

Industry Director's Directive # 2 Employment Tax and the Employees on the U.S. Outer Continental Shelf

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MEMORANDUM FOR INDUSTRY DIRECTORS, LB&I
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SUBJECT

Industry Director's Directive # 2—Employment Tax and the Employees on the U.S. Outer Continental Shelf

This Directive provides notice and field direction on the application of Internal Revenue Code (Code) section 3402, the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA) (collectively, employment tax) to remuneration for work performed on the Outer Continental Shelf, in the Gulf of Mexico (the OCS).

Background/Strategic Importance:

Our research indicates that many employers are not complying with their federal employment tax obligations for nonresident alien individuals they employ on the OCS. Under Code section 871(b), nonresident alien employees are subject to income tax on compensation effectively connected with the conduct of a trade or business within the United States. Nonresident alien employees that perform 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, are generally engaged in a U.S. trade or business. I.R.C. §§ 864(b), 638(1); Treas. Reg. § 1.638-1(a), (c).

Code section 1441 provides for a 30% withholding tax on the gross amount of salaries, wages, compensation, remuneration, or other fixed or determinable annual or periodic income derived by a nonresident alien employee from U.S. sources. Withholding under section 1441 is not required to the extent it is required under Code section 3402. I.R.C. § 1441(c)(4); Treas. Reg. § 1.1441-4(b)(1).

Under code section 3402, every employer making a payment of wages must withhold income tax. Wages generally include all remuneration for services performed by an employee for an employer. I.R.C. § 3401(a). Wages do not include remuneration for services performed within the United States by a nonresident alien employee after December 31, 2000, if the

remuneration is, or will be, exempt from income tax under a provision of the Code or an income tax treaty to which the United States is a party. Treas. Reg. § 31.3401(a)(6)-1(f). An employer may not exempt wages from withholding tax under an income tax treaty unless it receives a Form 8233, Exemption from Withholding on Compensation for Independent (and Certain Dependent) Personal Services of a Nonresident Alien Individual, from its nonresident alien employee. Treaty claims must be examined closely because certain treaties have special provisions that relate to the offshore oil and gas industry.

In the absence of a treaty exemption from federal income tax withholding, a nonresident alien employee may claim withholding allowances on Form W-4, Employee's Withholding Allowance Certificate. Notice 2005-76, 2005-2 C.B. 947, provides special rules for nonresident alien employees to use to complete Form W-4 and for employers to determine how much income tax to withhold from wages under Code section 3402. Notice 2009-91, 2009-48 I.R.B. 717, modifies Notice 2005-76 for wages paid to nonresident alien employees on or after January 1, 2010, through the end of calendar year 2010 only. Notice 2011-12, 2011-08 I.R.B. 717, announced that Notice 2009-91 has no effect for wages paid on or after January 1, 2011. Therefore, the modification to Notice 2005-76 made by Notice 2009-91 only applies for calendar year 2010 and does not apply for wages paid on or after January 1, 2011. Notice 2005-76 continues in effect for wages paid on or after January 1, 2011. Generally, a nonresident alien employee is only entitled to claim one withholding allowance on Form W-4. If the nonresident alien employee does not furnish a fully completed Form W-4 to his or her employer, the employer is required to withhold as if the nonresident alien employee were a single person with no withholding allowances.

Code sections 3101 and 3111 contain FICA tax provisions for employees and employers. FICA tax is calculated as a percentage of wages and imposed in addition to other taxes on those wages. I.R.C. §§ 3101, 3111, and 3121(a). Wages that are covered by a totalization agreement, as evidenced by a certificate of coverage issued by a foreign country, are exempt from FICA tax. The Social Security Administration's website provides a list of countries with which the United States has entered into a totalization agreement.

An employer is liable for FUTA tax in an amount equal to a certain percentage of total wages paid by the employer during the calendar year. I.R.C. §§ 3301, 3306. The employer is subject to FUTA without regard to whether it is required to make contributions to, or its employees are eligible to receive benefits under, a state unemployment compensation law. Rev. Rul. 75-87, 1975-1 C.B. 325. An employer is never exempt from FUTA under a treaty or totalization agreement.

