

INTERNAL REVENUE SERVICE

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Mr. [REDACTED]

Dear Mr. [REDACTED]:

This relates to your letter to the Social Security Administration dated September 30, 2000, regarding your participation in the social security system. The Social Security Administration requested that the Internal Revenue Service respond directly to you regarding the income tax and self-employment tax treatment of resident aliens living abroad. Social security and Medicare taxes only apply to wages paid for services performed as an employee. You did not receive a Form W-2 from an employer; consequently, for purposes of this letter, we have assumed you did not receive wages subject to social security and Medicare taxes. We emphasize, however, that this discussion is intended to provide general information and is not intended to address the facts and circumstances of your particular case.

U.S. Income Tax

United States income tax generally applies to the worldwide income of a resident alien regardless of where the resident alien lives. Thus, for federal income tax purposes, resident aliens are taxed the same as U.S. citizens. Similarly, a resident alien living outside the United States is generally required to file an income tax return and to pay estimated tax in the same way as a taxpayer residing in the United States. The U.S. income tax is imposed in addition to and not in lieu of either the social security and Medicare taxes or the self-employment tax.

Pursuant to the foreign earned income exclusion a taxpayer may qualify to treat up to \$76,000 of his income as not taxable by the United States. Additionally, pursuant to the foreign housing exclusion or deduction a taxpayer may be able either to treat a limited amount of income used for housing expenses as not taxable by the United States or to deduct certain housing expenses from income. To qualify for either of the exclusions or the deduction, a taxpayer must have a tax home in a foreign country and earn income

from personal services performed in the foreign country. Publication 54, *Tax Guide for U.S. Citizens and Resident Aliens Abroad* (copy enclosed) explains the foreign earned income exclusion and the foreign housing exclusion or deduction in detail.

### Self-Employment Tax

The self-employment tax generally applies to a self-employed resident alien living outside the United States. Self-employment tax is a social security and Medicare tax for individuals who work for themselves. It is similar to the social security and Medicare taxes withheld from the pay of wage earners. The self-employment tax applies to net earnings from self-employment while the social security and Medicare taxes apply to wages paid to an employee. Thus, a taxpayer will not be subject to both the self-employment tax and the social security and Medicare taxes with respect to a single item of income. The self-employment tax rules apply regardless of a taxpayer's age and even if a taxpayer is already receiving social security or Medicare benefits. Additionally, all self-employment income must be taken into account in figuring net earnings from self-employment—even income that is exempt from income tax because of the foreign earned income exclusion.

A taxpayer must pay self-employment tax and file Schedule SE if he was self-employed and had net earnings from self-employment of \$400 or more. The self-employment tax rate is 15.3%. The rate consists of two parts: 12.4% for social security and 2.9% for Medicare. Only the first \$76,200 of a taxpayer's combined wages and net earnings in 2000 is subject to any combination of the 12.4% social security part of self-employment tax or social security tax. However, all of a taxpayer's combined wages and net earnings in 2000 are subject to any combination of the 2.9% Medicare part of self-employment tax or social security tax.

The United States has entered into agreements with several foreign countries to eliminate dual coverage and dual contributions (taxes) to social security systems for the same work. Under these bilateral agreements self-employed persons who are subject to dual taxation will only be covered by the social security system of the country where they reside. Publication 533, *Self-Employment Tax* (copy enclosed) explains what income is subject to the self-employment tax, who must pay the tax, and how to figure and report the tax.

In summary U.S. income tax generally applies to the worldwide income of a resident alien regardless of where the resident alien lives. Similarly, self-employment tax generally applies to a self-employed resident alien living outside the United States.

We hope this discussion of the tax rules applicable to resident aliens is helpful to you. Please telephone me at (202) 622-6040 with any additional questions you may have or if I may be of further assistance to you in any way.

Sincerely,

JERRY E. HOLMES  
Chief, Employment Tax Branch 2  
Office of Assistant Chief Counsel  
(Exempt Organizations/Employment  
Tax/Governmental Entities)