

Office of Chief Counsel
Internal Revenue Service
Memorandum

Number: **201027046**

Release Date: 7/9/2010

CC:TEGE:ET1:SVBoominathan
PRENO-114614-10

UILC: 638.01-00, 861.01-00, 862.00-00, 864.01-01, 871.00-00, 1441.00-00, 1441.03-03,
3121.01-00, 3121.02-11, 3306.03-00, 3401.01-06, 3401.01-07, 3402.05-00

date: June 04, 2010

to: Dean A. O'Brien
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from: Paul J. Carlino
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Employment Tax, Branch 2
(Tax Exempt & Government Entities)

subject: Application of Employment Taxes to Work Performed by a Nonresident Alien
Employee on the Outer Continental Shelf

This memorandum responds to your request for advice in connection with the Internal Revenue Service's Large and Mid-Size Business division's directive LMSB-04-0909-037, Oct. 28, 2009, *Industry Director's Directive #1 – United States Outer Continental Shelf Activity*. This advice may not be used or cited as precedent.

ISSUE

Whether remuneration for services performed by nonresident alien (NRA) employees on structures permanently or temporarily attached to the Outer Continental Shelf (OCS) of the United States or on vessels or other devices engaged in activities related to the exploration for, or exploitation of, natural resources on the OCS is subject to the income tax withholding, Federal Insurance Contributions Act (FICA), and Federal Unemployment Tax Act (FUTA) provisions of the Internal Revenue Code (Code)?

CONCLUSION

Generally, services performed by NRA employees on structures permanently or temporarily attached to the OCS or on vessels or other devices engaged in activities related to the exploration for, or exploitation of, natural resources on the OCS are performed within the United States. Thus, remuneration for such services is subject to

income tax withholding, FICA, and FUTA. However, the facts and circumstances will determine the correct amount of tax, if any, in each particular case.

FACTS

The following is a generic description of typical facts. However, the resolution of any case must be based on the facts of that particular case.

A foreign corporation engages in activities related to the exploration for, or exploitation of, natural resources on the U.S. OCS in the Gulf of Mexico. The foreign corporation employs NRA employees on structures temporarily or permanently attached to the OCS for the purpose of exploring for or producing natural resources. The foreign corporation also employs NRA employees on vessels or other devices that engage in activities related to the exploration for, or exploitation of, natural resources on the OCS, or that transport supplies and personnel between locations on the OCS or between United States ports and locations on the OCS.

LAW AND ANALYSIS

1. Application of Income Tax Withholding

A. Taxation of effectively connected income (compensation) of NRAs

Section 871(b)¹ provides that a NRA engaged in a trade or business in the United States during the taxable year is subject to U.S. federal income tax on income that is effectively connected with the conduct of a trade or business within the United States.

Section 864(b) provides that the term "trade or business within the United States" includes the performance of personal services within the United States at any time during the taxable year. Such term, however, does not include the performance of personal services for a foreign person not engaged in a trade or business within the United States by a NRA temporarily present in the United States for a period or periods not exceeding a total of 90 days during the taxable year and whose compensation for such services does not exceed in the aggregate \$3,000 (the "business visitor exception"). See Treas. Reg. §1.864-2(b). If the NRA meets a similar rule, the compensation of the NRA will not be compensation from within the United States. See section 861(a)(3) and Treas. Reg. § 1.861-4(a)(1). As a general rule, the term "day" means a calendar day during any portion of which the NRA individual is physically present in the United States. See Treas. Reg. §§ 1.864-2(b)(2)(i) and 1.861-4(a)(2).

Section 861(a)(3) states that compensation for labor or personal services performed within the United States generally is income from sources within the United States. Section 862(a)(3) provides that compensation for labor or personal services performed

¹ All section references are to the Internal Revenue Code of 1986 or the regulations promulgated thereunder, unless otherwise noted.

without the United States is income from sources without the United States. See Treas. Reg. § 1.861-4(b)(2)(ii) for rules for sourcing of compensation of an individual who is an employee for labor or personal services performed partly within and partly without the United States.

