Global Payroll
and the
Expatriate Process

Utah Chapter APA Meeting
Travis Call, CPA
Agenda & Objectives

- Definitions(!)
- Explore the impact of Expatriates on payrolls and related tax laws
- Explore the impact of Inpatriates on payrolls and related tax laws
- Understand shadow payrolls
- Non-U.S. employees working in the U.S. - What to do?
Definitions: Assignee Types

- Expatriate
  - U.S. citizen or permanent resident outside the U.S.
- Inpatriate
  - Non-U.S. national in the U.S.
  - Foreign National
- Third-Country National (TCN)
  - Non-U.S. national outside of their home country
Definitions: Assignment Types

- Rotational / Commuter / Business Traveler
  - Generally works in host country and lives in home country
- Short-term
  - Less than 1 year
- Long-term
  - Greater than 1 year
- Permanent Transfer
  - Work contract and payroll moves to new country
Definitions: Payroll Types

- Home country payroll
- Host country payroll
- Split payroll
- Shadow Payroll
U.S. Expatriates (Expat)

- Overview
- U.S. Federal Income Taxation
  - Compensation Subject to Tax/Withholding Rules
  - Foreign Tax Credits
  - Foreign Earned Income and Housing Exclusions
- Social Security, Medicare, and State Disability
- State Taxation and Withholding
- Foreign Country Taxation/Tax Treaties
U.S. Expatriate - Overview

- U.S. citizens and residents face a number of tax challenges when they accept a foreign assignment, including:
  - substantial increase in taxable income due to assignment related expenses paid or reimbursed by employer
  - sale or rental of home
  - moving expenses
  - state residency issues
  - foreign earned income and housing exclusions
  - foreign tax credit
  - foreign tax planning
  - tax equalization
Expat Tax – Reporting Requirements

- Wage reporting (U.S. centric)
  - Worldwide income must be reported
    - Cash payouts in home and host countries
    - Benefits-in-kind in home and host countries
    - Non-taxable items in home and host countries
Compensation Subject to Tax

Typical expatriate compensation components (in addition to base, bonus, commissions, 401(k), etc.)

- Relocation allowance
- Hypothetical retained tax (pre-tax deduction)
- Home leave
- Taxable relocation
- Temporary housing
- Housing & Utilities
- Goods & Services Allowance
- Transportation/Car & Gas
- Equalization settlement
- Foreign taxes paid
- Visa & Immunizations
- Gross-up, for Medicare/FICA
- Miscellaneous foreign benefits--could include lease-break, maid services, etc.
Common Compensation Items

- Base salary
- Bonus
- Equity
- Hypothetical tax
- Housing norm
- Cost of living allow.
- Housing allow.
- Utilities allow.
- Education allow.
- Tax equalization
- Language lessons
- Home leave
- Transportation allow.
- Tax reimbursements
- Relocation allow.
- Tax preparation fee
## Compensation Example

<table>
<thead>
<tr>
<th></th>
<th>Gross Amount</th>
<th>Stay-at Home Amounts</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Base Wages</strong></td>
<td>100,000</td>
<td>100,000</td>
</tr>
<tr>
<td><strong>Bonus</strong></td>
<td>20,000</td>
<td>20,000</td>
</tr>
<tr>
<td><strong>401(K)</strong></td>
<td>(15,000)</td>
<td>(15,000)</td>
</tr>
<tr>
<td><strong>COLA</strong></td>
<td>15,000</td>
<td></td>
</tr>
<tr>
<td><strong>Education</strong></td>
<td>20,000</td>
<td></td>
</tr>
<tr>
<td><strong>Housing</strong></td>
<td>48,000</td>
<td></td>
</tr>
<tr>
<td><strong>Retained Hypo Tax</strong></td>
<td>(25,000)</td>
<td></td>
</tr>
<tr>
<td><strong>Foreign Tax</strong></td>
<td>60,000</td>
<td></td>
</tr>
<tr>
<td><strong>Medicare Gross-up</strong></td>
<td>3,000</td>
<td></td>
</tr>
<tr>
<td><strong>Gross Comp</strong></td>
<td>226,000</td>
<td>105,000</td>
</tr>
</tbody>
</table>
Negative Compensation

