Expatriates and Inpatriates Managing Payroll Tax Issues

July 15, 2014

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Agenda

- Definitions
- Multi-jurisdictional income
- Sourcing principles
- The U.S. rules
- Impact of double tax treaties and totalization agreements
- How can things possibly go wrong?
- Best practices
- Questions?

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Definitions

- Expatriate
- Inpatriate
- Double Tax Treaty
- Totalization Agreement
- Certificate of Coverage
- Home Country
- Host Country

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Definitions

- Tax Equalization
- Hypothetical Tax (Hypo-tax or hypo)
- Foreign Tax Credits
- Tax Protection
- Shadow Payroll

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Assignment Related Income

- Cost of living allowance
- Per diems
- Dependent education benefits
- Home leave
- Housing
- Hypo-tax
- Shipping and travel
- Tax equalization payments
  - Actual worldwide tax payments

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Double Tax Treaties

- U.S. has double tax treaties with almost 70 countries
- Each double tax treaty is different BUT generally an individual is tax exempt if
  - The employee is in the host country for 183 days or less,
    - In the taxable year concerned or rolling 12 month period
    - Referred to as 183 day rule
  - The employee compensation is paid by or on behalf of an employer which is not a resident of the host country, <u>and</u>
  - The compensation is not borne by a Permanent Establishment (PE) or fixed base which the employer has in the host country
  - Economic employer

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Totalization Agreements

- Similar to double tax treaties but focus is social security
- U.S. has totalization agreements with 24 countries
- Generally, individual can be covered in “Home Country‘” for up to 5 years
- May mean that income tax and social tax are treated differently for the same income

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Long-Term Assignments

- US inpatriate
- Residency elections
- 401k participation
- Non-U.S. retirement plans
- FATCA
- Split pay
- Visa status
  - F visas
  - J visas

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Long-Term Assignments

- US expatriate
- §911 exclusion and foreign tax credits
- Payroll issues
  - Inclusion of worldwide income
  - Withholding and reporting
    - US
    - Local payroll
  - Split pay
- Permanent Establishment issues

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Short-Term Assignments

- Usually 30 to 364 days
- Taxability determined under local law
- Taxability of allowances
- Availability of tax treaties
  - Employee is in the host country for 183 days or less
  - The employee compensation is paid by or on behalf of an employer which is not a resident of the host country, <u>and</u>
  - The compensation is not borne by a Permanent Establishment (PE) or fixed base which the employer has in the host country
- Economic employer

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Short-Term Assignments

- OECD Model – Who is the employer?
  - Who bears the responsibility or risk for the results produced by the individual's work?
  - Who has the authority to instruct the individual?
  - Who controls and has responsibility for the place at which the work is performed?
  - Who bears, in an economic sense, the cost of the remuneration paid to the individual?
  - Who puts the tools and materials necessary for the work at the individual's disposal?
  - Who determines the number and qualifications of the individuals performing the work?

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Sourcing Principles

- The general rule is that income is sourced where it is earned or over the "earnings period"
- Each taxing jurisdiction may have a different view of the earnings period
- U.S.
  - Generally where "earned"
  - Equity usually deemed to be earned from grant to vest
    - Maybe overridden by treaty
  - State sourcing may vary from Federal
    - E.g., Massachusetts stock options

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Sourcing of Income

	Earned	Paid
Base salary	Daily	Bi-weekly or semi-monthly or monthly
Bonus	Over bonus performance period or related to the achievement of a goal	Quarterly or annually or achievement of target
Commission	Related to a sale	After sale close
Pension	Daily	Post retirement
Stock options	From grant to vest/exercise	Upon exercise

What happens when an employee works in more than one taxing jurisdiction during the earning period?