Section 7701(a)(9) defines United States to mean, when used in a geographical sense, only the States and the District of Columbia.

Section 638(1), addressing continental shelf areas, provides that for purposes of applying chapter 1 of the Code (including sections 861(a)(3) and 862(a)(3) in the case of the performance of personal services) with respect to mines, oil and gas wells, and other natural deposits, the term United States when used in a geographical sense includes the seabed and subsoil of those submarine areas which are adjacent to the territorial waters of the United States and over which the United States has exclusive rights, in accordance with international law, with respect to the exploration for, and exploitation of, natural resources.

Section 1.638-1(a) provides that for purposes of applying any provision of chapter 1, 2, 3 or 24 (including sections 861(a)(3), 1441, and 3402 or other provisions dealing with the performance of personal services), with respect to mines, oil and gas wells, and other natural deposits, the term United States when used in a geographical sense includes the seabed and subsoil of those submarine areas which are adjacent to the territorial waters of the United States and over which the United States has exclusive rights, in accordance with international law, with respect to the exploration for, and exploitation of, natural resources. The term “continental shelf of the United States,” as used in this section, refers to the seabed and subsoil, included in the term United States.

Section 1.638-1(c) further clarifies that for purposes of applying section 638, persons, property, or activities which are engaged in or related to the exploration for, or exploitation of, mines, oil and gas wells, or other natural deposits need not be physically upon, connected, or attached to the seabed or subsoil to be deemed to be within the United States.

Based on these provisions of the Code and regulations, NRA employees who perform personal services on structures permanently or temporarily attached to the OCS or on vessels or other devices engaged in activities related to the exploration for, or exploitation of, natural resources on the OCS, and who do not satisfy the business visitor exception, are deemed to be engaged in a U.S. trade or business. In general, these NRA employees will not qualify for the business visitor exception since the foreign corporation will be engaged in a U.S. trade or business based on its exploration and/or exploitation activities within the OCS. As a result, these NRA employees are subject to U.S. federal income tax on compensation that is effectively connected with the conduct of a trade or business within the United States, unless such compensation is exempt from federal income tax pursuant to an applicable income tax treaty. The text of most

U.S. income tax treaties currently in force can be found on the IRS website at <http://www.irs.gov/businesses/international/article/0,,id=96739,00.html>.

B. Withholding under Section 1441 or Wage Withholding under Section 3402

Section 1441(a) and (b) imposes deduction and withholding of tax at the rate of 30 percent on salaries, wages, compensations, remunerations, or other fixed or determinable annual or periodical income of NRAs, to the extent these items of income are gross income from United States sources.

Section 1441(c) states that the deduction and withholding required in section 1441(a) and (b) is also required on amounts paid as compensation for personal services that are effectively connected with the conduct of a trade or business in the United States.

Section 1441(c)(4) provides that compensation for personal services performed by a NRA individual may be exempted from withholding under regulations prescribed by the Secretary. Section 1.1441-4(b)(1) provides that no withholding is required under section 1441 for a payment of compensation that is subject to withholding under section 3402. Section 3402 provides rules related to collection of income tax at source on wages.

Section 3402(a) provides that every employer making payment of wages is required to deduct and withhold Federal income tax according to tables or computational procedures prescribed by the Secretary.

Section 3401(a) defines wages for the purposes of income tax withholding under section 3402 as all remuneration for services performed by an employee for his employer, with certain specific exceptions.

Section 3401(a)(6) provides an exception from the definition of “wages” for remuneration paid for such services, performed by a NRA, as may be designated by regulations prescribed by the Secretary.

Section 31.3401(a)(6)-1(a), implementing section 3401(a)(6), provides that all remuneration paid for services performed by a NRA individual is subject to withholding under section 3402, if such remuneration otherwise constitutes wages within the meaning of section 31.3401(a)-1 and if such remuneration is effectively connected with the conduct of a trade or business within the United States.

Section 31.3401(a)(6)-1(b) provides that remuneration paid to a NRA individual for services performed outside the United States is excepted from wages and hence is not subject to withholding.

