

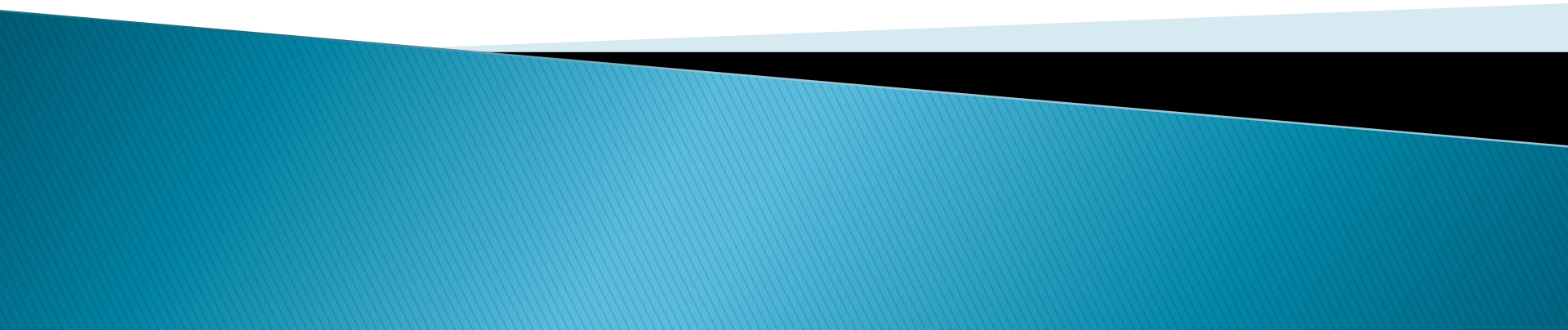
Expats and inpats - Do you know where your employees are?

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Objectives

By the end of this course you will understand:

- the individual tax considerations of expats and inpats
 - the corporate tax considerations of expats and inpats
 - the legal considerations of expats and inpats
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Agenda

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Overview of issues

» Individual tax considerations

Inputs – Executives coming to work in the USA

- ▶ IRS Publication 519: US Tax Guide for Aliens

- ▶ RESIDENCY TESTS:
 - Green Card Test – IRC Reg. Section 301.7701(b)-1(b)(1)
 - Substantial Presence Test – IRC Reg. Section 301.7701(b)-1(c)(1)

- ▶
 - Formula for the 183 day test:
 - •100% of current tax year days plus
 - •1 /3 of prior year plus
 - •1 /6 of second prior year

- ▶ Substantial Presence Relief is available under the Closer Connection Exception and under Treaties

Inpat Tips

- ▶ The transition year is a dual status year with options available pay the lower tax
- ▶ Residency start date is not necessarily the same as the visa start date – watch for the accidental triggering of residency
- ▶ Remember that foreign executives have their home country tax system as their frame of reference. They may be surprised that the US taxes on worldwide income, and that benefits not taxed in their home country are considered taxable compensation by the US (car, housing, children's tuition)

Inpat Tips (continued)

- ▶ The spouse may be expecting to work remotely in the US for their home country employer; this may subject the home country employer to US tax
- ▶ State residency may be different from US residency
- ▶ As US taxpayers these foreign executives are subject to international reporting requirements for foreign entities (Forms 5471, 8865, 3520, 8858) as well as foreign assets and foreign bank accounts (Form 8938 and TD F 90-22.1 “FBAR”). It may be best for the executive to simplify holdings before becoming a US tax resident. Most of the foreign reporting has potential non-compliance penalties of \$10,000+.