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Sourcing of Deductions

	Earned
401k	Same as salary and maybe bonus
Pre-Tax Medical (525 plans)	Same as salary
Hypo-tax	Agreed filing positions

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Example

- Peter, an employee of ACME Inc. in the U.S. is assigned to work in Germany for 3 years starting July 1, 2011. ACME obtain a Certificate of Coverage to retain Peter in the U.S. social security system during his assignment. In March 2012, Peter receives a bonus of $10,000 related to his performance during 2011. What taxes have to be paid?
- U.S. income tax on $10,000 x 50%*
- U.S. social tax on $10,000 x 100%
- German income tax on $10,000 x 50%

- Does the payer matter?

** Assuming a US citizen and the company takes a position that U.S. withholding is not required on foreign sourced income as the individual is subject to foreign withholding*

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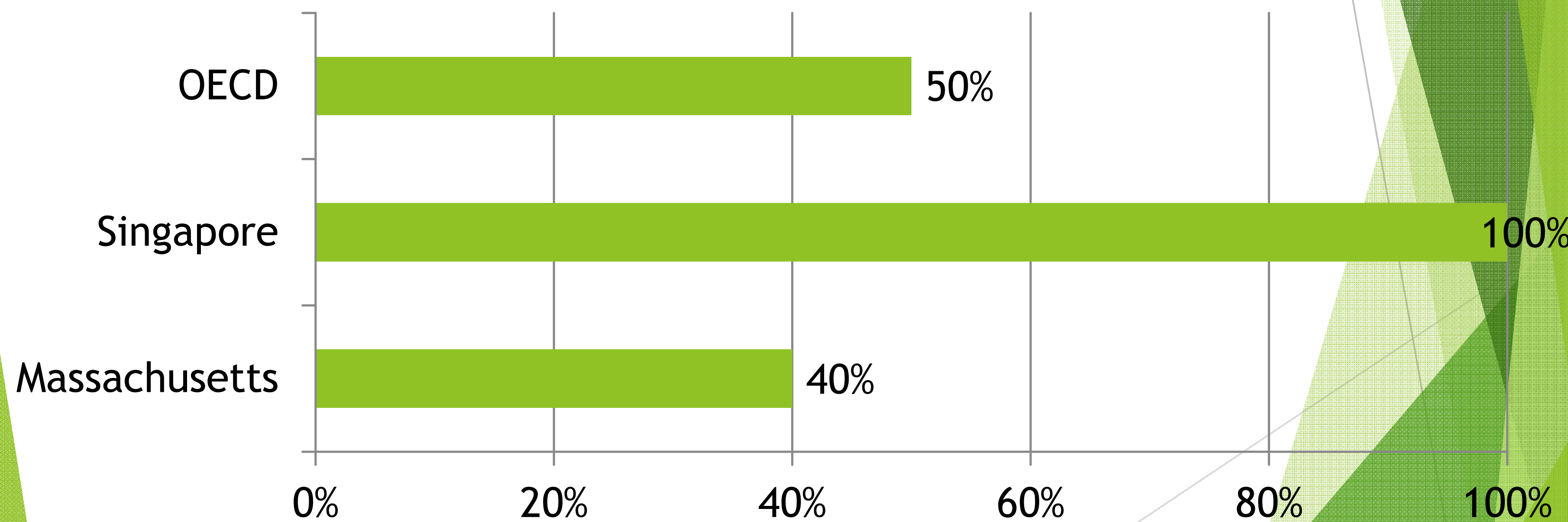
Sourcing For Equity Compensation

Employee is granted an award which vests on the 4th anniversary. Employee relocates 2 years after grant and exercises 3 years later. Chart shown the percentage sourced to jurisdiction of grant



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Equity Compensation

- Additional tax complications
  - Timing of taxation
  - Amount subject to tax
  - Qualifying plans
  - Corporate tax deduction

- Additional administrative complications
  - Tax equalization policies

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What Can Go Wrong?

- Double taxation
- Failure to withhold
- Payroll logistics
- Payroll audits
- Failure to properly communicate
  - With other payrolls
  - With employees

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Best Practices

- Calibrate the problem
- Create team – home and host
- Make appropriate risk management decisions
- What do you have in place for tracking?
- What do you need?
- Proactive compensation compliance
- Immigration compliance

Questions?

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