A PRACTITIONER’S GUIDE TO UNITED STATES EMPLOYMENT TAXATION OF NONRESIDENT ALIENS WORKING IN THE UNITED STATES

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I. INTRODUCTION

Foreign corporations are sending employees and consultants to the United States in increasing numbers to engage in sales activities, to ascertain the feasibility of establishing marketing, distribution, and manufacturing facilities in the United States, and to establish such facilities. The employment tax liability incurred by these nonresident aliens under the Federal Insurance Contributions Act (FICA),¹ the Self-Employment Contributions Act (SECA),² and the Federal Unemployment Tax Act (FUTA)³ has heretofore been virtually ignored by the Internal Revenue Service (IRS) because of the relatively low tax rate and small tax base of United States employment taxes. Many practitioners have now come to rely on this position of the IRS as an established fact. However, such reliance may soon become extremely risky. Substantial increases in the tax rate and base for United States employment taxes are slated for the near future. In view of these pending increases it is doubtful that the IRS will continue this period of relative neglect. Should the IRS change its stance serious problems might result. Consider the following hypothetical.

On March 1, 1976, A, a national and citizen of country X and an employee of a European multinational corporation (EURCO) is sent to the United States to work as a technician to assist EURCO’s unrelated exclusive distributor. A departs the United States and returns to X on September 15, 1976. Under the laws of X, employment outside X is not subject to X’s social security tax, nor are persons so employed permitted to make voluntary contribu-

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¹ I.R.C. §§ 3101-3126.
² I.R.C. §§ 1401-1403.
³ I.R.C. §§ 3301-3311.
tions to X's social security system. The United States and X are parties to a recently executed income tax treaty.

Under this set of facts, A is subject to, and liable for, the employee's portion of the United States FICA tax regarding the wages paid for his personal services rendered in the United States regardless of where disbursed. EURCO is subject to, and liable for, the employer's portion of the FICA tax for such wages, and for the entire FUTA tax on these wages. Although A is not subject to double social security taxes because of the laws of X, his failure and inability to make contributions to X's social security system for the period during which he is in the United States may leave him with insufficient covered periods of employment under the social security system of X to qualify for social security benefits from X. A may, either under the domestic law of X or the tax treaty between X and the United States, be able to claim the employer's portion of the FICA tax as a credit against the income taxes levied by X on his world-wide income. It is not likely that EURCO will be entitled to any credit for its payment of the employer's portion of the FICA tax or the FUTA tax. If and when A discovers his inability to qualify for X country's social security benefits, he will be a very unhappy employee. Further, EURCO will expend substantial amounts of time and money reporting the FICA and FUTA taxes.

A slight change in the facts of the above example will illustrate further difficulties which could be encountered in this area. Assume now that A and EURCO are subject to the social security taxes of X for the period of A's employment in the United States. They will also be subject to the social security taxes of the United States for the same period, with little likelihood for A to obtain United States benefits. The employee's portion of the FICA tax will likely be borne by EURCO. In addition, EURCO will have to bear the expense of the employer's portion of the FICA tax and the FUTA tax, as well as the expense of preparing the returns. A may be entitled to a tax credit for the employee's portion of the FICA tax against his X income taxes which will reduce the expense which will be borne by EURCO; however, it is not likely that the employer will be entitled to any tax credit for either the employer's portion of the FICA tax or the FUTA taxes paid by it to the United States.

Assume one final change in the given facts. Now A and EURCO are permitted to make voluntary contributions to the social security
system of X. In this case EURCO is put to an unpleasant test. If such voluntary contributions are made, EURCO will be, in effect, subject to double social security taxation for the period A is working in the United States. If EURCO does not make such contributions, A may not be entitled to benefits under X’s social security system because of the break in covered periods under that system.

These hypothetical situations are illustrative of the difficulties associated with the taxation of nonresident aliens working in the United States. This article is intended to provide practitioners with a practical guide to the recognition and subsequent resolution of problems with United States employment taxation which may be encountered by their nonresident alien clients. To that end, the article will discuss:

(a) the application of FICA to nonresident aliens,
(b) the application of SECA to nonresident aliens,
(c) the application of FUTA to nonresident aliens,
(d) the new “totalization” agreements, the enabling legislation behind such agreements, and the effect of these agreements on the problems of double social security taxation and loss of benefits resulting from the splitting of covered quarters of employment between the United States and the foreign country,
(e) the use of foreign tax treaties and tax credits to completely or partially avoid double social security taxation in situations where no totalization agreement is applicable, and
(f) general tax planning with or without a totalization agreement and with or without a tax treaty.

II. FEDERAL INSURANCE CONTRIBUTIONS ACT

The Federal Insurance Contributions Act is found in Chapter 21 of the Internal Revenue Code (Code). It imposes matching taxes, commonly known as “social security” taxes, on “employees” receiving “wages” from their “employment” and on their employers. During the calendar year 1979, the term “wages” will include only the first $22,900 earned by an employee. This taxable base will be subject to a 6.13 percent FICA tax payable by both the employer and the employee, resulting in a total FICA tax of

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4 See note 1, supra, for the included Code sections.
5 I.R.C. § 3101.
7 I.R.C. § 3101.
12.26 percent imposed on the employee's wages. Under present law, the FICA tax base and tax rate will increase in stages up to a maximum tax base for 1981 of $29,700 and a maximum tax rate for 1990 of 7.65 percent which will translate into a total FICA tax of 15.30 percent. (Note, however, that the Carter Administration and various congressional leaders have indicated their wish to delay, reduce or abandon such increases.

A. FICA Definitions as Applied to Nonresident Aliens

Nonresident aliens working in the United States are frequently surprised to find that FICA tax is taken out of their wages even though it is often a virtual certainty that they will not accumulate sufficient credits under the United States social security system to entitle them to benefits from that system. In fact, many of these workers may not be liable at all for the payment of FICA tax. It therefore becomes important for practitioners dealing with problems of this nature to understand the scope of the FICA as it applies to nonresident aliens.