Expats – US executives sent overseas on assignment

- ▶ IRS Publication 54: Tax Guide for US Citizens and Resident Aliens Abroad
- ▶ US citizens and resident aliens (green card holders) are taxed on worldwide income, and may also be taxed by the foreign country
- ▶ TAX RELIEF
 - IRC Sec 911 – Foreign Earned Income Exclusion (2012 = \$95,100) and Housing Exclusion (varies) – both on Form 2555
- ▶ TWO QUALIFYING TESTS:
 - Bona Fide Residence Test – calendar year residence
 - Physical Presence Test – 330 days during 12 consecutive months
- ▶ Foreign Tax Credits via Form 1116
- ▶ Tax equalization by employer
- ▶ Tax treaty positions

Expats (continued)

- ▶ Typical expat packages
 - Wages/Overseas bonus
 - Housing
 - Cost of Living Allowance
 - Schooling for children
 - Home leave
 - Tax equalization
 - Tax return preparation
- ▶ Income sourcing
 - Income is sourced where services are performed
 - Fringe benefits may be sourced on a geographic basis – better utilization of exclusion and foreign tax credits

Expatriate tips

- ▶ Understand the family circumstances – employment for spouse, schooling – state residency for colleges, medical issues, aging parents, etc.
- ▶ Watch pre and post assignment income for sourcing opportunities to use foreign tax credit carry forwards
- ▶ Skew more of the compensation toward benefits so that the extra compensation does not continue after the assignment is complete
- ▶ Consider impact on green card status

Overview of issues

»» Corporate tax considerations

Why is there a corporate tax issue?

- ▶ Many countries seek to impose an income tax under local income tax rules when businesses operate in the country.
 - The local tax rules (also known in tax parlance as “taxable presence”) can be overridden by a tax treaty (tax parlance, “permanent establishment” or “PE”).
 - Exceptions to local rules could be Rep Offices for supply chain activities (typical in Asia)
 - Exceptions to PE rules could be activities that are “preparatory and auxiliary” prior to the sale of a product
 - If the business has a taxable presence or a PE, then the business may need to pay income tax on the taxable profit of the activity.
 - Is this for a related or an unrelated party?

- ▶ Careful of signing contracts in country

So we have a PE – now what?

- ▶ Do we already have a registered entity or branch in country?
- ▶ If not, are there legal and tax differences between branch vs. subsidiary?
- ▶ What are the payroll tax obligations?
- ▶ Other taxes?
- ▶ Level of employees?
- ▶ Activities being undertaken – for local enterprise or home enterprise or some other related entity?
- ▶ Transfer pricing?

Tax deductibility?

- ▶ If the employee is doing work that benefits the home employer, what does this mean for the host employer?
 - Generally for the costs to be tax deductible, the cost needs to be incurred in deriving assessable/taxable income
 - If work being done for benefit of other than host employer, then host entity is performing a service and there needs to be an agreement and appropriate compensation
- ▶ Watch out for US subpart F rules
- ▶ Transfer pricing rules and requirements?

Overview of issues

»» Legal considerations

Legal considerations

- ▶ HR issues
 - Visa
 - Local labor law requirements
 - Security
 - Insurance
 - Length of tour
 - International medical, etc.
 - In country benefits
 - Right of return

Legal considerations (continued)

▶ Entity issues

- Is there an entity in country?
- Do we need to register an entity or branch?
- Capital requirements?
- Can entity legally employ non-residents?
- Can entity legally perform services?

