PAYMENT OF FOREIGN NATIONALS

by Karin Wolman and Teri A. Simmons[*]

INTRODUCTION

Most business immigration attorneys will have clients ask about how and where foreign national workers may be compensated. The answers will frequently depend on the specific visa status sought or already held by the foreign national worker.

Employers have a lot of legitimate questions in this area, such as: May we pay the foreign national worker as an independent contractor, or must we treat him or her as an employee? May we put the worker on the payroll of an entity overseas even if the worker and the job are physically located in the United States? Can we avoid withholding certain payroll taxes? May the worker's compensation package include shares or stock options? May the foreign worker receive partnership income in lieu of salary? Does the worker's visa status place any limitations on his or her having an ownership stake in the U.S. employer?

These questions arise in the context of immigration law but quickly develop into other practice areas and may require the advice of outside counsel. They involve the source of payment, manner of payment, ownership stake in the employer, and choice of entity for a new business, where a new U.S. entity is created in whole or in part to support the visa status for one or more foreign national workers. As this topic is broad and interdisciplinary, this article is not intended as a comprehensive treatise, but rather as an aid to issue-spotting for immigration practitioners, to flag areas where tax, corporate, and/or employment counsel should be consulted.

SOURCE AND MANNER OF PAYMENT

Multinational employers will often elect to source all or part of an expatriate's compensation abroad in order to support cost allocation objectives or to support the optimization of benefits. Accordingly, immigration counsel should work with tax counsel to define permissible payroll sourcing (within the constraints of the worker's immigration status) and to develop payroll sourcing plans with the goal of optimizing the receipt of benefits and avoiding double taxation. Allocation of corporate income should be reflected on nonimmigrant visa petitions so as to support tax goals.

U.S. immigration law and regulations clearly define payroll sourcing requirements for certain visa catego-

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ries. Sourcing will affect tax counsel's evaluation of payroll tax withholding and filing requirements.

The source of compensation for B-1 business visitors must be from abroad, even when they are supporting their foreign employer for extended periods in the United States.[1] In such instances, immigration counsel should work with tax counsel to analyze when and to what extent B-1 business visitors must file U.S. federal and/or state tax returns as residents or whether the U.S. employer is liable for FICA withholding. For example, foreign manufacturers are authorized to send foreign nationals to the United States as business visitors for purposes of performing installation, service, or repair of machinery purchased from the manufacturer outside the United States, if the manufacturer is required contractually to provide such services and the foreign national possesses specialized knowledge essential to the manufacturer's contractual obligation to provide the services.[2] Such installation, service, or repair work can often take over six months to complete. In these instances, the foreign national may become subject to taxation as a U.S. resident, even though their immigration status is nonimmigrant and nonresident, and tax counsel may advise the U.S. business entity for whom the foreign national is performing the described installation, service, or repair work to withhold FICA if the foreign national is not exempt under a totalization agreement. Such tax filings would not constitute an admission of a status violation on the part of the business visitor.

Employers may elect to compensate L and E nonimmigrants from sources either within the United States or from abroad, or both.[3] When preparing petitions, immigration counsel must indicate wage amounts and "other compensation," including, for example, bonuses, cost-of-living differentials, housing, automobiles, retirement plans, and health insurance. In such cases, immigration counsel should advise employers to work with tax counsel to determine their residence status for tax filing purposes, process their certificate of coverage under the applicable totalization agreement as proof of exemption from FICA taxation, and allocate income between the United States and the foreign country. In addition, tax counsel must evaluate cost transfer allocation in order to analyze whether the foreign entity maintains a permanent establishment under applicable income tax treaties and, generally, proper U.S. payroll tax withholding and reporting rules.

