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Mobility Matters

When home is where the visa is, don't forget taxes are global

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It is not unusual for employers in the United States to hire qualified foreign nationals to perform work on their behalf in the United States. Depending on what sort of visa the foreign national employee secures, there may come a point where the visa has to be renewed or it is desirable to change the employee's visa status (e.g., L-1A to L-1B or J-1 to H-1B, etc.). While they are navigating the immigration/visa process, U.S. employers can find themselves faced with situations where they may consider temporarily relocating the foreign national employee outside the U.S. until the employee has secured the requisite visa or work permit. In doing so, however, they may sometimes forget the tax consequences.

Some typical scenarios

In this section we will illustrate, using some fictional examples, what are fairly common scenarios involving foreign national employees working for U.S. employers in the United States who are facing a visa renewal or change of visa status.

Scenario 1

Mr. Ravi Kumar, an Indian national, has been working with ABC Corporation in the United States since 2012. In these past 6 years, he got married, had a daughter, and purchased a family home in Georgia. Unfortunately for Mr. Kumar, his H-1B visa is due to expire in June 2018 and since his application for the *Immigrant Petition for Alien Worker* is still pending with the United States Citizenship and Immigration Services (USCIS), Mr. Kumar cannot continue to work in the U.S. beyond June 2018. His immigration attorneys have advised him and his employer to relocate him outside the U.S. for a temporary period until the Immigrant Petition is approved, which should allow Mr. Kumar to obtain additional H-1B work authorization. ABC Corporation has agreed to transfer him to its office in Bangalore, India for approximately four to six months. Mr. Kumar will continue to be employed and compensated by the U.S. company and will also remain on the U.S. payroll.

Scenario 2

Joe Smith, a foreign national working for XYZ Corporation in the United States is making arrangements to relocate temporarily to Canada with his family. In his case, he originally transferred to the U.S. on an L-1B visa and with the L-1B term nearing completion, the company is looking to apply for an H-1B visa for him. This application can only be filed in April 2019, and in the meantime, Mr. Smith must leave the United States. The company made a decision to transfer him to Canadian employment and a Canadian payroll, considering the proximity to his current team.

Both of the above fictional situations offer a realistic glimpse of how companies can work with their high-performing employees to retain talent. In this globally mobile age, finding an alternative work location seems like an easy and expedient step, but it can be a risky one. The unforeseen and potentially significant consequences can be a tax and immigration minefield for these companies.

These transfers do not usually fall under the purview of traditional mobility programs. They are not defined by a policy, nor do they have a specific structure. Many times the "assignment" term is uncertain, with little flexibility to structure the relocation to mitigate taxes and other costs. Yet, more often than not, the compliance review for such moves falls on the shoulders of the global mobility program manager, for want of a more apt function that can handle such situations.

Four key areas

There are four key areas that must be reviewed.

1. Risk of establishing a permanent establishment in the host location for the U.S. company

A company is said to have a permanent establishment (PE) in another country if it has a fixed place of business in that country through which it carries on business activities. Where an individual is sent to perform his or her employment outside the U.S., he or she may be viewed as creating a PE or taxable corporate presence in the host location depending on the work performed. For instance, employees who regularly visit the business premises of a related overseas entity could trigger PE conditions. These visits could result in the foreign office being considered a fixed-place PE of the U.S. employer. Similarly, employees who conduct business activities to conclude contracts while travelling in another country could give rise to a PE of the U.S. company in that host country. The risk here is, if that happens, profits attributable to the work performed by this individual could be considered taxable income for the corporation in the host country.

Therefore, the first thing that program managers should seek to confirm is whether this relocation will trigger a PE for the U.S. company. Managers should gather as much information as possible about the relocation such as the title of the individual being considered for relocation, his role and responsibilities in the host location, his place of work in the host location, how long his stay will be, whether he will be performing work on behalf of the U.S. entity or the local entity, and so on. Then, ideally, they should be consulting with their in-house or external immigration counsel and tax advisers.

2. Income tax implications

Since the relocating employee will be subject to the laws of two jurisdictions (possibly more), it is important to determine what his liability to tax is. The income tax implications for the employee must be considered in the U.S. as well as the host location.

a. U.S. federal tax residency and host country residency positions

The sort of relocations described in our two scenarios above most commonly give rise to the "no-lapse" rule for U.S. residency determination. As per U.S. domestic tax law and regulations, a no-lapse rule will apply to individuals who were U.S. residents for any part of two consecutive years to make them resident through December 31 of the first year and starting January 1 of the second year.