The nature and extent to which the FICA tax applies to wages paid to nonresident aliens performing personal services in the United States can be determined by examining the FICA definitions of the terms "employment," "employee," and "wages," and by analyzing the effect on FICA taxation of the income tax treaties to which the United States is a party. If the FICA definitions do not apply to the employment of the alien worker, then the worker and his employer need not pay FICA taxes. On the other hand, if the nonresident alien qualifies as an "employee" receiving "wages" for his "employment" within the "United States," then

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2 I.R.C. § 3101.
4 "DAILY TAX REPORT (BNA) NO. 173, 1 & G-4-5 (Sept. 6, 1978) (statement by Federal Reserve Chairman, Arthur Miller); DAILY TAX REPORT (BNA) NO. 54, 1, G-7-8, X-1 (Mar. 20, 1978) (statement by Senator Nelson (D-Wis.)."
5 Generally, there is little chance that a nonresident alien could satisfy the requirements of 42 U.S.C. § 414(a) (1977) so as to qualify for United States social security benefits and still remain a nonresident alien for United States taxation purposes.
6 I.R.C. § 3121(b).
7 I.R.C. § 3121(d).
8 I.R.C. § 3121(a).
FICA taxes must be paid, unless an exemption provided by an applicable income tax treaty can be found.\textsuperscript{15}

The term "employee" is defined by Code § 3121(d) to be, \textit{inter alia}, any individual having the status of an employee under the usual common law rules, or any officer of a corporation. This definition provides little guidance as to the criteria used to determine the status of individual workers. One commentator lists the following eight factors to be used in distinguishing "employees" from self-employed independent contractors: (1) the degree or extent of control which the principal exercises over the details of the individual's work, (2) whether or not the principal has the right to discharge the individual, (3) the opportunity of the individual for profit or loss, (4) the investment by the individual in the tools and facilities for work, (5) the degree of skill required in the particular occupation, (6) the permanency and length of time the individual is engaged, (7) the method of payment, whether by time or by job, and (8) whether the parties believe that they are forming an employer-employee relationship.\textsuperscript{16} While not exhaustive, these guidelines serve as a basis for an initial determination of the status of a nonresident alien worker.

The FICA definitions of the terms "wages" and "employment" are also brief but contain lengthy provisions dealing with exceptions to the general definitions.\textsuperscript{17} "Wages" are defined to mean all remuneration paid to an employee for his employment.\textsuperscript{18} None of the enumerated exclusions from this definition deal specifically with nonresident aliens performing services in the United States, but a potential employer should examine each exclusion because one might be found which would exempt a particular nonresident worker from the payment of FICA tax.

"Employment" is defined to mean, \textit{inter alia}, any service performed by an employee for his employer within the United States, with exceptions listed for certain kinds of work.\textsuperscript{19} The only exceptions which apply specifically to nonresident aliens are the exceptions which exclude services performed in the employ of a foreign government,\textsuperscript{20} services performed for an instrumentality wholly

\textsuperscript{15} I.R.C. § 3101(a).
\textsuperscript{17} I.R.C. § 3121(a) and (b).
\textsuperscript{18} I.R.C. § 3121(a).
\textsuperscript{19} I.R.C. § 3121(b).
\textsuperscript{20} I.R.C. § 3121(b)(11).
owned by a foreign government, services performed for an international organization, and certain specific services performed by a nonresident alien during the period in which he is temporarily present in the United States as a nonimmigrant under subparagraphs (F) or (J) of section 101(a)(15) of the Immigration and Nationality Act, as amended. The first three exceptions deal mainly with a situation in which governmental immunity comes into play, and the latter exception excludes only a narrow range of services performed by foreign students, scholars, or other specialists. It is clear that the vast majority of nonresident aliens performing personal services within the United States cannot benefit from these exceptions.

In the event that an alien individual is found to be an "employee" within the meaning of the Code definition, it is still possible that he may work in an industry covered by an exception to the definition of the term "employment". These exceptions are listed in §3121(b) of the Code, and should be consulted in situations where nonresident workers are otherwise liable for the FICA tax under the specific FICA provisions.

B. Exemptions from FICA Tax via Income Tax Treaty

If a nonresident alien worker is deemed to be liable for the FICA tax under the FICA definitions, he may still find an exemption from such liability based on the provisions of an income tax treaty to which the United States is a party. At present the United States is a party to income tax treaties with 26 foreign countries. All of these treaties are fundamentally similar in

21 I.R.C. § 3121(b)(12).
22 I.R.C. § 3121(b)(15).
23 I.R.C. § 3121(b)(19).
24 The exceptions encompass at best a very slight percentage of nonresident aliens present in the United States.
25 I.R.C. § 3121(b).
26 Listed alphabetically, the countries are:

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The Belgian and British treaties were extended to cover certain overseas possessions of the
nature, setting forth exemptions in specified cases from the "income" taxes incurred by individual residents of one of the signatory countries working temporarily in the other signatory country. Each treaty contains an article specifying the United States taxes which are covered under its provisions. In every case, the United States taxes covered are federal "income" taxes. The question of whether FICA taxes are income taxes for treaty purposes has arisen on a number of occasions, and the answer has consistently been that FICA taxes are indeed "income" taxes within the scope of the various income tax treaties.\(^\text{27}\)

In general, the treaties exempt from federal income taxation the salary of a temporary worker who is a resident of one of the treaty countries and who is present in the United States for 183 days or less in any given taxable year.\(^\text{28}\) The "183 day" limitation has frequently been used advantageously by employers of nonresident alien workers. Since the "taxable year" of an individual is usually a calendar year, it is possible for a temporary worker to "straddle" two taxable years evenly and remain in the United States continuously for up to 366 days while remaining exempt from United States income taxes under a treaty exemption. However, care must be taken in utilizing such treaty provisions: if a temporary worker from a treaty country remains in the United States for 184 days in a taxable year (or one day over the limit set forth in the applicable treaty), he will automatically become liable for the federal income taxes which have accrued on all of the wages he has received for his employment in the United States during that taxable year.\(^\text{29}\)

The specific provisions of the applicable treaty should also be examined for limitations concerning the nationality of the employer of a temporary worker. The newer treaties differ

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Belgian and British governments which elected to remain parties to the original treaties after they became politically independent, and so there are actually more that 26 income tax treaties to which the United States is effectively a party. 1 TAX TREATY SERIES (CCH.) ¶61.

\(^{27}\) See Bissell, TAX MNGMT (BNA) 332, International Aspects of the U.S. Social Security Tax, at A-44 [hereinafter cited as Bissell], for a compilation of authority supporting the proposition that the FICA tax on employees qualifies as an "income" tax.