Students under F, J, and M nonimmigrant status with valid employment authorization are FICA-exempt, affording significant savings to both the foreign national and the U.S. employer.[4] Employers may wish to take this into account when planning for changes to H-1B status. Immigration counsel should be aware of the potential for immigration objectives conflicting with tax objectives in this scenario. Payroll and salary savings for both parties can continue as long as the worker stays in F-1, J-1, or M-1 status and maintains valid employment authorization pursuant to that status. That said, the timing of an H-1B petition to change status may require making this financial sacrifice earlier than otherwise desirable in order to avoid missing the annual H-1B cap.

For an H-1B worker, the U.S. employer must execute a labor condition application (LCA), confirming very specific payment obligations following a determination of the prevailing wage for the position and a comparison of the prevailing wage with the actual wage, the wage rate paid by the employer to all other individuals with similar experience and qualifications for the specific employment in question.[5] Particularly in instances of changes of status from F, J, or M student status which confer nonresident status on foreign nationals for tax purposes, immigration counsel must inform tax counsel of the date on which H-1B status commences, as foreign nationals in H-1B status must begin counting U.S. days for purposes of tax residence and FICA withholding.

While the labor regulations governing the LCA require H-1B nonimmigrants to be treated as employees and not as independent contractors,[6] there are specific provisions allowing for H-1B employees of multi-national corporations to be on foreign payroll and to receive non-U.S. benefits if reciprocal benefits treatment is provided to U.S. employees

[1] 9 *Foreign Affairs Manual* (FAM) 41.31 Note 11.1.

[2] 9 FAM 41.31 Note 7b; 9 FAM 41.31 Note 10.1a.

[3] 9 FAM 41.54 Note 9.1 (the source of remuneration is not controlling in determining eligibility for L-1 classification).

[4] Internal Revenue Code (IRC) §3121(b)(10), as clarified by Internal Revenue Service (IRS) Rev. Proc. 98-16. This rule covers enrolled students attending classes but does not include postdoctoral students, fellows, medical interns, or medical residents.

[5] The definition of "wages paid" at 20 Code of Federal Regulations (CFR) §655.731 specifies what counts as a payment in compliance with the labor condition application (LCA) obligations.

[6] 20 CFR §655.731(c)(2).

while working abroad on a temporary basis away from their permanent U.S. work sites.[7]

For nonimmigrants in a visa status that does not specifically require payment as an employee, such as O-1, TN, or F-1 status, immigration, tax, and employment counsel may need to be consulted jointly on the employer's decision whether to treat the foreign worker as an independent contractor or an employee. This decision entails a fact-based assessment of common-law factors, as codified for tax purposes,[8] including analysis of:

- Who controls the worker's actions;
- Who assigns or defines the worker's job duties;
- Who, if anyone, provides direct onsite supervision;
- Who sets the hours and location for the work to be performed;
- Who sets the rate of pay, and determines how and when the worker will be paid;
- Who, if anyone, provides reimbursement for work-related expenses;
- Who provides tools, supplies, or equipment needed to perform the work;
- The extent to which an ongoing, indefinite relationship exists;
- Whether there is a formal written agreement establishing the employment relationship;
- Whether the company provides benefits to the worker, such as paid vacation or sick days, health insurance, retirement plans, etc.

These are the same factors that define the worksite or place of employment of an H-1B nonimmigrant[9] and the secondary employer of an H-1B nonimmigrant for purposes of determining whether any displacement has occurred.[10]

Permissible forms of payment to O and P nonimmigrants must be assessed on a case-by-case basis, taking into account the nature of the relationship between the petitioner and beneficiary identified in the petition and supporting agreements, as well as industry norms in the field of endeavor. For example, investment bankers do not freelance for multiple employers at once; musicians and graphic designers do. A petitioner may be a straightforward U.S. employer, or it may be an agent, which may or may not also be an employer.[11] The O and P categories, as originally created for performers and athletes, accommodate a wide range of payment schemes, including no payment at all, so long as the compensation arrangement is clearly defined in the petition, and the formal agreement specifying it is attached as evidence.[12] However, in order to obtain approval, it is usually necessary for a petition to explain how the worker will be supported financially during the validity of the visa, so as not to have an obvious need or motivation to seek unauthorized work beyond the scope of the petition.

