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Considerations for Architecture & Engineering Firms Doing Business Overseas

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- A professional services firm with three distinct business lines
  - Wealth Advisory
  - Outsourcing
  - Audit, Tax, and Consulting
- 3,600 employees
- Offices coast to coast
- Serves 380+ architecture and engineering firms

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Speaker Introductions

- **Dave Leith**

  Dave is a principal in CLA's Albuquerque office and is the national practice leader for the firm's architecture and engineering sub-industry group. He has more than 25 years of experience advising closely-held businesses and their owners on tax, financial, and operational consulting and compliance.

- **Dave Springsteen**

  Dave is a manager in the International Tax Services group and is based in Tampa, Florida. He specializes in international taxation, assisting a variety of clients ranging from small entrepreneurs to major multinational subsidiaries with their individual and corporate work.

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Objectives for Today's Webinar

Gain a general understanding of:

- ✓ Tax rules and concepts prevalent in working outside the US
- ✓ Options on Structuring non-US operations
- ✓ Tax implications related to assigning employees overseas
- ✓ Foreign tax & financial reporting issues
- ✓ Worldwide tax efficiency and planning

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Tax & Financial Considerations are Important but First…

1. Create an International Strategic Plan
2. Research In-Country Issues
3. Understand Labor & Staffing Issues
4. Consider Business Relationships
5. Engage Competent Outside Advisors
6. Set a Realistic Budget
7. Get Firm Leadership buy-in

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Getting Your Toes Wet

Doing International Work from the States

- Client's project located outside US
- Predominant work done from US office
- Possible need for planning meeting and site visits overseas
- Tax Residency Certification may be needed
- Foreign Tax withholding
- Foreign Tax Reporting
- Define as much as possible in Contract

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Tax Rules and Concepts Prevalent in Working Outside the US

What to be aware of

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Physical Presence

- Tax filing requirement in a foreign jurisdiction is based on statutory requirements, court cases, or administrative authority
- What level of activity in a foreign jurisdiction will give rise to a filing requirement?
  - Most of the time the threshold is based on facts and circumstances
  - Threshold is usually very low
  - Engage local advisor to make determination

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Income Tax Treaties

- Mitigates international double taxation
- Prevents evasion of income tax
- Defines arbitration process for tax authorities if there is a dispute
- Generally overrides tax code (not always so in foreign jurisdiction)
- Issues with claiming treaty benefits for:
  - S corporations
  - Limited liability companies
  - Partnerships

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Income Tax Treaties

- Passive verse affirmative election
- Tax residency certification for withholding taxes
  - Submit request on Form 8802 to the Internal Revenue Service
    - S corporation and partnership issues
  - Receive Form 6166 to provide to foreign withholding agent

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Permanent Establishment (PE)

- In general a permanent establishment includes:
  - A fixed place of business
  - A place of management
  - A branch
  - An office
  - A factory
  - A workshop
  - A mine, gas well, quarry or place of extraction of natural resources
  - A person who habitually exercise an authority to conclude contracts binding on the enterprise

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PE verse "Engaged in a Trade or Business" Standard

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	Permanent Establishment	Engaged in a Trade or Business
Authority	Tax Treaties	Tax code, court cases, administrative rulings
Threshold to Establish Tax Filing Obligation	Higher	Lower
Certainty of Establishing Filing Obligation	Clear thresholds established in the PE article in each treaty	Based on facts and circumstance and multiple source of guidance

PE Differentiators for Model Country Treaties vs. Non-Model Country Treaties

- Model treaties are consistent generally
- Non-Model treaties are not consistent from Country to Country
  - Need to review and understand PE definitions
  - # of days presence by Employees are not consistent
  - Activities of contractors could create PE risk

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Options on Structuring Non-US Operations

Align with firm's international operating strategy

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Business Structure Considerations

- Alignment with international operating strategy
- Need to coordinate structure choice with:
  - Local licensing requirements
  - Types of work permitted under each structure
  - Legal requirements and liability limitations afforded
  - Foreign investment requirements and process
  - Repatriation of profits
  - Regulatory and financial reporting
  - Tax considerations

