

Nonprofit Organizations Committee Legal Quick Hit:

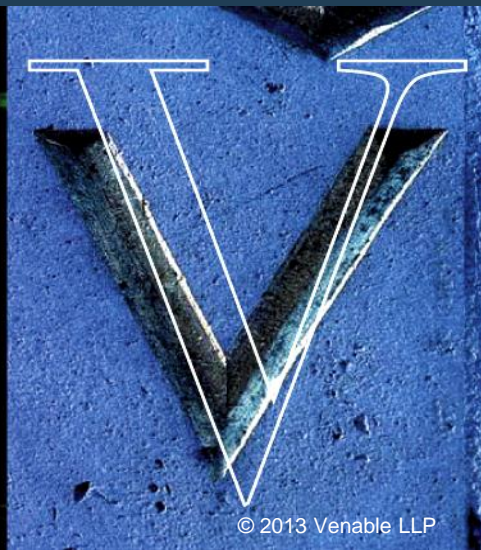
Your Nonprofit Has Gone Global: Now What Are Your U.S. and Foreign Tax Compliance and Reporting Obligations?

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PRESENTERS: CHARLES K. KOLSTAD, ESQ.

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Cross Border Tax Planning and Compliance

Overview

- Form of foreign operations
- Foreign tax treatment of the foreign operations
- U.S. tax treatment of the foreign operations
- VAT/GST issues
- Employee and independent contractor issues
- U.S. compliance issues



Form of Operation

- There are a number of ways in which a U.S. nonprofit can operate in a foreign jurisdiction:
 - Branch office
 - Wholly-owned subsidiary
 - Joint venture
 - Collaborative R&D



Form of Operation

- Branch office
 - The nonprofit registers as a foreign entity doing business in the foreign country
 - The nonprofit may have local filing obligations, and may or may not qualify as a nonprofit under local rules
 - Look at all of the activities of the nonprofit during the year
- Wholly-owned subsidiary
 - The nonprofit establishes a new company in the foreign country, with the nonprofit as the sole shareholder
 - Similar qualification issues as a foreign branch office



Form of Operation

- Joint venture
 - The nonprofit forms a joint venture with a local nonprofit to conduct agreed upon activities in that foreign country
 - Separate legal entity versus contractual joint venture
 - For U.S. tax purposes, both will be treated as partnerships
- Collaborative R&D
 - Both parties share information and resources



Foreign Tax Issues

- What functions does the nonprofit perform in the foreign country?
 - Conferences; R&D; classes?
 - Fund raising from local residents, with the funds being used for local or foreign projects?
- The foreign tax treatment of the nonprofit will depend upon the functions and activities of the nonprofit in that country
- May have to register with a local governmental agency if seeking local charitable contributions



Foreign Tax Issues

- If the local entity is a branch of the U.S. nonprofit, then it may have to register its U.S. and local officers and directors for corporate and tax law purposes
- The nonprofit may have to file financial accounts for both the U.S. and local operations (under local accounting methods) for corporate law and nonprofit law purposes
- May also have to file foreign tax returns similar to U.S. Form 990



Foreign Tax Issues

- If the local entity is a subsidiary or other separate legal entity, then it may have its own financial account and tax return filing requirements
- May have to disclose information regarding the cost allocations from the U.S. nonprofit and the use of the funds outside that foreign country



U.S. Tax Issues

- If the local entity is a branch of the U.S. nonprofit, then the nonprofit would need to include the income and expenses of the branch in its financial accounts and U.S. Form 990
- Where the local entity is a wholly owned subsidiary, then typically would not have to include any income of the local subsidiary in income for U.S. tax purposes until the local subsidiary declares a cash dividend to the U.S. nonprofit



VAT/GST Issues

- Many foreign countries impose a value added tax (VAT) or general sales tax (GST)
- U.S. nonprofits who put on conferences or conduct business in a foreign country may be required to register with the local VAT/GST authority, typically a different taxing authority from the authority responsible for income taxes
- May be required to register for VAT/GST even though not considered engaged in business for income tax purposes



VAT/GST Issues

- If subject to VAT/GST, then the U.S. nonprofit or local entity should register for VAT/GST, and collect the tax from participants or students
- VAT/GST would be paid with respect to taxable events, such as hotel conference rooms, meals, and other supplies paid for by the U.S. nonprofit or local entity
- The difference between the VAT collected and the VAT paid is then paid over to the appropriate taxing authority



