

I. Determining U. S. Residency Status

All individuals can be classified in one of four groups for U.S. tax purposes:

- U. S. Citizen
- Permanent Resident Alien (*"green card" which is usually pink*)
- Resident Alien for tax purposes
- Nonresident Alien for tax purposes

U. S. Tax System

- Taxed on world-wide income
- Receives Forms W-2 and 1099
- Files Form 1040 tax return
- Eligible to itemize deductions
- May claim unrestricted withholding allowances

Nonresident Alien Tax System

- Taxed only on U. S. sourced income
- Receives Forms 1042-S and W-2
- Never receives a Form 1099
- Files Form 1040NR / 1040NR-EZ
- May NOT itemize deductions
- May not claim standard deduction
- Restricted withholding allowances

To identify a Resident Alien or a Nonresident Alien for tax purposes, the Substantial Presence Test must be performed. This test counts the number of days present in the United States during a period of three calendar years according to the following formula:

	Number of Days		Total
Current Year	-----		-----
1 st Preceding Year	-----	Divide by 3 =	-----
2 nd Preceding Year	-----	Divide by 6 =	-----
			TOTAL -----

If the TOTAL is less than 183 days, the individual is a Nonresident Alien for tax purposes. If the TOTAL is equal to or greater than 183 days, the individual is taxed just like a U. S. Citizen.

Exemptions from the Substantial Presence Test:

The following situations exempt individuals from counting the days present in the United States:

Visa Type

F, J, M, Q	Students	Exempt five calendar years
J or Q	Non-Students (Scholars)	Exempt two of the past six calendar years

In the above instance, the word "Exempt" has nothing to do with whether the individual is exempt from Social Security, federal income tax or filing an income tax return.

J-1 Visa - What is "primary purpose" for being present in the U. S.? Find this information on line 4 of the *Immigration Form IAP-66*. Could impact decision to withhold Social Security and Medicare tax.

II. Determining Taxable Income

All income paid to a Nonresident Alien is taxable unless otherwise excluded. There are only three ways to exclude income:

- Foreign Source Income
- Internal Revenue Code
- Income Tax Treaty

Compensation is sourced at the location where the activity is performed. If the location of activity is outside the United States, the income is not taxable and not reportable.

Internal Revenue Code Exclusion Non-Compensation Section 117 (Qualified Scholarship)

To qualify for exclusion under Section 117, the income must be:

- A Qualified Scholarship
- Received by a candidate for a degree
- Awarded in order to study at an educational organization

Qualified
(non-taxable)

- Tuition
- Required Enrollment / Attendance Fees
- Required books, supplies, equipment
- Reportable on Form 1042-S only through 12/31/2000

Non-Qualified
(Taxable)

- Stipend (living allowance)
- Room / Housing
- Board / Meals
- Travel
- Cash
- Non-required equipment
- Reportable on Form 1042-S

To qualify as a "candidate for a degree", the individual must attend an institution or organization that regularly grants degrees – it is not required that the individual be enrolled in a degree-granting program.

If payment is made for teaching, research or other services, it is considered compensation not scholarship or fellowship.

Scholarship and fellowship and grant, allowance and award refer to payments that do not require the performance of a service. These payments may not be taxable and will be reported on Form 1042-S. If the individual is required to perform a service, the payment is considered compensation, is taxable and will be reported on Form W-2.

Does an income tax treaty exist between the United States and the individual's country of residence?

Tax Treaty Exemption Forms

- Form 8233 is used for Dependent (employee) and Independent (non-employee) compensation. Only good for one year. Must be renewed annually in January if tax exemption is to continue. Employer must review, sign and mail form to IRS within five (5) days of receipt.
- Form W-8BEN is used to claim a reduced rate or exemption from withholding as a resident of a foreign country (replaces Form 1001 January 2001). Form is valid for three years and must be given to employer. Form is retained for four years after the last year of tax treaty exemption.

Compensation paid to a Nonresident Alien employee is subject to special graduated withholding rates. The Form W-4 must be completed as indicated below:

- Single
- One Withholding Allowance
- An additional \$7.60 per week

If no W-4 Form is received, then tax at *Single* rate and zero allowances.

The standard rate of tax withholding for a Nonresident Alien is 30%, but there are several exceptions:

- Income excluded as foreign source under Internal Revenue Code or by Income Tax Treaty.
- Reduced rate (14%) for scholarship/fellowship payments to F, J, M, Q Visa holders.

- Per diem payments under USAID contracts.
- Employees working outside the United States
- Compensation to employees

III. U. S. Tax Reporting Responsibilities

Form 1042-S is used to report:

- All employee compensation payments that are exempt from taxation under an income tax treaty.

and

- All other taxable income paid to a Nonresident Alien.