\(^{28}\) The income tax treaties with Belgium, Denmark, Italy, Luxembourg, Norway and Sweden allow exemptions for lesser time periods varying from 90 to 182 days according to the individual treaty. Bissell, supra note 27, at note 304.

\(^{29}\) The exemption terminates at the end of the allotted time period and its coverage of wages earned in the same taxable year ceases. Bissell, supra note 27, at A-47.
somewhat from the older treaties on this point. Most of the older treaties require that the nonresident worker be an employee either of a company located in the treaty country or of a permanent establishment of a United States company located in that country. However, several of the older treaties allow an exemption from income taxation without regard to the employer's nationality, provided the nonresident worker earns less than a set dollar amount while he is present in the United States. The more recent treaties are extremely restrictive and deny the exemption if the salaries of nonresident alien employees are borne by a United States permanent establishment of the company.

The following are examples of the FICA aspects of the operation of various income tax treaties:

(1) A, a national and resident of Italy, renders personal services in the United States for 30 days on behalf of his Brazilian corporate employer. He receives wages in the amount of $2,000 for such services. Under Article XI(2)(a) of the United States-Italy income tax treaty, A is not liable for the employee's portion of the FICA tax on such wages despite the fact that his employer is not an Italian corporation, since this is one of the older treaties. If he was employed by an Italian resident or corporation, and if he was present in the United States for not more than 90 days during his taxable year, he would not be subject to the employee's portion of the FICA tax regardless of the compensation received.

(2) B, a national and resident of Japan, renders personal services in the United States on behalf of a Brazilian corporate employer. He is not entitled to an exemption from the employee's portion of the FICA tax under the United States-Japan income tax treaty. The older treaties which do not contain this requirement are listed in note 31, infra. These treaties, and the dollar amounts set by these treaties, are: the Austrian treaty (Art. X(1)(b), $3,000 limitation), the Canadian treaty (Art. VII(1)(b), $5,000 limitation), the treaty with Greece (Art. X(1)(b), $10,000 limitation), the Italian treaty (Art. XII(2)(a), $2,000 limitation), the treaty with Luxembourg (Art. XII(1)(b), $3,000 limitation), the Swedish treaty (Art. XII(b)(2), $3,000 limitation), the Swiss treaty (Art. XI(b), $10,000 limitation), and the treaty with Trinidad and Tobago (Art. 17(1)(b), $3,000 limitation). See 1 & 2 Tax Treaty Series (CCH).

Nine of the ten "newer" treaties (see note 53, infra, for a full list of the "newer" treaties) contain a limitation of this type: Art. 15(2)(c) of the Belgian treaty, Art. 19(2)(c) of the Finnish treaty, Art. 15(2)(c) of the French treaty, Art. 19(2)(c) of the Iceland treaty, Art. 18(2)(c) of the Japanese treaty, Art. 14(2)(c) of the Norwegian treaty, Art. 16(2)(c) of the Polish treaty, Art. 15(2)(c) of the Romanian treaty, and Art. 17(1)(a)(iii) of the Trinidad and Tobago treaty. Such a limitation also appears as Art. XII(2)(c) of the German treaty and Art. XVI(1)(b)(iii) of the Netherlands treaty. See 1 & 2 Tax Treaty Series (CCH).
because Article 18(2) of that treaty requires that $B$ be employed by a resident of Japan to be entitled to the exemption.

(3) Assume the same facts as in example (2) except that $B$'s employer is a Japanese rather than a Brazilian corporation. $B$'s employer is thus a resident of Japan. If $B$ was employed in the United States for not more than 183 days in his taxable year, $B$ would not be liable for the employee's portion of the FICA tax. If, however, $B$ was employed for 184 days in the United States during his taxable year, all wages from personal services rendered in the United States would be subject to the employee's portion of the FICA tax. If $B$'s tax year was the calendar year, it would be possible for him to be employed in the United States from July 1 of one calendar year to June 30 of the following calendar year without liability for the employee's portion of the FICA tax by combining two 183-day periods and thus "straddling" two calendar years.

A caveat is warranted here: treaty exemptions do not exempt foreign employers from their liability for matching FICA taxes. The matching FICA tax on employers has been held to be an excise tax and not an income tax, so income tax treaties are of little direct benefit to foreign employers of nonresident alien workers. However, foreign employers indirectly benefit to the extent that the gross salary of such an employee can be reduced by a figure roughly corresponding to the employee's otherwise-payable FICA tax and still yield the same net wage.

C. Options Available to Nonresident Aliens Liable for FICA Tax

In the event a nonresident alien worker and his foreign employer are not exempt from FICA taxation under either the Code or an income tax treaty, two basic options are open to them. They may ignore the FICA tax and rely on an apparent decision by the Internal Revenue Service (IRS) to dispense with attempts to collect FICA taxes from employees and their foreign employers where the employees were already exempt from United States income tax liability, or they may pay the FICA tax and attempt

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34 The IRS has never issued guidelines or rulings on this subject to alert nonresident aliens from treaty countries of their possible FICA tax liability, nor have they mounted any kind of concerted effort to collect FICA taxes from such aliens.
to achieve coverage for the employee under the United States social security system.

If the nonresident alien employee and his foreign employer decide to ignore the FICA tax, they will be exposing themselves to the risk that the IRS may change its policy.\(^{35}\) If such a policy change is applied retrospectively, foreign employees and employers could be held liable for past taxes, interest and penalties.\(^{36}\) To date, the IRS has chosen not to exercise its option of pursuing such violators, and has not issued any rulings on the subject which would indicate that it intends to hold such violators liable for nonpayment of FICA taxes. This policy is a logical one because a sudden decision by the IRS to collect such taxes might result in retaliation in kind by other countries against United States citizens working within their borders, and also because the IRS would likely spend many man-hours for the collection of what would probably be small amounts of money.