▶ Agreements

- Secondment agreement
- Local country employment agreement
- Services agreement

China – a cautionary tale

»» Issues to consider

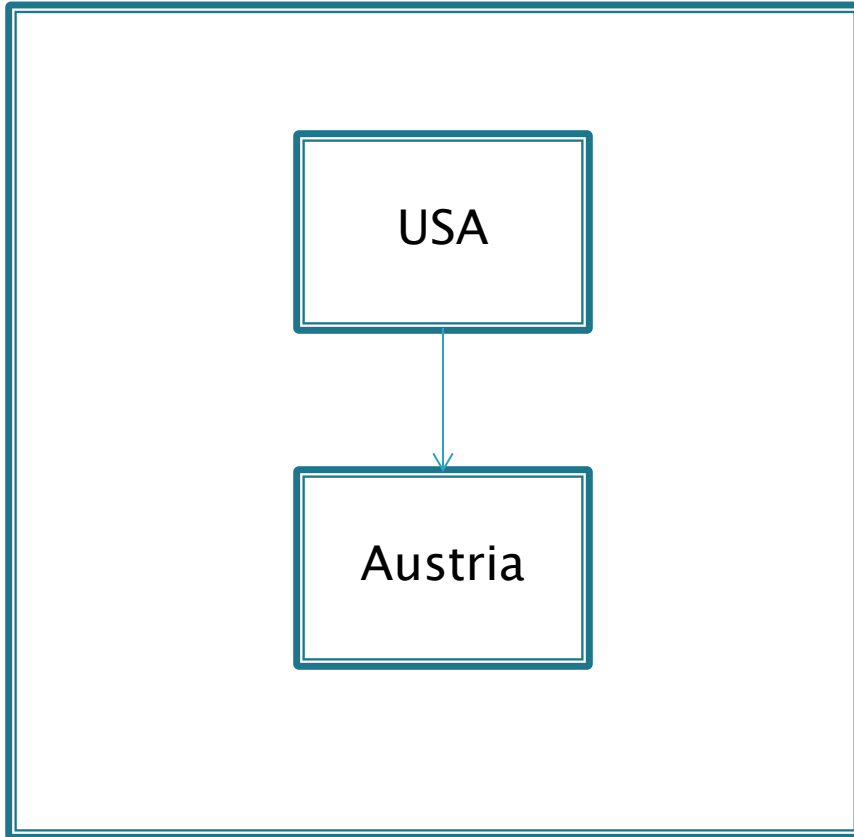
A cautionary tale in China

- ▶ **Secondment agreement**
 - Can create a secondment PE in China for the home entity (refer to Circular issued by the Chinese tax bureau in relation to the Singapore–PRC tax treaty)
- ▶ **Service agreement**
 - Can create a service PE in China for the home entity if services are performed in China
- ▶ **Chinese taxes**
 - voluntary tax and not eligible for the US FTC?
- ▶ **Other taxes?**
 - Business tax
 - VAT

