**Office of Chief Counsel**
**Internal Revenue Service**
# memorandum

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subject: Sourcing of Restricted Stock Unit (RSU) Income and Application of Federal Insurance Contributions Act (FICA) taxes and Federal Income Tax Withholding (FITW)

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

**Issues:**

1. What portion of the compensatory income arising from RSUs (RSU income) granted by , a U.S. based corporation and employer, to an individual for personal services performed by the individual initially within the United States as a common law employee of and later for personal services performed by the individual outside the United States as a common law employee of a controlled foreign corporation (CFC) of during the vesting period constitutes wages for Federal Income Tax Withholding (FITW) purposes?

2. What portion of the RSU income is subject to federal income tax withholding, reporting, and payment by ?

3. What portion of the RSU income received by an individual for personal services performed by the individual initially within the United States as a common law employee of and later for personal services performed by the individual outside the United States as a common law employee of a CFC of during

the vesting period constitutes wages for Federal Insurance Contributions Act (FICA) tax purposes?

4. What portion of the RSU income is subject to FICA tax withholding, reporting, and payment by ?

5. Would a Social Security totalization agreement (totalization agreement) between the United States and the country that the employees transfer to affect FICA tax liability?

**CONCLUSIONS:**

1. For FITW purposes, under § 3401(a) and the accompanying regulations, the term "wages" means all remuneration for services performed by an employee for his employer, including remuneration for personal services performed by a citizen or resident of the United States as an employee of a foreign corporation. Accordingly, under the facts provided, the full amount of the RSU income paid to each worker as a common law employee of for personal services performed within the United States and the RSU income paid to each worker as a common law employee for personal services performed outside the United States as an employee of the CFC is wages for FITW purposes.

2. Under the facts provided, the full amount of the RSU income is subject to federal income tax withholding, reporting, and payment by . Because is the common law employer, it is responsible for federal income tax withholding, reporting, and payment associated with the RSU income paid to a worker for services performed within the United States as an employee of . Additionally, , as the employer described in § 3401(d)(2), is responsible for federal income tax withholding, reporting, and payment associated with the RSU income paid to a worker for personal services performed outside the United States as an employee of the CFC.[1]

3. For FICA tax purposes, under § 3121(a) and the accompanying regulations, the term "wages" means all remuneration for employment, with certain exceptions not relevant here. Furthermore, § 3121(b) generally defines the term "employment" as 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 or performed outside the United States by a citizen or resident of the United States as an employee of an American employer as

[1] This conclusion and the following analysis do not address the impact of a worker transferring to a CFC in which the CFC's country has an income tax treaty in place with the United States. This memo also does not address how an income tax treaty between the CFC's country and the United States might affect FITW obligations.

defined in § 3121(h). Accordingly, under the facts provided, all remuneration for personal services performed by each worker within the United States as a common law employee of is wages. Because employment does not include services performed outside the United States for a non-U.S. employer, any remuneration for personal services performed outside of the United States for the CFC is not wages for FICA purposes.

4. In order to determine the portion of RSU income that is wages for FICA purposes, the employer must use a reasonable method for allocating the amount of RSU income that is attributable to services performed within the United States. Under these facts, the principles of §§ 861 and 862 for determining the source of services income can be used to determine the total RSU income subject to FICA taxes. Applying these provisions to each individual worker at issue here, an appropriate allocation of the total RSU income can be made on a time basis such that the amount of RSU income subject to FICA taxes is the amount that bears the same relation to the individual's total RSU income as the number of days the individual performed services as an employee for within the United States bears to the employee's total number of days of performance of services for both and the CFC from the RSU grant date to the RSU vesting date. may use an alternative basis to allocate the total RSU income to services performed for it and the CFCs if, under the facts and circumstances, the alternative basis more appropriately reflects the extent to which the compensation is related to services provided to and the CFCs, respectively. However, under the facts provided, using a time basis method of allocation, the portion of the RSU income paid to a worker as a common law employee of for services performed within the United States is subject to FICA tax withholding, reporting, and payment by .[2]

5. The existence of a totalization agreement could impact whether FICA taxes are owed on the portion of the RSU income attributable to services performed for in the United States. Whether FICA taxes apply should be determined after a detailed examination of the facts and circumstances, including the terms of the totalization agreement.

**Facts:**

is a U.S. based corporation organized under the laws of the state of . has foreign affiliates across the globe, incorporated under the laws of their own respective countries ("Controlled Foreign Corporations" or "CFCs"), which are

[2] This conclusion does not address the impact of a worker transferring to a CFC in which the CFC's country has a Totalization Agreement in place with the United States. Conclusion 5 will address how a Totalization Agreement between the CFC's country and the United States affects FICA tax withholding, depositing and payment obligations.

