DISCLAIMER

The information contained in this presentation is current as of the date it was presented. It should not be considered official guidance.
INTRODUCTION

• This webinar is intended to provide basic rules governing the tax treatment of income for foreign persons.

• It reflects the interpretation by the IRS of tax laws, regulations, and court decisions.

• The explanations are intended for general guidance only, and are not intended to provide a specific legal determination with respect to a particular set of circumstances.
INTRODUCTION

• Additional research may be required before a determination may be made on a particular issue. You may find additional information on the IRS website at www.irs.gov.

• You may also want to consult a tax advisor to address your particular situation.
GLOBALIZATION AND YOU

• The globalization of taxpayers and financial transactions affect all segments of the economy, including the government entity sector.

• It is important that entities dealing with vendors, employees, and various service providers, have an understanding of the basic rules and provisions governing transactions with international implications.

• This includes sourcing of income, withholding and reporting requirements.
THE IMPORTANCE OF U.S. IMMIGRATION LAW

• Immigration laws use categories of immigrants, nonimmigrants and illegal aliens.

• Tax laws refer to foreign persons, resident aliens (RA) and nonresident aliens (NRA).
THE IMPORTANCE OF U.S. IMMIGRATION LAW

Basic knowledge of U.S. immigration law is needed to:

• Determine U.S. tax residency of aliens
• Determine U.S. FICA tax liability of aliens
• Interpret some tax treaty articles
IMMIGRANT

• An alien who has been granted the right to reside permanently and work without restrictions in the U.S.

• Also known as a Lawful Permanent Resident (LPR). All immigrants are eventually issued a “green card” (United States Citizenship and Immigration Services (USCIS) Form I-551).

• LPR’s who are awaiting the issuance of their green cards may bear an I-551 stamp in their passports.
NONIMMIGRANT

• An alien who has been granted the right by the USCIS to reside temporarily in the U.S.

• Each nonimmigrant is admitted into the U.S. in the nonimmigrant status which corresponds to the class of visa with which, or purpose for which, he or she entered the U.S.
ILLEGAL ALIEN

• Also known as an “Undocumented Alien”.

• An alien who has entered the U.S. illegally and is deportable if apprehended, or

• An alien who entered the U.S. legally but who has fallen “out of status” and is deportable.
REMINDER

An employer who hires illegal aliens, or aliens who are working in violation of their nonimmigrant status, is expected to report and withhold taxes on payments to the aliens; just as it would with respect to payments to legal aliens and U.S. citizens.
FOREIGN PERSONS

A foreign person includes a nonresident alien individual, foreign corporation, foreign partnership, foreign trust, a foreign estate, and any other person that is not a U.S. person.
FOREIGN PERSONS

• Both the foreign person and the U.S. withholding agent are personally responsible for taxes on U.S. sourced income.

• Unsatisfied tax obligations of a foreign person will be sought from the U.S. withholding agent by the IRS.
TAXATION OF RESIDENT AND NONRESIDENT ALIENS

- Resident aliens and nonresident aliens can receive income as individuals, employees and as independent contractors.

- Resident Aliens are taxed on their worldwide income.

- Nonresident Aliens are taxed on their income from sources within the U.S. and on income that is effectively connected to a trade or business in the U.S.
VISA FACTS

• A visa allows a nonimmigrant to enter the U.S. in one of several different categories, which correspond to the purpose for which the nonimmigrant is being admitted to the U.S. For example, a foreign student will usually enter the U.S. on an F-1 or J-1 visa.

• The time limit on a visa is shown on the foreign alien’s Form I-94, Arrival and Departure Record.
COMMON VISAS

• F-1, J-1, M-1, Q-1 and Q-2
• H-1b and H-1c
• O-1 and TN
COMMON VISAS

• Certain visas will exempt the nonresident alien individual from Social Security and Medicare taxes. For example, a teacher or trainee with a “J” or “Q” visa.

• Each situation has different parameters to be considered by the employer.

GREEN CARD TEST

• A foreign individual who is a lawful immigrant under the laws of the United States has met the “Green Card” test.

• The individual has been issued or is awaiting the issuance of a Form I-551 (“Green Card”).
SUBSTANTIAL PRESENCE TEST

This test contains two parts. Both parts must be passed for an individual to be considered a resident alien. See Publication 519 for an example.

