tax on E's compensation. E, ABC, or both could be obliged to file local income tax returns to claim benefits under the X-Y treaty. Y law could require ABC to register for VAT or obtain other registrations or licenses.

That list of possible consequences is non-exhaustive. In reality, ABC and E's compliance obligations will be jurisdiction-specific and potentially numerous. To state the obvious: The work-from-anywhere policy, whatever its merits, creates an immense tracking and compliance burden for ABC, as well as much potential uncertainty for both ABC and its employees.

Amid that uncertainty, ABC's visionary CEO seeks guidance from her college roommate, T, now a tax lawyer, whom she retains to advise the company on its policy: "The founders hired me to take this company public, and the investment bankers tell me our policy creates unmanageable tax compliance risk. I can't revoke the policy because at least half our employees would quit. What can I do?"

III. (Possible) Self-Help

T proposes three potential approaches for mitigating the tax and compliance risk resulting from ABC's work-from-anywhere policy: (1) form a subsidiary in Y to employ E and others for periods they spend working there that exceed a specific number of days during the tax year;[24] (2) engage a professional employer organization (PEO) to serve as employer of record for all such employees; and/or (3) limit the remote work policy. For option (1), an intercompany service agreement would be put in place whereby ABC would pay the employing entity a markup on total costs.

As T explains, however, none of those potential solutions is a slam-dunk. And to complicate matters, by the end of 2022, nearly one-third of ABC's workforce is working outside X — and in fact, primarily from Y — for at least half the year. The CEO decides to implement option (1) and directs the company's general counsel to form Y Sub.

A. Form, Substance, and Employment

ABC should carefully evaluate the nature of its relationship with E. On our facts, is E an employee or an independent contractor? And if she is an employee, whose?

If Country X is the United States (or has analogous rules), the crucial element for distinguishing an employee from an independent contractor is whether the employer has control over the details of the worker's day-to-day work.[25]

In the United States, a 20-factor common law test determines whether that control exists.[26] The IRS has grouped the factors into three categories: behavioral control, financial control, and the relationship between the parties. In our example, that E chooses her own work location (off the employer's premises) and does not seem to have set work hours weighs in favor of independent contractor status. If she is an at-will employee without an employment contract who performs services exclusively for ABC, those factors point to employee status. Whether E should be considered an independent contractor or

[24] As its employees spread to countries across the globe, ABC could alternatively form a PE blocker subsidiary in Country Z, which has low corporate taxes, a broad treaty network, and a business-friendly regulatory environment, to employ all ABC employees working outside X. It could then take the position that any PE created by its nomadic workforce is that of the PE blocker, which would earn only cost-plus compensation. That approach presents generally the same considerations discussed regarding option (1).

[25] *See* reg. sections 31.3121(d)-1(c), 31.3401(c)-1(b), 31.3306(i)-1(b).

[26] *See* Rev. Rul. 87-41, 1987-1 C.B. 296.

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employee would also depend on the degree of supervision ABC exercises over how she performs her employment, and whether E or ABC bears her business and travel expenses.

Assuming E remains an employee,[27] query whether Y Sub would qualify as her employer under the foregoing principles. Y Sub might serve as E's paymaster and provide her services to ABC under a services contract, but it's unlikely the parties would alter their substantive operations and activities to match the form of that arrangement. E would still collaborate seamlessly with her ABC colleagues and be supervised by ABC personnel in the same manner as before. In substance, she would likely remain ABC's agent, potentially carrying on its business (rather than an independent services business of Y Sub) from Y. ABC's PE risk would remain, although in principle, no additional profit should be attributable to Y if ABC and Y Sub have gotten their transfer pricing right.

B. Transfer Pricing

ABC should also carefully evaluate its transfer pricing. Again, this is first a domestic law issue. A benchmarked cost-plus markup may be acceptable under Y law, depending on the functions, assets, and risks undertaken by the subsidiary, but that potential solution presents generally the same DEMPE questions as in the context of profit attribution to a PE. Are some of the employees in Y sales representatives managing relationships with ABC's local customers? Are the decision-makers for software development or corporate strategy among the cohort working outside X? Should the one-third of ABC's workforce that crossed the border be viewed as having brought some of the company's technology intangibles with them?

The last of those questions raises a domestic law issue on which treaties offer no help, and which has particular resonance if Country X is the United States: exit taxes.

