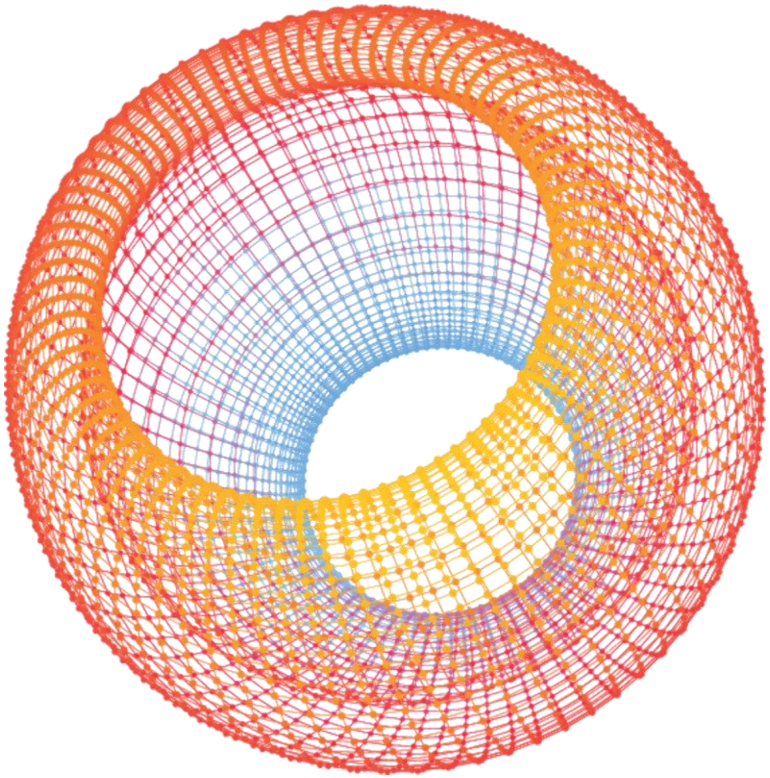

Managing a Global Payroll

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Agenda

General global compensation issues

U.S. expatriate payroll issues

Foreign national payroll issues

Miscellaneous global payment issues

Sources of compensation

- Payroll (U.S. **and** foreign)
- Accounts payable (U.S. **and** foreign)
- Expense reports (U.S. **and** foreign)
- Relocation vendors (U.S. **and** foreign)
- Equity compensation manager
- Pension plans (U.S. **and** foreign)

Is the payment taxable?

- Whether a payment is taxable vs. nontaxable depends, in many cases, on the intended length of the assignment (Rev. Rul. 93-86)
- If assignment is short-term, tax home does not change:
  - Short-term = an assignment realistically expected to last and does last for less than one year
  - If original intention of assignment length is one year or more, tax home changes even if the assignment ends up lasting less than one year
- "Away from home" rules:
  - Travel/living expenses are deductible as employee business expenses
  - Certain company paid items nontaxable (excluded from W-2)
  - Examples — transportation, work permits/visa fees, meals, and lodging

Is the payment taxable?

- Non-U.S. pension plans:
  - Qualified vs. nonqualified
  - Funded vs. unfunded
  - Vesting
  - Tax treaty relief:
    - Newer treaties specifically address pension taxability

Is the payment reportable?

- Moving expenses — even though nontaxable, these must be reported under U.S. tax law in box 12 of the W-2 (unless paid directly to shipper)
- Foreign country reporting — even though U.S. tax law may exempt a payment from U.S. taxation, the foreign country may deem it to be taxable:
  - Moving expenses
  - Per diems or other short-term assignment expenses

Year-end compensation accumulation

- How to collect data from various payment sources
- When to collect data:
  - Monthly, quarterly or annually?
  - **Remember:**
    - Cash wages must be included in payroll when paid
    - Non-cash wages may be added to payroll at any time as long as related tax withholding is deposited by 12/31/XX
- Coordination issues if foreign country systems on fiscal year-end basis
- Establish cut-off dates for inclusion in wage summary:
  - 12/31/XX for U.S. paid items
  - Fiscal cut-off (11/30/XX or 10/31/XX) for foreign paid items (noncash benefits only) per IRS Announcement 85-113

Approaches in expatriate pay delivery

- Home delivery:
  - 100% delivered from home payroll
  - Payroll may be “shadowed” in host payroll for the purposes of tax withholdings
    (i.e., PAYE in the UK)
- Host delivery:
  - 100% delivered from host payroll
  - Payroll may be “shadowed” in home payroll
- Split delivery:
  - Funds delivered from both home and host payroll
  - Payroll may still be “shadowed” back in home and/or host payroll for the portion not actually delivered

What drives the decision?

