

GLOBAL MOBILITY OF EMPLOYEES: PRACTICAL STRATEGIES

**Tax Executives Institute
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AGENDA

- Introduction & Relevance of Global Mobility Issues
- U.S. Income Tax Rules – the Basics
- Permanent Establishment Considerations
- Employment Taxes
- Pensions and Deferred Compensation
- ACA Relief for Expatriate Plans

GLOBAL MOBILITY – RELEVANCE

- An increasing emphasis on global commerce combined with governments' need for tax revenue results in increased scrutiny on compensation paid to cross-border workforces
 - E.g., Section 1441 withholding was a Tier I mandatory audit issue prior to revisions to tier system
- Anecdotal evidence suggests that many U.S. companies may find their procedures for cross-border payments and related withholding are inadequate and expose them to risk
- Employers need to track and record their employees' locations at all times
- IRS programs may allow employers to bring their programs into compliance without risking retroactive liability (e.g., past IRC § 1441 VCP)

U.S. INCOME TAX RULES – THE BASICS

- U.S. persons are taxed on worldwide income regardless of where work is performed or where the individual resides. U.S. persons include:
 - U.S. citizens
 - Lawful permanent residents (green card holders)
 - Resident aliens (substantial presence test)
 - Formula that determines whether person was in the United States for 183 days during the 3-year period that includes the current year and the 2 previous years
 - 120-day safe harbor
 - Closer connection exception and treaty tie-breaker rules may apply

U.S. INCOME TAX RULES – THE BASICS

- Non-resident aliens are subject to U.S. income tax only on U.S. source income
 - Income from services are sourced according to where services are performed (threshold inquiry where payments made to NRA)
 - Narrow exceptions for temporary workers and NRA crewmembers of foreign vessels
 - Where services are performed partly in the United States and partly without, income should be allocated on the basis that “most correctly reflects” the proper source of the income under the facts and circumstances of the particular case (usually on a time basis, but not always)

U.S. INCOME TAX RULES – THE BASICS

- Deferred compensation to NRA must be sourced based on:
 - Employer or employee contributions for services performed in the United States (relates back to where services performed)
 - Earnings on the contributions relating to services performed in the United States (earnings in U.S. plan generally U.S. source income)
 - Employer or employee contributions for services performed outside the United States
 - Earnings on the contributions relating to services performed outside the United States
- Treaty may provide for reduced withholding

U.S. INCOME TAX RULES – THE BASICS

- Non-resident aliens are subject to U.S. income tax only on U.S. source income
 - Sourcing rule does not distinguish between whether payments are made to an employee or an independent contractor (or a business entity)
 - Sourcing rules for options
 - Certain fringe benefits are sourced on geographical basis (e.g., principal place of work) – housing, education, transportation
 - Otherwise, apportionment on time basis (number of days)

Practice Note: NRAs are subject to gift and estate taxes only on “U.S. situs” property. U.S. citizens and “domiciles” are subject to transfer taxes on all transferred property regardless of property situs. May be an important consideration for inbound employees.

U.S. INCOME TAX RULES – THE BASICS

- Income Tax Withholding – U.S. Employees
 - Employers (domestic and foreign) are generally required to withhold and report / pay over withheld amounts for payments to U.S. persons
 - Exceptions:
 - At the time of payment, it is reasonable to believe that the payment will be excluded from gross income under IRC § 911 (U.S. citizens only)
 - Local withholding applies (U.S. citizens working offshore)
 - Reduced withholding under applicable tax treaty
- Secondary liability for failure to withhold

U.S. INCOME TAX RULES – THE BASICS

- Income Tax Withholding – NRAs with U.S. Source Income
 - Must determine whether payee is an employee (and payments are wages) or whether payee is an independent contractor and Section 1441 withholding applies
 - For employees, withhold at graduated rates under Code section 3402 (subject to flat-rate withholding rules for certain supplemental wages)
 - Non-employees generally are subject to 30% withholding under Code section 1441, even though the individual may be subject to tax at graduated rates
 - Determination will affect reporting and remittance mechanics

U.S. INCOME TAX RULES – THE BASICS

- If section 1441 rules apply, no withholding in certain circumstances:
 - Payee certifies on Form W-8ECI that income is “effectively connected income” with a U.S. trade or business
 - Properly documented treaty exception applies
 - No actual payments made
- Example
 - NRA director (treated as an independent contractor) attends board meetings both inside the United States and outside and he receives non-cash fringe benefits (theater tickets) during a board meeting in Japan. All other income is deferred to later year.

