

WITHHOLDING - HOW TO DO IT RIGHT AND THE CONSEQUENCES OF MISTAKES

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Agenda

- **Tier I initiative overview**
- **Reporting and withholding rules**
- **IRS §1441 Tier I initiative details**
- **Case studies**

Tier I Initiative Overview

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Taxation of Individuals

- **US citizen – taxed on worldwide income**
- **Resident alien – taxed on worldwide income**
 - “Green card holder”
 - Substantial presence test
 - First year election
- **Non-resident alien (NRA)**
 - Not US citizen or resident alien
 - Taxed on US sourced income

Taxation of Non-Resident Aliens

- **Effectively connected income (ECI)**
- **Non-ECI**
- **Non-US sourced income not taxable in US**

Effectively Connected Income

- **Connected to a US trade or business**
 - Compensation for personal services (sourced based on where services are performed)
 - Profits from operation of business in US
 - Income from partnership doing business in US
 - Income from real property (if election is made to treat as effectively connected)
 - Sale of US real property
 - Sale of business-related capital assets
 - Interest, dividends, etc. from assets or activities of US trade or business
- **Taxed at regular graduated rates**
- **Wages reported on W-2**

Nonresident Aliens – Deferred Payments

§864(c)(6) – Treatment of Certain Deferred Payments, Etc. – Income or gain of a NRA or foreign corporation which

(A) is taken into account for any taxable year, but

(B) is attributable to a sale or exchange of property or the performance of services in any other taxable year

Shall be made as if such income or gain were taken into account in such other taxable year

Nonresident Alien - Income

- **Not effectively connected**
 - Investment income
 - Passive income
 - Examples
 - Dividends
 - Interest
 - Rents and royalties
 - Alimony
 - Limited capital gain
 - Taxed at flat 30% rate or lower treaty rate
- **Exempt from US taxation**
 - Interest on deposits with banks §871(h) and (i)
 - Certain portfolio obligations
 - Most capital gains

IRC Sec 861. Income from Sources within US

(a) Gross income from sources with US. – The following items of gross income shall be treated as income from sources within the US

(3) Personal services. – Compensation for personal services performed in US; except ... shall not be deemed to be income from sources within US if-

(A) the services are performed by NRA temporarily present in US < 90 days during year,

(B) compensation does not exceed \$3,000 in aggregate, and

(C) employer not engaged in trade or business in the US

Sourcing Compensation

- **Sourced on workdays**
§1.861 - 4(b)(2)
- **Multi-year compensation**
§1.861 - 4(b)(2)(ii)(F)
 - Bonus
 - Equity awards

Taxability of Compensation

- **Wages for withholding except**
 - 3401(a)(5) services for a foreign government or international organization
 - 3401(a)(6) services performed by a **nonresident alien individual**
 - 3401(a)(8)(A) for services for an employer (other than the US...) –
 - (i) Performed by a citizen of the US if ... that remuneration will be excluded from gross income **under Sec 911**; or
 - (ii) Performed in a foreign country by such a citizen if ...the employer is required by law in the foreign country ... to **withhold income tax** upon such remuneration

Withholding on US-Source Non-Business Income

- **Persons subject to withholding**
 - Nonresident alien individuals
 - Foreign corporations
 - Foreign partnerships
 - Foreign estates and trusts
- **§1441 income subject to withholding**
 - Fixed or determinable, annual, or periodical
 - Derived from sources in US
- **85% of the social security benefits received by NRA are subject to 30% withholding tax §871(a)(3)**

Withholding on US-Source Non-Business Income

- **Applicable tax rate**
 - 30%
 - Except
 - Portfolio interest
 - Disposition of US real property interest
 - Foreign partner's distributive share of partnership's ECI
 - 14% withholding rate for certain scholarships and fellowships received by NRA
 - Treaties, usually 15%

Withholding on US-Source Non-Business Income

- **Withholding agent**
 - Obligated to withhold
 - Any person having control, receipt, custody, disposal, or payment of an item of US-source non-business income to a foreign person
 - Corporations distributing dividends
 - Debtors paying interest
 - Tenants paying rent
 - Licensees paying royalties
 - Agent liable for uncollected tax
 - Form W-8, W-8BEN or W-9 submitted to withholding agent
 - Deposits tax and files annual informational return (Form 1042/1042-S)

Withholding on US-Source Non-Business Income

- **Administrative matters**
 - Reduced withholding tax rates under US income tax treaties are only available to non-US beneficial owners that reside in a treaty country
 - Withholding agent (payor) can rely on submitted documentation
 - Form 8233 to claim treaty benefits
 - If payee fails to provide adequate documentation
 - Presumption that payee is US person
 - 28% backup withholding

Withholding on ECI

- **Withholding under § 1441 not required on US-source income effectively connected with US trade or business**
- **Personal services: withholding exemption doesn't apply unless compensation is**
 - Subject to standard wage withholding
 - Exempt from withholding §3402
 - Received by self-employed resident of Canada or Mexico
 - Exempt from tax by reason of a treaty exemption
 - Subject to a withholding agreement
- **ECI for foreign partner in partnership**
 - Withhold tax at specified rate for partner
 - Maximum tax rate for individual or corporation
 - Partnership remits quarterly tax payment

IRS §1441 Tier I Initiative Details

- **IRS §1441 Tier I initiative details**

Case Study – Employee Working in US

- **Facts:**

- Entered US on July 30, 2009
- 3 year assignment
- Working for US company

- **Issues:**

- Resident alien vs. non-resident alien?
- Withholding and reporting required?
 - Income tax
 - Social tax
 - FUTA tax

Case Study – Foreign Employer

- **Facts:**
 - Entered US on July 30, 2009
 - 3 year assignment
 - Working for Non-US company
- **Issues:**
 - Resident alien vs. non-resident alien?
 - Withholding and reporting required?
 - Income tax
 - Social tax
 - FUTA tax

Case Study – Short-Term Assignment

- **Facts:**

- Entered US on July 30, 2009
- 120 days
- Working for Italian company
- Reimbursed for travel, lodging, and incidental expense

- **Issues:**

- Resident alien vs. non-resident alien?
- Withholding and reporting required?
 - Income tax
 - Social tax
 - FUTA tax

Case Study – Equity Awards

- **Facts:**

- Entered US on July 30, 2005
- 3 year assignment, returned home July 30, 2008
- Restricted stock granted July 30, 2007, vests July 30, 2009

- **Issues:**

- Resident alien vs. non-resident alien?
- Withholding and reporting required?
 - Income tax
 - Social tax
 - FUTA tax

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