Section 31.3401(a)(6)-1(f) provides that remuneration paid for services performed within the United States by a NRA individual after December 31, 2000, is excepted from

wages and hence is not subject to withholding if such remuneration is, or will be, exempt from the income tax imposed by chapter 1 of the Code by reason of a provision of the Code or an income tax convention to which the United States is a party.

Based on these provisions of the Code and regulations, remuneration received by NRA employees for services performed on the OCS that are related to the exploration for, or exploitation of, natural resources on the OCS are subject to income tax withholding under section 3402. If withholding under section 3402 is not applicable, withholding may be required under section 1441. However, if remuneration earned by a NRA employee is exempt from U.S. federal income tax pursuant to an applicable income tax treaty then such remuneration is not subject to withholding under sections 1441 or 3402, provided that the employer (the withholding agent) has obtained appropriate documentation from the NRA.

C. Withholding Exemptions

Remuneration paid to a NRA employee who is temporarily present within the United States may be exempt from U.S. income tax under an income tax treaty if the NRA is a resident of the treaty country and certain other requirements are satisfied. Such requirements typically limit the number of days the NRA may be present within the United States (e.g., no more than 183 days in a 12-month period) and provide that the remuneration may not be paid by an employer who is a resident of the United States or borne by a permanent establishment that the employer has in the United States. Each case must be analyzed separately in light of the facts and the provisions of the applicable treaty. If a NRA employee is eligible for treaty benefits, he or she must claim the benefits by providing the employer with a completed Form 8233, *Exemption from Withholding on Compensation for Independent Personal Services (and Certain Dependent) Personal Services of a Nonresident Alien Individual*,.

In the absence of a treaty exemption, a NRA subject to withholding under section 3402 may claim withholding exemptions, such as the daily personal exemption amount, on Form W-4, *Employee's Withholding Allowance Certificate*. Section 3402(f)(1) provides that an employee receiving wages shall on any day be entitled to the withholding exemptions listed in the subparagraphs of section 3402(f)(1). Section 3402(f)(6) provides that, notwithstanding the provisions of section 3402(f)(1), a NRA individual is entitled to only one withholding exemption.² Section 31.3402(f)(6)-1 states generally that a NRA individual who is not a resident of Canada or Mexico, or who is not a resident of Puerto Rico during the entire taxable year, is allowed under section 3402(f)(1) only one withholding exemption.

² We note that section 3402(f)(6) was codified by the Mutual Educational and Cultural Exchange Act of 1961, P.L. 87-256, and refers to section 3401(a)(6)(A) and (B) of the Internal Revenue Code of 1954. Prior to amendment, section 3401(a)(6)(A) and (B) provided special rules for certain residents of Canada, Mexico, and Puerto Rico.

In order to receive the benefit of withholding exemptions under section 3402(f), the employee must file with his employer a withholding exemption certificate as provided in section 3402(f)(2). See Treas. Reg. § 31.3402(f)(1)-1(a)

Section 31.3402(f)(2)-1(a) requires the employer to request a withholding exemption certificate from each employee. If the employee fails to furnish a certificate, the employer is to consider such employee as a single person claiming no withholding exemptions. Section 3402(l)(1) requires the employer, for purposes of applying the withholding tables prescribed by sections 3402(a) and (c) to a payment of wages, to treat the employee as a single person unless there is a withholding exemption certificate furnished to the employer by the employee indicating the employee is married.

Section 31.3402(l)-1(c) states that for purposes of sections 3402(l)(2) and 31.3402(l)-1(b) (related to furnishing an employer an exemption certificate indicating marital status), an employee will be considered single if either the employee or the employee's spouse is, or on any preceding day within the same calendar year was, a NRA individual.

Notice 2005-76, 2005-2 C.B. 947, provides special rules for NRA employees to use in completing the Form W-4 and for employers in determining the amount of income tax to withhold under section 3402 from wages paid to NRA employees. Notice 2005-76 is effective with respect to wages paid to NRA employees after January 1, 2006. Notice 2009-91, 2009-48 I.R.B. 717, modifies the rules in Notice 2005-76, for determining the amount of income tax employers must withhold under section 3402 from wages paid to NRAs on or after January 1, 2010.

