

International Payroll

Chapter 14
(2018)

What we're going to cover

- US employees working abroad (expats)
- Aliens working in the US (inpats)
- Provisions that help the above employees avoid double taxation of their income

Federal Income Tax Withholding

- Wages earned by a **US citizen** working in a foreign country are subject to federal withholding unless:
 - Foreign earned income exclusion
 - Foreign housing cost exclusion
 - Mandatory foreign tax withholding
 - Wages for work done in Puerto Rico if bona fide resident for year
 - Wages for work done in other US possessions when at least 80% of earnings in one year
- Individual can also increase W-4 allowances to account for foreign tax credits

Federal Income Tax Withholding

- Wages earned by a **resident alien** working in a foreign country are subject to federal withholding unless:
 - Tax treaty allows application of US citizen exemptions
- Individual can also increase W-4 allowances to account for foreign tax credits

Social Security and Medicare Taxes

- US citizens and resident aliens are subject to FICA if:
 - Working abroad for a US employer
 - Working abroad for a foreign affiliate who elects to provide voluntary coverage
 - Elect by filing Form 2032 with the IRS
 - Separate EIN assigned for FICA taxes only
 - Covered under Totalization Agreement (generally 5 years or less)
 - Alleviates double taxation for “temporary” overseas assignments
 - Must apply for Certificate of Coverage from SSA to keep US social security coverage

Federal Unemployment Taxes

- US citizens working abroad for a US employer are subject to FUTA unless:
 - Working in Canada or Virgin Islands
- FUTA tax does not apply for:
 - Resident aliens working abroad
 - US citizens working for a foreign affiliate

Foreign Earned Income and Housing Cost Exclusions

- Under IRC Section 911
 - US citizens and resident aliens working abroad may qualify for the “foreign earned income exclusion” and exclude the first \$103,900 (in 2018) from gross income
 - Can also exclude certain housing costs from gross income
- If an employer reasonably expects the employee to qualify for the Sec 911 exclusion, then no withholding is required on the first \$103,900 of foreign earned wages

Qualifying for the Exclusions

- US citizen must:
 - Have foreign earned income
 - Have foreign “tax home”
 - Meet either the “bona fide residence test” or the “physical presence test” showing the employee did not live in the US during the year in question
 - Complete IRS Form 673

Foreign Tax Home

- The employee's home must be in a foreign country for the entire period for the residence or physical presence test
- The employee's home is:
 - The location of the principal place of business or employment
 - If no regular place of employment, where the employee regularly lives
- Coming to the US on vacation or maintaining a house in the US occupied by a spouse does not negate a foreign tax home

Temporary or Indefinite Assignment

- IRS defines temporary assignments as those lasting less than one year
 - Based on realistic expectation
- Temporary assignments don't qualify for the foreign income exclusions and are treated as business trips with expenses reimbursed, usually via an accountable plan

Bona Fide Residence Test

- Employee has to be a “bona fide” resident of a foreign country for at least an entire tax year (Jan thru Dec)
 - Qualify from start of continuous residence period, i.e. can qualify for part year
 - Foreign country can change

Bona Fide Residence Test

- Bona fide factors:
 - Takes family and intends on making the foreign country their home
 - Purchases a home or signs a long term lease
 - Involved in the culture / social life of the country
 - Employment agreement terms
 - Type of visa or residence permit
 - Intent to return or temporary visits to US for vacations or business are disregarded
 - Can't make statement of non-residency to foreign country, e.g. via tax return

Physical Presence Test

- Be physically present in a foreign country for a full 330 days during any consecutive 12 month period
 - The 330 days do not have to be consecutive
 - A full day is a continuous period of 24 hours beginning and ending at midnight
 - Can be multiple foreign countries

Foreign Earned Income Exclusion

- \$103,900 can be excluded in 2018
- Prorated by number of days qualifying as a bona fide resident or physically present
- Applies to taxable wages earned in a foreign country
 - Based on where the services are performed
 - Taxable moving expenses may be includable
- Income is attributed to the year earned NOT when paid, e.g. annual bonus paid in the following year
 - Income can be excluded in the year received, only if it would qualify for exclusion in the earnings year

