GLOBAL MOBILITY OF EMPLOYEES: PRACTICAL STRATEGIES

Tax Executives Institute
Los Angeles Chapter

November 3, 2017

Douglas Andre
(202) 662-3471
DAndre@ipbtax.com
Global Mobility Presentation Agenda

- Relevance of Global Mobility
- Categories of Foreign Workers
- U.S. Tax Considerations
- Tax Treaty Considerations
- Permanent Establishment (PE) Risk
- Employment Taxes
- Foreign Reporting Issues
- Key Questions “Before they go”
Global Mobility – Relevance

- Why increased scrutiny on cross-border workforces?
  - Increasing emphasis on global commerce
  - Governments’ need for tax revenue
  - Heightened national security concerns
  - Protection of national workforce
  - Strain on social benefit programs
Categories of Foreign Workers
Categories of Foreign Workers

- Depending on how you hire or deploy a worker will determine tax and other employee benefit ramifications for the worker.
- Some situations require a coordination of benefits between countries. Others require complete segregation of compensation and benefits.
- Issues:
  - Shifting references to the type or nature of assignment
  - Lack of proper written contractual arrangements
  - Missed or late government filings
  - Inadequate ongoing compliance
  - Failure to track where services were performed
Each can lead to unexpected and undesirable tax consequences, fines, litigation, fiduciary liability, unwelcome publicity and strained employer/employer relations affecting productivity/morale.
Categories of Foreign Workers (cont.)

FIRST - Employers need to:

- Properly plan and structure nature of cross-border deployment BEFORE taking the deployment happens.
- Consider visa, benefits, payroll/employment laws, “permanent establishment” issues.
- One size does not fit all.
- Determine nature of hire or deployment:
  - Secondment/Foreign Correspondent (expects to return to home country)?
  - Permanent Assignee/Foreign Hire (no expectation of return to home country)?
  - Business Traveler/Dual Employee?
  - Shifting categories amongst the above?
SECOND - Consider if there are specific worker’s programs that apply:

- U.S. examples:
  - Many visa categories (e.g., R, P, O, L, I, H, E) and each with several categories (e.g., H-1B, H-2A, H-2B, L-1A, L-1B)
  - NAFTA Professional
THIRD - Consider logistics:

- Tax treaty between the home and host countries?
- Payroll, employment and tax rules in home versus host country.
- What are employee benefits and compensation structures?
- Understand fiduciary exposure for Board, officers and other employees under local laws (e.g., ERISA).
- How to best track and record employee’s location and travel.
- Remember, tax residency (e.g., 183 days in U.S.) is different than place of employment which is immediate.
U.S. Tax Considerations
U.S. Tax Considerations

- U.S. persons - subject to U.S. tax on worldwide income regardless of where work 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 - whether person in the U.S. for 183 days during 3-year period including current year and 2 previous years (120-day safe harbor)
    - Closer connection exception and treaty tie-breaker rules may apply (e.g., Art. IV(2) of U.S. – Canada Tax Treaty for definition of "Residence")
Non-resident Alien Individual ("NRAI") - subject to U.S. income tax only on U.S. source income

- U.S. rules - income from services is sourced according to where services performed (threshold inquiry where payments made to NRAI)
- Narrow exceptions for temporary workers and NRAI crewmembers of foreign vessels
- Where services are performed partly in U.S. and partly out, income should be allocated on basis that "most correctly reflects" proper source of income under facts and circumstances of case (usually on a time basis, but not always)

Example – U.S. engineering firm providing services partly in and partly outside United States
U.S. Tax Considerations (cont.)

- Non-resident aliens are subject to U.S. income tax only on U.S. source income
  - Sourcing rule does not distinguish between whether payments made to employee, independent contractor or 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)
U.S. Tax Considerations (cont.)

- U.S. Income Tax Withholding – U.S. Employees
  - Employers (U.S. and non-U.S.) 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. Tax Considerations (cont.)

- Income Tax Withholding – NRAI with U.S. Source Income
  - Must determine whether payee is employee (and payments are wages) or whether payee is 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 individual may be subject to tax at graduated rates – check treaty for reduced withholding
    - Determination will affect reporting and remittance mechanics
If section 1441 rules apply, no withholding in certain circumstances:

- Payee certifies on Form W-8ECI that non-wage income is “effectively connected income” with a U.S. trade or business
- Properly documented treaty exception applies
- No actual payments made

Example

- NRAI director (treated as an independent contractor) attends board meetings both within the U.S. and in Japan and he receives non-cash fringe benefits (theater tickets) during a board meeting in Japan. All other income is deferred to later year.
Documentation Requirements for Reduced Withholding
- Domestic law exception (e.g., Section 911) only if valid W-4 and Form 673 provided
- Form W-8BEN to substantiate status of payee (NRAI) and treaty eligibility
- Form 8233 to claim withholding exemption under applicable treaty (NRAIs)

FATCA has made the documentation compliance rules considerably more complicated
Tax Treaty Considerations
The United States has entered into a number of bilateral tax treaties with provisions relevant to compensation for services:

- **Employment income (e.g., Canada, Art. XV)**
  - Wages derived by resident from employment taxable only in State of residence unless the employment is exercised in the other state.