C. Exit Taxes

U.S. exit tax rules are embodied in section 367.[28] Section 367(a) generally provides[29] that when a U.S. person transfers property to a foreign corporation in what would otherwise be a nonrecognition transaction, the U.S. person must recognize gain on the transfer as if the property had been sold for its fair market value.

Section 367(d) provides special rules for transfers of intangible property. In that case, gain must still be recognized, but the amount and character differ. The U.S. transferor is treated as having sold the intangible property in exchange for payments contingent on its productivity, use, or disposition, and as receiving either a deemed royalty stream over the intangible's useful life or a lump sum payment of an amount equivalent to the present value of that royalty stream in the year of the transfer. The amount must also be commensurate with the income realized by the transferee from exploiting the intangible, so it is subject to adjustment over time by the IRS.

The relevant definition of intangible property is in section 367(d)(4) and consists of a laundry list of specific items. Clause (F) covers "goodwill, going concern value, or workforce in place (including its composition and terms and conditions (contractual or otherwise) of its employment)," and clause (G) is a catchall that captures any other item whose value or potential value "is not attributable to tangible property or the services of any individual." Thus, even if the employees' migration did not produce a resulting migration of any ABC technology intangibles to Country Y, it may have triggered a shift of a workforce-in-place intangible.

Workforce in place, goodwill, and going concern value are recent additions to the

[27] If E remains an employee, under option (2), ABC would remain her common law employer despite having transferred E to a PEO's payroll. The PEO could qualify as E's statutory employer, thereby relieving ABC of employment tax liability for E, in limited circumstances. *See* IRS, "Third Party Payer Arrangements — Professional Employment Organizations" (updated Dec. 28, 2021). Using a global PEO service provider could reduce ABC's local compliance burden, and the PEO contract could indemnify ABC for mistakes or omissions by the PEO. Using a PEO would not, however, mitigate ABC's PE risk because ABC would continue to be E's employer in substance.

[28] Section 7874, the U.S. anti-inversion statute, which could also be characterized as an exit tax, is beyond the scope of this discussion. Likewise out of scope is the mark-to-market tax applied to individuals who expatriate. *See* sections 877, 877A. Because the United States exerts residence-based taxing jurisdiction over its citizens, this exit tax is voluntary for individual workers. In other jurisdictions, exit taxes may be triggered by an unintentional change of tax residency.

[29] Section 367 and the accompanying Treasury regulations are replete with nuances and exceptions.

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intangible property definition in the code. Before 2018 taxpayers routinely transferred those intangibles out of the U.S. tax base to related foreign persons, taking the position that those items could be offshored free of tax. In some cases, taxpayers ascribed high values to those items that enabled them to assign less value to other property transferred on a taxable basis at the same time and maximize value attributable to foreign affiliates under the transfer pricing rules.

The IRS caught on. In tax disputes involving cost-sharing arrangements for intangible property development between U.S. multinationals and their foreign subsidiaries, the IRS asserted that workforce in place (and goodwill and going concern value) had been made available to the foreign subsidiary through the cost-sharing arrangement and that the subsidiary should have paid for its share of future profits from exploiting those intangibles as part of its cost-sharing buy-in transaction.[30] The IRS argued that the predecessor of the clause (G) catchall provision, which was more narrowly worded, was broad enough to capture those items.

The regulatory history did not support that argument, and the courts didn't buy it. The IRS lost. And lost. Meanwhile, the Obama administration annually proposed budget legislation clarifying that workforce in place was already covered by the statute.[31] Congress did not act. Then, with an irony sadly lost on some of the principal players, the Trump administration granted the IRS's wish and made workforce in place an expressly identified item of intangible property in the 2017 Tax Cuts and Jobs Act.

1. What Is Workforce in Place?

The addition of workforce in place to the intangible property definition in section 367(d)(4) begs the question: What is it? In our example, one-third of ABC's workforce has moved. Does workforce in place mean only a company's entire workforce, or could some critical mass of people qualify? Intuitively, the activities and roles of that one-third of the workforce should matter. Whether they should be considered a workforce in place under section 367(d)(4) might depend on whether they represent a functional cross-section of the company, the entire sales force, or one or more complete development teams responsible for particular software.