- Part 1 – Days present in the current year must be at least 31, and
- Part 2 - The total of the following must be at least 183 days:
  - Current year days in U.S. x 1, plus
  - First preceding year days in U.S. x 1/3, plus
  - Second preceding year days in U.S x 1/6
EXAMPLE

The following is the 3-year travel history of Marie, a foreign individual.

<table>
<thead>
<tr>
<th>Year</th>
<th>#Days in US</th>
<th>Multiplier</th>
<th>Days Counted</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>122</td>
<td>1.000</td>
<td>122.00</td>
</tr>
<tr>
<td>2009</td>
<td>119</td>
<td>0.333</td>
<td>39.67</td>
</tr>
<tr>
<td>2008</td>
<td>136</td>
<td>0.167</td>
<td>22.67</td>
</tr>
</tbody>
</table>

The Result: 184.34
U.S. SOURCE INCOME

- Generally, nonresident aliens are taxed only on income from U.S. sources.

- The issue for the U.S. withholding agent is whether the U.S. sourced income is subject to withholding taxes or information reporting requirements.
U.S. SOURCE INCOME

• Generally, income is from U.S. sources if it is paid by domestic corporations, U.S. citizens, resident aliens or entities formed under the laws of the U.S. or a state.

• Income is also from U.S. sources if the property that produces the income is located in the U.S. or the services for which the income is paid were performed in the U.S.
Examples of income that may be from sources in the U.S. include:

- Compensation for personal services
- Interest and dividends
- Pensions and annuities
- Rental income
- Royalties
- Taxable scholarships and fellowship grants
- Other taxable grants, prizes and awards
FDAP INCOME

- **Nonbusiness** U.S. sourced income items such as:
  - Compensation for personal services
  - Interest and dividends
  - Pensions and annuities
  - Rental income
  - Royalties
  - Taxable scholarships and fellowship grants
  - Other taxable grants, prizes and awards
FDAP INCOME

• These are commonly referred to as “fixed or determinable annual or periodic income” – FDAP income, which require withholding taxes at 30% unless:
  – Covered by statutory rate (see Publication 515),
  – Reduced or exempt under a tax treaty, or
  – Considered to be effectively connected to the conduct of a U.S. trade or business
EFFECTIVELY CONNECTED INCOME (ECI)

• Generally, when a foreign person engages in a trade or business in the U.S., *all income* from sources in the U.S. connected with the conduct of that trade or business is considered effectively connected with a U.S. business.

• Income for services performed in the US is generally ECI.
EFFECTIVELY CONNECTED INCOME (ECI)

• Factors to consider in determining whether or not FDAP income is ECI:
  – Is the income from assets used in, or held for use in, the conduct of that trade or business, or
  – Were activities of that trade or business material factor in the realization of the income.

• After allowable deductions- ECI is taxed at graduated income tax rates applicable to U.S. citizens and resident aliens, and not the flat 30% rate. The payment of ECI is not subject to withholding, but reporting requirements exist.
THE WITHHOLDING AGENT

- Any person that has control, receipt, custody, disposal or payment of any item of income of a foreign person subject to Nonresident Alien (NRA) withholding.
- Responsible to withhold tax payments on U.S. source income.
- Responsible for correctly reporting income paid and withholding applied.
THE WITHHOLDING AGENT

• Potential civil penalties that withholding agents face:
  – The 100% penalty on the total amount of tax evaded.
  – The 20% accuracy-related penalty on the underpaid withheld taxes in the case of negligence.
  – A 75% penalty for the underpayment of withheld taxes in the case of civil fraud.
  – Additional taxes of 5% (to a maximum of 25%) for the negligent failure to file a return.
  – Additional taxes of 15% (to a maximum of 75%) for the fraudulent failure to file a return.
COMMON VISA TYPES
COMMON VISAS FOR EDUCATIONAL INSTITUTIONS

- F-1, issued to academic students.
- J-1, issued to exchange visitors – students, teachers, researchers, au pairs, physicians, trainees, flight trainees.
- M-1, issued to nonacademic students (practical training), vocational students.
OTHER COMMON VISAS

- H-1B, issued to workers in specialty occupations, such as scientist, engineers or computer programmers.
- H-1C, issued to foreign nurses.
- Q-1, issued to cultural exchange visitor; student or faculty.
- O-1, issued to individuals with extraordinary abilities in science, art, education, etc.
- TN, issued to teachers, engineers and scientist of Canada or Mexico pursuant to the NAFTA treaty.
SOCIAL SECURITY AND MEDICARE

F-1, J-1, M-1, Q-1/Q-2 VISAS FOR FOREIGN STUDENTS

Wages are exempt from social security and Medicare as long as the non-immigrant is a “non-resident alien”.