- International assignment policy
- Intended length of the assignment
- Post-assignment plans
- Tax law
- Country infrastructure
- Employee choice

Split payroll

- Purpose of a split payroll:
  - Exchange rate protection for assignee
  - Assignee convenience and personal cash flow management
  - Foreign country legal/labor law requirements (e.g., Russia, Brazil)
  - Tax withholding requirements
  - Determination of pensionable earnings in home country pension plans

Types of split payroll

- Traditional or recommended split:
  - Home related spendable items are deducted from base salary at home and the host spendable amounts are delivered to the assignee in the host country in host currency.
- Variable or flexible split:
  - Same as traditional split except the assignee determines the amount he/she wants delivered in the host location.
- Mandatory or enforced split:
  - Due to foreign country legal or labor law requirements.
- Shadow (or ghost or mirror)

Shadow payrolls

- What?:
  - A payroll in the host country which is intended to reflect or “mirror” the actual payroll being paid from the home country

- Why?:
  - Compliance: Calculating and remitting host country income and social taxes
  - Reporting: Producing a W-2 or host country equivalent
  - Tax return prep: Expedites the host country tax return process

Mechanics of split and shadow payroll

- Specifics around the payroll setup required to implement and run split and shadow payroll:
- **For example:**
  - What additional earning codes are needed?
  - What controls do you put in place to confirm that you’re not actually delivering amounts that should be shadowed (or imputed) only?
  - How do you manage the accounting and cross charging?

Accounting for splits

- **Home country accounting:**

	DR	CR
Compensation	$5,000	
Intercompany Transfer		$2,000
Cash		$3,000

- **Host country accounting:**

	DR	CR
Interco, transfer	$2,000	
Cash		$2,000

U.S. expatriate payroll issues (1)

- Federal tax:
  - Use IRS Form 673 to cease withholding for employees qualifying for foreign earned income exclusion
  - Use IRS Form W-4 to cease withholding on wages in excess of exclusion per year if employee is also subject to foreign tax withholding ("exempt" status is not applicable)
  - IRS Chief Counsel Memorandum #200814010 states that above 2 points only applicable for U.S. citizen, not green card holders
  - If mandatory foreign tax withholding required, then compensation paid is not "wages" per IRC and no Forms 673/W-4 required, but our advice is to have these in payroll file
  - **Taxable wages should be reported net of any hypothetical tax withholding (Rev. Rule 78-139 and PLR 8204074)**

U.S. expatriate payroll issues (2)

- Federal tax on supplementary wage payments:
  - Mandatory withholding at 39.6% rate once supplemental wages (inclusive of assignment allowances) in excess of $1 million in any tax year regardless of the number of withholding allowances claimed on the employee’s Form W-4
  - The $1 million is a measurement of supplemental pay from all employers during the year
  - An exception to this requirement is that, to the extent the supplemental wages are subject to foreign income tax withholding, they do not meet the definition of “wages” for withholding tax purposes (IRC Section 3401(a)(8)(A)(ii))

U.S. expatriate payroll issues (3)

- State tax:
  - First determine if assignee is a resident vs. nonresident of the state
    - Domicile vs. residency
  - If resident, use Form 673 to stop state withholding (if state follows Federal law) plus state version of W-4 (if the state allows manipulation of their W-4)
  - If nonresident, stop withholding state income tax on departure for assignment
    - Report wages related to workdays in-state while on assignment?
    - Report stock options and prior year bonus?

U.S. expatriate payroll issues (4)

- FICA and Medicare taxes:
  - Mandatory withholding required for:
    - U.S. citizen or resident employed by a U.S. corporation or employed by foreign corporation (greater than 10% U.S. ownership) with a §3121(l) election in effect, or
    - Non-U.S. citizen working in the U.S., **but**
  - Totalization agreements may override these normal rules, thus need to know if a certificate of coverage has been applied for and which country's social security tax is applicable

U.S. expatriate payroll issues (5)

- §3121 (l) election:
  - Permanent corporate level election made on Form 2032 (may not be terminated)
  - U.S. company must directly or indirectly own more than 10% of foreign affiliate
  - All U.S. citizens and residents employed by foreign affiliate must be covered
  - Employer is legally liable for both employer **and** employee FICA contributions

U.S. expatriate payroll issues (6)

- FICA and Medicare taxes:
  - IRC §3121(z):
    - Mandates that a non-U.S. subsidiary of a U.S. parent (greater than 50% owner) who is a U.S. government contractor must withhold FICA on wages paid to U.S. persons
    - Parent company is liable for the tax
    - This rule not applicable if the compensation is:
      - Subject to Social security tax in the foreign country, or
      - Covered by a 3121(l) election

U.S. expatriate payroll issues (7)

- FUTA and SUTA:
  - FUTA is mandatory for U.S. citizen employees on U.S. payroll, whether employed in U.S. or overseas
  - FUTA is not applicable for U.S. green card holder working outside of the U.S.
  - SUTA usually same as Federal, but should check rules for each state to be sure
  - Be aware there may be a problem collecting state unemployment benefits for employees outside of the U.S.