On the other hand, it may be highly desirable for a nonresident worker to pay the FICA tax. If a nonresident alien employed in the United States believes he can accumulate enough covered quarters under the United States social security system to enable him to claim benefits under the United States system, he may wish to pay FICA taxes on his wages in order to achieve that coverage.\(^{37}\) This opportunity would be of particular interest to an individual making frequent but short trips to the United States for the purpose of performing personal services in the United States since the payment of a small FICA tax for the wages earned during each visit could qualify the individual for United States social security benefits.\(^{38}\)

### III. Self-Employment Contributions Act

The Self-Employment Contributions Act can be found in Chapter 2 of the Code.\(^{39}\) The SECA tax is an employment tax imposed on "self-employment income," including that of resident
aliens working in the United States. The SECA tax is not imposed on an alien working in the United States if he is considered a nonresident alien for federal income tax purposes. The taxable base of such income subject to SECA tax has been set at $22,900 (minus any "wages" earned as a "employee" under Chapter 21 of the Code) for taxable years beginning in 1979, and is scheduled to rise to $29,700 for those taxable years beginning in 1981. The total SECA tax rate is 8.10 percent for taxable years beginning in 1979, increasing to 10.75 percent for taxable years beginning in 1990. A de minimis provision exempts small amounts from SECA taxation.

A. SECA Definitions as Applied to Nonresident Aliens

The two terms important to the consideration of SECA taxation are "self-employment income" and "nonresident alien". The term "self-employment income" is defined in the Code as "the net earnings from self-employment derived by an individual (other than a nonresident alien individual) during any taxable year." The term "net earnings from self-employment" is defined in turn as:

... the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this subtitle which are attributable to such trade or business, plus his distributive share (whether or not distributed) of income or loss described in section 702(a)(8) from any trade or business carried on by a partnership of which he is a member ...

Exclusions from this general definition follow in substantial number. If a foreign worker earns income from personal services which is not "self-employment income," then the SECA tax is not applicable.

An alien is exempt from SECA tax not only if he earns no self-employment income, but also if he is classified as a "nonresident

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46 I.R.C. § 1401.
47 I.R.C. § 1402(b).
48 I.R.C. § 1401(a)(7), 1401(b)(6).
49 I.R.C. § 1401(b)(2) states that the term "self-employment income" will not include "the net earnings from self-employment if such net earnings for the taxable year are less than $400."
50 I.R.C. § 1402(b).
51 I.R.C. § 1402(a).
52 I.R.C. § 1402(a)(1)-(12).
alien individual" for purposes of federal income taxation. Since the term "nonresident alien individual" is not defined in the portions of either the Code or the regulations which deal with the SECA, other Code sections and regulations must be examined. Guidance is found in the regulations dealing with the federal income tax. The income tax regulations under Section 871 of the Code define "residence" as follows:

An alien actually present in the United States who is not a mere transient or sojourner is a resident of the United States for purposes of the income tax. Whether he is a transient is determined by his intentions with regard to the length and nature of his stay. A mere floating intention, indefinite as to time, to return to another country is not sufficient to constitute him a transient. If he lives in the United States and has no definite intention as to his stay, he is a resident. One who comes to the United States for a definite purpose which in its nature may be promptly accomplished is a transient; but, if his purpose is of such a nature that an extended stay may be necessary for its accomplishment, and to that end the alien makes his home temporarily in the United States, he becomes a resident, though it may be his intention at all times to return to his domicile abroad when the purpose for which he came has been consummated or abandoned. An alien whose stay in the United States is limited to a definite period by the immigration laws is not a resident of the United States within the meaning of this section, in the absence of exceptional circumstances.

This definition provides at most a general guideline as to the considerations involved in determining residence for United States income tax purposes. More specific guidelines can be found in the various IRS publications dealing with the application of Code § 871.

An alien working in the United States who is a "nonresident alien" and whose employment is "self-employment" would escape all United States social security tax liability (FICA and SECA). He would avoid all FICA because he would have earned "self-

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50 I.R.C. § 1402(b). It is not stated anywhere in the Code that the phrase "nonresident alien individual" contained in § 1402(b) of the Code refers specifically to the definition of the term for federal income tax purposes. However, a strong argument for this proposition is found in Bissell, supra note 27, at A-25.

51 Treas. Reg. § 1.871-2(b) (1960).

52 A particularly helpful example of such a publication is The IRS Tax Guide for Aliens, I.R.S. Pub. 519 (Oct., 1972).
employment income" rather than "wages" from "employment," and he would avoid SECA because he is a nonresident alien.

B. Exemptions from SECA Tax via Income Tax Treaty

In the event that a self-employed alien individual is found to be a "resident" alien and thus otherwise liable for the SECA tax, he may still escape SECA tax liability in some cases under the provisions of an applicable income tax treaty.\(^5\) It is possible for an alien individual to be considered both a "resident" of the United States for the purpose of the application of the Code provisions and a "resident" of his home country for the purpose of the application of the provisions of an income tax treaty.\(^6\) This "dual residency" permits the SECA tax liability of an alien worker to be circumvented by allowing the worker to assert that his "residence" in his home country enables him to utilize the provisions of the income tax treaty between that country and the United States so as to escape all liability for the SECA tax. However, an alien worker attempting to utilize an income tax treaty to escape SECA tax liability must first satisfy the "183 day" time limitation requirement described in the FICA analysis above.\(^5\) The satisfaction of the "183 day" requirement unfortunately renders the utility of an income tax treaty exemption limited at best: the IRS is not likely to assert that an alien working in the United States for 183 days or less in a taxable year is a "resident" of the United States, and comparatively few aliens "straddle" two taxable years and remain in the United States for 366 days, thus exposing themselves to a determination of United States residency by the IRS. Therefore those alien individuals working in the United States who are considered by the IRS to be

\(^5\) For instance, it is possible under the ten "newer" treaties for a self-employed alien residing in the United States to obtain a treaty exemption if the alien is a teacher, student, researcher, trainee, or government worker and was classified as a resident of one of these ten treaty countries immediately before coming to the United States. See Articles 21, 22, and 23 of the Iceland treaty as examples of such exemptions. The remaining nine treaties contain provisions analogous to those of the Iceland treaty. These nine treaties are the treaties with the countries of Belgium, Finland, France, Japan, Norway, Poland, Romania, Trinidad and Tobago, and the Union of Soviet Socialist Republics. See 1 & 2 TAX TREATIES SERIES (CCH).

