

Tax Implications of Hiring International Employees

Due to business or operational requirements, domestic companies often hire foreign employees to work in their United States operations. In addition to various social, legal, and human resource concerns, a U.S. employer must also address the tax implications of hiring non-U.S. citizens. The following discussion is an overview of the impact of income and social taxes on the employer and the foreign employee.

Employer Withholding and Reporting Considerations

Employers that hire foreign employees will be required to withhold all applicable taxes and file all requisite employer payroll forms. The withholding rates and forms will vary depending on the employee's type of services provided, length of contract, home country, and type of Visa. Employers should have a solid understanding of the specific tax withholding and reporting requirements when considering whether to hire a foreign employee. Having an understanding of these items will enable the employer to determine the administrative requirements and total payroll costs that it will incur related to the potential employee.

Employee Income Taxes

How a foreign employee will be taxed in the United States will depend on whether that employee is considered a "resident" for federal income tax purposes. Generally, a foreign employee that meets an objective "physical presence test" based on the number of days he or she resides in the United States will be treated a resident for federal income tax purposes. In addition, a foreign citizen working in the United States under a permanent Visa (Green Card) will be treated a resident for federal income tax purposes. The United States taxes its citizens and residents on their worldwide income.

A foreign employee that is not considered a resident for federal income tax purposes will be taxed only on his or her U.S. source income. A foreign employee treated as a non-resident for tax purposes will file Form 1040-NR to report his or her salary and wages earned while working in the U.S. as well as any other U.S. source investment or other income.

However, a foreign employee treated as a U.S. resident under the physical presence or Green Card test will be taxed on his or her worldwide income. A foreign employee treated a resident for tax purposes will file Form 1040 and will report all income from both U.S. and foreign sources. A foreign employee required to pay U.S. tax on his or her worldwide income potentially may be subject to double taxation on that income (i.e., the income is taxed both in the U.S. and the employee's home country).

In order to alleviate this problem, U.S. tax law allows foreign income tax credits to be claimed on the employee's U.S. income tax return. In addition, provisions contained in a tax treaty between the U.S. and the employee's home country may also be applied to provide relief from double taxation. Currently, the U.S. has income tax treaties with close to 70 countries. A full list of U.S. income tax treaties can be found on the IRS website: <https://www.irs.gov/businesses/international-businesses/united-states-income-tax-treaties-a-to-z>.

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Social Taxes

Other taxes that impact U.S. employers and their foreign employees are the “social insurance” taxes attributable to the employee’s wages. Generally, the U.S. employer will be required to pay Social Security, Medicare, and federal and local unemployment taxes on the foreign employee’s wages. Notwithstanding the employer’s requirement to withhold U.S. payroll taxes, the foreign employee also may be required to pay social taxes on the wages earned in the U.S. to their home country.

Similar to an income tax treaty, the provisions of a “totalization” agreement may be applied to alleviate the potential double tax effect of social taxes. Totalization agreements are designed to prevent double taxation on the same income for purposes of social taxes and to prevent gaps in coverage for employees working outside their home country. The United States currently has 26 totalization agreements in place with other countries and the full list can be found on the IRS website:

https://www.ssa.gov/international/agreements_overview.html

Other Tax Considerations

As previously discussed, the foreign employee’s U.S. tax filing responsibilities can vary based on several factors. The employees may also be subject to reporting requirements related to foreign bank accounts and investment holdings. These rules can be complex and difficult for the foreign employee to manage. Because of this, it is common for U.S. employers to provide income tax compliance and other tax assistance to its foreign employees.

The tax laws that apply to both U.S. employers and the foreign workers that they employ are extremely complex. If you have any questions regarding the tax implications of hiring foreign employees, please contact Sarah Huckaby at (817) 259-9792 or sarah.huckaby@whitleypenn.com.