Based on these provisions of the Code and regulations, a NRA employee who is not exempt from wage withholding under an income tax treaty is generally only entitled to claim one withholding exemption on Form W-4. If the NRA employee does not furnish a Form W-4 to the employer, the employer is required to withhold as if the NRA employee was a single person, claiming no withholding exemptions.

2. Application of FICA and FUTA Taxes

Sections 3101 and 3111 impose FICA taxes on employees and employers, respectively. FICA taxes are imposed as a percentage of wages, as defined in section 3121(a), and are in addition to other taxes on those wages. See Sections 3101, 3111, and 3121(a).

Sections 3101(c), relating to the employee portion of FICA, and 3111(c), relating to the employer portion of FICA, provide that during any period in which there is in effect a totalization agreement, wages received by or paid to an individual shall be exempt from the taxes imposed by sections 3101 and 3111 to the extent that such wages are subject under such agreement exclusively to the laws applicable to the social security system of such foreign country. Under a totalization agreement, a certificate of coverage issued by one country serves as proof of exemption from social security taxes on the same

earnings in the other country. A listing of countries with which the United States has totalization agreements can be found on the Social Security Administration website at http://www.ssa.gov/international/agreements_overview.html

Section 3301(a) imposes the FUTA tax on every employer, as defined in section 3306(a), equal to a certain percentage of the total wages, as defined in section 3306(b), paid by the employer during the calendar year with respect to employment, as defined in section 3306(c).

Section 3306(a) defines “employer” for purposes of the FUTA as a person who pays a certain amount of wages during the calendar year or employs at least one individual for a certain length of time during the current or preceding calendar year. An employer is subject to FUTA even if not required to make contributions under a state unemployment compensation law, or if its employees are ineligible to receive benefits under the state unemployment compensation law. See Rev. Rul. 75-87, 1975-1 C.B. 325.

Section 3121(a) defines wages for purposes of the FICA as all remuneration for employment, with exceptions not relevant here. Section 3306(b) provides a similar definition of “wages” for purposes of the FUTA.

Section 3121(b) defines “employment” for purposes of the FICA to include any service of whatever nature, performed by an employee for the person employing him, irrespective of the citizenship or residence of either, within the United States. Section 3306(c) provides a similar definition of “employment” for purposes of the FUTA.

Section 31.3121(b)-3(b) provides that, with respect to services performed within the United States, the place where the contract of service is entered into is immaterial. The citizenship or residence of the employee or of the employer also is immaterial except to the extent provided in any specific exception from employment. Thus, the employee and the employer may be citizens and residents of a foreign country and the contract of service may be entered into in a foreign country; however, if the employee performs services within the United States, there may be employment for FICA purposes. Section 31.3306(c)-2(b) provides a similar rule for FUTA.

Section 31.3121(b)-3(c) provides that services performed outside the United States do not constitute employment for FICA purposes. Section 31.3306(c)-2(c)(1) provides a similar rule for FUTA.

Section 3121(e)(2) defines “United States” for purposes of the FICA, when used in a geographical sense, to include the Commonwealth of Puerto Rico, the Virgin Islands, Guam, and American Samoa. Section 31.3121(e)-1(b) provides that for purposes of the employment tax regulations, the term “United States”, when used in a geographical sense, means the several States (including the territories of Alaska and Hawaii before their admission as States), the District of Columbia, the Commonwealth of Puerto Rico,

and the Virgin Islands. Section 3306(j)(2) provides a similar definition of “United States” for purposes of the FUTA. See also, Treas. Reg. § 31.3306(j)-1(b)

The Outer Continental Shelf Lands Act (OCSLA) declares the policy of the United States to be that the subsoil and the seabed of the OCS appertain to the United States and are subject to its jurisdiction, control, and power of disposition, as provided in that Act. See OCSLA, sec. 3(1), codified at 43 U.S.C. 1332(1). Additionally, section 4(a)(1) of the OCSLA provides that the Constitution and laws and civil and political jurisdiction of the United States laws are extended to the subsoil and seabed of the OCS and to all artificial islands, and all installations and other devices permanently or temporarily attached to the seabed, which may be erected thereon for the purpose of exploring for, developing, or producing resources therefrom, or any such installation or other device (other than a ship or vessel) for the purpose of transporting such resources, to the same extent as if the OCS were an area of exclusive Federal jurisdiction located within a State. See OCSLA, sec. 4(a)(1), codified at 43 U.S.C. 1333(a)(1).

