New York Law Journal

WWW.NYLJ.COM

An ALM Publication

VOLUME 251—NO. 14

WEDNESDAY, JANUARY 22, 2014

Outside Counsel

Expert Analysis

Foreign IT Companies Under Tax Scrutiny After Infosys Settlement

By
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Eight of the top 10 companies that filed a request with U.S. Department of Labor in fiscal year 2013 to temporarily hire a foreign professional were either Indian IT companies or IT companies that did the bulk of their development work in India.[1] One of them, Infosys Limited, was recently sued by the United States in the U.S. District Court for the Eastern District of Texas for "systemic fraud and abuse of immigration processes." *United States v. Infosys Limited*, Case No. 4:13-cv-634 (E.D., Texas). In its complaint, the United States alleged that Infosys knowingly circumvented the U.S. visa and employment laws by disguising hundreds of its foreign employees as business visitors and then causing such employees to perform skilled work in the United States in lieu of U.S. citizens and legitimate work visa holders.[2]

The Infosys case, filed on Oct. 30, 2013, was settled the same day. Under the settlement, Infosys agreed to pay the United States $34 million—the highest settlement amount in any immigration matter.[3] The release granted by the United States to Infosys under the settlement expressly carves out claims related to violations of federal tax laws.

Press reports following the Infosys settlement indicate that federal authorities are scrutinizing other IT companies from India for their alleged misuse of U.S. immigration laws. Based on the tax carve out in the Infosys release, foreign corporations should also be concerned about additional tax liabilities from the use of visiting employees. Thanks to certain peculiar features of the U.S.-India bilateral tax treaty (U.S.-India Tax Treaty)[4] discussed below, foreign corporations from India are particularly vulnerable to U.S. taxes if their employees have been frequently traveling to the United States on business.

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H-1 and B-1 Visas

For performing work in the U.S., a foreigner (alien) is required to obtain a work visa. The most frequently used work visa by foreign workers in the U.S. is the H-1 visa. However, the process of getting an H-1 visa is expensive, drawn out and subject to various conditions. These conditions include the obligation to pay prevailing wage, limitations on the type of services that are permitted, educational and other qualifications required of the alien, among others. As a result, many foreign corporations are inclined to send their home-country employees to the U.S., ostensibly for performing tasks not amounting to engaging in work or employment in the U.S., on short-term business visitor visas (the B-1 visa).

The B-1 visa is a visa for aliens who enter the U.S. for the purpose of conducting business. A B-1 visa-holder is permitted to engage in commercial transactions that do not involve gainful employment (such as a merchant who takes orders for goods manufactured abroad), negotiate contracts, consult with business associates, litigate legal disputes, participate in scientific, educational, professional or business conventions or conferences, or undertake independent research.[5] However, the visa holder is not permitted to work or enter into an employment relationship in the U.S.[6] Under Section 101(a)(15)(B) of the Immigration and Nationality Act, a B-1 visa holder may not come to the U.S. "for the purpose of…performing skilled or unskilled labor."

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In its complaint against Infosys, the government alleged, among other things, that Infosys submitted "invitation letters" to U.S. Consular Officials that contained false statements regarding the true purpose of a B-1 visa holder's travel in order to deceive U.S. consular officials and secure entry of the visa holder into the United States. According to the complaint, these letters often stated that the purpose of travel was for "meetings" or "discussions" when in fact, the true purpose was to engage in activities not authorized under a B-1 visa. Furthermore, it directed B-1 visa holders to deceive U.S. consular officials in order to secure entry into the United States. Additionally, Infosys failed to maintain satisfactory I-9 employment verification records.

Foreign corporations that have extensively used B-1 visas have relied, in part, on a practice tacitly permitted by the U.S. immigration authorities.[7] The practice, called "B-1 in lieu of H-1," is referenced in guidance materials issued to U.S. immigration adjudicators.[8] Under that practice, an alien who received no salary or remuneration from a U.S. source (other than an expense allowance or other reimbursement incidental to temporary stay) could enter the U.S. on a visitor's B-1 visa. Such an alien could perform services that primarily benefit an employer abroad (as for instance, an Indian employer such as Infosys). However, the Infosys complaint demonstrates that the "B-1 in lieu of H-1" practice was not a safe harbor for foreign corporations utilizing B-1 visas.

Tax Vulnerability

The Infosys complaint was filed by three U.S. departments: Justice, State, and Homeland Security. Notably missing was the Internal Revenue Service. The release the U.S. provided to Infosys under the settlement specifically carves out "any civil, criminal or administrative claims, investigations or prosecutions arising under Title 26 [Internal Revenue Code] of the United States or any regulations promulgated under the authority of any statute contained therein."[9]

Performance of work by foreign professionals in the United States has tax consequences. These potential consequences include the professionals' foreign employer being subject to (i) U.S. federal income and branch profits taxes and state taxes on income properly attributable to its U.S. activities for the period during which its employees performed services in the U.S., (ii) a duty to withhold federal income tax and Social Security tax from wages paid to such employees, and (iii) a duty to pay the employer portion of Social Security and unemployment taxes with respect to those employees. Further, the visiting foreign professionals might be subject to U.S. federal income tax on their earnings attributable to services performed in the United States.