Although the U.S. Treasury Department has not yet issued regulations under new section 367(d)(4), other guideposts are available. Section 197 identifies goodwill, going concern value, and workforce in place, "including its composition and terms and conditions (contractual or otherwise) of its employment" as intangibles for which amortization deductions may be claimed. The definition in reg. section 1.197-2(b)(3) suggests that workforce in place encompasses all value placed on employees or any of their attributes, including experience, education, training, and terms and conditions of employment. For section 367(d) purposes, however, the catchall provision in the intangible property definition refers to value "not attributable to the services of any individual," implying that workforce in place captures value attributable only to employees as a group — that is, workforce in place is akin to a synergy value.

That interpretation aligns with the holdings in a line of U.S. Tax Court cases predating the addition of goodwill, going concern value, and workforce in place to the definition of intangible property. Those cases distinguish the goodwill of a business from a worker's personal goodwill. For example, in *Martin Ice Cream*,[32] a family-owned corporation had long distributed Häagen-Dazs ice cream products based on the personal relationship and oral agreement one of the two shareholders had with the founder of Häagen-Dazs. When Häagen-Dazs went public, it initiated negotiations with the corporation for its distribution rights. During the negotiations, the

[30] *See Amazon.com v. Commissioner*, 148 T.C. 108 (2017), *aff'd*, 934 F.3d 976 (9th Cir. 2019); *Veritas Software Corp. v. Commissioner*, 133 T.C. 297, 316 (2009).

[31] *See, e.g.*, Treasury, "General Explanations of the Administration's Fiscal Year 2017 Revenue Proposals," at 14 (Feb. 2016).

[32] *Martin Ice Cream Co. v. Commissioner*, 110 T.C. 189 (1998).

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corporation formed a wholly owned subsidiary to serve as the transactional counterparty and distributed its stock to the shareholder in complete redemption. The IRS determined that the purchase price ultimately paid by Häagen-Dazs measured the gain that the corporation should have recognized on the stock distribution. Its underlying premise was that the corporation owned all the assets sold to Häagen-Dazs, including rights under the oral agreement with Häagen-Dazs's founder and the distribution network. The Tax Court, however, found that the shareholder, not the corporation, owned the assets because the intangible value arose from his individual efforts and interpersonal relationships, not from the corporation's operation of its business.

Internal IRS guidance (LMSB-04-0907-62) from 2007 likewise supports the view that workforce in place represents a synergy value created by workers as a collective. It explains that an individual's employment contract or know-how may lack substantial value independent of that person's services because the gross value is effectively offset by the liability to pay the person's compensation. An assembled research team, however, may be expected to have a substantial value that is attributable to the team's collective contracts and know-how because no one or several individuals may be able to bargain compensation sufficient to eliminate the premium.[33]

Returning to our example, we would need some additional facts about ABC's workers in Country Y to evaluate whether there could be any such synergy value associated with them. Do they have employment contracts and, if so, what are the terms and conditions? In particular, are they at-will employees? The turnover rates and required education and training for their roles would also be relevant. If employees can and do come and go at will — and with regularity — one could argue that ABC realizes no premium or synergy value associated with any of them.[34]

Under section 367(d)(4), informed by the definition of workforce in place in the section 197 regulations, a transfer of workforce in place requires a transfer of more than one employee — but more than one need not necessarily mean all. The IRS took the position in the 2007 internal guidance that a research workforce within a larger business qualifies as a workforce in place. That position merits examination.

Returning to our example, suppose that the one-third of ABC's workforce who work remotely from Y and who are thus on Y Sub's payroll make up its development teams. All salespeople, post-sales support staff, back-office teams, and executive leadership, including the chief technology officer, remain in Country X. Research and development strategy and funding decisions continue to be made from X by ABC's executive leadership. ABC has arguably transferred a research workforce to Y Sub. Yet Y Sub is effectively a shell company; it could not and would not exist independently of ABC, and ABC could not realistically spin it off to a third party. The only premium associated with the Y workers is the markup paid to Y Sub to compensate its Y compliance functions and satisfy transfer pricing rules.

Positing a transfer of workforce in place in that scenario — independently of ABC's other intangible assets — seems like a stretch.