The Service has ruled, based on sections 3(1) and 4(a)(1) of the OCSLA, that the definition of the term United States in section 7701(a)(9) includes the OCS to the same extent as if the OCS were an area of exclusive Federal jurisdiction located within a state. See Rev. Rul. 86-108, 1986-2 C.B. 175; Rev. Rul. 81-257, 1981-2 C.B. 214; Rev. Rul. 77-197, 1977-1 C.B. 344; Rev. Rul. 56-505, 1956-2 C.B. 891.

Revenue Ruling 86-108 provides guidance on whether services performed by NRA individuals on an oil rig attached to the OCS are “employment” under section 3121(b). The ruling concludes that services performed on an oil rig attached to the OCS are performed within the United States and thus, are “employment” under section 3121(b). The ruling states that the same reasoning that applied in revenue rulings 81-257 and 77-197 to determine that the activities performed on the OCS were performed within the United States as defined in section 7701(a)(9) for purposes of applying the air transportation tax under section 4261, applied to determine that the definition of United States in section 3121(e)(2) included the OCS and oil rigs operating on it for purposes of section 3121(b).

Section 3121(b)(4) provides an exception from the definition of “employment” for purposes of the FICA for service performed by an individual on or in connection with a vessel not an American vessel, if (A) the individual is employed on and in connection with such vessel when outside the United States, and (B) either (i) such individual is not a citizen of the United States, or (ii) the employer is not an American employer. See also, Treas. Reg. § 31.3121(b)(4)-1(d). Section 3306(c)(4) provides a similar exception from the definition of “employment” for purposes of the FUTA. The section 3306(c)(4) exception differs from the FICA exception in that 1) the residency or citizenship of the individual, and 2) the status of the employer as an American or non-American employer, are not factors in determining whether the exception applies. See also, Treas. Reg. § 31.3306(c)(4)-1(d).

Section 3121(f) defines “American vessel” for purposes of the FICA to mean any vessel documented or numbered under the laws of the United States; and includes any vessel which is neither documented or numbered under the laws of the United States nor documented under the laws of any foreign country if its crew is employed solely by one or more citizens or residents of the United States or corporations organized under the laws of the United States or of any State. Section 3306(m) provides a similar definition of “American vessel” for purposes of the FUTA.

Section 31.3121(b)-3(c)(2)(v) provides that a vessel includes every description of watercraft, or other contrivance, used as a means of transportation on water. Section 31.3306(c)-2(c)(v) provides a similar rule for FUTA.

Section 3121(h) defines an “American employer” for purposes of the FICA to include an employer that is an individual who is a resident of the United States, a partnership if two-thirds or more of the partners are residents of the United States, or a corporation organized under the laws of the United States or of any State. Section 3306(j)(3) provides a similar definition of “American employer” for purposes of the FUTA.

Section 31.3121(b)(4)-1(c) provides that the expression “on or in connection with” refers not only to service performed on the vessel, but also to services connected with the vessel which are not actually performed on it (for example, shore services performed as officers or members of the crew, or as employees, or concessionaires of the vessel).

Based on these provisions of the Code and regulations, remuneration for services performed by NRA employees on structures permanently or temporarily attached to the OCS or on vessels or other devices engaged in activities related to the exploration for, or exploitation of, natural resources on the OCS may be subject to FICA tax, provided a totalization agreement does not apply, or the services are not excepted from the definition of employment by section 3121(b)(4). The same reasoning as applies to the FICA applies to the FUTA, with the exception that totalization agreements do not exempt employers from FUTA tax.

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Please call me or Syd Gernstein at (202) 622-6040 if you have any further questions.

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