



GMS Flash Alert

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United States – Sourcing of Multi-Year Compensation for Social Security Tax

On July 7, 2023, the U.S. Internal Revenue Service (IRS) released Office of Chief Counsel Memorandum 202327014¹ (the “Memo”), which gives guidance on, among other things, how restricted stock unit (RSU) income which is earned over a period of multiple tax years should be sourced for U.S. Social Security (“FICA”) purposes.

WHY THIS MATTERS

There is little official guidance on how compensation should be sourced for FICA, leaving employers to interpret for themselves how best to adapt income tax regulations to apply to FICA tax. Though the Memo is narrow in scope, its principles are broad enough to give employers comfort that their FICA calculations are likely to meet with approval should their payroll be subjected to IRS audit.

Details on the Memo

The Memo is addressed to a U.S. company that grants RSUs to common law employees of its own and of its foreign affiliates, and addresses situations when the period over which an RSU vests spans periods when the taxpayer’s regular compensation was in part not subject to FICA.

Determining Portion of RSU Income Subject to FICA

In general, U.S. citizens and residents are subject to FICA on all compensation received from American employers,² while compensation received by any person from a foreign employer is subject to FICA only on the portion related to service provided in the United States. In the latter case, the vesting period may include periods of service provided both within and outside the United States. In that case, the Memo holds that a “reasonable method” such as number of

workdays during the vesting period within and without the U.S. should be applied to determine the portion of the RSU income that relates to U.S. service.³ That portion should be subject to FICA.

Effect of Totalization Agreements

The Memo also addresses the interaction of bilateral Social Security totalization agreements with domestic rules.⁴ These agreements are concluded between two countries to harmonize Social Security taxation and benefits. A principal goal of totalization agreements is to prevent double Social Security taxation, and application of a totalization agreement may result in situations where compensation is subject to FICA when it would not otherwise be under U.S. domestic law, and vice versa – compensation that would otherwise be subject to FICA may be exempt under a totalization agreement. If an RSU vesting period falls in whole or in part in a period in which a totalization agreement alters the applicability of FICA tax, the totalization agreement should also apply to the portion of the RSU income that was earned during that period.

KPMG INSIGHTS

IRS memoranda of this nature do not have the effect of creating precedent: they are issued at the request of a specific taxpayer and apply only to that taxpayer. Still, they are generally issued when clear guidance is lacking, and thus are extremely useful in giving insight into the current approach of the IRS to a given topic or situation. In this case, although the Memo applies only to RSUs granted to U.S. citizens and residents, by analogy its principles can be applied to other forms of multi-year compensation, to nonresident aliens, and to other types of employers.

FOOTNOTES:

1 Office of Chief Counsel, Internal Revenue Service Memorandum, Number: [202327014](#), Release Date: 7/7/2023.

2 An “American employer” is defined in Internal Revenue Code section 3121(h) as a corporation that was organized under the laws of the United States or one of the 50 states or the District of Columbia; a partnership if two thirds of its partners are residents of the U.S.; an individual who is a resident of the U.S.; a trust if all of the trustees are residents of the U.S.; and the United States itself, or any instrumentality of the United States.

3 This mirrors the sourcing principles of Treasury Regulations section 1.861-4, which is applicable to sourcing of compensation, including multi-year compensation, for federal income tax purposes.

4 The United States currently has totalization agreements with 30 countries: Australia, Austria, Belgium, Brazil, Canada, Chile, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Luxembourg, The Netherlands, Norway, Poland, Portugal, Slovakia, Slovenia, South Korea, Spain, Sweden, Switzerland, the United Kingdom, and Uruguay.

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