For instance, if Mr. Ravi Kumar were to depart the U.S. in June 2018 and return in March 2019, he will be considered a U.S. tax resident until December 31, 2018, even though he was not present in the U.S. between June and December 2018. He will also be considered a U.S. tax resident from January 1, 2019, even though he was not present in the U.S. between January and March 2019. As a U.S. tax resident, he will continue to be taxed in the U.S. on his worldwide income.

At the same time, depending on his travel dates, Mr. Kumar may be considered a tax resident in the host location, giving rise to dual tax residency. When this happens, the income tax treaty between India and the U.S. would need to be reviewed to determine tax residency and thereby, which country has the primary right to tax income.

b. Potentially higher federal tax costs

If an individual relocated to a country that has a higher income tax rate than the U.S., then his overall tax cost will increase simply as a result of the relocation. For instance, Joe Smith who will relocate to Canada is likely to face this situation. Income tax rates in Canada are generally substantially higher than the United States. Assuming his salary remains the same, his tax cost will increase.

c. Potential exemption of wages from tax under the avoidance of double taxation agreement or income tax treaty

It is a common misconception that an individual will automatically qualify as a nonresident of the host location if he is overseas for a short duration, and, as a nonresident, he may be able to claim an exemption from tax for his wages in the host location based on the tax treaty between the U.S. and that location. However, treaties can be complex and a careful review of the specific tax treaty should be conducted to confirm if this individual is eligible for the treaty exemption.

The OECD model tax treaty and the U.S. model tax treaty, which are the bases for most tax treaties between the U.S. and other countries, provide the following conditions under which a resident of the United States providing services in the host location may claim an exemption from host country tax on wages:

- the individual is present in the host location for a period not exceeding 183 days in any 12-month period beginning or ending in the fiscal/taxable year concerned, and
- the remuneration is paid by, or on behalf of, an employer who is not resident of the host location, and
- the remuneration is not borne by a permanent establishment which the employer has in the host location.

Program managers must review the specific treaty eligibility conditions and make sure that decisions are not based on general or erroneous assumptions.

d. U.S. state tax residency

Depending on the state the individual resided in before leaving the U.S., he may not be able to cease his state tax residency. Most U.S. states do not allow individuals to cease their residency for temporary absences outside the state. If the individual continues to maintain state residency, he will be subject to state tax on his worldwide income during his period of absence.

3. Social tax implications

Social tax implications may arise based on the nature of the relocation. An employee of a U.S. company is responsible to pay U.S. FICA and Medicare taxes. Thus, if the company makes the decision to keep the employee on a U.S. employment contract, then he will continue to pay U.S. FICA and Medicare taxes. The host location may also have social tax implications based on the nature of the relocation agreement.

In cases where the U.S. has a social security totalization agreement with the host location, the employee may be exempt from host location social security taxes if he is sent to the host location by the U.S. company for a limited period of time. The employee would need to obtain a U.S. Certificate of Coverage indicating that he continues to be subject to U.S. social security taxes.

However, if the individual is relocating to a location where there is no totalization agreement, a further review will be required, since the possibility of double taxation exists. If the nature of the relocation triggers a host country social tax requirement and there is no totalization agreement between the two locations, the employee may be subject to social taxes in the U.S. as well as the host location, resulting in additional tax cost.

4. Employer obligations

Even while an employee remains an employee of the U.S. company and on the U.S. payroll, certain kinds of relocations may trigger host country payroll obligations for the employer. For instance, some countries may require payroll reporting and withholding on a monthly basis even if the individual is a U.S. employee receiving her pay in the United States. This might then require creating a "shadow payroll" or a "split payroll" so that the employer is able to fulfil its obligations and remain compliant in the host location.

Conclusion

We have learned through discussions with immigration professionals employed with KPMG Law LLP in Canada that over the past 18 months there has been heightened scrutiny of immigration/visa applications. Additionally, applications on behalf of certain nationalities – such as India and China – continue to face a substantial back-log in immigrant (green card) visa processing. Green card processing for persons born in India and China can stretch out for several years or more. This requires that U.S. employers of such nationals anticipate this possibility and plan ahead to enhance their ability to retain these workers.

Some employers may be able to employ foreign national employees outside of the U.S. temporarily, which may allow for a future transfer back to the United States. But a careful analysis of employment law, tax law, and immigration law must be conducted to reduce the risk of complications and additional costs.

Employees working in the U.S. on visas should be evaluated by their employers to determine if an early initiation of the permanent resident process is warranted. Additionally the possibility of overseas relocations should be considered while the U.S. immigration process proceeds. This may provide employers with more leeway for planning the timing of a relocation. Good planning can potentially result in lower tax costs, reduced risk, as well as managing expectations surrounding the relocation for managers and their employees.

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