U.S. INCOME TAX RULES – THE BASICS

- Documentation Requirements for Reduced Withholding
 - Domestic law exception (e.g., Section 911) only if valid W-4 and Form 673
 - Form W-8BEN to substantiate status of payee (NRA) and treaty eligibility
 - Form 8233 to claim withholding exemption under applicable treaty
- FATCA has made the documentation compliance rules considerably more complicated

GLOBAL MOBILITY – PERMANENT ESTABLISHMENT RISK

- Question of whether employees and contractors working in foreign country will trigger PE in that country
 - Fixed place of business through which business is carried on (office, branch, place of management, etc.)
 - Construction, assembly, installation project, or drilling rig does not create a permanent establishment unless the project lasts more than 12 months
 - Presence of an agent with authority to conclude contracts may trigger PE

GLOBAL MOBILITY – PERMANENT ESTABLISHMENT RISK

- Consequence of PE
 - Attributable income may be taxable by source country
 - May trigger an income tax return filing requirement (even if no taxable income)
- Domestic law context may (and likely will) employ different rules (e.g., U.S. trade or business / ECI rules)

GLOBAL MOBILITY – PERMANENT ESTABLISHMENT RISK

- The foreign sub solution
- Use of secondment arrangements
 - And resulting issue: who's the employer?
- Problems arise when positions inconsistent for
 - Qualified plan coverage
 - Employer deductibility of wage expenses
 - Social Security Tax Withholding
- Form and substance of secondment arrangement (*Striker*)
 - Terms of assignment reflect intent of the parties
 - Tax equalization to home country
 - Home country control over secondee (e.g., exclusive right to discharge)

GLOBAL MOBILITY – EMPLOYMENT TAXES

- U.S. FICA Tax Withholding
 - Generally required for wages paid by any employer for services within the U.S., regardless of the employee's citizenship or residency status
 - Exception for nonresident aliens temporarily present in the U.S. under certain types of visas
 - Exception for certain temporary foreign agricultural workers
 - Generally required for services performed outside the U.S. by U.S. citizens and residents, but only for wages paid by an American employer
 - The term “American employer” includes U.S. corporations, the U.S. government, U.S. residents, and partnerships where 2/3 of the partners are U.S. residents
 - Also includes service under a U.S. government contract for a foreign member of a U.S.-based controlled group

GLOBAL MOBILITY – EMPLOYMENT TAXES

- U.S. FICA Tax Withholding
 - Not required for employment with a foreign affiliate of a U.S. employer, except as provided by a totalization agreement or a Section 3121(l) agreement
- Bilateral Totalization Agreements (more common)
 - Prevents double taxation where both countries provide for coverage
 - Permits social security credits in both countries to be added together
 - Especially useful for temporary assignments, where a minimum period of service is required for social security benefits
 - Not available for local hires
 - Only available in about 25 countries

GLOBAL MOBILITY – EMPLOYMENT TAXES

- Section 3121(l) Agreements (less common)
 - American employer must have at least a 10% interest in the foreign affiliate
 - Agreement is irrevocable
 - Provisions apply to all U.S. citizens employed by the foreign affiliate, including local hires
 - American employer is responsible for withholding and paying the employer and employee share of FICA taxes
- Income tax treaties rarely address social security taxes

GLOBAL MOBILITY – EMPLOYMENT TAXES

- Common audit issues – employees who work in multiple countries
 - Be prepared to substantiate time spent/work performed in each location or reason to allocate U.S. versus non-U.S. source income on other than a time basis
 - NRA withholding documentation (W-8BEN and treaty claims)
 - Tax equalization payments and how withholding is calculated
 - Mechanisms for depositing payroll taxes