Form 1042-S is used to report:

- Type of income
- Gross income paid
- Applicable rate of tax withheld or reason for exemption from withholding
- Total tax withheld
- Country of residence

Individual may receive a Form 1042-S and a Form W-2; only a Form 1042-S or only a Form W-2. Individual should never receive a Form 1099.

IV. FICA Tax Withholding or OASI (Old Age & Survivors Insurance) or Social Security and Medicare Tax

A. In order for an individual to be exempt from FICA tax withholding under Sec. 3121(b)(19), an individual must be:

- A Nonresident Alien;
- Present in the U.S. under an F-1, J-1, M-1 or Q-1 Visa; and
- Performing services in accordance with the primary purpose of the visa's issuance

These visa holders will be considered Nonresident Aliens regardless of the number of days present in the U. S. for a two or five year period (depending upon if they are a "teacher or trainee" or a "student". When F-1, J-1, M-1 or Q-1 Visa holders stay beyond these time periods but are still considered Nonresident Aliens under a treaty with the alien's country of residence, there can be a situation where wages are excluded by treaty from income tax withholding but are still subject to FICA withholding. FICA tax applies retroactively to the beginning of the calendar year in which the residency status occurred. Time periods for which NRA's are claiming this exemption must be monitored to ensure that FICA is properly withheld where appropriate.

B. Exemption Under Internal Revenue Code Sec. 3121(b)(10)

Payments to Nonresident Aliens enrolled and regularly attending classes may be exempt from FICA under the student FICA exemption. Section 3121(b)(1) sets forth the student FICA exemption which generally provides that a student who works for the school at which he/she is enrolled and regularly attends classes is exempt from the FICA tax. This exception applies to U.S. citizens and Nonresident Alien Students.

C. Application of Tax Treaties to FICA Tax Withholding

With the exception of the tax treaty with the former USSR, income tax treaties apply only to federal income tax withholding. Therefore, an exemption from FICA tax withholding is usually only allowed under Sec. 3121(b) of the Internal Revenue Code.

D. Social Security "Totalization" Agreements

The United States has bilateral Social Security agreements with 17 countries. The agreements eliminate dual Social Security coverage and taxes and improve benefit protection for workers who have divided their careers between the United States and another country.

To utilize the totalization agreement as an exemption for U.S Social Security tax, the foreign employee must prove either he/she or a third party on his/her behalf is continuing to pay the Social Security tax to his/her country for the income that he/she earns while working in the U.S. Employees may establish this by providing a "coverage certificate" from their home country Social Security authorities.

If you want to know more about international Social Security Agreements, call the Social Security Administration's Office of International Policy (OIP) at (410) 965-3548 or (410) 965-3554. You may also obtain the details about each agreement from their World Wide Web address:

http://www.ssa.gov/international/inter_intro.html

V. Summary

A. Employees

1. All Nonresident Alien (non U.S. citizens) employees must be identified.
2. The aliens must be divided into two groups: "Resident Aliens" and "Nonresident Aliens" as defined by Internal Revenue Code Sec. 7701(b) or by a tax treaty.
3. For withholding tax purposes, treat Resident Aliens the same as U. S. citizens.
4. For withholding tax purposes, treat Nonresident Aliens according to the special withholding rules that apply to nonresidents.
5. Nonresident Aliens who refuse to attend a Tax Determination Interview and/or file a proper Form W-4 as required by IRS regulations shall have federal income taxes withheld at the rates pertaining to single status, zero exemptions allowed.
6. Some Nonresident Aliens are eligible for exemptions from federal income tax withholding because of tax treaties if they file IRS Form 8233 accompanied by the required statement as a result of attending a Tax Determination Interview.
7. WSU reports wages paid to a Nonresident Alien which are exempt under a tax treaty on Forms 1042-S. Any additional wages paid to a Nonresident Alien over and above the exempt amount are reported on Form W-2.
8. With certain exceptions, international students and scholars who are temporarily present in the U.S. on F-1, J-1, M-1 and Q-1 Visas are usually exempt from withholding of Social Security and Medicare taxes. This exemption does not apply to spouses and children on F-2, J-2, M-2 and Q-2 Visas or to Nonresident Aliens who have become Resident Aliens or to Nonresident Aliens who have changed to any immigration status other than F-1, J-1, M-1 or Q-1.