Foreign Housing Cost Exclusion

- Can exclude reasonable housing expenses exceeding the base housing amount, up to a maximum of 30% of the foreign earned income exclusion:
 - Rent
 - Utilities and insurance
 - Taxes and fees
 - Furniture rental and household repairs

Foreign Housing Cost Exclusion

	Maximum Foreign Earned Income Exclusion	Housing Cost Exclusion Limitation	Base Housing Amount	Maximum Foreign Housing Cost Exclusion
2018	\$ 103,900	\$ 31,170	\$ 16,624	\$ 14,546

- May be adjusted for locations with higher cost of living (published by the IRS)
- Prorated by number of days qualifying as a bona fide resident or physically present

Foreign Exclusion Limitations

- Can't double dip
 - Not eligible for earned income tax credit
 - Can't take exclusion for housing already excluded elsewhere
 - Can't take foreign tax credit for excluded income
- Foreign earned income exclusion is limited to lesser of:
 - The foreign earned income exclusion (\$103,900) or
 - Excess of total foreign earned income over elected housing cost exclusion

Foreign Exclusion Limitations – Example

- Expat wages qualifying as foreign earned income: \$95,000
- Reasonable foreign housing expenses: \$20,000
- Expat physically present in foreign country for entire year

	Maximum Foreign Earned Income Exclusion	Housing Cost Exclusion Limitation	Base Housing Amount	Maximum Foreign Housing Cost Exclusion
2018	\$ 103,900	\$ 31,170	\$ 16,624	\$ 14,546

1. Calculate foreign housing exclusion
 - Actual housing expenses of \$20,000 less base housing amount of \$16,624 = \$3,376
 - As this is less than maximum exclusion amount of \$14,546 it can be taken in full
 - Therefore, housing exclusion for 2018 is **\$3,376**

Foreign Exclusion Limitations – Example

- Expat wages qualifying as foreign earned income: \$95,000
- Reasonable foreign housing expenses: \$20,000
- Expat physically present in foreign country for entire year

	Maximum Foreign Earned Income Exclusion	Housing Cost Exclusion Limitation	Base Housing Amount	Maximum Foreign Housing Cost Exclusion
2018	\$ 103,900	\$ 31,170	\$ 16,624	\$ 14,546

2. Determine allowable foreign earned income exclusion

– Lesser of:

- The foreign earned income exclusion (\$103,900) or
- Excess of total foreign earned income of \$95,000 over elected housing cost exclusion of \$3,376 = \$91,624
- Therefore, earned income exclusion for 2018 is **\$91,624**

Foreign Exclusion Limitations – Example

- Expat wages qualifying as foreign earned income: \$95,000
- Reasonable foreign housing expenses: \$20,000
- Expat physically present in foreign country for entire year

	Maximum Foreign Earned Income Exclusion	Housing Cost Exclusion Limitation	Base Housing Amount	Maximum Foreign Housing Cost Exclusion
2018	\$ 103,900	\$ 31,170	\$ 16,624	\$ 14,546

3. Calculate unused foreign earned income exclusion
 - Maximum exclusion of \$103,900 less amount claimed of \$91,624 = \$12,276
 - Can be used against future foreign earned income related to 2018, e.g. bonus

US Income Tax Treaties

- Designed to clarify each country's taxing jurisdiction
- Common tax treaty benefits:
 - Personal service income exempt from foreign taxes if in country less than 183 days
 - Professors and teachers exempt for 2-3 years
 - Students / trainees / apprentices exempt
 - Resident alien can qualify for foreign earned income exclusions under nondiscrimination clause
 - Tax credits to avoid double taxation
 - Tax saving clause – US citizens and residents are always taxed!!