GLOBAL MOBILITY – EMPLOYMENT TAXES

- Common errors
 - Identifying the employer – home country vs. host country
 - Can affect FICA tax withholding rules, responsibility for remitting employment taxes
 - Secondment arrangements
 - Tax equalization – promises vs. reality
 - Some equalization agreements do not cover sources of income other than the employer
 - Failing to properly claim treaty relief
 - Taxpayers often are required to complete Forms 8233, W-8 BEN, and/or W-4 to receive treaty relief
 - Providing tax advice to employees and directors

GLOBAL MOBILITY – U.S. QUALIFIED PLANS

- Company has a lot of control about who is eligible for U.S. 401(k) and pension plans
 - Most 401(k) and pension plans exclude nonresident aliens
 - Can probably exclude other groups – but need to check plan language first (may need to amend plan before alien begins work in U.S.)
 - Usually can continue to include U.S. citizens in U.S. plans, even if they are working abroad
- Need to review/amend plan language ahead of time

GLOBAL MOBILITY – U.S. QUALIFIED PLANS

- **Examples:**
 - Employees of the following entities who are paid on a U.S. payroll may become Plan participants:
 - XYZ U.S. Holdings, Inc.
 - ABC Process Solutions, LLC., except those individuals who are employees of NewCo Mobility Services (India) Pvt. Ltd
 - Beginning February 1, 2017, NewCo Mobility Services, Inc.
 - Eligible Employees include employees of the following entities:
 - Systems Company, LLC
 - Systems Company International

GLOBAL MOBILITY – NON-U.S. PENSIONS AND DEFERRED COMPENSATION

- Foreign funded arrangements taxed under Section 402(b)
 - Benefits become taxable when they vest
 - HCEs taxed on trust earnings in discriminatory plans
 - Funded arrangements are not subject to Section 409A
- Unfunded arrangements may be subject to Section 409A
 - Must comply or qualify for an exemption
 - Exemptions cover broad-based foreign retirement plans, and amounts excludable by treaty or pursuant to Code section 911
 - If exempt from or compliant with Section 409A, taxation is deferred until distribution or funding, whichever comes first
 - If plan violates Section 409A, vested benefits (using a different definition of vesting than Section 402(b)) are subject to immediate income taxation, plus a 20% penalty tax and premium interest tax retroactive to the vesting date
- Common mistakes: application of section 911 to deferred compensation, contributions to funded retirement plan, pension & annuity payments
- Common mistakes: Failure to file forms required for treaty protection

GLOBAL MOBILITY – GLOBAL SHARE PLANS

- Many companies grant equity awards to employees – stock options and other equity awards subject to vesting schedules
- If non-U.S. employees with equity awards come to the U.S., the sourcing rules of Code section 86I apply
 - Taxation is determined based on days in the U.S.
- Double taxation may be an issue
- National Association of Stock Plan Professionals (NASPP) has a Global Stock Plan portal with resources on a country-by-country basis (www.naspp.com/international)

GLOBAL MOBILITY – AFFORDABLE CARE ACT

- Legislation enacted in December of 2014 provides special relief under ACA for expatriate health plans
 - Relief applies to insured and self-insured plans where substantially all of the primary enrollees are
 - Temporarily assigned to the U.S. and receiving other “multinational benefits;”
 - Working outside the U.S. for at least 180 days during a 12-month period; and/or
 - Part of a group performing international nonprofit work
 - To qualify for relief, the plan must:
 - Provide minimum value
 - Cover inpatient hospital services, physician services, and emergency services in host country (and in the home country, if working in the U.S.)
 - Satisfy other U.S. mandates for health plans (e.g., HIPAA special enrollment)
 - Offer dependent coverage through age 26 if dependent coverage is offered
 - Relief is effective for plans issued or renewed on or after July 1, 2015

GLOBAL MOBILITY – AFFORDABLE CARE ACT

- Expatriate plans that meet the above requirements are entitled to the following relief:
 - Exempt from market reform rules (e.g., lifetime and annual limits, no cost-sharing for preventive care)
 - Exempt from ACA fees (e.g., PCORI and transitional reinsurance program)
 - Automatically qualify as providing minimum essential coverage for both the individual and employer mandates
 - Not exempt from 6055 and 6056 reporting rules
 - Not exempt from the Cadillac plan tax



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