\(^6\) Not all treaties allow such "dual residency", however. "Dual residency" under the newer treaties would be allowed under the "tie-breaker" rules whenever an alien individual is treated both as a resident of the United States for the purposes of United States taxation and as a resident of the treaty country for treaty purposes. "Dual residency" would be rare under the large majority of the older treaties. See Bissell, supra note 27, at A-47.

\(\text{See text at notes 28 and 29.}\)
“residents” of the United States are unlikely to be able to satisfy the “183 day” requirement for the utilization of an income tax treaty exemption.

It is sometimes assumed that a nonresident alien working in the United States would rather be categorized as “self-employed” than as an “employee” in order to fall within the exemption of nonresidents from the SECA tax and thus escape all United States social security tax liability. However, two additional factors should be taken into consideration for tax planning purposes. First, restructuring the employment of an alien individual so that he is considered “self-employed” could well result in excluding the individual from all employee benefit plans of his former “employer”.56 Second, the IRS may consider the new self-employment structure a sham, and assert that the alien individual’s “employer” is fully liable for both the employer and employee portions of the FICA tax, plus interest and penalties.57

IV. FEDERAL UNEMPLOYMENT TAX ACT

The Federal Unemployment Tax Act is contained in Chapter 23 of the Code.58 It imposes an excise tax at a set rate of 3.2 percent on “employers” paying “wages” to “employees” whose “employment” is covered under the FUTA provisions.59 The tax base of “wages” subject to the FUTA tax is $6,000 per annum.60

A. FUTA Definitions as Applied to Nonresident Aliens

The definitions of the terms “employer,” “employee,” “wages,” and “employment” are similar to those in FICA. However, the FUTA definitions of the terms “employer” and “employment” are more restrictive in their scope than the analogous FICA definitions. An “employer” for FUTA tax purposes must have paid wages totaling $1,500 in a calendar quarter of the present or the preceding year or must have had a minimum of one employee on the payroll for all or part of a day during 20 separate weeks in the present or previous

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56 The benefits from such plans accruing to an alien individual could be deemed by the IRS to constitute “wages” being paid to that individual, thus subjecting the benefits to FICA tax liability.
57 I.R.C. § 6672.
58 See note 3, supra, for the included Code sections.
59 I.R.C. § 3301.
60 I.R.C. § 3306(b)(1).
calendar year. This *de minimis* rule generally exempts an employer from FUTA tax liability if its United States business operations are minimal or if it is a foreign company having no United States-based employees. Thus, an employer is usually not liable for FUTA tax on wages less than or equal to $1,500 per calendar quarter paid to a nonresident alien employee performing personal services in the United States. Under similar circumstances, FICA tax liability would be almost certain. The FUTA definition of the term "employment" is also narrower in scope than the similar FICA definition, exempting from FUTA coverage a larger number of classes of wage-earning individuals. These definitional differences, while not radical in effect, are important to note because the fundamental similarity between the FICA and FUTA in this respect frequently results in a tendency on the part of employers to overlook the differences and thus either inadvertently subject themselves to possible tax penalties or miss exemptions which could have resulted in substantial savings.

FICA and FUTA differ in several other areas. The first area is the duration of established coverage under the two systems. A nonresident alien paying FICA tax on wages received for personal services performed in the United States accumulates quarters of coverage which remain credited to him on a permanent basis. The same alien would lose the unemployment benefits resulting from his employer's payment of FUTA tax on his behalf if he lost his job and remained unemployed in the United States for one year. An unemployed alien often loses his ability to remain in the United States as well; since he is often subject to deportation on charges that he has abandoned his authorized visa status.

The second area is the possibility of crediting qualifying state taxes against the FUTA tax in order to reduce the total FUTA tax liability of the employer. The FUTA provides a credit against the FUTA tax of up to 2.7 percent of wages paid by the employer, if this 2.7 percent is paid as a compulsory tax to a state unemploy-

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61 I.R.C. § 3305(a).
62 I.R.C. § 3306(a)(1).
64 As discussed in the FICA analysis above, there is very little which an employer can do to avoid FICA excise tax liability.
65 I.R.C. § 3306(c)(1)-(18).
67 I.R.C. § 3304(a)(7).
ment fund which meets specific standards set forth in the Code.\textsuperscript{69} The remaining .5 percent must be paid as the net FUTA tax, for use by the federal government to aid state administration of state unemployment programs.\textsuperscript{70}

Two final points about the FUTA tax should be made. First, the FUTA tax, like the employer portion of the FICA tax, is an excise tax and thus is not subject to exemption by income tax treaties.\textsuperscript{71} Second, the IRS has evidently chosen to treat the collection of the FUTA tax in a manner similar to the collection of FICA taxes, meaning that the payment of the FUTA tax on a nonresident alien exempted from the payment of federal income tax has been effectively voluntary in nature.\textsuperscript{72}

V. TOTALIZATION AGREEMENTS

The United States has recently initiated a program to reach agreement with a number of foreign countries to alleviate or eliminate altogether the problems of individuals who work for a set period of time in more than one country and thus become subject to the social security systems of several countries. On December 20, 1977, President Carter signed into law legislation enabling him to enter into executive bilateral agreements with foreign countries interested in coordinating their social security systems with the United States social security system.\textsuperscript{73} To date, the United States has signed "totalization" agreements with the Italian Republic ("Italy")\textsuperscript{74} and the Federal Republic of Germany ("West Germany").\textsuperscript{75} Negotiations are under way for totalization agreements with Canada, France, Switzerland, and the United Kingdom.\textsuperscript{76}

\begin{itemize}
  \item \textsuperscript{69} I.R.C. § 3304(a)(1)-1(17).
  \item \textsuperscript{71} I.R.C. § 3301.
  \item \textsuperscript{72} The considerations listed in note 34 in the FICA analysis section of this paper can be used again to draw the same conclusion as to the FUTA tax.
  \item \textsuperscript{73} International Social Security Agreements Act, 42 U.S.C. § 443 (1977).
  \item \textsuperscript{74} Agreement Between the United States of America and the Italian Republic on the Matter of Social Security, May 23, 1973 [hereinafter cited as the Italian agreement], reprinted in H. R. Doc. No. 95-297.
  \item \textsuperscript{75} Agreement Between the United States of America and the Federal Republic of Germany on Social Security, January 7, 1976 [hereinafter cited as the German agreement], reprinted in International Social Security Agreements Act: Hearing on H. R. 14429 Before the Subcomm. on Social Security of the House Comm. on Ways and Means, 94th Cong., 2d Sess. (1976).
  \item \textsuperscript{76} See Bissell, supra note 27, at A-54.
\end{itemize}
A. In General

