Hair trigger

Employment Tax International Tax

01 January 2017

Employees travelling to the US for business purposes may trigger unexpected employee and employer tax and reporting obligations, explain *Seb Purbrick* and *Simon Mahon*

Key Points

What is the issue?

Employers with Short Term Business Visitors traveling to the US should be aware of US and UK employment tax considerations, as even very short trips can trigger unexpected employee and employer tax and reporting obligations and create a compliance and administrative burden.

What does it mean to me?

Increased tax administration, unexpected financial risk, exposure to compliance and income based penalties and other regulatory and risk concerns.

What can I take away?

All employee travel to the US carries risk of some form of non-compliance, no matter how infrequent or short the business trip may be. Although non-resident withholding is actually a widely established practice it is not well understood by UK employers. Companies should track employee travel and be able to show the US federal, state and local taxing authorities they are being compliant and managing all tax risk associated with business travellers. Employees should know their exposure to local tax rules. Relying on an Income Tax Treaty agreement does not remove significant tax administration and reporting requirements.

The US authorities are increasing their audits of foreign workers and duties undertaken by Short Term Business Visitors (STBVs). There has been a steady increase in activity by UK and US regulators over recent years. The IRS Foreign Payment Practice Unit is actively requesting companies to provide business traveller data during audits to assess any implications from transfer pricing, permanent establishment and employer Federal withholding.

Business travel is an area that has attracted wider attention in recent years. The location of employees, and economic activities being undertaken by them, have the potential for implications under Country-by-Country Reporting (action 13 of the BEPs initiative), Foreign Account Compliance Tax Act (FATCA) and Common Reporting Standard provisions.

Multi-national enterprises, particularly in the regulated sectors, have invested large sums to track and assess employee travel around the globe to manage the risk and regulatory concerns. These organisations have committed significant resources and time. Mobility teams or specialist teams established for this purpose are now required to report to business leaders within the organisation the full extent of employee travel and the steps being taken to be compliant.

Smaller organisations may not have the resources to adopt complex tracking systems or hire staff to manage this area of compliance. However, in today’s climate not adequately dealing with the problem can cause significant repercussions.

Information return filing penalties imposed by the IRS can rise to a maximum of $1,500,000.

What is an STBV?

An STBV is typically seen as an employee that performs work for the employer away from his normal place of business. This could involve international travel, but also domestic travel of employees working inter-State in the US (some US travel can give rise to City and Local income taxes). As widely understood an STBV is usually not travelling under a formal assignment or secondment policy as employees travelling under these arrangements would generally have provision in place with their employer to be tax compliant. However, as organisations increasingly seek to take steps to manage the compliance obligations of business visitors they are implementing specific policies that apply to all STBVs including STBVs that are also subject to formal assignment policies as they are already based for employment purposes outside their home country.

The duration of travel can be as little as one day, with no maximum numbers of days. The frequency of travel can also be varied with either a set pattern of travel or no current understanding of likely future travel.

There is no formal definition of STBVs within statute, it is a term used by professionals and organisations for differing purposes and therefore can have different meanings to different people. If an employee is undertaking ad hoc travel, which is not visible to compliance/risk managers, HR or payroll professionals, tax and financial managers, it is likely the employee forms part of the STBV population.

Senior executives will carry greater risk as they are key decision makers and will drive profit within the organisation, are remunerated more generously, and carry greater visibility of duties being undertaken in other jurisdictions.

Employment tax considerations for employers

The starting point for understanding the issue is that the US, like most other countries, considers remuneration earned during working time spent in the US (known as US source wages) as income liable to taxation in the US if received by a non resident.

Accordingly employers of non resident individuals spending time working in the US will firstly need to consider US domestic income tax legislation (the Internal Revenue Code (IRC)) to understand their compliance obligations in addition to understanding the implications of the United States – United Kingdom Income Tax Treaty.