- Hypothetical tax
  - A compensation reduction retained by employer (generally replaces actual home country withholding)
  - Most commonly based on home country tax laws
- Housing norm
  - Hypothetical cost of home country housing retained monthly by employer
  - Generally a function of base salary, family size, and maintenance of primary residence in home country
Compensation Subject to Tax

• Payments by the foreign entity and/or external third parties (Relo Company):
  • All payments made in the foreign location on behalf of the employee must also be captured in the Company’s reporting process. (For example, payments to rental management companies for deposits, etc.)
  • Exchange rates--If taxable relocation payments are made by foreign entities or third parties, all payments must be converted to U.S. dollars at the exchange rate that applies on the date of payment. Average exchange rates are allowed for amounts paid evenly over a period of time.
Relocation Expenses

• Direct relocation expenses – U.S. non-taxable
  • Shipping of household goods / U.S. storage
  • Travel from home to host country
• Indirect relocation expenses – U.S. taxable
  • Immigration services
  • International HR services
  • Tax services
• Losses sustained by the move – U.S. taxable if reimbursed by company
  • Sale of car
  • Sale of home
U.S. Income Taxation

- U.S. citizens and residents
  - Are taxed on their worldwide income
  - regardless of where they live
  - and regardless of where the income is paid.
Foreign Tax Credits

- Designed to avoid double taxation on foreign source income. The foreign tax credit allows U.S. taxpayers to claim a dollar-for-dollar tax credit against the U.S. tax that is due on foreign source income.
- The foreign tax credit is limited to the lesser of the following two amounts:
  - The U.S. tax on the net foreign source earnings, or
  - The foreign taxes paid or accrued by the U.S. taxpayer during the year plus carryover from prior tax years of foreign taxes.
Foreign Earned Income & Housing Exclusions

- A U.S. citizen or resident who establishes a tax home in a foreign country and who meets either the bona fide residence test or the physical presence test (see next slide for detail) may elect to exclude two items from gross income:
  - Foreign earned income up to $99,200 in 2014 (indexed for inflation), and
  - Foreign housing costs to the extent they exceed a base amount $15,872 but limited to maximum housing expenses of $29,760 (unless city is listed in IRS notice)
  - Income in excess of the exclusion amount is taxed at the higher income tax rates.
Tax Reimbursements

- Common ways to protect assignees from excess tax
  - Tax Equalization (TEQ)
    - Process to ensure that assignee pays no more / no less tax than s/he would have paid if they did not leave their home country
  - Tax Protection
    - Process to ensure that assignee pays no more tax than s/he would have paid if they did not leave their home country
    - If the assignee pays less tax, they retain the tax savings
Tax Reimbursements (cont.)

- Common tax reimbursement methods
  - Tax loans / Tax advances
    - Employer pays the required actual home/host country taxes
    - Loans/Advances are generally added to compensation
    - If not added to compensation, loan agreement with employee needs to be executed and imputed interest added to compensation for interest-free loan
  - Loans should never be executed for executive employees (Section 402 of Sarbanes-Oxley Act)
  - Tax gross up
    - Employer pays the additional tax due on assignment compensation, plus the tax on the tax
    - Tax gross ups are generally added to compensation
Tax Reimbursements (cont.)

- How should repayments made to the company under terms of a tax reimbursement program be handled?
  - If repaid during the same calendar year?
  - If repaid during a subsequent calendar year?
Claim of Right Doctrine

- The tax treatment of an amount that was included in taxable income in a previous year because the taxpayer appeared to have a right to the income, but is then returned to the payor of the income in a later year, is governed by the “claim of right” doctrine.
- IRC Section 1341(a)
Claim of Right Doctrine (cont.)