These agreements are intended to solve two basic problems: (1) the imposition of double social security taxes on the wages of citizens or nationals of one country working in another country and (2) the loss of social security benefits by such an individual resulting from the splitting of periods of coverage between the two countries, with neither total of covered years being sufficient to entitle the individual to receive benefits from either of the respective countries. The two problems are usually mutually exclusive for nationals of foreign countries rendering personal services in the United States. That is, if a nonresident alien working in the United States and his employer are paying social security taxes to both the United States and his home country for the period during which he is employed in the United States, then he loses no coverage in his home country and occupies the same or a similar status as if he had never left his country. On the other hand, if a nonresident alien only pays the United States tax, or pays no tax at all, he stands to lose the coverage in his home country. While double payment of social security taxes ensures that the individual will accumulate covered periods in the social security systems of both the countries involved, it also unfortunately ensures that the total wage and benefit cost to his employer will be significantly more than had the individual and employer paid social security tax to only one of the two countries involved.

A totalization agreement between the United States and the home country of such an individual solves this problem. The enabling legislation mentioned above sets forth the following mandate concerning such agreements:

... employment or self-employment, or any service which is recognized as equivalent to employment or self-employment under this title, shall, on or after the effective date of such agreement, result in a period of coverage under the system established under this title or under the system established under the laws of such foreign country, but not under both . . .”

[emphasis added]

This provision requires the totalization agreements to ensure that nationals of the United States and the foreign country signatory will earn quarters of coverage under their home country social

security system for periods of employment or self-employment in the other country. The legislation also requires the agreements to permit periods of coverage under the social security system of a foreign signatory to be combined with periods of coverage under the United States system for purposes of establishing benefit amounts under the United States system.

Although it is not entirely apparent on the face of the legislation, totalization agreements are intended to help United States companies avoid paying social security taxes to two countries for the same employment. They are also intended to permit United States employees who have worked in covered employment under the social security systems of both the United States and the other signatory country, but who do not have sufficient periods of coverage under either system to independently qualify for benefits from either country, to elect to receive a "totalized" benefit from both countries. If the worker elects to receive such a benefit, then each country pays to him a proportionate fraction of its normal benefit, which fraction is based upon the ratio of the covered periods of the worker in that country to the total of the covered periods in both countries. The worker thus receives a "totalized" benefit from each country. Generally, the agreements will solve the same types of problems for both a foreign signatory’s companies and its citizens working abroad.

The enabling legislation contains two important limitations. First, it limits the permissible scope of totalization agreements to old-age, disability, and survivors benefits. Hospital insurance-Medicare benefits cannot be covered by such agreements. Second, the legislation requires the accumulation of a minimum of six calendar quarters of coverage by a nonresident alien before the alien may elect to receive "totalized" United States benefits. This provision is apparently designed to prevent the filing of large numbers of claims by nonresident aliens who qualify to receive only very small amounts.

The legislation allows, but does not require, totalization

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78 It is important to note, however, that the enabling legislation does not affect the application of the FUTA tax to foreign employers for whom personal services are rendered by employees in the United States.

79 The term "totalized" thus designates the mathematical operations used to calculate the "pro rata" share of the benefits to which the worker is entitled under the social security system of one of the two countries.


agreements to include a provision requiring a totalized benefit payable to an individual residing in the United States to be increased by the United States to the extent that the sum of the benefit being paid by the other country and the benefit being paid by the United States is less than the minimum benefit payable under the United States Social Security Act.\textsuperscript{82} This seems to provide United States negotiators with an attractive bargaining chip.

B. The Italian Agreement

The Italian agreement does not allow the permissive exemption of a nonresident alien from the employment taxes of the country in which he is working (permission being granted by the government of that country if the exemption will result in the worker becoming liable for employment taxes in his home country), while the German agreement does allow such an exemption.

The Italian agreement contains jurisdictional rules for the social security tax systems of both Italy and the United States. Generally, a United States national employed abroad and his employer are not subject to the FICA tax unless the United States national is employed by an "American employer",\textsuperscript{83} or by a foreign subsidiary of a domestic corporation which domestic corporation has elected, through an agreement with the IRS, to pay the full FICA tax for all United States nationals employed by the subsidiary.\textsuperscript{84} The Italian agreement changes the general rule so that services performed by a United States national in Italy, even if not falling within one of the two exceptions listed above, subject the United States national and his employer to United States FICA tax liability.\textsuperscript{85} This change also applies to Italian nationals. An Italian national employed outside Italy and his employer are not normally covered by the Italian social security system. Under the Italian agreement, however, services performed by an Italian national in the United States for an Italian employer or an enterprise controlled by an Italian firm will be covered by the Italian social security system.\textsuperscript{86}

\textsuperscript{83} See I.R.C. § 3121(b) for the definition of this term. It might also be worthwhile to note that out-of-country services are included in the definition of the term "employment" in I.R.C. § 3121(b).
\textsuperscript{84} I.R.C. § 3121(l).
\textsuperscript{85} Italian agreement, supra note 74, Article 7, Section 2.
\textsuperscript{86} Id. Article 7, Section 3.
Additional jurisdictional rules deal with periods of duplicative coverage. United States nationals who are subject to the social security systems of both Italy and the United States for the same period of work are subject to the United States system and exempt from the Italian system. 87 Italian nationals and dual Italian-United States nationals subject to both systems for the same period of work, 88 must elect to be subject to one of the two systems and will then be exempt from the taxes of the other system. 89 Third-country nationals working in either the United States or Italy who are subject to both the Italian and United States social security systems must pay only the tax of the country in which they are working. 90 The essence of the agreement is therefore that United States nationals who work in Italy for "American employers" or a foreign subsidiary of a domestic corporation which has made the FICA election will be exempt from Italian "social security" taxes and will pay United States taxes. Italian nationals working in the United States for Italian employers or for an enterprise controlled by an Italian firm may elect to be exempt from United States social security taxes 91 and thus pay only Italian taxes. 92

