

ID: CCA_2016040115005811

UILC: 901.01-00

Number: **201617009**

Release Date: 4/22/2016

From: [REDACTED]

Sent: Friday, April 01, 2016 3:00:58 PM

To: [REDACTED]

Cc:

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Subject: Employer Payment of Employee Foreign Income Tax Liability

This confirms our oral advice concerning the U.S. tax consequences when an employer pays an employee's foreign income tax liability directly to the foreign tax authority, but does not withhold tax from the employee's wages to cover the payment of that liability. The situation presented involves an employee who is subject to tax in both the U.S. and a foreign country on wages for services performed in that country. The foreign levy is an income tax within the meaning of section 901 and Treas. Reg. §1.901-2(a) that is eligible for the foreign tax credit. The foreign country may or may not view the employer's payment of the employee's foreign income tax liability as additional compensation income taxable to the employee. However, it is well-settled that for U.S. income tax purposes, the discharge of an employee's tax or other legal obligation by his employer in connection with the employer-employee relationship is compensation for services that is taxable as gross income to the employee and deductible by the employer (subject to applicable limitations). See *Old Colony Trust Co. v. Comm'r*, 279 U.S. 716 (1929).

The employee may elect under sections 901(a) and 905(a) to claim a foreign tax credit, subject to applicable limitations and in lieu of an itemized deduction, for the amount of foreign income taxes paid or accrued during the taxable year. In the circumstances described above, the employee is the person who is considered to pay the creditable foreign tax. The person by whom tax is considered paid for purposes of section 901 and 903 "is the person on whom foreign law imposes legal liability for such tax, even if another person (e.g., a withholding agent) remits such tax." Treas. Reg. § 1.901-2(f)(1). The regulation's parenthetical reference to a withholding agent is an illustrative example, and does not limit the principle that in determining the identity of the person considered to pay the tax for purposes of section 901, legal liability is determined by reference to the person on whom the tax is imposed under foreign law, and not by reference to the person that remits the tax payment. The regulations confirm that tax is considered paid by the person on whom foreign law imposes legal liability even if another party to a direct or indirect transaction with the taxpayer agrees, as a part of the transaction, to assume the taxpayer's foreign tax liability. Treas. Reg. § 1.901-2(f)(2).

Please call [REDACTED] if you have further questions.