- The general rule:
  - An item was included in gross income for a prior tax year because it appeared that the taxpayer had an unrestricted right to the item;
  - A deduction is allowable for the future tax year in which the income is returned to the payor because it was established after the close of the prior tax year that the taxpayer did not have an unrestricted right to the item or to a portion of the item; and
  - The amount of the deduction exceeds $3,000
Tax Reimbursements Example

- Company owes assignee $4,480.
  - Need to deliver $4,480 net to assignee.
  - TEQ settlement is wages to assignee (i.e., assignee incurs tax on this amount).
- Assume: 25% federal, 5% UT, and 1.45% Medicare (assume maxed out on OASDI).
- With no gross up, assignee would incur U.S. federal tax of $1,120; UT State tax of $224; and Medicare tax of $64.96; resulting in a net in-pocket amount of $3,071.04 (vs. $4,480).
Tax Reimbursements Example

- Company should:
  - Gross-up the $4,480 payment.
  - Report $6,535.38 as wages.
  - Remit $2,055.38 as withholding (on behalf of assignee).
    - Federal tax of: $1,633.85
    - Utah tax of: $326.77
    - Medicare tax of: $94.76
  - Pay the employee a net payment of $4,480.
Withholding Rules

- Compensation Subject to Withholding:
  - All wages derived from employment (including benefits), unless specifically excepted, are subject to withholding.
  - Again, regardless what wages are labeled—e.g., salary, fees, etc.—and regardless what, how, and where wages are paid.
U.S. Federal Income Tax

• Methods used to reduce or eliminate U.S. tax withholding:
  • IRS Form W-4 with attachment(s):
  • IRS Form 673
    • Foreign earned income exclusion
    • Foreign housing exclusion
  • Mandatory foreign income tax withholding
IRS Form W-4

- Completed by the U.S. international assignee to inform the employer of the expectation:
  - To qualify for foreign earned income and housing exclusions, and/or
  - To qualify for the claim of foreign tax credits, and thereby eligible for a reduction in current tax withholdings
IRS Form 673

- Foreign earned income exclusion
  - Up to $99,200 (2014) of foreign source income earned during the assignment period is excludable from taxable income
  - One of two tests must be met
    - Bona Fide Residence
    - Physical Presence Test
- Foreign housing exclusion
  - Cost of foreign housing that is in excess of a base amount determined by the IRS annually is excludable from taxable income
Foreign Inc. Tax Withholding

• In accordance with IRS Sec. 3401
• Used when compensation is foreign source and subject to a mandatory foreign country tax withholding
• Home country payroll should document the mandatory foreign withholding and maintain a copy in the employee file
  • Countries with mandatory withholding
    • Canada, UK, China
  • Countries with no mandatory withholding
    • Hong Kong, Singapore (assessment in the following year)
Social Security and Medicare

- FICA taxes must be currently withheld – no exemption from withholding for expatriates.
What about Foreign Social Tax?

- The expatriate may be exempt from the foreign country’s social taxes based on a **Totalization Agreement** (treaty for social taxes) with that country.
  - The employee must remain an employee of the Home country and pay Home country social taxes.
  - The Company must apply for a “Certificate of Coverage” in the Home country.
  - The Certificate of Coverage must be kept with the Host country payroll file to substantiate non-withholding in the event of a payroll audit.

[http://www.ssa.gov/international/agreement_descriptions.html](http://www.ssa.gov/international/agreement_descriptions.html)
State Taxation and Withholding

• Whether an expatriate continues to be liable for state income tax during the foreign assignment period varies from state to state.
  
  • Most states follow a residency or domicile approach to taxation.
  
  • Some states have “bright-line” laws that involve time tests.
State Taxation and Withholding

- **Domicile:** no definite intent on moving from the state permanently.

  - Intent is determined based on the facts and circumstances of each individual situation.

  - As a general rule, maintaining a home, business affiliations, social affiliations, bank accounts, driver’s license, and voter registration within a state are all factors which may indicate that you still have a domicile in that state.
State Taxation and Withholding

Residency Approach

- Some states will not let you break residency/domicile unless you move to another U.S. state (i.e. Colorado, Georgia, Utah)
- Some states will not tax you as a resident if you do not maintain a residence (home or place to stay) within the state and spend no more than a certain number of days in the state (usually 183 days)

- California Bright-Line Test:
  - Employment related contract >18 months,
  - <45 days in California during the tax year,
  - Income from intangibles <$200K.
Utah Resident

• You are a Utah resident if you:
  • Are domiciled in Utah for the entire year, even if temporarily outside of Utah for an extended period of time (this could be several years, in certain situations); OR
Utah Resident (cont.)