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grants Restricted Stock Units ("RSUs") to its common law employees. . The number of units subject to award, vesting commencement date, and vesting schedule are established on the award date through the . These RSUs are payable in stock and generally vest over a period, typically vesting on . The employees at issue are all either U.S. citizens or U.S. residents.[3]

The employees may transfer to a CFC of after the RSUs have been granted, but before all the RSUs have vested. In the present case, it is an agreed fact that the employees at issue performed services for solely in the United States and for the CFCs solely outside the United States. There are no § 3121(l) agreements in place.[4] Each employee that transfers to a CFC provides services to the CFC under the direction and control of the CFC and not under the direction or control of . In this case, the CFCs are the common law employers of the transferred employees after the transfer takes place.

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. Furthermore, none of the employees at issue are exempt from FICA taxation due to a certificate of coverage[5] in place under a totalization agreement[6] for the stock compensation.

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[3] This memo presumes that the U.S. residents remain U.S. residents through the time when the RSUs vest.

[4] Generally, services performed by a U.S. citizen or resident outside the U.S. for a foreign subsidiary are not covered by FICA. Section 3121(l) of the Code provides for an agreement between the Secretary of the Treasury and a U.S. domestic corporation whereby the U.S. domestic corporation agrees to report and pay an amount equivalent to the employer and employee FICA taxes that would be due for employees of a foreign subsidiary of the U.S. domestic corporation who are U.S. citizens or residents performing services outside the U.S. so that such employees may be covered by the U.S. social security system.

[5] 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. See Rev. Rul. 80-56.

[6] Conclusion 5 will address how a Totalization Agreement between the CFC's country and the United States affects FICA tax withholding, depositing and payment obligations.

which is used for RSUs issued to employees of CFCs. The includes , which includes additional and modified terms and conditions that govern the RSUs granted to a participant under the if, at the time of vesting, the participant resides in one of the countries listed in . Pursuant to the terms of the the vesting of an award requires continued active service , from the grant date through the applicable vesting date. Furthermore, except as expressly provided in the

Currently, has engaged , a stock brokerage firm, to administer the RSU awards. contracts with , , to be the broker of these RSUs.

. Upon vesting of the RSUs, initiates payment of the RSUs and the employee receives the stock.[7] The net amount of shares deposited in an employee's account upon vesting depends upon the number of shares in which the employee vests at the time, the fair market value of stock on the vesting date, and any applicable adjustments, *e.g.*, tax withholding.

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[7] Typically, the terms of RSUs provide that the payment of the stock will occur upon or within a short period of time following the satisfaction of the vesting condition. For income tax purposes, if payment occurs no later than two and a half months after the end of the taxable year in which the vesting condition is satisfied, then the payment is not considered deferred compensation. See Treas. Reg. § 1.409A-1(b)(4). If the payment occurs more than two and a half months after the end of the taxable year in which the vesting condition is satisfied, then the RSU provides for a deferral of compensation and is subject to the requirements of § 409A. See Treas. Reg. § 1.409A-1(b)(1). Since states that the employees receive shares of stock upon vesting of the RSUs, this CCA does not address the situation in which § 409A applies. This memo also does not contemplate or address the situation in which the RSU is settled only in cash.

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**LAW:**

*FITW:*

Section 3401(a) generally defines the term "wages" for FITW purposes as all remuneration for services performed by an employee for his employer, with certain specific exceptions.[8] Treas. Reg. § 31.3401(a)-1(a)(2) provides that the name by which remuneration for services is designated is immaterial. Thus, salaries, fees, and bonuses are wages if paid as compensation for services performed by the employee for his employer. Treas. Reg. § 31.3401(a)-1(a)(3) provides that the basis upon which the remuneration is paid is immaterial in determining whether the remuneration is wages. Unlike the FICA provisions, the FITW provisions do not include a definition of employment.

Treas. Reg. § 31.3401(a)-1(b)(7) explains that "wages" includes remuneration for services performed by a citizen or resident of the U.S. as an employee of a nonresident alien individual, foreign partnership, or foreign corporation, whether or not such alien individual or foreign entity is engaged in trade or business within the United States. Any person paying wages on behalf of a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, is subject to all the provisions of law and regulations applicable with respect to an employer.

