

## MEMORANDUM

DATE: March 14, 2008  
TO: Avmar Tax Files  
FROM: Bucci Law Offices, P.A.\*  
RE: Withholding responsibilities and liabilities with respect to wages paid to yacht crew members

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### Purpose

The purpose of this memorandum is to analyze the United States federal tax withholding requirements with regard to the payment of wages to nonresident alien yacht crew members through a foreign-based company. There are many potential pitfalls associated with paying wages to nonresident aliens including, but not limited to, the correct sourcing of income, allocation issues, and, if those wages are subject to tax, the identification of the person or entity responsible for withholding. The Internal Revenue Service (I.R.S.) provides for fees and civil penalties for the failure to properly collect and remit taxes. Thus, adherence to the rules set forth by the I.R.S. is imperative. This memorandum will interpret the applicable Internal Revenue Code (I.R.C.) rules and provide an analysis of liabilities for remitting such taxes to the United States government.

### Facts

AvMar International LLC ("AvMar") is a foreign limited liability company. AvMar pays crew members aboard various yachts through an offshore bank account. The yachts at issue are foreign flagged and employ between two (2) and twenty (20) crew members of various nationalities. The crew positions include, but are not limited to, Captain, First Mate, Stewardess, Boatswain Mates, Chef, and Engineer.

With regard to U.S. citizens or residents working onboard a U.S. flagged vessel, federal tax withholding applies without question, just as it applies to any U.S. citizen or resident under I.R.C. § 3402. As such, this issue will not be discussed further in this memorandum.

### Issues

1. Are nonresident alien crew members working onboard a foreign flagged yacht subject to the United States Internal Revenue Code's federal tax withholding requirements?
2. Who is responsible for withholding?

Section 3402(a)(1) of the I.R.C. provides the general withholding rule and states that every employer making the payment of wages is required to withhold federal income taxes. Section 1441 also requires withholding with respect to nonresident aliens and states that any

person paying wages, compensations, or remunerations constituting U.S. source gross income must deduct and withhold 30% thereof.

According to I.R.C. § 1441(c)(4), the regulations may exempt compensation for personal services. Treasury Regulation § 1.1441-4(b)(1)(i) states that withholding under § 1441 is not required if the personal service compensation of the nonresident is subject to withholding under I.R.C. § 3402.

The withholding statutes apply only to U.S. source income. Section 861 defines income from sources within the U.S. –

(a) Gross income from sources within United States. The following items of gross income shall be treated as income from sources within the United States:

(3) Personal services. Compensation for labor or personal services performed in the United States; except that compensation for labor or services performed in the United States shall not be deemed to be income from sources within the United States if--

(A) the labor or services are performed by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of 90 days during the taxable year,

(B) such compensation does not exceed \$ 3,000 in the aggregate, and

(C) the compensation is for labor or services performed as an employee of or under a contract with--

(i) a nonresident alien, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, or

(ii) an individual who is a citizen or resident of the United States, a domestic partnership, or a domestic corporation, if such labor or services are performed for an office or place of business maintained in a foreign country or in a possession of the United States by such individual, partnership, or corporation.

*In addition, compensation for labor or services performed in the United States shall not be deemed to be income from sources within the United States if the labor or services are performed by a nonresident alien individual in connection with the individual's temporary presence in the United States as a regular member of the crew of a foreign vessel engaged in transportation between the United States and a foreign country or a possession of the United States. (emphasis added)*

The flush language of § 861(a)(3), found above, was added as a part of the Taxpayer Relief Act of 1997 (section 1174; Public Law 105-34) and applies for taxable years after December 31, 1997.

## Summary

Whether nonresident alien crew members working onboard a foreign flagged yacht are subject to federal tax withholding requirements depends largely on the facts and circumstances of each case.

Upon retaining AvMar Payroll Services, clients will be assisted in sorting through their own individual facts and circumstances so that a thorough evaluation of I.R.C. requirements and liabilities can be prepared.

**\*CIRCULAR 230 DISCLAIMER:** The IRS now requires written advice (including electronic communications) regarding one or more Federal (i.e., United States) tax issues to meet certain standards. Those standards involve a detailed and careful analysis of the facts and applicable law which we expect would be time consuming and costly. We have not made and have not been asked to make that type of analysis in connection with any advice given in this e-mail. As a result, we are required to advise you that any Federal tax advice rendered in this e-mail is not intended or written to be used and cannot be used for the purpose of avoiding penalties that may be imposed by the IRS.

In the event you would like us to perform the type of analysis that is necessary for us to provide an opinion that does not require the above disclaimer, as always, please feel free to contact us directly.

\*Disclaimer: This memorandum is intended to serve as a guide, with a broad overview of some of the federal tax requirements and consequences under the above-described facts. Each client's facts and circumstances vary and should be evaluated individually in order to determine the proper tax treatment. We do not guarantee that the methods discussed in this memorandum will apply to a specific client's situation and strongly recommend that each client obtain independent and competent tax advice regarding these matters.

For more information please contact, Christin M. Bucci is a C.P.A. and a practicing attorney, with an LL.M. in both Taxation and International and Comparative Law. She has an extensive background in Tax Law, which includes serving as a manager at PricewaterhouseCoopers. Christin is the founder of Bucci Law Offices, P.A., a full-service, boutique law firm, serving local, national, and international clients, and specializing in Tax Law.