B. Scholarships, Fellowships and Grants

1. All amounts paid to Nonresident Aliens in the form of scholarships, fellowships, grants and financial aid that exceed mandatory enrollment fees must be reported to IRS on Form 1042-S regardless of the amount paid unless the grant is from sources outside the United States, in which case the grant is neither reportable nor subject to withholding.
2. Payees who are temporarily present in the U.S. holding F-1, J-1, M-1 or Q-1 Visas are subject to withholding at 14% of the taxable portion of the grant. These individuals are considered to be engaged in a U. S. trade or business.

3. Some Nonresident Aliens are eligible for exemptions from federal income tax withholding because of tax treaties if they file IRS Form W-8BEN.
4. In general, those portions of a scholarship, fellowship or grant that are used to pay tuition, fees, books, supplies or equipment are not taxable under Sec. 117 of the Internal Revenue Code if the recipient is a candidate for a degree. Any portion of the scholarship, fellowship or grant over and above the five items mentioned above is taxable.
5. Stipends, tuition waivers or other financial aid paid to or on behalf of Nonresident Aliens which require the recipient to perform services in exchange for the financial aid (such as graduate assistantships) are taxable as wages and reportable to the IRS.

VI. Summary of Forms and Documents

A. U. S. and Naturalization Service Forms and Documents

- **Employer Information Bulletin 96-08: Employee or Independent Contractor?**, provides information on how to identify an independent contractor for INS purposes.
- **IAP-66, Certificate of Eligibility for Exchange Visitor (J-1) Status**, required for nonimmigrant exchange visitors.
- **Form I-9, Employment Eligibility Verification**, must be completed by each worker and is used by the agency to determine the worker's citizenship status, employment authorization and identification and registration numbers.
- **Form I-20, Certificate of Eligibility for Nonimmigrant (F-1) Student Status**, is to be completed by an official of the school attended by the F-1 Visa holder. The form is a certification concerning the educational program and financial support of the student.
- **I-94 Card, Departure Record**, issued to non-immigrant aliens upon arrival in the U. S. The departure record contains the alien's name, country of citizenship, date of birth, visa type and the date through which the alien may stay. Changes in the alien's status, extensions of stay and eligibility for employment may be noted.
- **Form I-151, Alien Registration Card (Green Card)** replaced March 20, 1996 with the I-551.

- **Form I-551, Alien Registration Receipt Card**, issued by the Immigration and Naturalization Service, is the official document to identify permanent resident aliens.
- **Visa**, an official endorsement of a passport indicating the owner has permission to enter or cross a particular country. The Visa type further identifies the primary purpose of the visit and relates to a section of law. In most instances, the section of law refers to the Immigration and Nationality Act. Non-immigrant Visas have one letter and one number or one letter. Immigrant Visas have either two letters and one number or one letter and two numbers, and the holders are classified as resident aliens.

B. Internal Revenue Forms and Publications

- **Form 8233, Exemption from Withholding on Compensation for Independent Personal Services of a Nonresident Alien Individual**, is required to be completed by the Nonresident Alien when he/she claims the personal exemption, a treaty exemption or both. WSU is responsible for monitoring the tax treaty benefit eligibility period for each individual who has filed a Form 8233.
- **Form W-7, Application for IRS Individual Tax Identification Number (TIN)**, is for individuals not otherwise eligible to receive a Social Security number.
- **Form W-8BEN, Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding**, is required for nonresident individuals to tell payor that individual is not subject to certain U. S. information return reporting or backup withholding rules. The form is also used to claim a reduced rate of or exemption from withholding as a resident of a foreign country with which the United States has an income tax treaty. The University is responsible for keeping all Forms W-8BEN and for monitoring the tax treaty benefit eligibility period for each student who has filed a Form W-8BEN. See the W-8BEN instructions for more details.
- **IRS Publication 15, Employer's Tax Guide**
- **IRS Publication 15A, Employer's Supplemental Tax Guide**
- **IRS Publication 515, Withholding of Tax on Nonresident Aliens and Foreign Corporations**
- **IRS Publication 519, U. S. Tax Guide for Aliens**
- **IRS Publication 520, Scholarships and Fellowships**

- IRS Publication 570, Tax Guide for Individuals With Income From U.S. Possessions
- IRS Publication 597, Information on the United States–Canada Income Tax Treaty
- IRS Publication 901, United States Tax Treaties
- IRS Publication 1542, Per Diem Rates
- IRS Publication 1915, Understanding Your IRS Individual Taxpayer Identification Number

IRS forms and publications may be ordered in several ways:

By Phone: **1-800-829-3676**

By Mail: **IRS Forms Distribution Center**
Western Area Distribution Center
3041 Sunrise Blvd
Rancho Cordova, CA 95742

By Computer: <http://www.irs.ustreas.gov>