Indeed, economic theory suggests that workforce in place — along with goodwill and going concern value — is an indivisible intangible asset that arises from, and attaches to, a business as a whole. Workforce in place, goodwill, and going concern value are sometimes referred to as

[33] That proposition seems contrary to evidence that collective bargaining produces higher wages for at least some groups of workers. *See, e.g.*, Henry S. Farber et al., "Unions and Inequality Over the Twentieth Century: New Evidence From Survey Data," NBER Working Paper No. 24587 (Apr. 2021).

[34] The "mass asset rule," which arises in the context of section 197 and is now largely obsolete, provides some intuition about workforce in place. It holds that an asset is not subject to amortization if it continually and automatically regenerates. At any given time, the asset is the same in all material respects as it always has been, even if elements of its composition evolve. The workforce of a stable company is an example: People leave and are easily replaced. If that process happens without substantial effort on the company's part, the workforce is a mass asset and so not subject to amortization. To be sure, an asset not subject to amortization remains an asset, but regular turnover and speedy ramp-up without material training imply that the asset's residual value, over and above head count costs, may be limited or nil.

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residual business assets.[35] Residual business assets represent the residual value of a business as a whole, over and above the piecemeal value of its other, discretely identifiable tangible and intangible assets, but they do not exist independently of those assets. For example, goodwill cannot be transferred without also transferring other assets of the business, and workforce in place cannot be transferred without also transferring the workers. Logically, residual business assets exist as a penumbra of a holistic business.[36]

2. Has There Been a Transfer?

In the prototypical section 367(d) case, there is an affirmative, acknowledged, on-purpose transfer of something. A U.S. company incorporates its foreign branch or conducts a restructuring following an acquisition. Disputes surround what was transferred, not whether there was a transfer at all. In our example, ABC affirmatively incorporated Y Sub and has adopted a policy of putting employees on Y Sub's payroll in some circumstances. But neither ABC nor Y Sub exerts material control over whether an employee works from Y or for how long. People are transferring, not being transferred, as subjects, not objects. The moves are voluntary and potentially temporary in nature.

Bross Trucking[37] offers some insight on that fact pattern. Chester Bross wholly owned and operated a trucking company that primarily hauled construction materials and equipment for related companies in his road construction business.

Bross Trucking was basically a one-man show. Bross ran it with a few administrative staff, using trucks leased from a related company and generally hiring independent contractors as drivers. He had a knack for relationships but not for rules, found himself in some regulatory trouble, and effectively ran the company into the ground.

Bross had three sons, none of whom had worked for Bross Trucking. When Bross Trucking shut down, they set up shop as LWK Trucking, leased the vehicles formerly used by Bross Trucking, and started servicing Bross Trucking's customer accounts. About half of the Bross Trucking workforce, some of whom were employees and the rest of whom were contractors, elected to join them. LWK Trucking eventually developed its own branding and launched new business lines, and the sons were more successful staying in bounds of applicable regulations than their father had been. To compound Bross's legal troubles, however, the IRS determined that Bross Trucking had made a taxable distribution to him of goodwill, customer relationships, and workforce in place, all of which he had transferred in a second taxable transaction to his sons.

The Tax Court followed *Martin Ice Cream* in concluding that any goodwill or customer relationships of the Bross Trucking business were personal to Bross. The corporation could not have distributed to him what he already owned. The court also pointed to LWK's having different leadership (the sons, not Bross) and expanding into new business lines as evidence that LWK was its own business with its own goodwill, customer relationships, and other intangibles. As for workforce in place, the court found there was no evidence that the workers had been transferred, as opposed to leaving voluntarily, and that the overlap between the two companies' workforces was "only" 50 percent.

Bross Trucking has some relevance for our example: If a voluntary move by half the workforce is not a transfer of a workforce-in-place intangible, then for ABC, a voluntary move by one-third of the workforce should not be such a transfer, either. But Y Sub is not analogous to LWK. It is not a distinct and stand-alone business but rather a captive service provider to ABC. It's therefore unclear how much weight *Bross Trucking* carries for our example.