U.S. expatriate payroll issues (7) (cont.)

- SUTA determining the proper state of coverage:
  1. **Principal place of business** — the state in which the employer's principal place of business is located
  2. **Residence or legal situs** — the state of residence of the employer if the employer is an individual, the state whose laws under which the employer was organized if the employer is a corporation, or the state which has a plurality of the partners or trustees as its residents
  3. **Employer election** — if above tests do not apply
  4. **Claim filing** — state where an individual files a valid claim if service is not covered in any state by the above reasons

U.S. expatriate payroll issues (8)

- Recent IRS activity:
  - Increasing payroll audits for current 673s and W-4s
  - In 2016 W-2 reporting penalties increase to $500 per return/statement – W-2Cs could trigger this
  - NRA withholding compliance:
    - Only claims one withholding allowance
    - Single filing status
    - Employer must add back value of exemption when calculating withholding
  - “Lock in Letters” to employers to change W-4 to single with one allowance:
    - Results for W-2 reasonableness check
    - Not payroll audit
    - Not a W-4/673 review

U.S. expatriate payroll issues (8) (cont.)

- Recent State activity:
  - What is your support for not withholding on 100% of income reported in Box 1 wages?
  - Telecommuters
  - Deferred compensation and equity sourcing

U.S. totalization agreements

- Italy (11/78)
- Germany (12/79)
- Switzerland (11/80)
- Belgium (7/84)
- Norway (7/84)
- Canada (8/84)
- United Kingdom (1/85)
- Sweden (1/87)
- Spain (4/88)
- France (7/88)
- Portugal (8/89)
- Netherlands (11/90)
- Austria (11/91)
- Finland (11/92)
- Ireland (9/93)
- Luxembourg (11/93)
- Greece (9/94)
- South Korea (4/2001)
- Chile (12/2001)
- Australia (10/2002)
- Japan (10/2005)
- Denmark (10/2008)
- Czech Republic (1/2009)
- Poland (3/2009)
- Slovak Republic (5/2014)
- Hungary (9/2016)

Note: Agreements with Brazil & Mexico pending.

U.S. totalization agreements (cont.)

- Agreement provisions:
  - General rule (territorial) — pay where you work
  - Detached worker rule — if the employee is temporarily transferred to work for the same employer in a foreign country, he/she will be covered only by home country employer:
    - Temporary = five years or less
    - Same employer — does not work if local hire in foreign location by nonaffiliate entity
    - Exception for consecutive assignments

U.S. totalization agreements (cont.)

- Agreement provisions (cont.):
  - Special exceptions — authorities may jointly agree
  - Italian agreement:
    - Does not have a detached worker rule
    - Basic rule is territorial
    - Coverage is based primarily on worker's nationality
    - Rule: If a U.S. citizen (employed or self-employed) working in Italy would be covered under the U.S. system absent the agreement, he/she will remain covered under the U.S. system

U.S. totalization agreements (cont.)

- Certificates of coverage:
  - Document obtained from coverage country
  - Presented to authorities in agreement country as proof of foreign exemption under the agreement
- U.S. certificates: employer can request from Social Security Administration (SSA) website (www.SSA.gov/international)
- Foreign certificates:
  - U.S. employer cannot stop withholding of Social Security tax until foreign country certificate obtained
  - U.S. employer retain in case of audit (not filed with SSA)

Foreign national payroll issues (1)

- Federal tax:
  - Federal income tax withholding obligation even if assignee employed by foreign entity
    - Foreign entity may file Form 2678 with the IRS in order to enter into an agent relationship with U.S. company to fulfill its Federal income and social tax withholding obligations
  - Domestic U.S. tax law exemption from withholding if employee spends less than 90 days in U.S. or earns less than $3,000, whichever is less
  - Treaties may extend this exemption to less than 183 days and unlimited compensation amounts if assignee is employed by non-U.S. employer and salary costs borne outside of the U.S.
    - However, treaties do not cover payroll withholding obligations so there may be some formalities to follow in order to avoid a withholding or reporting obligation (e.g. Canada)

Foreign national payroll issues (2)

State tax:

- Most states, Illinois and Missouri for example, follow Federal rules relating to taxability and/or withholding obligations
- Some states, such as California, New Jersey, and Pennsylvania, have their own rules which are contrary to Federal (especially relating to income tax treaty exemptions)

Foreign national payroll issues (3)