Expatriate Example – #1

- »» US employee sent to work at supplier location in Austria

US employee at supplier in Austria

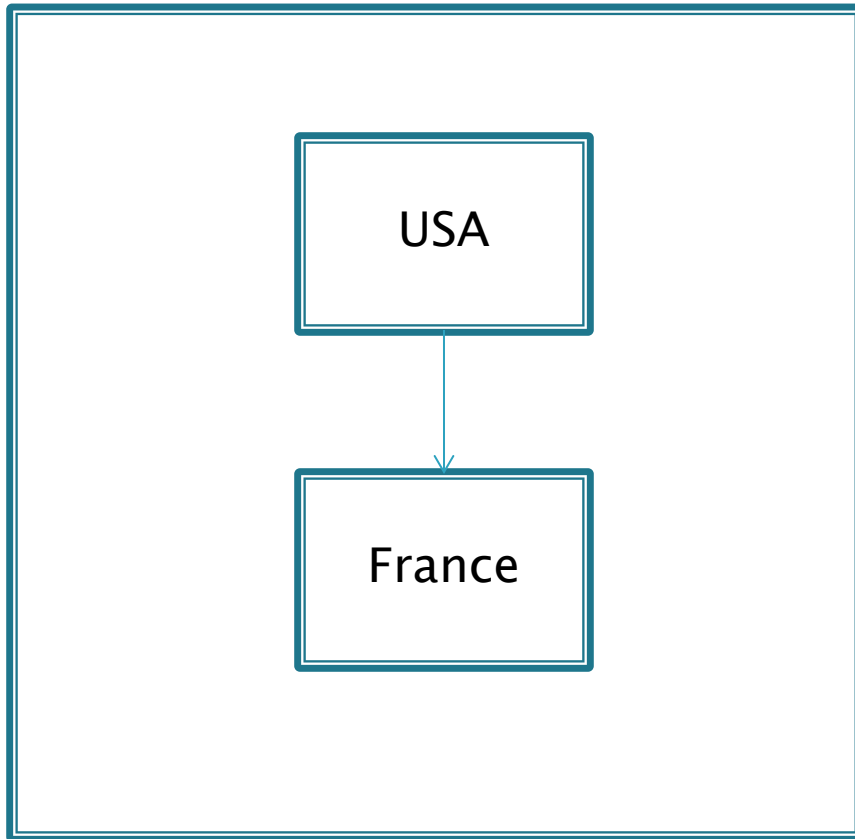


- ▶ Secondment agreement from USA to Austria
- ▶ Employee agreement
- ▶ Service agreement between USA and Austria

Expatriate Example – #2

- »» US employee sent to work at factory facility location in France

US employee at facility in France

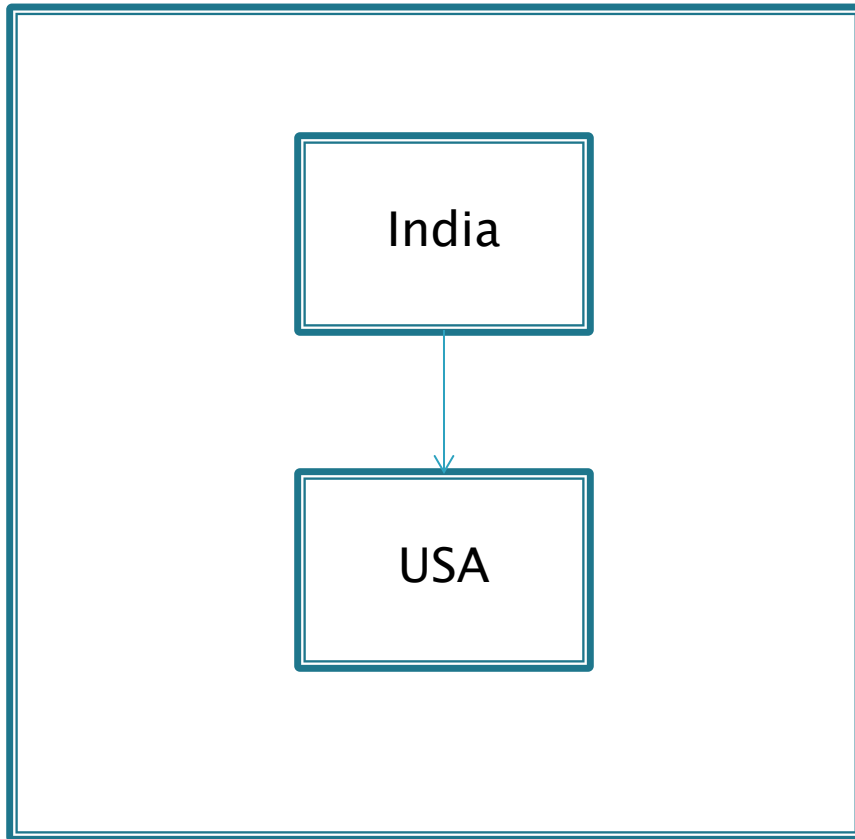


- ▶ Secondment agreement from USA to France
- ▶ Employee agreement
- ▶ No service agreement as for benefit of French entity