• Foreign students who have been in the U.S. for more than 5 calendar years become “resident aliens”.
SOCIAL SECURITY AND MEDICARE

F-1, J-1, M-1, Q-1/Q-2 VISAS
FOR FOREIGN STUDENTS

• Social security and Medicare tax exemption ceases when the payee becomes a “resident alien”, unless

• The student FICA exception applies, allowing them to be exempt from social security and Medicare. See Revenue Procedure 2005-11.
FEDERAL INCOME TAX WITHHOLDING

F, J, M, and Q VISAS
SCHOLARSHIPS AND FELLOWSHIP GRANTS

• There is no withholding on a qualified scholarship received by a candidate for a degree, regardless of whether the individual is a resident or nonresident alien.
FEDERAL INCOME TAX WITHHOLDING

F, J, M, and Q VISAS
SCHOLARSHIPS AND FELLOWSHIP GRANTS

• For nonresident alien students with an “F”, “J”, “M”, or “Q” visa, who receive a U.S. source grant or scholarship that is not fully exempt, withhold tax at 14% (or lower tax treaty rate) on the taxable part of the scholarship or grant that is not a payment for services.
However, if the student is not a candidate for a degree and the grant does not meet certain requirements, tax will be withheld at the 30% (or lower tax treaty) rate.
FEDERAL INCOME TAX
WITHHOLDING

F, J, M, and Q VISAS
SCHOLARSHIPS AND FELLOWSHIP GRANTS

• Any part of a scholarship or fellowship grant that is a payment for services is subject to graduated withholding rates applicable to U.S. citizens and resident aliens.

• See IRS Publications 515 and 519 for more information regarding scholarships and fellowship grants.
WITHHOLDING ON ALIENS EMPLOYED IN THE U.S.

- Identify all aliens (non-U.S. Citizens) on the payroll who were paid for dependent personal services (wages).

- Divide the aliens into two groups: “Resident Aliens” and “Nonresident Aliens”. Refer to IRS Publication 519 for more information on the residency status of aliens.

- Treat resident aliens the same as U.S. citizens. They are generally subject to social security, Medicare and federal income tax withholding, with some exceptions. A Form W-4 should be secured.
FEDERAL INCOME TAX WITHHOLDING

F-1, J-1, M-1, Q-1/Q-2 VISAS

• Resident aliens – graduated income tax rates applicable to U.S. citizens.

• Nonresident aliens – Withholding adjustment for NRAs for wages paid in 2011 discussed earlier applies. Form W-4 subject to special instructions discussed earlier also applies.
WITHHOLDING ON ALIENS EMPLOYED IN THE U.S.

• Nonresident aliens are also generally subject to social security and Medicare taxes, with some exceptions. Federal income tax, unless addressed by a tax treaty, is withheld per a procedure that requires the use of a chart and tables. See Chapter 9 of the 2011 Publication 15, Circular E, Employer’s Tax Guide, for specific instructions and an example.
WITHHOLDING ON ALIENS EMPLOYED IN THE U.S.

• Form 8233 is secured with respect to income exempt under a tax treaty.
• Form W-4 is secured with respect to income not exempt under a tax treaty, subject to special instructions, for the applicable number of withholding allowances claimed.
FORM W-4

• *Nonresident aliens who fail to file* Form W-4, or file an invalid Form W-4, shall have federal income taxes withheld at the rates pertaining to single status, zero withholding allowances, with no other special rules.