Section 3402(a) provides that, except as otherwise provided in this section, every employer making payment of wages shall deduct and withhold upon such wages a tax determined in accordance with tables or computational procedures prescribed by the Secretary of the Treasury.

In general, an employer is required to collect the tax by deducting and withholding the amount from the employee's wages as and when paid, either actually or constructively. Treas. Reg. § 31.3402(a)-1(b).

[8] Section 3401(a)(8)(A) provides that wages does not include remuneration paid for services for an employer, other than the United States or any agency thereof, that are either performed by a citizen of the United States if, at the time of the payment of such remuneration, it is reasonable to believe that such remuneration will be excluded from gross income under § 911, or performed in a foreign country or in a possession of the United States by such a citizen if, at the time of the payment of such remuneration, the employer is required by the law of any foreign country or possession of the United States to withhold income tax upon such remuneration. Because § 3401(a)(8)(A) only applies to citizens of the United States and requires either a payment-by-payment determination or a determination on whether a specific foreign country's laws require withholding on renumeration, this memo does not discuss whether such RSU income would be excluded from wages under § 3401(a)(8)(A) for FITW purposes. Furthermore, this memo is not considering the application of § 3401(a)(8)(A) .

Treas. Reg. § 31.3402(a)-1(b) further provides that wages are constructively paid when they are credited to the account of or set apart for an employee so that they may be drawn upon by him at any time although not then actually reduced to possession. To constitute payment in such a case, the wages must be credited to or set apart for the employee without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, must be made available to him so that they may be drawn upon at any time, and their payment must be brought within the employee's own control and disposition.

Treas. Reg. § 31.3402(a)-1(c) generally provides that an employer is required to deduct and withhold the tax notwithstanding the wages are paid in something other than money (for example, wages paid in stocks or bonds) and to pay over the tax in money. If wages are paid in property other than money, the employer should make the necessary arrangements to ensure that the amount of the tax required to be withheld is available for payment in money.

Section 3401(d)[9] provides that the term "employer" means the person for whom an individual performs or performed any service, of whatever nature, as the employee of such person (commonly referred to as the common law employer), with two enumerated exceptions. One exception is under § 3401(d)(2), which generally provides that in the case of a person paying wages on behalf of a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, the term "employer" means such person.

*FICA Taxes:*

FICA taxes consist of Old-Age, Survivors, and Disability Insurance taxes, commonly referred to as social security taxes, which include an employee portion imposed at a rate of 6.2% of wages received by employees (§ 3101(a)) and an employer portion imposed at a rate of 6.2% of wages paid by employers (§ 3111(a)); Hospital Insurance taxes, commonly referred to as Medicare taxes, which also include an employee portion imposed at a rate of 1.45% of wages received by employees (§ 3101(b)(1)) and an employer portion imposed at a rate of 1.45% of wages paid by employers (§ 3111(b)); and, effective for tax years beginning after December 31, 2012, employees are also subject to Additional Medicare tax (AdMT) imposed at a rate of 0.9% upon wages received by an employee in excess of enumerated dollar thresholds that are dependent upon each employee's filing status in a calendar year. See § 3101(b)(2).

Section 3121(a)(1) provides that the social security portion of FICA tax imposed under §§ 3101(a) and 3111(a) is only imposed on wages up to the contribution and benefit base for social security each year (social security wage base). There is no wage base for the Medicare portions of FICA tax.

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[9] This memo does not address whether may be the § 3401(d)(1) employer.

FICA taxes are computed as a percentage of "wages" paid by the "employer" and received by the employee with respect to "employment." In general, all payments of remuneration by an employer for services performed by an employee are subject to FICA taxes, unless the payments are specifically excepted from the term "wages" or the services are specifically excepted from the term "employment".

Section 3121(a) provides that the term "wages" for FICA tax purposes, means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash, with certain enumerated exceptions. Treas. Reg. § 31.3121(a)-1(i) further provides that remuneration for employment, unless specifically excepted, constitutes wages even though at the time paid the relationship of employer and employee no longer exists between the person in whose employ the services were performed and the individual who performed them.

With certain exceptions, § 3121(b) generally defines the term "employment" as 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 or performed outside the United States by a citizen or resident of the United States as an employee of an American employer as defined in § 3121(h).

In general, the employer is required to withhold and pay to the IRS the employee share of FICA taxes from wages when paid to the employee, see § 3102(a), and to pay to the IRS the employer share of FICA taxes with respect to wages when paid to the employee, see § 3111. If the employer fails to withhold the tax, the employer is nevertheless liable for payment of the tax under § 3102(b).