For purposes of FICA and FUTA, wages include all remuneration for employment. I.R.C. §§ 3121(a); 3306(b). Employment includes, with certain specified exceptions, any service performed by an employee for an employer, within the United States for an employer regardless of the citizenship or residence of either. I.R.C. §§ 3121(b), 3306(c). Services performed within the United States include services performed on the OCS. See, e.g., Rev. Rul. 86-108, 1986-2 C.B. 175. Employment does not include services performed by an individual on or in connection with a vessel that is not an American vessel if certain conditions are met. See I.R.C. §§ 3121(b)(4), 3306(c)(4); Treas. Reg. §§ 31.3121(b)(4)-1(d), 31.3306(c)(4)-1(d).

Planning and Examination Guidance:

Chief Counsel Advice (CCA 201027046) dated June 4, 2010, addresses the applicability of employment taxes to remuneration received by nonresident alien employees for services performed on the OCS.

An OCS compliance steering committee has been established to help identify, develop, resolve, and improve Service coordination of issues related to OCS activities. In addition, to facilitate the proper calculation of employment tax, OCS employers are advised to provide all information related to OCS employment tax obligations directly to the examiner instead of filing delinquent returns with the Campus Centers. Quarterly employment tax periods during which an OCS employer had no employees working on the OCS should be accounted for by placing zeroes on the appropriate report. Employers with a continuing presence on the OCS should file future quarterly employment tax return Forms 941 by using zeroes for any quarterly period during which they had no employees actually working in the OCS.

Examiners who are contacted by employers with questions about employment tax obligations for individuals employed on the OCS should notify the OCS compliance steering committee of the contact.

Questions should be directed to the following IRS personnel:

- For employment tax issues, *Dean O'Brien* at (972) 308-1233
- For shipping issues, *Brenda Sarini* at (973) 569-4812
- For natural resources and section 638 issues, *Ellen Kolpin* at (713) 209-3644
- For withholding tax issues, *Thomas Logan* at (202) 283-8387.

Examiners assigned OCS cases are required to complete the following actions:

1. Secure OCS compliance steering committee approval on whether to assert penalties prior to any discussion with the taxpayer; and
2. Input mandatory Uniform Issues List (UIL), Project, and Tracking codes.

These requirements will remain in place until all cases assigned to the field have been completed or until such time as the issue owner executive issues a directive eliminating these requirements.

Planning and Examination Risk Analysis:

The field should address all relevant issues, including an employer's solicitation of Forms W-4, withholding, reporting, and payment of employment tax, and claims for tax exemption under an income tax treaty or totalization agreement. Examiners should challenge arguments by taxpayers who have not complied with the provisions of the Code relating to employment tax.

Issue Tracking:

Project Code 0555

Tracking Code 1555

Project established UIL Codes:

1. 638.03-01. US Outer Continental Shelf (OCS) - US Flag vessels engaged in Oil & Gas

- Exploration, Repair, or Maintenance
2. 638.03-02. US Outer Continental Shelf (OCS) - Foreign Flag vessels engaged in Oil & Gas Exploration, Repair, or Maintenance
 3. 638.04-01. US Outer Continental Shelf (OCS) - Foreign Flag vessels engaged in Bareboat Charter Rents
 4. 861.04-01 Compensation for Services - Place where Services Performed
 5. 864.01-01 Definition of Trade or Business - Personal Services
 6. 1441.05-01. US Outer Continental Shelf (OCS) - Withholding on Foreign-Flag Vessels engaged in Bareboat Charter Rents
 7. 1441.05-02. US Outer Continental Shelf (OCS) - Withholding on Foreign-Flag Vessels engaged in Time or Voyage Charters for Services
 8. 3401.01-06. US Outer Continental Shelf (OCS) - Income tax withholding, FICA, & FUTA for Foreign Employees working on Oil & Gas Rigs
 9. 3401.01-07. US Outer Continental Shelf (OCS) - Income tax withholding, for Foreign Employees Working on Foreign Flag Vessels.
 10. 3402.05-00 Withholding Exemptions and Exemption Certificates

This LB&I Directive is not an official pronouncement of the law and cannot be used, cited, or relied upon as such.

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