- **Pensions and Annuities (e.g., U.K. Art. XVII)**
  - State of residence of beneficial owner has exclusive right to tax pensions and similar payments.
  - Social security payments taxed only in residence country.

- **Savings clause (e.g., Germany, Art. I)** – U.S. retains right to tax citizens and residents as if no treaty in place.
Permanent Establishment (PE) Risk
Permanent Establishment (PE) Risk

- Essentially a corporate and tax presence imposed by the source country on the foreign entity deemed to be doing business in the source country due to the nature, length and type of activities performed by expatriate employee(s).
- U.S./Canada – might trigger federal, state, provincial and local corporate and tax filings
- From PWC survey of 200 multinational corporations in US/Europe:
  - 89% are paying more attention to issue of PE
  - 86% indicate that increased mobility triggers heightened PE risk
  - 63% agree that tax authorities are becoming more aggressive in assessing PE

(Source “Permanent Establishments 2.0” PWC 2013)
Permanent Establishment (PE) Risk (cont.)

- 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.)
  - Presence of an agent with authority to conclude contracts may trigger PE
- Question arises who is agent working for (especially if operating under secondment arrangement)?
- Consequence of PE:
  - Attributable income may be taxable by source country
  - May trigger an income tax return filing requirement (even if no taxable income)
- Inadvertent triggering of Services PE (Art.V(9) of U.S./Canada Treaty) – must know rules for counting numbers of days home-country employees are present in foreign country
- Domestic law context may (and likely will) employ different rules (e.g., U.S. trade or business / ECI rules)
Treaties generally exclude activities of a preparatory or auxiliary nature

For example, activities that don’t rise to PE under U.S./Canada Treaty:

- Building or construction site project lasting less than 12 months
- Installation or drilling rig lasting less than 3 months in a 12-month period
- Use of facilities to store, deliver, or display goods
- Use of facilities for the purchase of goods or to collect information
- Advertising, supply of information, scientific research or similar activities which have preparatory or auxiliary character
- Combination of these activities need not be preparatory or auxiliary in character in order to avoid PE
Permanent Establishment (PE) Risk (cont.)

- The foreign sub solution
- Use of secondment arrangements - 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)
- Other considerations and best practices for secondment agreements
Employment Taxes
U.S. FICA Tax Withholding

- Generally required for wages paid by any employer for services within the U.S., regardless of employee’s citizenship or residency status
  - Exception for NRAIs 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 if paid by American employer
  - The term “American employer” includes U.S. corporations, 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 foreign member of U.S.-based controlled group
Global Mobility – Employment Taxes (cont.)

- **U.S. FICA Tax Withholding**
  - Not required for employment with foreign affiliate of U.S. employer, except as provided by 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 (including U.S. – Canada Totalization Agreement)
Global Mobility – Employment Taxes (cont.)

  - Coverage (Art.V): Persons subject to residence State laws when working in host country if period of work ≤ 60 months (or longer with mutual consent)
    - Competent Authority agreement provisions
  - Benefits eligibility (Art.VII & VIII): Credit for time worked in residence State (totalization provision)
  - Miscellaneous provisions:
    - Mutual assistance
    - Information sharing, confidentiality provisions
Global Mobility – Employment Taxes (cont.)

- 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
Global Mobility – Employment Taxes (cont.)

- 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
  - NRAI withholding documentation (W-8BEN and treaty claims)
  - Tax equalization payments and how withholding is calculated
  - Mechanisms for depositing payroll taxes
Foreign Reporting Issues & Key Questions
Foreign Reporting Issues

- Wage statements for non-U.S. jurisdictions
- Host country employment contract requirements
- Host country visa application requirements
- Foreign country business registration requirements, thresholds
Key Questions to be Asking

- Where are we sending home-country employees and are tax/totalization treaties available?
- Numbers and duration home-country employees will be in host country? Material risk of PE? Tracking system in place?
- Appropriate written agreements executed.
- Are travelers U.S. persons?
- What tasks will be performed in the host country and for whom?
- Will travelers remain eligible for benefits plans, home-country social security benefits? Filings? Disclosure?
- What other perks will they receive and how will perks be taxed?
- Are there foreign reporting obligations?
- Protections for boards, officers, others under statutes like ERISA re pension and other liabilities.
IVINS, PHILLIPS & BARKER, founded by two of the original judges on the United States Tax Court in 1935, is the leading law firm in the United States exclusively engaged in the practice of federal income tax, employee benefits and estate and gift tax law. Our decades of focus on the intricacies of the Internal Revenue Code have led numerous Fortune 500 companies, as well as smaller companies, tax exempt organizations, and high net worth individuals to rely on the firm for answers to the most complicated and sophisticated tax planning problems as well as for complex tax litigation. We provide expert counsel in all major areas of tax law, and we offer prompt and efficient attention, whether with respect to the most detailed and intricate of issues or for rapid responses to emergency situations.

Disclaimer

This presentation, including any attachments, is intended for use by a broader but specified audience. Unauthorized distribution or copying of this presentation, or of any accompanying attachments, is prohibited. This communication has not been written as a formal opinion of counsel.