Under Article 8 of the Italian agreement, periods of coverage under the system of one country are credited as periods of coverage under the system of the second country, where such credit is deemed necessary to qualify a nonresident alien worker for benefits in the second country. 93 Italian authorities are not required to apply this rule unless a worker has one year of coverage under Italian law, and United States authorities are not

87 Id. Article 7, Section 4(a).
88 They would be subject to double taxation if employed in the United States by an Italian employer or an enterprise controlled by an Italian company. Italian nationals and dual nationals working in the United States for other employers would be subject to United States social security taxes and would not be subject to the Italian social security tax. They would thus not be entitled to elect under Article 7, Section 4(b) of the Italian agreement.
89 Italian agreement, supra note 74, Article 7, Section 4(b).
90 Id. Article 7, Section 4(c).
91 Italian nationals or dual national employees who are taxed under the Italian social security system or elect to be so taxed as provided in the Italian agreement, are exempt from the employee's portion of the FICA tax under Code § 3101(c). Their employers are exempt from the employer's portion of the FICA tax under Code § 3111(c). Self-employed Italian nationals and dual nationals who are taxed under the Italian system or elect to be so taxed as provided in the Italian agreement, are exempt from the SECA tax under Code § 1401(c).
92 Italian agreement, supra note 74, Article 7, Section 3.
93 Id. Article 8, Section 2.
required to apply the rule unless the worker has six quarters of coverage under United States law.94

The mechanics of determining benefits are set out in Article 9 of the Italian agreement. If a worker is fully eligible for benefits under the laws of one of the two countries, then that country shall establish the benefit amount based on the total periods of coverage under its laws.95 Each country shall also determine a theoretical "basic benefit amount"96 by considering all periods of coverage under the laws of Italy and the United States as if they were periods of coverage under its own laws.97 Each country then establishes the basic benefit amount to which the worker is entitled based upon the ratio of the coverage actually completed under its own laws to the total of all periods covered under the laws of both countries.98 The worker then elects for each country whether benefits shall be awarded by that country in accordance with the first or second method.99 For example, if an Italian national was covered for 20 quarters under Italian law and 10 quarters under United States law, and if he was not entitled to benefits under either system based upon the actual covered quarters worked in either country, each country would calculate the pro rata basic benefit amount according to the following formula:

\[
\frac{\text{Periods of coverage in State A}}{\text{Total periods of coverage in both States}} \times \frac{\text{Theoretical basic benefit amount in State A, determined as if all periods of coverage were in State A}}{\text{Pro rata, basic benefit amount in State A}} = \text{Pro rata basic benefit amount}
\]

The Italian calculation would be:

\[
\frac{20}{30} \times \frac{\text{Theoretical basic Italian benefit amount determined as if the worker had 30 periods of Italian coverage}}{\text{Pro rata basic benefit from Italy}} = \text{Pro rata basic benefit from Italy}
\]

94 Id. Article 8, Section 4.
95 Id. Article 8, Section 1.
96 Id. Article 1, Section k.
97 Id. Article 9, Section 2.
98 Id.
99 Id. Article 9, Section 3.
The United States calculation would be:

<table>
<thead>
<tr>
<th>Theoretical basic amount determined as if the worker had 30 periods of United States coverage</th>
<th>Pro rata basic benefit for the United States</th>
</tr>
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<td>10</td>
<td>30 x</td>
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If, under the above facts, the Italian worker were entitled to Italian benefits without the United States periods of coverage, then he would be entitled to receive both full benefits from Italy and a totalized benefit from the United States. Further, if he were eligible for full benefits in both countries without totalizing periods of coverage, he would be able to elect to receive benefits under both systems based on periods of actual coverage, a totalized benefit from both countries, or a benefit based on actual periods from one and a totalized benefit from the other.

Returning to the facts of the example above, the benefits of the Italian agreement can be highlighted by assuming that A is a national of Italy and EURCO is an Italian corporation. Under the Italian agreement, A is subject to the social security systems of both countries. However, A may elect instead to be subject to either the United States system or the Italian system. If he elects to be subject to the Italian system, then neither A nor EURCO will be required to pay FICA taxes. A’s employment will be subject only to the taxes imposed by the Italian social security system. EURCO will avoid the expense of double social security taxes and the expense of double reporting. A will not risk the loss of his Italian social security benefits by reason of the accumulation of too many quarters of employment in the United States which were not covered under the Italian social security system. If, instead, he elects to be subject to the United States system, he and EURCO will pay only United States taxes for the periods of his employment in the United States. Neither A nor EURCO will pay Italian social security taxes. EURCO will avoid the expense of double taxation and double reporting. In addition, A’s quarters of employment covered by the United States system can be treated as covered periods under the Italian system to establish the minimum period of coverage for qualification for Italian benefits. Further, if A works at least 6 calendar quarters in the United States under its system, he will be entitled to a totalized benefit from the United States.
C. The German Agreement

The West German totalization agreement is essentially the opposite of the Italian agreement. It provides that an individual is generally not subject to tax in his home country but is subject to tax in the country in which he is working. However, there are two important exceptions to this general rule. First, an individual who is "sent" by his employer to the other country will be subjected to the tax of the country from which he was "sent" without regard to either his taxable status in the country to which he was "sent" or the country of his nationality. This "sent" exception will undoubtedly promote a number of different interpretations by those who would prefer to be taxed by the country in which they are working. Perhaps later a comprehensive definition of the term will be added to the agreement. Second, an individual who is subject, under the German agreement, to the tax of the country in which he is working may apply to the social security authorities of that country for an exemption from their social security taxes, if his employer consents and if the exemption will result in taxation of the individual in the other signatory. This exemption illustrates the inherently flexible nature of the German agreement, allowing the permissive exemption of a nonresident alien from the employment taxes of the country in which he is working.

Applying the German agreement to the facts of the previous example but assuming that EURCO is a German corporation and A is a German national, the following results obtain:

1. neither A nor EURCO would be required to pay FICA taxes;
2. A's employment is subject to the German social security tax system only;
3. EURCO will avoid the expense of double German and United States social security taxes and the expenses of double reporting;
4. A will generally not risk the loss of his German social security benefits by reason of quarters of employment in the United States not covered under the German social security system.