US business visitor de minimis exemption

In limited circumstances a US de minimis exemption to Federal income tax withholding is available.

Code section 861(a)(3) provides this by treating compensation for services performed in the US as being deemed to be performed outside the US. This applies where the individual is in the US for a period or periods not exceeding 90 days during the taxable year and whose compensation does not exceed in aggregate $3,000, and the services are provided on behalf of a foreign employer. Given the relatively low threshold of $3,000, this is not a widely available or used exemption, employers would therefore treat their foreign workers as taxable from day 1.

Income Tax Treaty Article 14: a way out?

Where IRC s861(a)(3) is not available Article 14(2) of the US/UK Income Tax Treaty looks to alleviate the employee and employer from an income tax obligation in respect of the duties carried out in the US. Most of the treaties the US has with other countries contains similar articles. In the UK treaty the article provides three conditions, in order to exempt the remuneration from Federal income tax, under 14(2);

a) The employee should not be present in the US for greater than 183 days in a rolling 12 month period that begins or ends in the tax year concerned.

b) The remuneration should not be paid by, or on behalf of, an employer resident in the US.

c) The remuneration should not be borne by a permanent establishment (PE) which the employer has in the US.

This article in the treaty is well known by professional advisers and in-house mobility managers. However, the detail behind the provision is not well understood and application of the different elements is not necessarily straightforward.

For example, there are significant questions between how the UK and US authorities have interpreted the meaning of the ‘employer’ for the purposes of paragraph 14(2)(b), which can create two different outcomes to the same situation.

HMRC guidance leads to the adoption of the ‘economic employer’ concept. This applies a number of factors when determining which entity is the ‘employer’, such as who (the UK or US entity) is benefiting from the work being undertaken, who is bearing the financial risk and who is controlling and directing the work (other factors are also considered). This is referenced in DT1922 of the Double Tax Relief manual and the commentary in section 8.14 of the OECD Model Tax Convention.

The IRS on the other hand, looks to the definition of the common law employer that controls and directs the services. The term ‘employer’ is not defined in the treaty and one must look to the definition of employer in the country where treaty benefits are being claimed. This creates a situation open to challenge where interpretation differs between the US and UK.

However, where a treaty claim is available this will have to be undertaken by having the foreign national employee complete a Form 8233, that includes a US taxpayer identification number (‘TIN’) or a copy of a Form W-7 Application for an ITIN. The employer is required to submit the Form 8233 to the IRS for approval and is obliged to withhold income tax until the form is completed and signed correctly. The form is signed by the withholding agent under penalties of perjury. Compliance failure with respect to these forms is commonplace.

US sourced wages are also subject to social security contributions and Medicare tax (collectively FICA) from day 1 of US entry. However, under the US/UK Totalization Agreement (a sort of double taxation treaty for National Insurance and social Security) a Certificate of Coverage (‘COC’) should be applied for in order to document exemption from US FICA and the ongoing National Insurance Contribution coverage (if applicable).

When considering condition (c) of Article 14 and the interaction with Article 5 ‘Permanent Establishment’ and Article 7 ‘Business Profits’, complications arise with respect to corporate tax when contemplated alongside the position taken in respect of the employee. For example, a UK employer that determines the employee is not working for the benefit of the US employer when travelling into the US on business, exposes the UK employer to the risk of having a corporate tax presence in the US through a permanent establishment.

The threshold applied to determining a PE can be as simple as an employee working from a desk that is regularly available. This can open the employer to attributing profit to the PE in the US which carries with it significant accounting, reporting and corporate tax obligations in the US.

A tale of two payrolls?

If a domestic or treaty exemption is not available, the employer will be required to operate non-resident withholding through a US registered payroll, which would be in addition to the existing UK payroll. The UK payroll can apply for reduced PAYE amount under Net of Foreign Tax Credit application with HMRC. This will address double taxation and cash flow issues for the employee and employer.

