



Federal Agency Seminar 2011

Withholding and Reporting of Tax on
Wage Payments to Foreign Persons



Objectives

- Know why tax residency is important
- Which income non-resident alien are subject to FIT withholding
- Introduce the special W-4 rules
- Know that non-resident aliens are subject to FICA tax

Income from independent personal services...

- Provided by a Non-Resident Alien is generally subject to 30% withholding for self employment income per Code § 1441

Income for personal services qualify as wages when...

- There is an employer-employee relationship
 - Individual who performs the services subject to the will and control of an employer
 - Employer has the legal right to control both the method and the result
- This is call dependent personal services



Tax Residency

- Resident Alien
- Non-Resident Alien
- Dual-Status Taxpayer

Tax residency is based on...

- Green Card Test – A lawful permanent resident of the U.S.
- Substantial Presence Test – Numerical formula for counting days of presence in the U.S. over a 3 year period



Exempt Individuals from the SPT

- 5-calendar-year non-resident rule for students. They are individuals typically issued an F, J, M or Q visa
- 2/7-calendar-year nonresident rule for teachers and trainees



Why tax residency?

- A resident alien is a U.S. Person, and is usually taxed the same as a U.S. citizen on their worldwide income
- A nonresident alien is a Foreign Person, and is subject to special rules of taxation on their U.S. source income



Source Rules on Fringe Benefits

- Housing – EE's main job location
- Education – EE's main job location
- Local transportation – EE's main job location
- Tax reimbursement – jurisdiction imposing tax
- Hazardous or hardship duty pay – location of pay zone
- Moving expense reimbursement – EE's new main job location



NRA employee income tax W/H

- NRA employee is subject to graduated W/H
- Income consists of salary, bonus or any other pay for personal services

Special withholding rules...

- Write "Nonresident Alien" or "NRA" above the dotted line on line 6 of Form W-4
- A nonresident alien cannot write "exempt" on line 7 of Form W-4
- A nonresident alien may claim only "single" filing status on line 3 of Form W-4, even if he is married

Special withholding rules...

- With certain exceptions, a nonresident alien cannot claim more than one personal exemption on Form W-4
- Exceptions are residents of Canada, Mexico, Korea, India



Computation of Withholding

- Add an amount to the non-resident alien's wages solely for calculating the income tax withholding for each payroll period.
- The amount to add changes each year

Amount to add for TY 2011 is...

Weekly	\$40.40
Bi-weekly	\$80.80
Semimonthly	\$87.50
Monthly	\$175.00
Quarterly	\$525.00
Semiannually	\$1,050.00
Annually	\$2,100.00
Daily or Miscellaneous	\$8.10



Income Tax Treaties

- Provide some exemptions from U.S. federal income taxes
- Do not generally provide exemptions for FICA/FUTA taxes.
- “Dependent Personal Services” or “Government Services” articles may provide an exemption for wages.



Income Tax Treaty Exemptions

- Must file Form 8233 with the withholding agent to claim a tax treaty exemption on any personal service income.
- If the W-8BEN is filed, it will be only valid telling the employer that they are a foreign person

Audit Tips

- Each Form 8233 must report the U.S. TIN of the treaty claimant, or the treaty claim is invalid (Treas. Reg. §1.1441-1(e)(4)(vii))
- Verify the tax treaty exemption, because the IRS examiner will
- Form 8233 good for the tax year and the income listed



Employer Reporting Requirements

- Employers must report exempt wages under a tax treaty to a non-resident alien on Forms 1042 and 1042-S
- Wages paid to non-resident alien not exempted are included on the Forms 941 and W-2

All wages subject to FICA if the services are performed...

- Within the U.S. by U.S. citizens, resident aliens, and nonresident aliens;
- Outside the United States by U.S. citizens and resident aliens if paid by an American Employer;
- On board American ships and aircraft if certain conditions are met; or
- In accordance with conditions recognized in a Totalization Agreement with a foreign country.



NRA Exceptions to FICA Liability

- NRA performing services allowed under F-1, J-1, M-1 or Q-1/Q-2 visa status; and
- The services being performed is the purpose they were admitted into the U.S.A.

NRA Exceptions to FICA Liability

- FICA tax exemptions which apply to U.S. citizens may also apply to non-resident aliens
- For a list of other exempt services, refer to Publication 15 - Circular E (a.k.a. Employer's Tax Guide)



International Agreements on Social Security Taxes

- Usually known as Totalization Agreements
- Can only be invoked when a foreign person is subject to coverage for the resident country & social security
- Employee presents the U.S. employer a certificate of coverage
- U.S. employer must keep a copy of the certificate of coverage
- www.ssa.gov/international/index.html



Audit Tip

- The Service will request an employer to substantiate that a non-resident alien employee can be excluded from social security and/or Medicare coverage.



What do we know?

- Resident and non-resident aliens employees, in general, have the same liability for social security and Medicare as a U.S. citizen
- A non-resident alien U.S. source income is subject to social security and Medicare



Foreign Students

- Are typically here on a F-1, J-1, M-1, Q-1, or Q-2 visa
- 5 year exemption from withholding
- Are exempt from U.S. FICA taxes on wages paid by an on-campus employer



Foreign Trainee

- Usually admitted on a J-1 or H-3 visa to pursue training in a specific field, typically less than 1 year
- Considered as a non-student
- If admitted on a J visa, exempt individual for only 2 Calendar years
- Has 6 years to use the exemption



Foreign Trainee

- If a J visa status, the Foreign Trainee may be exempt from FICA Tax liability if all conditions are met:
 - In J status
 - U.S. employment allowed
 - Nonresident Alien under the residency rules
- Tax Treaty may extend the income tax exemption



Foreign Scholar

- Alien teacher or researcher admitted into the U.S.A. on a J-1, Q-1, Q-2, H-1B, O-1 or TN visa
- Considered a non-student
- If admitted on a J or Q visa, exempt individual for only 2 Calendar years
- Has 6 years to use the exemption

Foreign Scholar

- If a J visa status, the Foreign Trainee may be exempt from FICA Tax liability if all conditions are met IRC §3121(b)(19):
 - In J or Q status
 - U.S. employment allowed
 - Nonresident Alien under the residency rules
- Tax Treaty may extend the income tax exemption

Practical Training

- Practical training falls into two categories –
 - Curricular – allows the student to work off-campus before graduation in the same field of study
 - Optional – allows the student to work off-campus after graduation in the same field of study usually 1 year
- No FICA liability if IRC §3121(b)(19) is met



Reporting Payments

- Income tax withholding
 - Exempt – report on Forms 1042 & 1042-S
 - Taxable – report on Forms 941 & W-2
- FICA Tax Liability
 - Exempt – no reporting
 - Taxable – report on Forms 941 & W-2

Audit Tip

- If a foreign person is excluded from Federal income tax withholding, the payor should be able to adequately substantiate the exclusion-
 - Forms W-8BEN or 8233 for Treaty exemption
 - VISA and tax residency requirements

What did we Learn?

- Tax Residency
- FIT withholding for non-resident alien employee
- FICA Tax liability for non-resident alien employee

Resources

- www.irs.gov
- Publication 15 & 15-A
- Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Entities*
- Publication 901, *Tax Treaties*



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