- **You are a Utah resident if you:**
  - Are domiciled in Utah for any period of time during the taxable year, but only for the duration of that period; OR
Utah Resident (cont.)

• You are a Utah resident if you:
  • Maintained a place of abode in Utah and spent 183 or more days of the taxable year in Utah, even if you did not meet the definition of being domiciled in Utah. In determining whether you spent 183 or more days in Utah, a day means a day in which you spend more time in Utah than in any other state.

http://incometax.utah.gov/filing/residency
Utah Domicile Exception

- You are no longer considered a Utah resident for tax purposes if:
  - You had only met the condition of being domiciled in Utah because you are registered as a Utah voter or have a permanent home or habituation in Utah (for a property for which you are claiming the primary residence property tax reduction) but you have been absent from the state for 761 or more days without spending 30 or more days in Utah any year during that 761 day period.
Utah Residents Working Out of State for a Period of Time

- Utah residents who work out of state (or out of the country) for a period of time, but are still considered domiciled in Utah, must pay Utah income tax on all income earned here or out of state.
Utah Residents Working Out of State for a Period of Time

- Example:
- A Utah family moves to Japan for four years. They still own their house in Utah that they claim as their primary residence for Utah property tax purposes. Utah income tax is due on all earnings from Japan because they are still considered a Utah resident for property tax purposes.
State Withholding Rules

- State tax withholdings should continue during the foreign assignment unless residency is broken.

- Even though a person may break residency or domicile, a liability in that state may be incurred if the person returns to that state for business trips or for trailing liabilities (stock options, bonuses, commissions, etc). Each state has a minimum threshold for when non-resident taxpayers need to report their state-source wages.
Impact of Income Tax Treaties

Most countries impose income tax on individuals either working in or deriving income from within their borders.

- The U.S. has tax treaties with many countries (about 64) under which U.S. citizens or residents may be able to receive favorable tax treatment. The purpose of a tax treaty is to ensure that citizens or residents of the two treaty countries are not taxed by both countries on the same income.

- Tax treaties often provide relief to expatriates on short-term assignments / business trips under three general conditions (must meet all three):
  - Less than 183 days in the foreign country (depending on treaty, can be during any 12 month period, the calendar year or the tax year).
  - Paid from the home location
  - Compensation is borne by the home location

The wording of each treaty is slightly different and must be reviewed before relying on the general rule above.
Foreign Country Shadow Payroll

- Many countries have reporting requirements
- Many countries also have withholding requirements
- Such countries will require a “shadow payroll” implementation
  - Pay delivery still in U.S.; 100% reporting in U.S.
  - Secondary reporting mechanism
  - Enables remittance of foreign taxes
U.S. Inpatriates (Inpat) - Overview

- U.S. Inpatriate = Foreign National
- U.S. Foreign National – classification for tax purposes
- U.S. resident and nonresident taxation
- Payroll implications of residence status
- Income tax treaties
- U.S. immigration and visa status
- Practical Solutions for non-U.S. employees
Inpatriate Definitions

- U.S. foreign nationals - individuals who are not U.S. citizens nor U.S. tax residents
- U.S. – inbound individuals
- IRS definition = nonresident aliens
- Here’s an alternative for payroll use:
  - Non-U.S. employees working in the U.S.
Tax classification is important as it determines:
- U.S. tax filing status and related requirements for an individual.
- U.S. Employer payroll reporting requirements.