• The 2011 Form W-4 advises nonresident aliens to review IRS Notice 1392, *Supplemental Form W-4 Instructions for Nonresident Aliens*, before completing Form W-4 for special instructions that are required.
For income tax withholding purposes, nonresident aliens are subject to special withholding rules. An NRA:

- Cannot write “Exempt” on line 7.
- May claim only “Single” filing status on line 3, regardless of actual marital status.
- With certain exceptions, cannot claim more than one withholding allowance.
- Is required to write “Nonresident Alien” or “NRA” above the dotted line on line 6.
WITHHOLDING ADJUSTMENT FOR NRAs

• A procedure using a chart and tables applies for figuring the amount of income tax to withhold from the wages of nonresident alien employees performing services within the U.S.

• There are two steps required to calculate how much income tax to withhold from the wages. Chapter 9 of the 2011 Publication 15 provides an example explaining these steps.
WITHHOLDING ADJUSTMENT FOR NRAs

• The amounts added under the chart in Publication 15 are added to wages solely for calculating income tax withholding on the wages of the NRA employee.

• The chart amounts should not be included in any box on the employee’s Form W-2 and do not increase the income tax liability of the employee.
WITHHOLDING ADJUSTMENT FOR NRAs

• Also, the chart amounts do not increase the social security or Medicare tax liability of the employer or the employee.

• Pursuant to Article 21 of the US-India Income Tax Treaty, nonresident alien students and business apprentices from India are not subject to this special procedure for determining withholding.
EXEMPTIONS FROM WITHHOLDING FEDERAL INCOME TAX ON AliENS EMPLOYED IN THE U.S.

• Some *nonresident aliens* are eligible for exemptions from federal income tax withholding on some or all of their wages because of tax treaties.

• To claim an applicable exemption, they must file Form 8233 with their employer.
Totalization Agreements

- The U.S. has social security agreements (also known as totalization agreements) with many countries, to eliminate dual taxation and coverage.
Totalization Agreements

• Compensation may be exempt from social security and Medicare taxes under one of these agreements.

• More information and a list of agreement countries can be found at www.socialsecurity.gov/international or see Chapter 7 of IRS Publication 15-A, Employers Supplemental Tax Guide.
REPORTING WAGES PAID TO ALIENS EMPLOYED IN THE U.S.

• **Resident Aliens** – Reported on Forms 941 or Form 944 and W-2 in the normal manner.

• **Nonresident Aliens** – Report wages that are exempt under a tax treaty on Forms 1042 and 1042-S. Any additional wages paid over and above the exempt amount are reported on Forms 941 or Form 944 and Form W-2 in the normal manner.
REPORTING WAGES PAID TO ALIENS EMPLOYED IN THE U.S

- Even in situations in which all of a nonresident alien’s wages are exempt from federal income tax under a tax treaty, and in which all federal wages would be reported on Form 1042-S, the filing of a Form W-2 is usually still required to report state and local wages and income taxes withheld.
INDEPENDENT CONTRACTOR PAYMENTS
REPORTING AND WITHHOLDING REQUIREMENTS ON INDEPENDENT PERSONAL SERVICES PAID TO FOREIGN PERSONS ON U.S. SOURCE INCOME

In general, an entity must withhold 30% of any payment of an amount subject to withholding made to a payee that is a foreign person unless it can reliably associate the payment with documentation that establishes:

• the payee is a U.S. person or
REPORTING AND WITHHOLDING REQUIREMENTS ON INDEPENDENT PERSONAL SERVICES PAID TO FOREIGN PERSONS ON U.S. SOURCE INCOME

Withhold 30% unless you can reliably associate the payment with documentation that establishes:

• the payee is a foreign person who is the beneficial owner of the income and is entitled to a reduced rate of withholding.

• A beneficial owner is a person who has the right to the economic enjoyment of the income.
• **Resident Aliens** who are recipients of U.S. source income from independent personal services are treated as U.S. persons and Form W-9 should be secured.

• For individuals, the taxpayer identification number (TIN) on Form W-9 is generally an SSN. However, in some cases, an Individual Taxpayer Identification Number (ITIN) may be used. See the Instructions for the Requester of Form W-9.
DOCUMENTATION REQUIRED

*Foreign persons* who are recipients of U.S. source income need to submit one of several forms to document their identity and status for tax purposes.

Those discussed here are:

- Form W-8BEN
- Form W-8ECI
- Form 8233

Payers are responsible for requesting a Form W-8 from any persons they presume, or otherwise believe to be, a foreign person.
FORM W-8BEN

Foreign persons use this form to:

• Establish payee is not a U.S. person.