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Branch Office

- No separate legal entity
- Immediate U.S. taxation of profits and losses
- Transfer pricing issues
- Foreign currency issues
- Foreign tax issues
  - U.S. corporation would file and pay the tax related to net foreign source income
  - Foreign taxes available as a credit on U.S. return

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Foreign Subsidiary

- Separate legal entity
- Potential U.S. tax implications on any outbound transfer to the subsidiary of appreciated property
- No current U.S. taxation unless one of the anti-deferral rules apply
- Transfer pricing issues
- Foreign tax issues
  - The subsidiary would file a tax return in the local country
  - Indirect foreign tax credit available when owner is a C corporation

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Partnership or Joint Venture

- Formal or informal
- No deferral
- Transfer pricing issues
- Foreign currency issues
- Foreign tax issues
  - U.S. entity would be liable for foreign taxes
  - Foreign income taxes would be available as a credit on the U.S. return

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Check-the-Box Rules

- These rules determine the default classification of a foreign entity as a disregarded entity, partnership, or corporation for U.S. purposes
- After the default classification is determined, eligible entities may make an election to be treated as an entity different from its original classification
  - Must file Form 8832
  - Election can be retroactive up to 75 days
- "Per se" entities are not eligible to change their default classification

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Tax Implications Related to Assigning Employees Overseas

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Assignment of Employees-*Company* Issues

- Choice of entity structure impacts flexibility on assigning US employees to work internationally
  - Branch office (more flexible)
  - Separate Legal Entity (subsidiary)—(more formal)
- Employment package considerations:
  - Compensation, benefits and Insurance
  - Housing
  - Travel & Moving costs
  - Home Leave
  - Tax Equalization or Protection Policy
- Foreign payroll and reporting
- Visa and Work permitting

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Assignment of Employees-*Employee* Issues

- Employees' taxed in US on worldwide income
- Double-tax mitigated by treaty and/or other US tax mechanisms (Watch State/City taxes in US)
- Subject to foreign residency rules, tax returns generally required in both jurisdictions
  - Different reporting and rules
  - Engage competent advisors (planning and structuring)
- Social Security-like coverage
- Tax equalization or protection

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Tax Equalization or Protection

- Not the Law. It is an HR policy that is very common
- Goal is to ensure assignment is tax neutral to assigned employee “as if” they were not assigned
- Usually managed entirely by employer through Hypotax withholding estimated upfront
- Employer pays employee taxes with Hypotax w/h
- Settlement occurs after employee tax filings made and actual liabilities are known.
- Some companies use “tax protection” policies in lieu of tax equalization

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Totalization Agreements

- Social security agreements between the U.S. and foreign jurisdiction
- Alleviates double taxation with respect to social security taxes
- Provides benefit protection to employees
- Certificate of coverage to claim benefits

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Employee Taxation - Foreign Earned Income Exclusion

- U.S. employees are eligible to exclude up to $97,600 of foreign earned income
- Must meet the Tax Home test and either the Bona Fide Residence or Physical Presence test
- Foreign Housing Exclusion
  - You can also claim an exclusion/deduction from gross income for your housing amount
  - The housing exclusion applies only to amounts considered paid for with employer-provided amounts
  - The housing deduction applies only to amounts paid for with self-employment earnings

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Employee Taxation - Foreign Earned Income Exclusion

- Physical Presence Test
  - Must be physically present in a foreign country, or countries for at least 330 full days during an period of 12 months in a row
- Bona Fide Residence Test
  - Depends on your intention about the length and nature of your stay (facts and circumstances)
- Tax Home Test
  - Regular or principal place of business, employment or post of duty

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Employee Taxation - Foreign Tax Credit

- U.S. persons may claim a credit or deduction for foreign income taxes, but not both
- Creditable taxes:
  - Income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country
- A credit is allowed for the lesser of:
  - Creditable foreign taxes paid; or
  - U.S. pre-credit tax X (foreign source taxable income/worldwide taxable income)

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Foreign Tax & Financial Reporting Issues to Consider