As a general rule, bilateral tax treaties provide relief by limiting U.S. taxation of residents of the treaty country to only U.S.-sourced trade or business income which is attributable to or effectively connected with a "permanent establishment" in the United States. Under most tax treaties, a "permanent establishment" is defined as a fixed place through which the business of an enterprise is wholly or partly carried on, including a branch, an office, a factory a workshop, etc.

Most U.S. bilateral tax treaties are modeled on what is known as the U.S. Model[10] tax treaty or the OECD Model[11] tax treaty. The India-U.S. Tax Treaty, however, is modeled on the so-called UN Model[12] treaty preferred by India. That form of treaty is intended to protect developing countries by giving them greater opportunity to tax foreign enterprises. A key feature of the UN Model treaty is that it has a lower threshold for finding a permanent establishment than the U.S. or OECD Models.

Under the UN Model treaty, the furnishing of services by employees of a foreign enterprise in the other country for a period or periods aggregating more than six months within any 12-month period results in that enterprise having a permanent establishment in the country where the services are performed. There is no comparable provision under the U.S. Model and the OECD Model treaties.[13]

Companies affected by the U.S.-India Tax Treaty are distressed to find that that treaty has a threshold that is even lower than that contained in the UN Model treaty. Under the U.S.-India Tax Treaty, the furnishing of services by employees of the foreign corporation in the other country for a period or periods aggregating more than 90 days within any 12-month period,[14] or the performance of services for a related enterprise,[15] results in the foreign corporation having a permanent establishment in the other country (here, the U.S.).

In other words, an Indian corporation whose employees collectively perform services in the United States for 90 days or more in any 12-month period is deemed to have a permanent establishment in the United States even if the corporation had no branch, office, factory, workshop, etc. in the United States. Accordingly, such a corporation is subject to U.S. taxes and is required to file annual federal and state income tax returns. Worse, both the corporation and the employees could potentially be subject to payroll taxes and obligations to file payroll returns, even if an individual foreign employee might have spent a fraction of the 90-day period in the U.S.

The foregoing onerous provision of the U.S.-India Tax Treaty makes Indian corporations particularly vulnerable to violating U.S. tax laws if foreign employees of the corporation have frequently visited the United States for the performance of services. It is no surprise therefore that the United States expressly carved out violations of tax laws from the release it granted under the Infosys settlement.

Lesson

The Infosys settlement indicates that corporations sending foreign professionals to perform services in the United States should expect to face greater immigration and tax scrutiny going forward. Such corporations should promptly review their immigration and tax practices associated with their employees' visits to the United States to ensure compliance with U.S. laws.

1. See http://www.foreignlaborcert.doleta.gov/pdf/Statistics_FY%202013_YTD_Q4_final.pdf <site last visited Dec. 27, 2013>.
2. Many of the allegations in the complaint first appeared in a separate whistleblower suit brought by an employee of Infosys in 2011. The whistleblower suit was decided on unrelated state law claims. *Palmer v. Infosys Technologies Limited*, Case No. 2:11-cv-217 (M.D. Alabama).
3. A copy of the settlement (Infosys settlement) is available at http://www.ice.gov/doclib/news/releases/2013/131030plano.pdf <site last visited Dec. 27, 2013>.
4. Tax Convention with the Republic of India, Jan. 1, 1991 (the U.S.-India Tax Treaty). See http://www.irs.gov/pub/irs-trty/india.pdf <site last visited Dec. 27, 2013>.
5. U.S. Foreign Affairs Manual (FAM), Volume 9, §41.31 note 8.
6. FAM, Volume 9, §41.31 note 7(a).
7. See, for example, Kurzban's Immigration Law Sourcebook, 11th Edition, American Immigration Law Foundation, page 645, and Immigration Law and Procedure, Matthew Bender, §2:14.05[3].
8. See, for instance, Immigration and Naturalization Service Operating Instruction 214.2(b), and the website of the U.S. Consulate General in Chennai, India, at http://chennai.usconsulate.gov/types_of_visas/temporary-employment-holp/b1-in-lieu-of-h2.html <site last visited Dec. 27, 2013>.
9. Infosys settlement, page 21.
10. United States Model Income Tax Convention of Sept. 20, 1996 (U.S. Model).
11. Articles of The Model Convention With Respect To Taxes on Income and on Capital (OECD Model).
12. United Nations Model Double Taxation Convention between Developed and Developing Countries (UN Model).
13. The U.S. appears to also have a similar provision in its treaty with Thailand. Generally, the treaty position of the U.S. in conventions with other developing countries is the furnishing of services for 183 or more days.
14. See Article 5(2)(l)(i).
15. See Article 5(2)(l)(ii). For purposes of the treaty, an enterprise of one country is related to an enterprise of the other country if one of the enterprises participates directly or indirectly in the management, control, or capital of the other enterprise. The enterprises are also related if the same persons participate directly or indirectly in the management, control or capital of both enterprises.