In general, wages are considered to be paid by the employer and received by the employee at the time they are actually or constructively paid. Accordingly, wages are subject to FICA taxes at the time that they are actually or constructively paid. See Treas. Reg. § 31.3121(a)-2(a). This is referred to as the general timing rule. See Treas. Reg. § 31.3121(v)(2)-1(a)(1).

Treas. Reg. § 31.3121(a)-2(b) provides that wages are constructively paid when they are credited to the account of or set apart for an employee so that they may be drawn upon by him at any time although not then actually reduced to his possession. To constitute payment in such a case, the wages must be credited to or set apart for the employee without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, must be made available to the employee so that they may be drawn upon at any time, and their payment must be brought within the employee's own control and disposition.

Section 3121(v)(2) and the regulations thereunder govern the FICA tax treatment of nonqualified deferred compensation (NQDC) plans.

Treas. Reg. § 31.3121(v)(2)-1(a)(2)(i) provides that to the extent that remuneration deferred under an NQDC plan constitutes wages within the meaning of § 3121(a), the

remuneration is subject to the special timing rule described in Treas. Reg. § 31.3121(v)(2)-1(a)(2).

Section 3121(v)(2)(A) and Treas. Reg. § 31.3121(v)(2)-1(a)(2)(ii) define the special timing rule. Under the special timing rule, an amount deferred under a nonqualified deferred compensation plan is required to be taken into account as wages for FICA tax purposes as of the later of (A) the date on which the services creating the right to that amount are performed (within the meaning of Treas. Reg. § 31.3121(v)(2)-1(e)(2)), or (B) the date on which the right to that amount is no longer subject to a substantial risk of forfeiture (within the meaning of Treas. Reg. § 31.3121(v)(2)-1(e)(3)).

Treas. Reg. § 31.3121(v)(2)-1(e)(2) provides that services creating the right to an amount deferred under a nonqualified deferred compensation plan are considered to be performed as of the date on which, under the terms of the plan and all the facts and circumstances, the employee has performed all of the services necessary to obtain a legally binding right (as described in Treas. Reg. § 31.3121(v)(2)-1(b)(3)(i)) to the amount deferred.

Treas. Reg. § 31.3121(v)(2)-1(e)(3) provides that the determination of whether a substantial risk of forfeiture exists must be made in accordance with the principles of § 83 and the regulations thereunder.[10]

Treas. Reg. § 31.3121(v)(2)-1(b)(1) defines "nonqualified deferred compensation plan" to mean any plan or other arrangement, other than a plan described in § 3121(a)(5), that is established (within the meaning of Treas. Reg. § 31.3121(v)(2)-1(b)(2)) by an employer for one or more of its employees, and that provides for the deferral of compensation (within the meaning of Treas. Reg. § 31.3121(v)(2)-1(b)(3)).

Treas. Reg. § 31.3121(v)(2)-1(b)(3)(i) defines the term "deferral of compensation" for FICA tax purposes. A plan provides for the deferral of compensation with respect to an employee only if, under the terms of the plan and the relevant facts and circumstances, the employee has a legally binding right during a calendar year to compensation that has not been actually or constructively received and that, pursuant to the terms of the plan, is payable to (or on behalf of) the employee in a later year. An employee does not have a legally binding right to compensation if that compensation may be unilaterally reduced or eliminated by the employer after the services creating the right to the compensation have been performed. For this purpose, compensation is not considered subject to unilateral reduction or elimination merely because it may be reduced or eliminated by operation of the objective terms of the plan, such as the application of an objective provision creating a substantial risk of forfeiture (within the meaning of § 83). Similarly, an employee does not fail to have a legally binding right to compensation

[10] Treas. Reg. § 1.83-3(c)(1) generally provides that a substantial risk of forfeiture exists only if rights in property that are transferred are conditioned, directly or indirectly, upon the future performance (or refraining from performance) of substantial services by any person, or upon the occurrence of a condition related to a purpose of the transfer if the possibility of forfeiture is substantial.

merely because the amount of compensation is determined under a formula that provides for benefits to be offset by benefits provided under a plan that is qualified under § 401(a), or because benefits are reduced due to investment losses or, in a final average pay plan, subsequent decreases in compensation.

Treas. Reg. § 31.3121(v)(2)-1(b)(4)(iii) provides, in relevant part, that a plan under which an employee obtains a legally binding right to receive property (whether or not the property is restricted property) in a future year may provide for the deferral of compensation within the meaning of Treas. Reg. § 31.3121(v)(2)-1(b)(3) and, accordingly, may constitute a nonqualified deferred compensation plan, even though benefits under the plan are or may be paid in the form of property.