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[35] *See, e.g., Amazon.com v. Commissioner*, 148 T.C. 108, 159 (2017), *aff'd*, 934 F.3d 976 (9th Cir. 2019) (referring to workforce in place and "growth options" as residual business assets). *See also Ithaca Industries Inc. v. Commissioner*, 97 T.C. 253, 264 (1994) (concluding that because an assembled workforce is necessary to allow the business to operate and generate income, it "generally is not an asset that is separate and distinct from going-concern value"); Joint Committee on Taxation, "General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984," JCS-41-84, at 428 (1984) (regarding earlier, unrelated changes to section 367, explaining that goodwill and going concern value differ from other business intangibles because they are "generated by earning income, not by incurring deductions").

[36] To be sure, it matters how one defines the "business" for this purpose. A company may operate multiple business lines. A multinational enterprise may operate subsidiary companies that have specific focuses, such as R&D, distribution, or manufacturing, that could in principle exist and operate separately from one another. Each is arguably a "business" having its own goodwill, going concern value, and workforce-in-place intangibles.

[37] *Bross Trucking Inc. v. Commissioner*, T.C. Memo. 2014-107.

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Two other Tax Court cases have some relevance for whether an intangible, assuming one exists, was transferred. *Medtronic* and *Eaton* are transfer pricing cases.[38] In each, the U.S. taxpayer had adopted a transfer pricing policy for its Puerto Rico manufacturing subsidiary (which was treated as a foreign corporation for U.S. tax purposes) that left most of the value chain profit in Puerto Rico, where it was only lightly taxed thanks to U.S. and Puerto Rican incentives in place at the time. The IRS made transfer pricing adjustments that treated the Puerto Rican subsidiaries as the tested parties and left them with only a routine return — such that most of the system profit was taxable in the United States to the U.S. parent companies, Medtronic and Eaton.

Those transfer pricing adjustments were the first prong in a two-pronged IRS litigation strategy. The second prong was poorly briefed but cleverly conceived: If, as the taxpayers asserted, the functions, assets, and risks of the Puerto Rican subsidiaries merited the lion's share of profits from the taxpayers' businesses, the subsidiaries must have unique and valuable intangibles, including workforce in place.[39] And those unique and valuable intangibles must have been transferred to the subsidiaries from the U.S. groups on incorporation in transfers that would have triggered section 367(d).

If one applies the IRS's logic conversely, one might argue that the absence of substantial profit in Y Sub indicates that no valuable intangibles were transferred. Y Sub earns only a markup on costs. However, that argument simply begs the question whether Y Sub and ABC have gotten their transfer pricing right.

Ultimately, whether ABC has transferred a workforce-in-place intangible to Y Sub is uncertain, not only because our example is light on facts but also because it is far from clear under existing authorities whether workforce in place can attach to any particular subset of a workforce, and whether voluntary moves by at-will employees should be viewed as transfers cognizable under section 367(d). That lack of clarity, together with the increasing incidence of mobile and remote work, invites a policy solution.

IV. Policy Considerations

Policymakers (tax or otherwise) are not known for getting ahead of problems. Squeaky wheels are greased. Festering boils are lanced — sometimes after they have already mostly healed. It is not in the nature of political economics to offer grand solutions before an issue comes to the attention of the public at large. Even so, because the emerging phenomenon of mobile work presents a golden opportunity for a proactive policy response, I offer some limited prescriptions and an invitation for fresh thinking and guidance.

A. The Treaties

The discussion above highlights uncertainty in the application of various treaty provisions to remote and mobile workers and their employers when cross-border work results from the worker's choice.

Determining the residency of a digital nomad under domestic laws and treaties is not a task for the faint of heart — but the existing legal framework remains sufficiently strong, and the burden of applying tiebreaker rules among multiple potential claimants properly rests with the nomad herself.

Governments may, however, want to revisit the 183-day threshold and winner-takes-all approach to the taxation of employment income found in many treaties. If a Canadian tax resident spends ski season in Switzerland, springtime in Paris, summer in Greece, and autumn in New York, and her compensation is in all instances borne by her Canadian resident employer, Canada's claim on her employment income is not obviously superior to those of Switzerland, France, Greece, and the United States. To be sure, Canada will likely allow a deduction against the employer's income for the nomad's compensation, but unlike the four other contenders for taxing rights over that compensation, Canada has not expended government revenue to provide services and infrastructure used by the nomad during the year. No straightforward tax policy answer suggests itself.

[38] *See Medtronic Inc. v. Commissioner*, T.C. Memo. 2016-112, *vacated by* 900 F.3d 610 (8th Cir. 2018); and *Eaton Corp. v. Commissioner*, T.C. Memo. 2017-147.