German agreement, supra note 75, Article 6, Section 1.
Id. Article 6, Section 2.
Id. Article 6, Section 5.
The Italian agreement became effective on November 1, 1978,\textsuperscript{103} and the German agreement will become effective in the near future.\textsuperscript{104} These agreements will likely pave the way for the negotiation of a number of such agreements in the near future. Until totalization agreements become commonplace, however, the existing means of lessening the United States employment tax liability of nonresident aliens working in the United States and their employers must be utilized.

VI. FOREIGN TAX CREDIT RELIEF

An individual who is not entitled to exemption from United States social security taxes under the provisions of the Code, an income tax treaty or a totalization agreement may obtain relief from double social security taxation if he is entitled, under the income tax laws of his home country or under an income tax treaty between the United States and that country, to a tax credit for the United States social security taxes which he has paid. To obtain partial or full relief, three conditions must generally be met:

1. the individual must be subject to the income tax laws of the particular foreign country,
2. the country must allow a tax credit against its own income taxes for some or all of the United States social security taxes paid by the individual, and
3. the individual's income tax liability to the foreign country must be large enough to absorb some or all of the credit allowed for the United States social security tax.

It is important to remember that in such cases an individual will

\textsuperscript{103} This date was established as the effective date of the Italian agreement by a representative of the Department of Health, Education and Welfare.

\textsuperscript{104} 42 U.S.C. §§ 433(e)(1), (2), which established the effective dates of totalization agreements, provide:

(e)(1) any agreement to establish a totalization agreement entered into pursuant to this section shall be transmitted by the President to the Congress together with a report on the estimated number of individuals who will be affected by the agreement and the programs established by this Act. (2) such an agreement shall become effective on any date, provided in the agreement, which occurs after the expiration of the period (following the date on which the agreement is transmitted in accordance with paragraph (1)) during which each House of the Congress has been in session each of 90 days; except that such agreement shall not become effective if, during such period, either House of Congress adopts a resolution of disapproval of the agreement.

President Carter submitted the German-United States agreement to the Congress on September 21, 1978, 124 CONG. REC. H. 10366-67 (daily ed. Sept. 21, 1978). Absent Congressional disapproval, the agreement will be fully in effect as soon as Congress has been in session on each of 90 days beginning September 21, 1978.
actually pay FICA or SECA tax and will, therefore, earn quarters of coverage under the United States social security system.

Most of the bilateral income tax treaties to which the United States is a party require the other signatory to allow a credit against domestic taxes for the United States federal income taxes paid on the United States-source personal services income of a resident of that signatory who is working in the United States, if such income is also taxable by that other signatory. Some of the treaties, however, permit the foreign country to determine by its domestic law the extent to which credit will be allowed. For example, Canada is not required under the United States-Canada income tax treaty to allow a credit against domestic taxes for any FICA or SECA taxes imposed on any United States-source personal services income of Canadian residents; however, Canada has chosen to permit a credit of this nature, and Canadian domestic law reflects this choice.

It should be noted that the credit against domestic taxes is not unlimited. All the treaties contain a formula which limits the credit to a figure corresponding to the individual's total foreign income tax liability multiplied by the ratio of United States-source income to the individual's worldwide income.

Generally, a treaty or domestic tax credit mechanism is utilized only by those nonresident aliens who are still considered residents in their home country for income tax purposes. Because most foreign countries impose a tax on the income of only those persons who reside within their borders, the credit mechanism is of interest to only those nonresident alien persons who are subject to tax in the United States on their United States-source income, but who are still considered residents of their home country for that country's income tax purposes.

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105 An example of such a requirement can be found in Article XIV(3) of the United States income tax treaty with Greece.

106 There are 9 such treaties: Article XV(2) of the Australian treaty, Article XV of the Canadian treaty, Article XIII(2) of the Irish treaty, Article 5(1)(b) of the Japanese treaty, Article XIX(3) of the Netherlands treaty, Article XIII(2) of the New Zealand treaty, Article XV(2) of the Pakistani treaty, Article 4(2) of the treaty with Trinidad and Tobago, and Article XIII(2) of the treaty with the United Kingdom. See 1 & 2 TAX TREATY SERIES (CCH). 32.

107 See Article XV of the Canadian treaty, 1 TAX TREATY SERIES, (CCH) ¶ 1224.


109 This formula is similar to the limitation formula contained in I.R.C. § 904.
For example, A, a citizen and resident of Denmark, renders personal services in the United States on behalf of a Danish corporation for a total of sixty days and receives $4,000 as compensation for such services. Under the United States-Denmark income tax treaty, A will be subject to United States income taxation on this compensation. A will be subject under the principles described above to the employee's portion of the FICA tax, and A's employer will be subject to both the employer's portion of the FICA tax and the FUTA tax. Under Article XV(b) of the Danish treaty, Denmark must, in effect, grant A credit for the employee's portion of the United States FICA tax paid on his behalf against his Danish income tax subject to the proportional limitations described above. The employee's portion of the FICA tax is a United States "income" tax under the Danish treaty by reason of Article II(2) of the Danish treaty, which provides that any United States term not otherwise defined will have the meaning which that term has under United States law. As indicated previously, the employee's portion of the FICA tax is an "income" tax under United States law. No credit would be granted under the treaty for the employer's portion of the FICA tax or for the FUTA tax since they are deemed to be excise taxes and not "income" taxes. It is possible, however, that Danish domestic law might grant such a credit.

VII. CONCLUSION

While in the past the IRS has not taken a tough stance on the collection of United States employment taxes from nonresident aliens working in the United States and their employers, the situation may change in the near future. The increases in the tax rate and base of the FICA and SECA taxes and the new totalization agreements may focus the attention of the IRS on these taxes, making the payment of United States employment taxes a much more financially important issue to foreign corporations and their United States counsel.

Recently, the IRS has begun to inquire as to the identity of the person responsible for collection and payment of FICA and FUTA taxes in cases involving United States employers which have obtained intra-company transferee visas for foreign executives transferred to them from an affiliated foreign company. The next
step may be inquiries to foreign companies whose employees and consultants obtain other types of visas for the purpose of rendering personal services in the United States for foreign companies. While it is difficult to predict the actions of the IRS, it is at this stage that the thorough practitioner will begin to acquaint himself with the potential problems surrounding United States taxation of nonresident aliens working in this country. It is hoped that this article will help prepare practitioners to deal with such problems.