Treas. Reg. § 31.3121(v)(2)-1(f)(1) provides, in general, that an amount deferred under an NQDC plan for any employee is treated, for purposes of withholding and depositing FICA tax, as wages paid by the employer and received by the employee at the time it is taken into account in accordance with Treas. Reg. § 31.3121(v)(2)-1(e).

*Sourcing:*

Section 861(a)(3) generally provides that compensation for labor or personal services performed in the United States shall be treated as income from sources within the United States. Furthermore, Treas. Reg. § 1.861-4(a)(1) establishes that compensation for labor or personal services includes fees, commissions, fringe benefits, and similar items, and such compensation for services performed in the United States is from sources within the United States, irrespective of the place or time of payment.

Section 862(a)(3) establishes that compensation for labor or personal services performed without the United States shall be treated as income from sources without the United States.

Additionally, Treas. Reg. § 1.861-4(b)(2)(ii)(A) generally provides that, for compensation for labor or personal services performed partly within and partly without the United States by an individual as an employee, the part of such compensation that is attributable to the labor or personal services performed within the United States, and that is therefore included in gross income as income from sources within the United States, is determined on a time basis as defined in § 1.861-4(b)(2)(ii)(E). Treas. Reg. § 1.861-4(b)(2)(ii)(E) provides that the amount of compensation for labor or personal services performed within the United States determined on a time basis is the amount that bears the same relation to the individual's total compensation as the number of days of performance of the labor or personal services by the individual within the United States bears to his or her total number of days of performance of labor or personal services.

Treas. Reg. § 1.861-4(b)(2)(ii)(F) provides that the source of multi-year compensation arrangements is determined generally on a time basis over the period to which the compensation is attributable. Multi-year compensation means compensation that is

included in the income of an individual in one taxable year but that is attributable to a period that includes two or more taxable years. The determination of the period to which such compensation is attributable, for purposes of determining its source, is based upon the facts and circumstances of the particular case. For example, an amount of compensation that specifically relates to a period of time that includes several years is attributable to the entirety of that multi-year period. The amount of such compensation that is treated as from sources within the United States is the amount that bears the same relationship to the total multi-year compensation as the number of days (or unit of time less than a day, if appropriate) that labor or personal services were performed within the United States in connection with the project bears to the total number of days (or unit of time less than a day, if appropriate) that labor or personal services were performed in connection with the project. In the case of stock options, the facts and circumstances generally will be such that the applicable period to which the compensation is attributable is the period between the grant of an option and the date on which all employment-related conditions for its exercise have been satisfied (the vesting of the option).

Treas. Reg. § 1.861-4(b)(2)(ii)(G) Example 6 provides the appropriate sourcing method for a multi-year compensation arrangement in the case of stock options:

> On January 1, 2006, Company Q compensates employee J with a grant of options to which section 421 does not apply that do not have a readily ascertainable fair market value when granted. The stock options permit J to purchase 100 shares of Company Q stock for $5 per share. The stock options do not become exercisable unless and until J performs services for Company Q (or a related company) for 5 years. J works for Company Q for the 5 years required by the stock option grant. In years 2006-08, J performs all of his services for Company Q within the United States. In 2009, J performs 1/2 of his services for Company Q within the United States and 1/2 of his services for Company Q without the United States. In year 2010, J performs his services entirely without the United States. On December 31, 2012, J exercises the options when the stock is worth $10 per share. J recognizes $500 in taxable compensation (($10−$5) × 100) in 2012.

Under the facts in the example, the applicable period is the 5-year period between the date of grant (January 1, 2006) and the date the stock options become exercisable (December 31, 2010). On the date the stock options become exercisable, J performs all services necessary to obtain the compensation from Company Q. Accordingly, the services performed after the date the stock options become exercisable are not taken into account in sourcing the compensation from the stock options. Therefore, pursuant to

paragraph (b)(2)(ii)(A), since J performs 3 1/2 years of services for Company Q within the United States and 1 1/2 years of services for Company Q without the United States during the 5-year period, 7/10 of the $500 of compensation (or $350) recognized in 2012 is income from sources within the United States and the remaining 3/10 of the compensation (or $150) is income from sources without the United States.

*Totalization Agreements:*

Generally, an income tax treaty applies to income taxes in the United States and the respective contracting state. A social security totalization agreement applies to U.S. Social Security and Medicare taxes, as well as the social taxes in the other contracting state. The United States has entered into totalization agreements with several foreign countries for the purpose of avoiding double taxation of income with respect to social security taxes. These agreements are considered when determining whether any U.S. citizen or resident alien working abroad is subject to FICA taxes or social taxes of a foreign country.