- FICA and Medicare taxes:
  - General rule is that employee is subject to Social Security tax in the country where the services are performed
  - FICA/Medicare may still be applicable even if wages are exempt from income tax pursuant to an income tax treaty
  - Exceptions to the rule for U.S.-based services:
    - F, J, M, or Q Visa holders
    - Totalization agreements
    - Tax treaty exemption of wage income

Foreign national payroll issues (4)

- FUTA and SUTA:
  - General rule is that all services performed in the U.S. subject to these taxes
  - Exception would be:
    - As with Social Security tax, holders of F, J, M, or Q Visas are exempt from FUTA and SUTA

Payments to nonresident aliens ("NRA") (1)

- Form 1042-S (Foreign Person's U.S. Source of Income Subject to Withholding):
  - Used to report amounts paid to NRA that are subject to withholding (even if no amount is deducted and withheld)
    - Including payments exempt from U.S. tax pursuant to an income tax treaty
  - Similar to 1099 (used in lieu of for NRA)
  - Not used to report W-2 amounts (other than treaty benefits for dependent services compensation)

Payments to nonresident aliens (“NRA”) (2)

- Form 1042-S:
  - In early 2009 the IRS identified 1042-S compliance as a tier 1 audit issue
    - Prior to 2010, IRS never cross-checked 1040-NR claimed withholding with Form 1042-S source documents
  - IRS, upon audit, will mandate statutory withholding if proper and current paperwork exempting payments from U.S.-tax withholding not on file:
    - ITIN: Form W-7 (copy is acceptable)
      - ITIN’s now valid for 5 years
    - Form W-8 BEN (copy not acceptable) to claim treaty exemption for FDAP (fixed, determinable, and periodic income)
      - Valid for 3 years
    - Form 8233 to claim treaty exemption for U.S. effectively connected compensation
      - Annual filing

Equity compensation withholding issues (1)

- An employee may be granted an equity award in one country, vest in that award in a second country, exercise in a third country, and ultimately sell the shares in a fourth country:
  - **As a result, there could be employer reporting and withholdings as well as individual tax implications in each jurisdiction**
- Increasing legislation to capture mobile employee gains:
  - **“Trailing” tax obligations: Income may be subject to tax irrespective of residency status**
  - **“Exit taxes”: More and more countries are imposing charges upon departure and special reporting requirements**

Equity compensation withholding issues (2)

- **RSUs:** Vesting and distribution are planned events, determination of withholding and report consequences can be determined prior to vesting
- **Stock Options:** Calculations done at time of exercise. With short turnaround time, may require upfront streamlining
  - Timeliness of U.S. tax deposits is major audit issue for non-U.S. headquartered multinationals
- Withholding analysis to determine “minimum statutory withholding rates” taxes for equity awards
- Taxable equity award income and withholding may need to be apportioned for mobile employees:
  - Using assignment locations and dates or self-certification a blended withholding rate of tax to apply to the income on the vesting date for RSUs or options upon exercise

U.S. payroll requirements

Type of Tax	U.S. Citizen Working Outside of the U.S. as an Employee of a U.S. Company	Non-U.S. Citizen or Resident Working In the U.S. (whether or not employed by a U.S. Company)	Non-resident Alien Working Outside of the U.S. as an Employee of a U.S. Company (commonly referred to as TCNs)
Federal Income Tax	Required unless employee qualifies for foreign earned income exclusion (must complete Form 673) and/or wages subject to foreign income tax withholding (must complete new Form W-4)	Required unless employee qualifies for treaty exemption, U.S. domestic de minimis rules (less than 90 days in U.S. and less than US$3,000 wages related to those days) or has exempt type of visa (F, J, or M Visa and non-U.S. employer)	Not required
State Income Tax	Required unless employee is able to terminate State tax residency and/or domicile	Required and must check to see if state honors Federal treaty exemptions	Not required
FICA/ Medicare	Required, unless relief is available under totalization agreement	Required, unless employee is transferred from a country where the U.S. has a Totalization Agreement in place and the home country certificate of coverage has been obtained	Not required, although some Totalization Agreements allow TCNs who are transferred from the U.S. to an Agreement country to obtain a U.S. certificate of coverage

U.S. payroll requirements (cont.)

Type of Tax	U.S. Citizen Working Outside of the U.S. as an Employee of a U.S. Company	Non-U.S. Citizen or Resident Working In the U.S. (whether or not employed by a U.S. Company)	Non-resident Alien Working Outside of the U.S. as an Employee of a U.S. Company (commonly referred to as TCNs)
FUTA	Required for the U.S. citizen employees but not applicable to U.S. Green Card holders	Required	Not required
SUTA	Usually required if subject to FUTA but should check rules for each state	Required	Not required

Questions?

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