Input Example – #1

- »» Indian employee sent to work at head office in California, USA

Indian employee at head office in California, USA

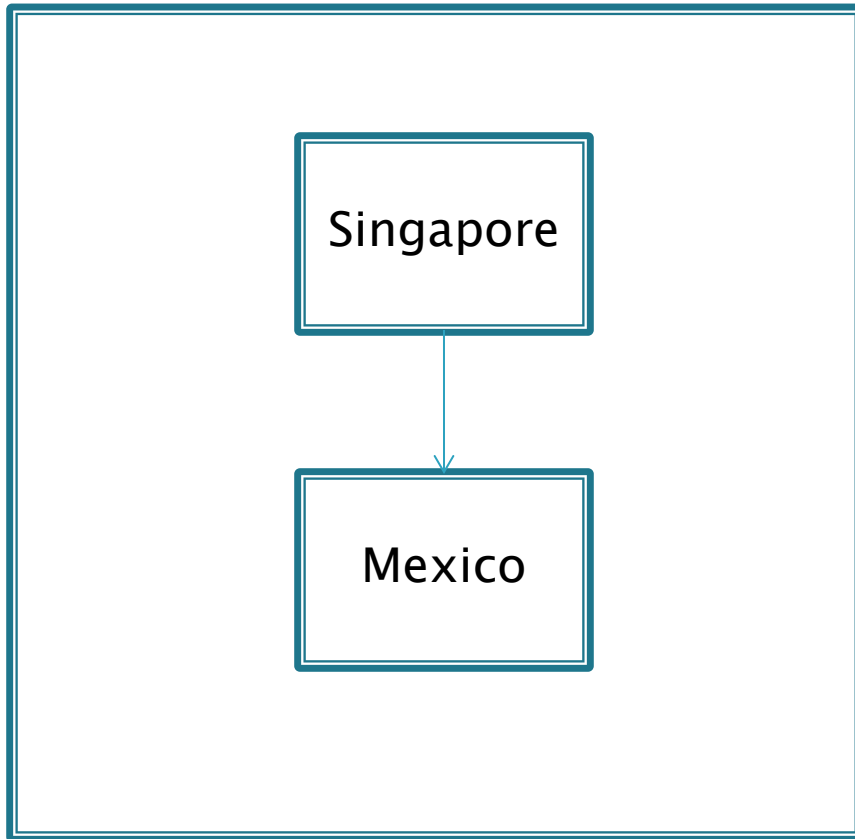


- ▶ Secondment agreement from India to USA
- ▶ Employee agreement
- ▶ No service agreement as for benefit of US entity

Inpat Example – #2

- » Singapore employee sent to work at factory facility location in Mexico

Singapore employee at factory in Mexico



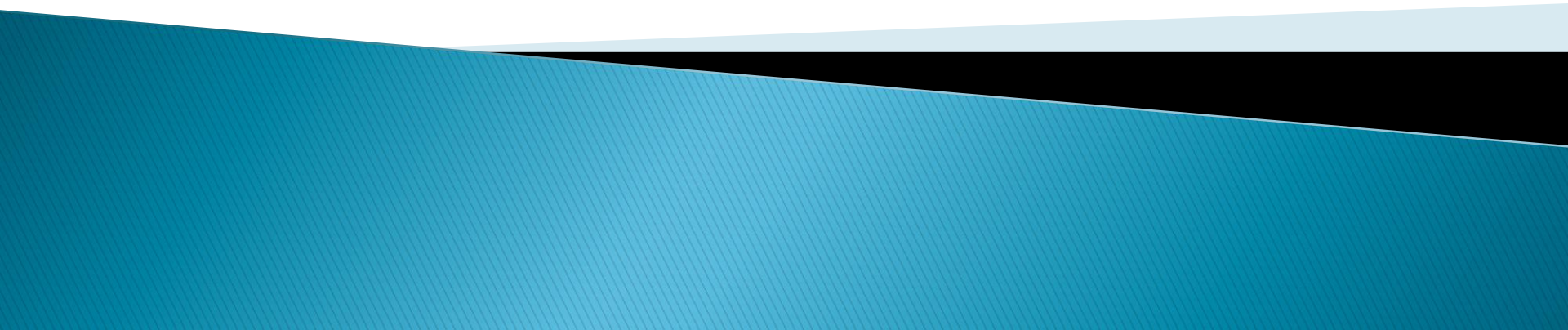
- ▶ Secondment agreement from Singapore to Mexico
 - Does local law require?
- ▶ Employee agreement
- ▶ Service agreement as for benefit of USA entity so Mexico and USA agreement
 - Watch for FBCSvI

Expats and Inpats

Questions?