VAT/GST Issues

- Failure to register for VAT/GST and to pay over any VAT/GST when due can result in significant penalties
 - Also, if the U.S. or local entity pays VAT/GST but does not collect it when required, then the VAT/GST becomes a cost to the U.S. or local entity and not to program participants



Employee Issues

- When a U.S. nonprofit expands its global operations, it is typical to have U.S. employees work abroad
 - U.S. citizens and tax residents are taxed on worldwide income, regardless of where earned or whether repatriated back to the U.S.
 - Those employees may also be subject to local country taxes



Employee Issues

- When a U.S. nonprofit expands its global operations, it is typical to have U.S. employees work abroad (cont'd.)
 - Long term residents may qualify for the benefits of Section 911
 - U.S. income exclusion for a portion of the salary and other benefits
 - U.S. income exclusion for a portion of any housing allowance



Employee Issues

- U.S. employees typically paid by the U.S. nonprofit and seconded to the foreign location
 - Still subject to U.S. payroll and social security taxes
 - May be subject to local country social security taxes as well, but effect could be reduced by a totalization agreement between the U.S. and that foreign country



Employee Issues

- U.S. employees paid by the U.S. nonprofit
 - Employee can claim a foreign tax credit for the local country taxes against the U.S. tax liability on the income allocated to time spent working abroad
 - Typically income and taxes are allocated between U.S. source and foreign sources on a days worked basis



Employee Issues

- U.S. employees paid by the local entity/branch
 - Employee now subject to local income, social security, and other applicable withholding tax requirements
 - Employee generally not exempt from local social security taxes, even if there is a totalization agreement, when paid by a local entity
 - Can still claim a foreign tax credit for the local income taxes against the U.S. income tax on that income



Employee Issues

- May also have employees from the foreign country work in the U.S. from time to time
 - For example, at a convention or as a visiting professor
- Unless resident in a country with which the U.S. has an income tax treaty, typically subject to U.S. tax on any salary or other payments
 - Treaty country residents typically not subject to U.S. tax unless present in the U.S. for more than 183 days in the calendar year



U.S. Compliance

- The U.S. imposes significant information reporting requirements on U.S. taxpayers with overseas operations
- Those requirements apply to U.S. nonprofits, not just for-profit entities
- The IRS and the Justice Department are very focused on international information reporting, even by nonprofits



U.S. Compliance

- Form 90-22.1 (FBAR)
 - Filed if a person has signature authority over, or a financial interest in, one or more foreign financial accounts with a total aggregate balance of more than \$10,000
 - Must be filed, even if the person does not have an actual financial interest in the account(s)
 - For these purposes, the term person includes individuals and nonprofits
 - Due June 30th of each year; a U.S. Treasury Department form, not an IRS tax form



U.S. Compliance

- Form 90-22.1 (FBAR) (cont'd.)
 - Considered to have a financial interest if the U.S. person owns more than 50% of the equity or other interests in a foreign entity
 - Foreign financial accounts include foreign bank accounts, securities brokerage accounts, mutual funds, hedge funds, private equity funds, and certain insurance contracts
 - Penalty of \$10,000 for each unreported foreign financial account; six year statute of limitations
 - Filed electronically after July 1, 2013



U.S. Compliance

- Forms 926/5471
 - Filed if the U.S. nonprofit owns at least 10% of the stock of the foreign entity
 - Form 926 is filed for the taxable year the foreign entity is formed
 - Form 5471 is an annual information reporting form used to report the operations of the foreign entity (includes a balance sheet, income statement, and other information)
 - Filed with Form 990



U.S. Compliance

- Form 8938
 - A new IRS tax form that became applicable starting with the 2011 tax year
 - At the moment, only applicable to individuals and not nonprofit entities
 - Report specifies foreign financial assets
 - Includes many assets reported on Form 90-22.1, but also includes stock of foreign entities and a broader range of foreign financial accounts
 - Not filed with Form 990 until the regulations change



U.S. Compliance

- Other Forms
 - Form 8865: Filed to report investments in foreign partnerships
 - Form 8261: Filed to report investments in Foreign Passive Investment Companies



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