BUSINESS OWNERSHIP BY NON-RESIDENTS

One of the first questions from an individual client who is also a principal in the U.S. business through which he or she will derive visa status is, "How can I get paid?" This may combine issues of immigration, tax, and corporate law and may affect choice of entity when planning the formation of the U.S. business. As such, it is prudent to involve tax and corporate counsel at the planning stage.

A nonresident alien cannot own shares in an S corporation without disqualifying the corporation for S corporation status.[13] A U.S. resident, such as a "green card" holder, can own shares in an S corporation.

Ownership by a nonresident alien in a U.S. partnership or LLC (not treated as a corporation) generally results in the nonresident alien being attributed the business activities of the partnership, with the result that the nonresident alien has to file a U.S. federal income tax return. Such an ownership interest also triggers a withholding requirement by the partnership or the LLC on the nonresident alien's

[7] 20 CFR §655.731(c)(3) *et seq.*

[8] Sec. 530(e)(3), Revenue Act of 1978, as amended.

[9] 20 CFR §655.715.

[10] 20 CFR §655.738(d).

[11] 8 CFR §214.2(o)(2)(iv).

[12] As of this writing, the flexible nature of employment under the O-1 visa is under attack, per the USCIS "O & P Fact Sheet" of October 7, 2009, which asserts that an employer may not serve as an agent unless it is "in business as an agent." This claim is *ultra vires*, as it contradicts the plain language of 8 CFR §214.2(o)(2)(iv) and (iv)(E). There have been reports of requests for evidence in which USCIS has asserted that the O-1 petitioner must guarantee payment of salary, but this requirement is also is *ultra vires*, as O-1 regulations do not contain any requirement that the beneficiary be paid, nor do they specify the form of payment.

[13] IRC §7701(b)(1)(A)(i); Treas. Reg. 1.1361(g)(1).

share of the taxable income or recognized gains of the partnership.

The definition of "wages paid" for an H-1B worker requires that the worker be treated as an employee, with all applicable payroll taxes withheld.[14] However, a partner in an LLC may not be treated as an employee for employment tax purposes, so a partnership stake by an H-1B holder in the employing entity is at odds with the payroll tax withholding and "employer/employee" requirements.[15] Payment of LLC members as employees is not explicitly prohibited under tax law but is disfavored because it can cause problems with calculation of payroll taxes and fringe benefits such as retirement plans. It can also cause complications in the treatment and reporting of unreimbursed business expenses incurred by the individual (2 percent AGI limit for regular employees vs. unreimbursed partnership expenses on Schedule E for an LLC member). For these reasons, the LLC is a poor choice of entity to sponsor a foreign worker under H-1B status, since the worker must be treated as an employee and paid a salary in order to comply with the terms of his or her visa status.

Ownership of a U.S. corporation by a nonresident alien generally does not result in any U.S. tax return filing requirements, but the U.S. corporation is required to withhold on dividend payments to the nonresident alien at a 30 percent rate, subject to reduction by treaty.[16]

CONCLUSION

These are common scenarios encountered in a business immigration practice and do not represent an exhaustive list. We hope they will serve to alert immigration practitioners to those areas where the interests of both client and counsel are best protected by seeking the advice of competent tax, corporate, and/or employment counsel.

[14] 20 CFR §655.731(c).

[15] IRS Rev. Rul. 69-184 ("Bona fide members of a partnership cannot be employees for purposes of the employment tax provisions of the Internal Revenue Code." For this reason, distributions to LLC members follow partnership law, where the LLC elects to be treated as a partnership for tax purposes. This ruling does not specifically address distributions to the sole member of an SMLLC that elects treatment as a disregarded entity, nor whether such distributions can be considered "wages").

[16] IRC §1441.