Expensive and complex

Foreign Tax and Financial Reporting

- Functional Currency requirement
- Need for in-country accounting and reporting
  - VAT
  - Payroll
  - Indirect taxes
  - Expertise of accounting standards
- Impact on and coordination with US financial and tax reporting
  - Exchange gain/loss
  - Process and timing

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Foreign Tax and Financial Reporting-continued

- Basis of accounting differences
  - Accrual vs. Cash
- Statutory audits
- Tax returns and tax audits
- Service agreements
- Benchmarking and transfer pricing reporting
  - More formal
  - Often required to be submitted
  - Transfer pricing means related party agreements must be at arms' length

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Transfer Pricing

- Number one global tax issue
- Strict enforcement and regulatory burden
- Information sharing
- Types of transactions:
  - Tangible property
  - Intangible property
  - Controlled services
  - Financing arrangements

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Repatriation of Foreign Profits

- Potential local country withholding tax on portion treated a dividend
- Approval or limitation by foreign exchange or regulatory bodies
- Tax efficient repatriation:
  - Intercompany charges (transfer pricing)
  - Right mixed of debt and equity
    - ◊ Debt principal repayment is tax-free
  - Claim reduced withholding rate under income tax treaty
    - ◊ Interest and dividends

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Worldwide Tax Efficiency and Planning

Coordinate with your domestic and international tax advisors

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Worldwide Tax Efficiency

- Coordinating foreign structure with existing U.S. operations
  - Tax management
    - ◊ Minimization of overall tax burden
    - ◊ Debt planning
    - ◊ Corporate verse check-the-box structure
  - Tax attribute management
    - ◊ Optimize foreign tax credits and net operating losses
  - Treasury management
    - ◊ Efficient cash redeployments and repatriation
  - Structure management
    - ◊ Efficient acquisitions and dispositions

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Worldwide Tax Efficiency

- Foreign tax credit analysis and planning
  - Deduction verse credit
  - Paid verse accrued
  - Proof of credits
  - Determination of creditable taxes
  - Maximizing foreign source income
  - Correctly allocating direct and indirect expenses

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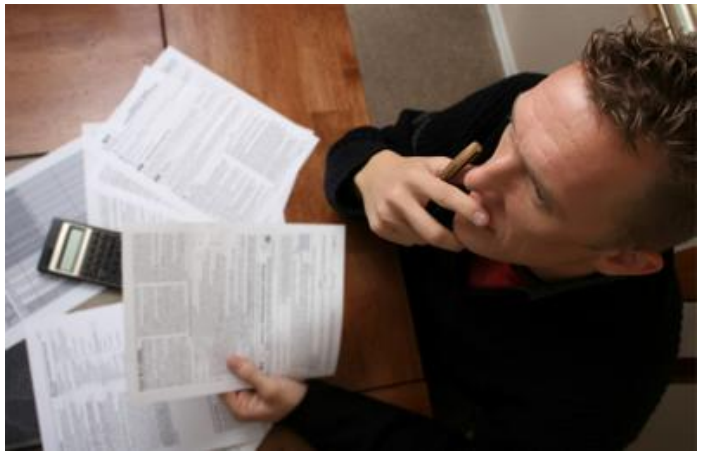
Worldwide Tax Efficiency

- Tax treaty planning
  - Properly claiming treaty benefits
  - Limitation on benefits article planning
  - Correct analysis and interpretation of treaty benefits
    - ◊ Local country resource needed



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Consider an IC-DISC

- Separate corporate entity established by U.S. firm or it's owners
- No impact on how the firm does business
- Allows for prospective tax savings on portion of international activity (carved-out profits)

Link to CLA article regarding IC-DISC opportunity for A/E firms:

http://www.cliftonlarsonallen.com/Construction-Real-Estate/IC-DISC-Tax-Savings-Architecture-and-Engineering-Firms-With-International-Projects.aspx

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What We Do For Architects & Engineers

- Audit, accounting, consulting and tax
- Tax incentives for unique design processes and approaches, and energy efficient design
- Strategic ownership transition planning and business valuation
- International operational expansion and worldwide tax-efficiency
- Integrated tax and cash flow planning
- FAR compliance, and consulting and maximizing overhead rates
- Private client tax and wealth advisory for owners

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Questions?

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Thank you!

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