The United States enters into totalization agreements with foreign countries to coordinate coverage and contributions (*i.e*., taxes) under the U.S. social security program with comparable programs of other countries (also sometimes referred to as social insurance taxes or social taxes). The agreements work by assigning social security coverage and, in turn, social security tax liability, to only one country. The general principle of all totalization agreements is that a worker should pay taxes and be covered only under the social security system of the country in which the individual actually works. This rule is known as the territoriality rule, meaning the territory in which a person is working determines tax liability. All other coverage provisions of totalization agreements constitute exceptions to this general rule.

Totalization agreements, generally, eliminate double social security taxation of the same earnings for the same work.[11] Thus, for example, wage income that is subject to both FICA and foreign social security taxes will be exempt from FICA taxes to the extent that, under a totalization agreement with the foreign country, the wage income is subject solely to taxes imposed under the social security system of the foreign country.[12] Conversely, if, for example, the compensation is subject to FICA tax in the United States, but not social security taxes in the foreign country, then the totalization agreement's provisions on taxes would not apply to eliminate double social security taxation and only FICA would apply.

**ANALYSIS:**

*The portion of the RSU income paid to a worker that would be subject to FITW:*

For purposes of FITW, wages are generally defined as all remuneration for services performed by an employee for his employer. See § 3401(a). Under the facts being considered, it is agreed that, at the time of grant, each worker at issue was a common

[11] See 42 U.S.C. 433(c)(1)(B)(i).
[12] See Id.

law employee of for federal employment tax purposes and performing services for within the United States, and that after the worker transferred to a CFC, they were a common law employee of the CFC performing services for the CFC outside the United States until the time of vesting.

Section 3402(a)(1) provides that every employer making payment of wages shall deduct and withhold upon such wages a tax determined in accordance with tables or computational procedures prescribed by the Secretary. Treas. Reg. § 31.3402(a)-1(b) provides that the employer is required to collect the tax by deducting and withholding the amount thereof from the employee's wages as and when paid, either actually or constructively. Wages are constructively paid when they are credited to the account of, or set apart for, an employee so that they may be drawn upon by him at any time although not then actually reduced to possession. To constitute payment in such a case, the wages must be credited to or set apart for the employee without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, must be made available to the employee so that they may be drawn upon at any time, and their payment must be brought within the employee's own control and disposition.

Furthermore, an employer is required to deduct and withhold the tax notwithstanding that the wages are paid in something other than money, for example, stock, and to pay over the tax in money. See Treas. Reg. § 31.3402(a)-1(c).

The shares paid in settlement of RSUs are taxable income and this income is considered wages pursuant to § 3401(a) when it is actually or constructively paid. Under the facts provided, because payment of the RSU shares is initiated on the date of vesting, at that time there would no longer be a substantial limitation or restriction, since the employee would have beneficial ownership of the stock.[13] Therefore, upon initiation of payment of the vested RSUs, the RSU income constitutes wages that have been actually or constructively paid to the employee and is subject to FITW at that time.

At the time of vesting, the RSU income is comprised of an amount attributable to services performed during the portion of time that the worker spent employed by working within the United States and an amount attributable to services performed during the portion of time that the worker spent employed by the CFC working outside the United States. Regardless that RSU income is comprised of an amount attributable to time a worker spent employed by a CFC and working outside the United States, § 31.3401(a)-1(b)(7) provides that wages include the remuneration for services performed by a citizen or resident of the U.S. as an employee of a foreign corporation, whether or not such foreign entity is engaged in trade or business within the United States. Therefore, the full amount of the RSU income would be wages for FITW purposes. Section 31.3401(a)-1(b)(7) also provides that any person paying wages on behalf of a

[13] See 2020 WL 2616460, Chief Counsel Attorney Memorandum, IRS AM 2020-004, for a discussion of the application of § 83 to stock-settled RSUs.

foreign corporation not engaged in trade or business within the United States is subject to all the provisions of laws and regulations applicable with respect to an employer.