[39] The court pointed out in both cases that the gist of the IRS's argument seemed to be that the subsidiaries could not possibly be as profitable as they were unless intangibles were transferred to them.

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Employers would benefit from enhanced OECD guidance on the "at the disposal of" condition for the creation of a fixed place of business PE. For example, when an employee selects her own work location on premises not controlled by the employer (such as a home office), the OECD model commentary could clarify the consequences of the employer's reimbursing the employee for costs associated with that location. It could also expand on the notion of work that by its nature requires an office and address the treatment of employees' home offices when the employer does not supply physical premises on which the employees could choose to work, either at all or in reasonably close proximity to the employee. Ultimately, the commentary should connect the effective power to use with effective and practical control over a premises. And unless the employer bears substantially all costs of procuring and maintaining the premises, or the employee holds out the office to the public as a place of business of the employer (such as by taking in-person business meetings there), an employee's home office, self-rented coworking space, or Airbnb terrace should never be viewed as within the employer's effective and practical control.

Further, the OECD Forum on Tax Administration, in conjunction with the BEPS inclusive framework, could build and maintain an online tool for employers and nomadic workers to identify and evaluate the local withholding, registration, and other compliance obligations triggered by the workers' travels. Mitigating compliance risk would benefit taxpayers. Facilitating compliance and revenue collection would benefit tax authorities. And reducing the incidence of tax professionals' favorite trope — traps for the unwary — would benefit all stakeholders.

B. U.S. Law

Regulations under new section 367(d)(4) are on the IRS's 2021-2022 priority guidance plan. For many reasons — some wholly unrelated to the subject matter of this article — they should be made a true priority. And with an eye to the growing incidence of remote and mobile work, they should define the contours of workforce in place.

More specifically, regulations under section 367(d)(4) should generally adopt the definition of workforce in place from section 197 but also clarify that a workforce-in-place intangible (i) can arise and exist only for a discretely identifiable business activity; (ii) is indivisible and should thus be deemed transferred only if the entire group of individual workers needed to perform that business activity is transferred; and (iii) consists of any premium or synergy value realized by the transferor in excess of the costs of creating and maintaining the workforce.

The regs should further confirm that worker-initiated, voluntary moves by at-will employees, separately from other business assets, are not transfers cognizable under section 367(d). When a group of employees transfers by choice, as compared with being transferred, untaxed value could in principle escape the U.S. base. However, those kinds of voluntary moves, with the employer merely shifting payroll responsibility to a related party for risk mitigation and administrative convenience, are far afield of the legislative purpose that motivated the addition of workforce in place to the code's list of specifically identified intangibles. Voluntary moves by at-will employees further raise the question whether the employer should be credited with owning a workforce-in-place intangible associated with them. Remote and mobile work reflect a shift of power from employers to workers. If the workers ultimately control where, when, and whether they carry on the employer's business, one could argue that they, not the employer, own any synergy value they create.

C. Where the Money Is

Tax policymakers should evaluate now how well or poorly DEMPE and control concepts map to a world of mobile and remote work. Executives and highly skilled professionals whose work is dominated by digital screens are the workers most likely to go mobile. They are also most likely to be responsible for controlling and taking decisions regarding critical business risks, including for intangibles. If those activities are performed everywhere, but nowhere in particular, the DEMPE analytical framework breaks down.

One solution might be to alter the PE threshold to recognize nexus even in the absence

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of a fixed place of business or agent exercising contract authority if a critical mass of workers spends sufficient time working in a jurisdiction. That could be a new form of agency PE, created by agents' control of DEMPE functions or other critical business risks from within the jurisdiction. Assets, risks, and profit would then be attributed to the PE under the usual rules.

An alternative solution — and one I favor — would be to retreat from the nose-counting trend of recent years and place renewed emphasis on legal relationships, legal ownership, contracts, and capital. The arm's-length standard may have fallen into disfavor, but it retains a powerful conceptual purity, permeates treaties and domestic transfer pricing laws globally, and remains a common baseline for the world's commerce. And at arm's length, contractual risk allocations and other contractual terms matter, and capital providers, not service providers, earn the lion's share of profits. Less emphasis on people functions in profit allocation could forestall the next wave of mobile income. ■

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