Conclusion

You will now have an understanding of:

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 - the legal considerations of expats and inpats
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Disclaimer

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International tax is the focus of Kate Leonard's practice as a partner with Hutchinson and Bloodgood, LLP. As part of this practice Kate works closely with law firms under Kovel letters to serve clients who have entered the IRS Offshore Voluntary Disclosure Initiative program. She also lectures to both CPAs and attorneys on international tax topics.

Hutchinson and Bloodgood, LLP is a member of PKF International, a worldwide network of legally independent member firms, and this network is an invaluable resource to Kate's clients who are located in six continents around the world. She works closely with the PKF member firms in Tokyo and Osaka.

Kate has been active in the CPA community, as an AICPA Council representative and member of the AICPA's Form 5471 and Foreign Nationals Task Forces, CalCPA's San Diego President and CalCPA's Secretary/Treasurer, Chair of CalCPA's Global Opportunities Committee, CalCPA's International Conference Co-chair and founding (and frequently chairing) the US-Mexico Annual Joint CPA Conference.

In July 2012 Kate was appointed the Honorary Consul General of Japan in San Diego, in recognition of her decades of involvement with Japan. The position involves the safeguarding Japanese nationals in San Diego and the enhancement the business, cultural and academic ties between San Diego and Japan.

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Mr. Strong joined Goodrich Corporation in 2006 and has held roles of increasing responsibility within the legal department prior that organization becoming part of United Technologies Corporation. Prior to joining the company, Mr. Strong held similar roles with Honeywell International, Inc. and The NORDAM Group, Inc. Before going in-house, Mr. Strong was a practicing attorney with the law firm of Tilly & Fitzgerald, P.C.

Mr. Strong received his bachelor's degree from the University of Oklahoma, majoring in Political Science with a minor in Spanish, and his Juris Doctor from the University of Oklahoma College of Law. Mr. Strong currently sits on the Board of Directors at the Living Coast Discovery Center (formerly the Chula Vista Nature Center).

Narelle MacKenzie, CPA



Narelle MacKenzie is a well known international tax consultant, located in San Diego. She has over 25 years experience working in international taxes, having spent most of her career working with, or for, multinational companies. Ms. MacKenzie is an International Tax lecturer at San Diego State University, first appointed in 2007.

Narelle seeks to understand the business operations and drivers to ensure that the global tax planning and compliance works in synergy with the business, and maximizes the returns to shareholders, whilst ensuring such tax planning is done to the highest ethical standards.

She has worked in both public accounting and industry for employers such as Goodrich Corporation (a Fortune 500 company that was acquired by United Technologies), PricewaterhouseCoopers LLP, and Toyota Australia. Her business experience has covered diverse industries and activities, including supply chain activities and initiatives, identification and implementation of new manufacturing facilities, establishing representative offices, secondment arrangements, customer sales and support initiatives and general cross-border issues.

Ms. MacKenzie has advised on cross-border activities in many and diverse countries and works with tax advisors in those countries to identify optimal, strategic tax solutions for you and your clients. Some of the various countries experiences include: US (federal and state), Mexico, Brazil, Singapore, China, Scotland, India, Turkey, Japan, Germany, South Korea, Netherlands, Canada, Luxembourg, Chile, Sweden, Norway, Russia, Australia, UK and France.

As well as lecturing at SDSU, she is a highly sought after speaker, course instructor and guest lecturer and has presented at many and diverse conferences including CalCPA, the ABA, CITE, AWSA and PwC.

She is a Past President of CalCPA (San Diego chapter), and currently serves on the Audit Committee for St James by the Sea, La Jolla.

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