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Tax Complexities of Hiring a Non-Resident Alien

By Jennifer Mace

With the increasing globalization of companies, it is advantageous for companies to understand the tax implications of sending a foreign national to work in the United States. The term foreign national is used to describe individuals who are non-U.S. citizens — also referred to as aliens.

Specifically, this article refers to non-U.S. parent companies sending employees who are foreign nationals to the United States to work in connection with a U.S. subsidiary company. When a foreign employee has an assignment in the United States, there are several issues to consider, including the length of his assignment in the United States, which company will pay the individual (the foreign parent company or the U.S. subsidiary), and the tax implications. The information provided here discusses the rules surrounding taxability of income to a foreign employee working in the United States and the possible exclusion of income from U.S. taxation.

For a foreign parent company, there is a key distinction in the set of rules applied to a foreign national working in the United States. The rules are dependent, in part, upon whether the foreign company is from a treaty country. Tax treaties between the United States and certain foreign countries are available to provide mitigation of double taxation between the two countries.

Non-treaty countries include most South American and African countries, Malaysia, Hong Kong and Singapore. In general, a non-treaty country is a country that the United States considers to be a tax haven. Treaty countries include most European countries, Canada, Japan, China, India and Australia.

Employees working in the United States who come from non-treaty countries have a very limited set of rules to use in the determination of any exclusion from taxable income earned while working in the United States. Foreign national employees must meet the following criteria to exclude income from U.S. tax:

- The work must be performed on behalf of the office/place of business maintained in a foreign country.
- The foreign employee must not work in the United States for more than 90 days in the taxable year.
- The employee must earn less than $3,000, which cannot be paid by the U.S. subsidiary. It must be paid and borne by the foreign company. The wages paid to a foreign national employee cannot be charged back to the U.S. subsidiary. The cost of the wages must be both paid and borne by the foreign company.

Foreign national employees who fail to meet any of the above criteria, including those who are paid on U.S. payroll during their time in the United States, are subject to U.S. income tax on the income earned while working in the United States. Depending upon who is paying the wages, etc. (the foreign parent or U.S. subsidiary), that entity will need to comply with U.S. withholding requirements.

Foreign national employees working in the United States who come from a treaty country receive a broader exemption from U.S. taxes. Typically, treaties between the United States and a foreign country will contain a "dependent personal services" clause to exclude income earned in a non-resident country. Dependent personal service clauses generally allow for the exclusion of income from taxation when a resident of one country does not spend more than the specified number of days in another treaty country.

In order to exclude income under a personal services clause, the foreign national must meet the guidelines in his or her country's specific treaty. The following are the typical requirements in the treaty provisions:

- Treaties may vary regarding the number of days a person may be present, but the general limit is less than 183 days in the non-resident country during either a taxable year or a 12-month period.
- The employer must be a foreign company, incorporated or formed outside of the United States.
- The employee's salary must be paid and borne by a foreign company. It cannot be deducted or paid by a permanent establishment that the employer maintains in the United States. Also, the salary cannot be paid or borne by a U.S. subsidiary company of a foreign parent company.

Foreign employees who do not qualify for a treaty, or tax code, exemption will be subject to U.S. income tax on the income earned while working in the United States. As mentioned above, the entity paying the wages will need to comply with U.S. withholding requirements.

In the event the individual is paid by a U.S. company, U.S. federal income tax, and Medicare and Social Security taxes must typically be withheld. However, if the country the foreign employee is from has a Social Security agreement with the United States, the individual may have the option of paying taxes into his or her home country's social system rather than into the U.S. Social Security system.

Individuals who are temporarily working in the United States may be able to apply for a "certificate of coverage" and pay social taxes only to their home country. If that's the case, the U.S. employer must keep a copy of the employee's certificate of coverage on record to prove it is not required to withhold U.S. social taxes. This, however, applies only to employees of companies in countries with which the United States has a Social Security agreement.

These agreements are separate from the income tax treaties mentioned previously and each Social Security agreement has different rules regarding applicability, length of time in effect and renewal options. Sales and growth opportunities in the United States are vast for foreign companies. However, the tax implications are complicated. Foreign companies considering sending foreign employees to the United States should consult their tax advisors regarding the tax implications in their particular situations.

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