Upon initiation of payment of the vested RSUs, it is the responsibility of the employer to deduct and withhold income taxes on the RSU income. , as the common law employer of the workers before the transfer took place, would be responsible for deducting and withholding on the RSU income attributable to the work performed for . Additionally, § 3401(d)(2) provides that the employer means the person paying wages on behalf of a foreign corporation not engaged in trade or business within the United States. See also § 31.3401(d)-1(e). Although, under the facts being considered, the CFC was the common law employer of the workers after the transfer took place, , under § 3401(d)(2) is the statutory employer since it is making payments on behalf of the CFC, which is not engaged in a trade or business within the U.S. Accordingly, would also be responsible, as the statutory employer, for deducting and withholding income taxes on the RSU income attributable to the work performed for the CFC. Because would be responsible for withholding income taxes on the full amount of RSU income, a reasonable allocation under § 861 would be unnecessary for income tax purposes.

*What portion of the RSU income is subject to FICA taxes?:*

For purposes of FICA taxes, wages are generally defined as all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash. See § 3121(a). Employment generally means any service by an employee for the person employing him within the United States and any service performed outside the United States by a citizen or resident of the United States as an employee of an American employer. See § 3121(b). However, under the facts being considered, , at the time of grant, each worker at issue was a common law employee of and performing services for in the United States, and that after the worker transferred to a CFC, they were a common law employee of the CFC and performing services for the CFC outside the United States until the time of vesting (*i.e.*, when the substantial risk of forfeiture has lapsed because the required services have been performed).

The grant of the RSUs constituted a legally binding right to receive property in a later year conditioned upon the future performance of substantial services by each worker; thus, the RSUs provide for the deferral of compensation for FICA tax purposes.[14] See Treas. Reg. §§ 31.3121(v)(2)-1(b)(3)(i) and (b)(4)(iii). Generally, any plan or other arrangement established by an employer for one or more of its employees that provides for the deferral of compensation is an NQDC plan. Because the RSUs are an arrangement established by for its employees that provides for the deferral of compensation, the RSUs are an NQDC plan for FICA purposes, and are therefore

[14] The facts of this memorandum do not contemplate an RSU award that is granted, vested, and paid all in the same calendar year.

subject to FICA tax under the special timing rule. In this case, the RSUs must be taken into account as wages for FICA tax purposes on the vesting date because it is the later of the date on which services creating the right to the RSUs are performed or the date on which the RSUs are no longer subject to a substantial risk of forfeiture. See, *e.g.*, Treas. Reg. § 31.3121(v)(2)-1(e)(7) Example 2.

For purposes of withholding and depositing FICA tax, the RSUs are wages paid by [15] (to the extent the RSUs are wages within the meaning of § 3121(a)) and received by the workers at the time they are taken into account. See Treas. Reg. § 31.3121(v)(2)-1(f)(1). Therefore, is required to treat the vesting date as the date the RSUs were paid by for purposes of withholding and depositing FICA tax because that is when the RSUs are taken into account.[16]

Section 3121(a) generally provides that wages mean all remuneration for employment, and § 3121(b) generally provides that employment means any service performed by an employee for the person employing him, irrespective of the citizenship or residence of either, within the United States or performed outside the United States by a citizen or resident of the United States as an employee of an American employer. Employment does not include services performed outside the United States for a non-U.S. employer. Accordingly, any remuneration received for services performed for the CFC outside of the United States is not wages, making an allocation necessary to determine which portion of the RSU income is wages for FICA purposes and which portion is not.

For the reasons explained below, § 861 provides an acceptable method for determining the portion of the RSU income that is U.S. source income, and thus, attributable to services performed in the United States for . As U.S. source income for services performed for , these amounts would be wages for FICA purposes under § 3121(a) and would be subject to FICA tax withholding and reporting by .[17]

*For purposes of determining wages for FICA taxes, can sourcing rules be applied?:*

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[15] By its terms, the definition of employer in § 3401(d) applies only to federal income tax withholding. In *Otte v U.S.*, 419 U.S. 43 (1974), however, the Supreme Court held that a person who is an employer under § 3401(d)(1) of the Code, relating to federal income tax withholding, is also an employer for purposes of FICA withholding under§ 3102. Although *Otte* extends the duties and liabilities of employers in connection with the payment of taxes under § 3102, it has no effect in determining whether remuneration is wages under § 3121(a) or whether services are employment under § 3121(b). Accordingly, because the services performed by the employees for a CFC outside of the United States do not constitute employment under § 3121(b) (unless a § section 3121(l) agreement or totalization agreement provided that their services were employment) or wages under § 3121(a), would not be a § 3401(d) employer for FICA purposes for the RSUs income attributable to the work performed outside the United States for the CFC.

[16] See 2020 WL 2616460, Chief Counsel Attorney Memorandum, IRS AM 2020-004, for a discussion of the application of the FICA tax withholding and deposit rules to stock-settled RSUs.