Employer Tax Reimbursement Policies

- Expat compensation packages:
 - Housing allowance
 - Relocation expenses
 - Education allowance
 - Vacation allowance
 - Hardship allowance
 - Cost of living allowance
 - Foreign service premium
- Encouraging employees to take foreign assignments

Employer Tax Reimbursement Policies

- Tax protection plans
 - Employee won't pay more in taxes than if stayed in the US
 - Employee benefits from lower tax rates
- Tax equalization plans
 - Employee pays taxes as if stayed in the US
 - Employer benefits from lower tax rates
- Hypothetical taxes
 - Pre-tax deduction of estimated “stay at home” tax amount
 - Used by employer to fund actual tax liabilities

Expatriate State Tax Issues

- Need to consider:
 - Domicile – “true, fixed, permanent home”
 - Residence – where employee lives for more than a “temporary or transitory” purpose
 - Physical presence
 - Tangible connection
- Not all states allow the foreign tax exclusions or allow for a credit for foreign taxes paid

Resident and Nonresident Aliens Working in the US

- Alien = foreign citizen
- Resident aliens
 - Includes permanent residents (green card holders)
 - Taxed on worldwide income, treated the same as a US citizen
 - Substantial presence test
 - Present for at least 31 days in current calendar year; AND
 - Current calendar year days + 1/3 of preceding calendar year days + 1/6 of second preceding calendar year days is at least 183 days
 - Some exceptions, e.g. students for up to 5 years, commuter days for Canadian or Mexican residents, closer connection to foreign tax home if in the US for less than 183 days, income tax treaty rules, etc.
- Nonresident aliens – not a resident

Nonresident Alien Taxation

- Subject to federal withholding on US source income, i.e. US workdays
 - Some benefits can be sourced geographically, e.g.
 - Housing, education and local transportation
 - Tax reimbursements
 - Moving expenses
 - Beware trailing liabilities
- Complete “NRA” W-4 (Single, 1) – cannot claim exempt (exception for residents of Canada, Mexico and South Korea)
- Special withholding calculation – add \$\$ to wages

Nonresident Alien Taxation

- Exemption for “commercial travelers” if:
 - In US for less than 90 days
 - Earn less than \$3,000 of US source income
 - Employed by:
 - US employer in a foreign country; OR
 - Foreign employer not engaged in a US trade or business
- Treaty exemptions can also apply
- All aliens authorized to work in the US should obtain a SSN
 - ITINs can generally only be applied for if SSN is denied
- Independent contractors – withhold 30% unless they have specific treaty coverage (Form W-8)

Nonresident Alien Taxation

- Subject to FICA taxes unless:
 - Certificate of Coverage
 - Student visa (F, J, M, Q)
 - Foreign government employee
- Subject to FUTA taxes unless:
 - Student visa (F, J, M, Q)
 - Foreign government employee

Depositing and Reporting Obligations

- Employees:
 - Follow general deposit and reporting rules
 - If employee is being paid overseas, may have to run a shadow payroll to make deposits timely
- Nonemployees / independent contractors:
 - Deposits
 - Over \$2,000 on 7th, 15th, 22nd or last day of month – deposit within 3 business days
 - Between \$200 and \$2,000 – deposit by 15th of following month
 - Less than \$200 – carry over to next month (and if less than \$200 for the year, pay with annual Form 1042)

Depositing and Reporting Obligations

- Nonemployees / independent contractors:
 - Reporting
 - Annual Form 1042 – due by Mar 15 of following year
 - Annual Form 1042-S – due to payees and IRS by Mar 15
 - Over 250 forms must be filed electronically (same requirements as 1099 series)
 - Penalties for late filing and deposits
 - Same as 1099 series returns

Types of Visas

- Immigrant, i.e. green cards
- Nonimmigrant
 - **B-1 – business visitors**
 - E-3 – Australian residents working in specialty occupations
 - **F-1 – students**
 - **H-1B – specialty workers**
 - J-1 – exchange visitors
 - **L-1A and L-1B – intracompany transfers**
 - M-1 – nonacademic or vocational students
 - O-1 and O-2 – extraordinary ability (arts, science, education, athletics)
 - P-1, etc. – entertainers, athletes
 - Q – cultural exchange visitors
 - R-1 – religious occupations
 - **TN – Canadian and Mexican professionals working under NAFTA**