• Claim the payee is the beneficial owner of the income for which the W-8BEN is being provided.

• If applicable, claim a reduced rate of, or exemption from, withholding as a resident of a foreign country with which the U.S. has an income tax treaty on income that is not personal services income (such as rental income). A U.S. TIN is required in most instances. A TIN may be an SSN, EIN, or ITIN.
FORM W-8BEN

This form *should not be used* by a nonresident alien individual who claims exemption from withholding on compensation for *independent or dependent personal services* performed in the U.S. Form 8233 should be used in this situation.
FORM W-8ECI

• Used by a foreign person to claim exemption from 30% withholding in cases in which the payee has Effectively Connected Income (ECI) (such as personal services income that is being treated as business profits under a tax treaty).

• Cannot be used by an NRA individual with personal service income.

• Must report payee’s U.S. TIN, or it is invalid.
ITIN

• An ITIN is an IRS individual taxpayer identification number.

• It is a nine-digit number beginning with the number “9”, has a “7” or “8” for the fourth digit, formatted like an SSN (9XX-7X-XXXX).

• It is issued to individuals who are required for U.S. tax purposes to have a U.S. TIN but who do not have, and are not eligible to obtain, a social security number.

• Form W-7 is used to apply for an ITIN.
PERIOD OF VALIDITY

• Forms W-8BEN (without a U.S. TIN) and W-8ECI will remain in effect from the date the form is signed and ending on the last day of the 3rd succeeding year received, unless a change in circumstances makes any information on the form incorrect.
PERIOD OF VALIDITY

• Example: If form was received on Sept 30, 2010, it will remain in effect until Dec 31, 2013.

• Form W-8BEN (with a U.S. TIN) will remain in effect until a change in circumstances makes any information on the form incorrect, provided the withholding agent reports on Form 1042-S at least one payment annually to the beneficial owner who provides the W-8BEN form.
Foreign persons who provide Form W-8BEN or Form W-8ECI (or applicable documentary evidence) are exempt from backup withholding and Form 1099 reporting.
PRESUMPTION RULES

• If a payment cannot be associated with valid documentation, the presumption rules must be applied to ensure the proper amount of tax is withheld. See Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Entities.*
PRESUMPTION RULES

• These rules must be followed if you know, or have a reason to know, that a Form W-8 or other evidence provided is incorrect or unreliable.

• If you complied with this rule, you are not liable for tax, interest, or penalties even if the rate of withholding that should have been applied based on the payee's actual status is different from that presumed and withheld.
FORM 8233

An NRA uses Form 8233 to claim tax treaty exemption for some or all income from:

- Independent personal services (independent contractor services)
- Dependent personal services (wages)
Use Form 8233 to claim tax treaty exemption for some or all income from:

- Personal services income and noncompensatory scholarship or fellowship income from the same withholding agent.
- And/or to claim a personal exemption amount to reduce independent personal services income.
- Generally required to have an SSN, however, an ITIN may be used.
PROCESSING FORM 8233

• NRA individual provides three copies to Payer.

• Payer reviews the form and signs the certification in Part IV.

• Payer mails one copy of Form 8233, including any attachments submitted by the NRA, to the IRS within 5 days of receipt.

• Payer gives one copy to the NRA individual and one copy is kept by the entity.

• Form 8233 must be completed every year.
SPECIAL RULES FOR INDEPENDENT PERSONAL SERVICES

- Personal Exemption

- Final Payment Exemption
PERSONAL EXEMPTION

• Pay subject to the 30% (or lower tax treaty) rate may be reduced by a personal exemption amount ($3,700 for 2011).

• NRA is generally allowed one personal exemption.

• Residents of Canada, Mexico, or South Korea; a student or business apprentice from India; and U.S. nationals* are generally entitled to the same exemptions as U.S. citizens.
PERSONAL EXEMPTION

• Each allowable exemption must be prorated according to the number of days in the tax year during which the alien performs services in the U.S.

(*U.S. national refers to a citizen of American Samoa or the Northern Mariana Islands who chose to become a U.S. national instead of a U.S. citizen.*)
FINAL PAYMENT EXEMPTION

• The final payment for compensation during the tax year for independent personal services may be entirely or partly exempt from withholding.