US State and Local tax consequences must also be examined. Each US State and Local taxing authority, with limited exception, has autonomy to apply its own tax and withholding regulations. The State and Local taxing authorities do not always recognise the income tax treaty between the US and UK , which can lead to a State/Local tax authority taxing income exempt from federal taxes from the first day of working in the US. The employer may be required to register within each taxing jurisdiction where employees travel to, and also consider and implement unemployment (FUTA and SUTA) tax withholding.

Income tax considerations for employees

Employees travelling to the US for business purposes may look to their employer to assist with income tax compliance and, if applicable, tax withholding on wages as defined by Internal Revenue Code §3401. This will not, however, free the employee from the personal tax requirements placed on the individual by the Federal, State and Local authorities. Furthermore, unlike the UK, the majority of US persons with employment income will file a US income tax return as the US does not differentiate between self-assessment and non self-assessment taxpayers as the UK does.

More forms, more filing

Even if the employee does consider himself exempt from Federal income taxes having evaluated the treaty exemption, he does still need to file an income tax return (form 1040NR) in order to claim the exemption.

As with the employer State obligations, the employee may need to file State income tax returns and pay taxes, where working in a State that does not recognise treaty based positions. Where State taxes have been paid for UK resident employees, a claim can be made on the UK self-assessment tax return to handle double taxation.

The employee will also need to apply for a Social Security Number (‘SSN’) or an Individual Taxpayer Identification Number (‘ITIN’). A business visitor is not eligible for a US SSN but individuals with a right to work in the US must obtain an SSN at the social security administration. The application for an SSN or ITIN can prove challenging and professional guidance is recommended.

Can an STBV be a US resident?

The employee would consider the US residency rules. This is assessed under the Substantial Presence Test (SPT). The SPT is a 183 day count test, looking at days of US presence over a three year period. The test combines 100% of the days spent in the US during the year of assessment, one third of the days spent in the prior year, and one sixth of the days of presence in the year two years before the year of assessment, to determine if 183 days or more are spent in the US during this period.

Under this test, it is conceivable a business traveler with frequent US travel could inadvertently establish US residence. In this case the employee would be taxable in the US on worldwide income and would need to assess reporting under the foreign bank account and foreign asset reporting required by FATCA regulations. Days of presence include any day in the US, including time spent on holidays or non-work related matters.

Furthermore, the employer must then report worldwide wages and withhold US income tax thereon, not just US sourced wages potentially resulting in double withholding until the US and UK income tax returns are filed. A US resident may complete a form W-4 to reduce the required US withholding in anticipation of a foreign tax credit available for the foreign sourced wages.

An employee that is not considered a US resident, otherwise known as a Non Resident Alien (NRA), would need to consider reporting US source income (the remuneration in respect of US workdays, US source Investment) and associated income tax filing and available treaty positions/disclosures.

Other considerations

Employees travelling to the US as business visitors are not only creating an exercise in day counting and personal tax responsibilities. There are a wide range of business tax and other commercial, regulatory, employment law and immigration considerations.

For example, where individuals are generating profit through the activities being undertaken in the US the organisation will need to review and comply with corporate tax considerations, and where appropriate, apply a transfer pricing methodology to recognise attributable revenue and expenses. Any employees performing tasks that are not preparatory or auxiliary will need particular attention from the Tax Director within the organisation.

Individuals working in highly regulated sectors, such as investment management services, require their employer to be well versed in FCA and SEC regulations. Internal immigration controls should also be put in place to ensure employees are only performing tasks permitted by their VISA and not putting the business at undue risk. Senior employees being denied entry at US border controls can easily become an unwanted headline.

Conclusion

Employers with STBVs travelling to the US will need to be well versed in US and UK employment tax considerations, as even very short trips can create a compliance and administrative burden. Day counting is a starting point but employers should also be aware of the activities being undertaken and other business risks. Employees would typically look to their employer for assistance in meeting their personal tax obligations.