To Be or Not to Be Self- Employed Versus Employed
On a Foreign Assignment Outside the U.S.

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The goal of this article is to provide a comprehensive checklist of information for the United States (U.S.) person to consider prior to accepting an assignment outside the U.S. This article is not designed to teach you the required technical competence to perform self compliance; however, it will certainly arm you with the technical knowledge to determine if your U.S. Certified Public Accountant (CPA) tax preparer knows all that they should know to provide you with technically competent professional services.

To Be Employed Versus Self-Employed (SE):

Generally, employees on foreign assignments have some advantages over those self-employed (SE). Although some of these other advantages were eliminated under TCJA 2017, as emphasized below.

Eliminated under TCJA 2017- ~~Although *foreign* UREE will be excluded from Schedule A, therefore not affecting the amount of the FEIE claim; conversely.~~ However well worth noting although the TCJA 2017 eliminated UREE, it does not affect Schedule C expense claims of SE persons placing a new advantage for SE persons using a Schedule C.

All overseas SE person's Schedule C *foreign* expenses and applicable *foreign* self-employed adjustments on 2023 IRS Form 1040 Schedule 1-Part II- Adjustments to Income line(s) 11-24z (e.g. ½ the SE tax, the SEHI deduction, etc…) dollar for dollar reduce the amount of the $126,500 for 2024 ($120,000 for 2023, $112,000 for 2022, $108,700 for 2021, $107,600 for 2020, $105,900 for 2019, $103,900 for 2018, $102,100 for 2017, $101,300 for 2016, $100,800 for 2015, $99,200 for 2014, $97,600 for 2013, and $95,100 for 2012) FEIE available.

Additionally, as a SE person's net SE income is subject to U.S. FICA (Federal Insurance Contributions Act) taxes- social security 6.2 percent on the first $168,600 for 2024 ($160,200 for 2023) of wages and Medicare (1.45 percent on all wages or net SE income) taxes, SE persons additionally end up paying both the employee and employer portions. This effectively combines to 15.3 percent (6.2 percent + 1.45 percent = 7.65 percent x 2) FICA taxes for all SE persons reporting net income on Schedule C, which is always assessable if net income on Schedule C arises, since SE FICA taxes are *not* affected by the FEIE and HD.

However, persons *employed* abroad and not on U.S. payroll, but instead locally hired on a foreign payroll are not subject to U.S. employee FICA taxes at all. They would become subject to the social security tax regime of the respective country in which they work, if any.

To mitigate the above, the IRS always views the *substance over legal form* of an employee-employer or master-servant relationship under common law definition to hold. Further, IRS Revenue Ruling 87-41 dictates that subject to a twenty point analysis it may be possible to declare earnings on IRS Form 1040 as line 1 wages (versus as an independent contractor or self-employed individual on IRS Form 1040- Schedule C) and subject this wage income to only the employee ½ portion of the SE tax using Form 8919, Uncollected Social Security and Medicare Tax on Wages, where an individual works for a U.S. business issuing them wage income on Form 1099-NEC, as box 1- Nonemployee Compensation. If they work for a foreign corporation then there are no U.S. SE or FICA tax implications to consider in this respect.

Where clearly the individual fails the common law employee-employer definition or it may be difficult to apply IRS Revenue Ruling 87-41 to avoid U.S. FICA SE taxes then the self-employed taxpayer may consider: 1) Totalization/ Social Security Agreements reached between the U.S. and thirty (30) countries that may alleviate U.S. SE FICA taxes, failing which, 2) going on a foreign or a third party payroll PEO type arrangement, 3) having their client put them on payroll, 4) having a non-related person own a foreign entity that in turn pays them a wage, or 5) a U.S. SE person doing business abroad may also do business directly through a foreign entity to avoid U.S. FICA SE taxes, where they have not checked the box on Form 8832 (Entity Classification Election) to be treated as a one-member disregarded entity that automatically defaults to a Schedule C (Profit or Loss from a Business). Assuming the foreign entity is an active business (no Sub Part F income- generally passive income), then we recognize shareholder or owner corporate deferral reporting of both salary and dividends on a cash paid basis.

However, there are a myriad of onerous U.S. reporting requirements whenever a U.S. person owns directly or indirectly 10% or more of any foreign entity. Form(s) 5471- Information Return of U.S. Persons with Respect to Certain Foreign Corporations, 8865- Return of U.S. Persons with Respect to Certain Foreign Partnerships (or where the U.S. person invests more than $100,000 USD in the case of a foreign partnership) and 8858- Information Return of U.S. Persons with Respect to Certain Foreign Disregarded Entities - may come into play along and in the case of a foreign corporation only Form 926- Return of a U.S. Transferor of Property to a Foreign Corporation. The complexity of these respective forms, their instructions, including the need to apply U.S. Generally Accepted Accounting Principles (G.A.A.P.) makes the associated compliance further burdensome and costly. Further in the majority of cases the U.S. CPA will not have the detailed information required for such compliance. As such usually it is the foreign accountant or client themselves whom must complete these forms.

Further the TCJA of 2017 imposed not only a one time "deemed repatriation tax" or 'transition tax' of 15.5% on untaxed foreign earnings or business profits accumulated overseas from 1986- December 31, 2017 held in cash or cash-equivalents and 8% for profits held in non-cash form, but also starting for the 2018 income tax year forward under IRC Sec 951(A) imposed an annual GILTI (Global Intangible Low Tax Income) inclusion for individuals on Form 8992- U.S. Shareholder Calculation of Global Intangible Low-Taxes Income (GILTI). The GILTI would be taxed at ordinary U.S. income tax rates.

As in the case of the one-time 2017 'Repatriation" IRC Sec 965 tax, this would apply whether or not the funds had been repatriated by deeming these earnings to be repatriated, for any U.S. persons (U.S. individuals, domestic corporations, partnerships, trusts and estates) owning more than 10% of a controlled foreign corporation (CFC), where a CFC is a foreign corporation in which U.S. persons control more than 50%.

<u>Other Interesting Facts:</u>

- These exclusions- FEIE, HE and HD are elective, and should not be used when they trigger income inclusion. This would occur, for example where Schedule C expenses outstrip income and these expenses are added back to actually create income.

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