• The nonresident alien must file specific information with the IRS. See IRS Publication 519.

• The IRS will determine the amount of the nonresident alien’s tentative income tax for the tax year.
FINAL PAYMENT EXEMPTION

• A letter, directed to the payer, will be sent to the nonresident alien showing the amount of the final payment that is exempt from withholding and the final amount that can be paid to the alien.

• The nonresident alien must give two copies of the letter to the payer.

• This exemption is available only once during the tax year and applies to a maximum of $5,000 of compensation.
**FORM 1042**

*Form 1042* is an annual withholding tax return used to report payments and income tax withholding from a Forms 1042-S.

- It reports the aggregate of NRA payments;
- NRA withholdings; and
- Tax deposits made.
FORM 1042-S

• Reportable for any amount in excess of 0 – there is no minimum amount that triggers a filing requirement.

• Withhold at 30% or lesser tax treaty rate.

• Reportable to individuals, partnerships, corporations, trusts and estates.

• A Form 1042-S is required even if the entire amount of compensation is exempt from tax under tax treaty provisions.

• Failure to file and failure to furnish penalties under IRC 6721 and 6722 are applicable.
FORM 1042-S

• Examples of payments to be reported on the Form 1042-S:
  – Wages exempt under a tax treaty;
  – Compensation and withholding for personal services performed in the U.S.
  – Scholarships, fellowships, grants or financial aid paid to NRA that is not excludable from gross income as a “qualified scholarship.”
Summary

• We’ve learned more about these topics today:
  – Globalization
  – The importance of U.S. Immigration law
  – Resident and nonresident alien tax status
  – U.S. Sourced income
  – The different withholding rules in the case of FDAP or ECI income
  – Nonresident alien individuals as an employee or independent contractor
ADDITIONAL SOURCES OF INFORMATION

• *Information For International Taxpayers*

• *New Developments in International Taxation*

• *Alien Taxation – Certain Essential Concepts*
ADDITIONAL SOURCES OF INFORMATION

• **Classification Of Taxpayers For U.S. Tax Purposes**

• **Determining Alien Tax Status**

• **Taxation of Resident Aliens**
ADDITIONAL SOURCES OF INFORMATION

- **Taxation of Nonresident Aliens**
  [http://www.irs.gov/businesses/small/international/article/0,,id=96477,00.html](http://www.irs.gov/businesses/small/international/article/0,,id=96477,00.html)

- **Taxation of Dual-Status Aliens**

- **Tax Withholding on Foreign Persons**
  [http://www.irs.gov/businesses/small/international/article/0,,id=106981,00.html](http://www.irs.gov/businesses/small/international/article/0,,id=106981,00.html)
ADDITIONAL SOURCES OF INFORMATION

• *Tax Treaties*  

• *Taxpayer Identification Numbers*  
  [http://www.irs.gov/businesses/small/international/article/0,,id=96696,00.html](http://www.irs.gov/businesses/small/international/article/0,,id=96696,00.html)

• *Miscellaneous International Tax Issues*  
ADDITIONAL SOURCES OF INFORMATION


• *Amounts Subject to Reporting on Form 1042-S* [http://www.irs.gov/businesses/small/international/article/0,,id=102336,00.html](http://www.irs.gov/businesses/small/international/article/0,,id=102336,00.html)

• *Form 1042 Annual Withholding Tax Return for U.S. Source Income of Foreign Persons* [http://www.irs.gov/businesses/small/international/article/0,,id=102325,00.html](http://www.irs.gov/businesses/small/international/article/0,,id=102325,00.html)
ADDITIONAL SOURCES OF INFORMATION

- Publication 515, Withholding of Tax on Nonresident Aliens and Foreign Entities

- *Publication 15*, Circular E Employer’s Tax Guide


- *Publication 901*, U.S. Tax Treaties


- *FSLG Specialist(s) for your state* as found at [www.irs.gov/govt/fslg/article/0,,id=103384,00.html](http://www.irs.gov/govt/fslg/article/0,,id=103384,00.html)
COMMENTS

• We value your comments and would appreciate your feedback on this Webinar at:
  
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• If you have Federal Tax topics for Government Entities for future Webinars, please provide ideas at the above e-mail address