10 Common Misconceptions about the US Taxation of Foreign Nationals

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Foreign nationals are taxed like US citizens.
Some foreign nationals are taxed like US citizens
- US lawful permanent residents (green-card holders) and
- Nonimmigrants who meet the 183-day substantial presence test (SPT)

These foreign nationals are called “resident aliens” but a more descriptive term is “tax residents”
#1 Facts

- The SPT is a weighted average formula based on countable US days
  - All of the current calendar year’s US days (2010)
  - 1/3 of the preceding calendar year’s countable US days (2009)
  - 1/6 of the second preceding calendar year’s US days (2008)
- Partial US days do count
- But some US days do not count
  - See IRS Publication 519
Some foreign nationals are taxed under a special tax regime
- US-source income only some taxed on a gross basis
- No standard deduction
- Few deductions and one personal exemption
- Single or married-filing-separately rates
- Few credits
- Form 1040NR or 1040NR-EZ tax return

These foreign nationals are called “nonresident aliens” but a more descriptive term is “tax nonresidents”
#1 Facts

- Employers and payers must use special withholding and reporting rules for income payments to these tax nonresidents
  - Special wage withholding and Form W-4 rules
  - 30% NRA withholding for non-wage income payments
    - 14% withholding for taxable scholarships and fellowships of F, J, M, or Q recipients
  - Form 1042-S, not Form 1099 reporting
“Exempt individual” means exempt from tax.
“Exempt individual” means exempt from counting US days under the SPT

- F, J, and M students are exempt from counting days for 5 calendar years
- J and Q nonstudents are exempt from counting US days for 2 out of the current 7 calendar years

These exempt (from counting days) individuals must consider calendar years during prior visit in F, J, M, or Q status
Foreign nationals aren’t subject to tax if they are in the United States for less than 183 days.
#3 Facts

- Tax nonresidents are subject to US tax on their US-source income regardless of the amount of time they are in the United States unless an exception applies
  - Tax residents are subject to US tax on their worldwide income in the same manner as US citizens

- US-source income includes
  - Compensation for US work days unless an exception applies
  - Scholarship and fellowship grants if
    - They are for study or research in the United States and
    - Paid by a US grantor
  - Prizes and awards granted by a US resident
There are 3 compensation exceptions

- The commercial traveler rule – less than 90 days, less than $3000 in the aggregate, and paid by a foreign employer
  - Foreign governments are not included in the definition of foreign employer
  - Foreign nonservice grants are not compensation for this purpose
- A nonimmigrant in F, J, M, or Q status employed and paid by a foreign employer
- A tax treaty exemption if employed and paid by a foreign employer and the maximum US days are not exceeded
  - The maximum is typically 183 US days but some treaties specify as few as 89 days
  - But we only have treaties with 65 countries!
Foreign nationals are not subject to Social Security and Medicare taxes (FICA).
Compensation for employment performed in the United States is subject to FICA unless an exception applies.

There are two exceptions that might apply to foreign national workers:

- The Student FICA Exception under the same rules as US citizens
- The NRA FICA Exception but only for
  - F-1, J-1, M-1, and Q-1/Q-2 status individuals
  - Who are tax nonresidents

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#4 Facts

- FICA is refundable if it was withheld in error but not on the individual’s US tax return
  - Form 843 Claim with Form 8316
- FICA is not refundable even if the worker will never vest for FICA purposes (It’s a tax!)
Scholarships, fellowships, and stipends are not subject to tax.
#5 Facts

- Qualified scholarships and fellowships are not subject to tax or reporting if the recipient is a candidate for a degree at an educational institution
  - Tuition and required fees
  - Fees, supplies, and equipment required for all participants in a course of study

- All other scholarship and fellowship grants are subject to tax (regardless of their name)
  - Room and board and travel reimbursements
  - Taxed as wages if services are required in return for the grant

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#5 Facts

- But taxable scholarship and fellowship grants are not subject to income reporting if the recipient is a US citizen or a tax resident
  - Form 1098-T is not income reporting (it is for education credit purposes)
  - Taxable grants must be recorded on Form 1040 under wages with “SCH” on the dotted line

- Taxable scholarship and fellowship grants paid to or on behalf of tax nonresidents are subject to NRA withholding and Form 1042-S reporting
  - Taxable grants must be recorded on Form 1040NR or 1040NR-EZ
Travel expense reimbursements are not subject to tax.
Travel expense reimbursements are subject to tax unless

- The recipient is temporarily away from their tax home on business
  - Business means that the individual is performing services (employment or self-employment)
  - Assignments longer than one year are not temporary
- The expenses are reimbursed under an accountable plan
  - See the articles about travel reimbursements in *A View from the Crow’s Nest* archives available on www.windstar.com
Foreign students and scholars from treaty countries are not subject to tax.
Students and scholars from treaty countries might be eligible for tax treaty exemptions from tax if

- They came to the United States from the treaty country
  - Treaty eligibility is based on tax residence in the treaty country not citizenship
- They came for the purpose of the specific article (studying, training, teaching, or research)
  - Individuals who come for one purpose (F-2 dependents) who change status are not eligible for treaty benefits
Some treaties do not provide exemption for compensation for teaching and research.
Some treaties only provide benefits for studying and training if the amounts arise from outside the United States.
Some treaties provide benefits for:
- US-source scholarships and fellowships but not compensation for services (Russia)
- Compensation during study or training but no benefit for US-source scholarship and fellowship grants
Students and scholars must

- Meet the conditions of the treaty and article for an exemption from tax
- Provide the proper withholding certificate (W-8BEN or 8233) for exemption from withholding

If treaty-exempt income is not reported on Form 1042-S, they must provide the withholding certificate information with the tax return
Foreign students and scholars with only treaty-exempt income don’t have to submit a US tax return.
- Tax residents whose only income is treaty-exempt income reported on Form 1042-S are not required to submit a US tax return
- Tax nonresidents whose only income is treaty-exempt income must submit a Form 1040NR or Form 1040NR-EZ unless
  - Their treaty-exempt income is reported on page 1 but it is less than the personal exemption amount ($3,650)
  - Their only treaty-exempt income is reported on page 4 of Form 1040NR (dividends, royalties, etc.)
Foreign nationals can e-file.
#9 Facts

- Tax residents can e-file provided they have all necessary taxpayer identification numbers (TINs) for their tax return.
- Tax nonresidents may not e-file because the IRS has not yet specified e-filing for:
  - Form 1040NR or 1040NR-EZ or
  - Dual-status tax returns – part-year nonresidents and part-year residents.
Foreign nationals can use popular tax preparation software such as TurboTax.
Foreign nationals may use popular software such as TurboTax if
- They are full-year tax residents
- They have all necessary TINs for their tax return

Tax residents who have complex tax situations and disclosure requirements because of foreign assets or income from abroad may need a knowledgeable paid preparer.
#10 Facts

- Tax nonresidents may not use popular software which has no Form 1040NR or 1040NR-EZ tax return capability
Questions?

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