For U.S. tax purposes, there are 2 alternatives
- U.S. Resident
- U.S. Nonresident

Individuals are resident aliens if they pass either the ‘Green Card’ test or the ‘substantial presence test’.
- Individuals who do not pass either of these tests are nonresident aliens.
Substantial Presence Test

- This test is known as ‘the 183-day test’
- If individual exceeds 182 days, U.S. residence status is met.
- Specifically, if individual spends at least 31 days in the U.S. in current year and 183 or more days over the following 3-year period:
  - Current year days x 1
  - First prior year days x 1/3
  - Second prior year days x 1/6
- Individual is then considered a U.S. resident alien
U.S. Resident – The Basics

- U.S. resident aliens are taxed on their world-wide income
- Eligible for full ranges of deductions, personal exemptions and credits
- Taxed same as U.S. citizens
- Individual files Form 1040
U.S. Nonresident – The Basics

- Taxed on U.S.-source income only
- For employer wages, this results from physically working in the U.S. (U.S. work days)
- Deductions, exemptions and credits are limited
- Individual files Form 1040NR
Payroll Withholding – U.S. Resident

- U.S. resident aliens are generally subject to same federal employment taxes, and withholding on their worldwide income as U.S. Citizens
- Withholding procedures should follow same rules / procedures for U.S. employees (working in the U.S.)
- Form W4 required to reduce, adjust withholding
Payroll Withholding – U.S. Non-Resident

- Only U.S.-source income is subject to federal employment taxes and withholding.
- Territorial rule in place
  - No withholding on wages paid for work done outside the U.S.
  - Required withholding for wages paid for work inside the U.S., unless exempt under tax code or tax treaty
Inpatriate & U.S. Non-Resident – Payroll Withholding - Exemptions

- Exemption from tax withholding via the tax code:
  - Present in the U.S. not more than 90 days
  - Compensation not greater than $3000
  - Employed by foreign employer
Inpatriate & U.S. Non-Resident – Payroll Withholding - Exemptions

• Exemption from tax withholding via Tax Treaty include the following:
  • F- and J- visa holders if employed by a foreign employer. (This does not apply to U.S. employers)
  • Employees of foreign governments and international organizations
  • Employees under Dependent Personal Services clause
    • Employee physically present less than 183 days in the U.S. in tax year or rolling 12-month period
    • Employed by foreign employer
    • Salary costs are not charged to U.S. entity
  
Specific country treaty provisions / interpretations must be reviewed!
Inpatriates and Social Security Tax

- In general, social security and Medicare tax (FICA) apply to wages paid for work done in the U.S.
  - Regardless of employee or employer’s citizenship or residence.
- Temporary exemption offered
  - Totalization Agreements (usually up to 5 years)
  - Nonresident aliens with F, J or M visas
State tax considerations

- Most states generally follow U.S. Federal definition of wages and tax withholding

- **Key Utah considerations**
  - Tax Treaties only apply to the extent Utah source income is excluded from federal adjusted gross income on the federal return
  - Foreign tax credits not allowed for individuals
    - [http://incometax.utah.gov/filing/income](http://incometax.utah.gov/filing/income)
  - In summary, state filing / reporting requirement may exist even if none exists for Federal (California, New York)
Non-U.S. employees working in the U.S.

- Job #1 – Find them!
- Again, U.S. tax withholding requirement apply regardless of:
  - Residency status of employer
  - Residency status of employee
  - Payroll remittance location
Non-U.S. employees working in the U.S.

- What are the alternatives for employer and payroll compliance?
- Add employees to U.S. payroll
  - Social Security or ITIN required
  - ITIN (Individual Tax ID number) may not be issued until tax return is filed in some cases
  - Prepare Form W2 at year-end to report U.S. taxable wages
- Initiate Shadow or Dummy payroll
  - Outsource or Insorce
    - Social Security or ITIN required
    - Prepare Form W2 at year-end to report U.S. taxable wages
Non-U.S. employees working in the U.S.

- If employees cannot be placed on payroll
  - Employee reports wages on Form 1040
  - Employee will be subject to under-withholding penalties
  - Employer penalty for failure to report and withhold income tax and FICA
Question & Answers
Global Mobility Tax, LLP

- Travis Call
  - Senior Tax Manager, Global Mobility Tax, LLP
  - 3651 N 100 E, Suite 225, Provo, UT 84604
  - Phone: 801.850.6271
  - Email: travis.call@glomotax.com

www.glomotax.com