[17] This memo only addresses the reporting and withholding obligations of . It does not address the FITW and FICA obligations of the CFC employing a U.S. person, if any.

The FICA rules do not directly invoke the sourcing rules in §§ 861 and 862. However, the sourcing rules help determine the extent to which income derived partly from services performed within the United States and partly from services performed outside the United States is U.S. source income. Thus, the sourcing rules are an acceptable set of analogous principles that can be used to determine which part of the RSU income is attributable to services performed for in the United States, which aids in establishing withholding obligations on the RSUs for FICA purposes.

In the present case, it is an agreed fact that the employees at issue performed services for solely in the United States and for the CFCs solely outside of the United States. Furthermore, the RSUs were granted while these employees were employed by and later vested while they were employed by the CFCs. As a result, it is reasonable to rely on § 861 regarding income from services performed partly within and partly without the United States to determine the extent to which the RSU income is attributable to services performed for within the United States for purposes of determining FICA obligations.

To determine which portion of the RSU income is from sources within the United States, Treas. Reg. § 1.861-4(b)(2)(ii)(A) provides that income from services performed as an employee partly within and partly without the United States, like the RSUs, is sourced on a time basis using the method set forth in § 1.861-4(b)(2)(ii)(E) (the "time-basis method"). The U.S. source portion of employee compensation under the time-basis method is generally determined based on the number of days the employee performed services in the United States relative to the total number of days the employee performed services, domestically or abroad, during the taxable year. In this case however, because the payment of RSU income is includible in a single taxable year (when the RSU vests) but is attributable to a multi-year period beginning on the grant date and ending on the vesting date, the time-basis method must be applied over the course of the vesting period. See Treas. Reg. § 1.861-4(b)(2)(ii)(F).

Applying similar principles in case, the U.S. sourced portion of the RSU income would be the ratio of days during the vesting period that the employee worked for

(*i.e.*, before the CFC employed them abroad) to the total number of days the employee worked during the vesting period for the .

Example 6 in Treas. Reg. § 1.861-4(b)(2)(ii)(G) illustrates how to determine the source of a multi-year compensation arrangement involving stock options using the time basis method under § 1.861-4(b)(2)(ii)(E).

Following this example, the applicable allocation period would be between the date the RSUs were granted and the date the RSUs vested. Therefore, within this period, the portion of the RSUs that is U.S. source income, and attributable to services performed for within the United States, is the amount of RSU income that bears the same relation to the individual's total RSU income as the number of days of performance of

labor or personal services for within the United States bears to the total number of days of performance of labor or personal services for the .

*What impact can a totalization agreement have on the FICA tax determination?:*

The existence of a totalization agreement between the United States and the country in which the employee works when the RSUs vest could result in the compensation being treated as exempt from FICA tax. The determination of how, if at all, a totalization agreement impacts this scenario requires a detailed understanding of the specific facts and circumstances, including the terms of the applicable totalization agreement and how the non-U.S. country treats the compensation from a social security tax perspective.

The RSU income attributable to services performed for within the United States is considered wages for FICA purposes under § 3121(a) and is subject to FICA taxes. If the laws of the foreign country where the employee is working when the RSU vests also subject the portion of the RSU income attributable to services performed for within the United States to social security taxes in the foreign country, then there is the potential for double social security taxation on the same earnings. Under such circumstances, the totalization agreement's provisions preventing double social taxes might apply to exempt the RSU income from FICA taxes. However, if the foreign country does not impose social taxes on the U.S.-source portion of the RSU income, then there is no double social security taxation on the same earnings and the totalization agreement's provisions on social taxes do not apply. In that case, the U.S.-source portion of the RSU income would remain subject to FICA taxes.

If the U.S.-source portion of the RSU income is subject to social insurance taxes in the foreign country, then the terms of the particular totalization agreement should be analyzed to confirm which country may apply its social taxes to such compensation. An employer seeking to exclude compensation from FICA under a totalization agreement is required to obtain a certificate of coverage from the country that is applying its social security taxes to the compensation in order to substantiate that non-U.S. social taxes applied to the income. If the taxpayer provides a certificate of coverage proving that social taxes were paid to the foreign country on the U.S. source-portion of the RSU income, then the totalization agreement should be analyzed to confirm that such compensation is exempt from FICA tax.

Absent a determination that the compensation is exempt from FICA under the totalization agreement, the U.S.-source portion of the RSUs should be treated as wages for FICA purposes.

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Please call Nina Huson or Michael Swim at (202) 317-6798 if you have any further questions.