

U.S. Tax Guide for Non-Residents

Table of Contents

A. U.S. INCOME TAXES ON NON-RESIDENTS

- 1. Nonresident Alien or Resident Alien?
 - Nonresident Aliens
 - Resident Aliens
 - Green Card Test
 - Substantial Presence Test
 - Closer Connection to a Foreign Country
 - Effect of Tax Treaties
- 2. Source of Income
 - Resident Aliens
 - Nonresident Aliens
 - Interest Income
 - Dividends
 - Personal Services
 - Transportation Income
 - Scholarships, Grants, Prizes, and Awards
 - Pensions and Annuities
 - Rents or Royalties
 - Real Property
 - Personal Property
- 3. Exclusions From Gross Income
 - Nonresident Aliens
 - Interest Income
 - Services Performed for Foreign Employer
 - Gain From the Sale of Your Main Home
 - Scholarships and Fellowship Grants

B. ESTATE TAXES ON U.S. ASSETS OF NON-RESIDENTS

1. Nonresident Alien or Resident Alien?

Introduction

You should first determine whether, for income tax purposes, you are a nonresident alien or a resident alien. *Figure 1-A* will help you make this determination.

This is important because a resident alien's income is generally subject to tax in the same manner as a U.S. citizen. If you are a resident alien, you must report all interest, dividends, wages, or other compensation for services, income from rental property or royalties, and other types of income on your U.S. tax return. You must report these amounts whether from sources within or outside the United States. A nonresident alien usually is subject to U.S. income tax only on U.S. source income

Nonresident Aliens

If you are an alien (not a U.S. citizen), you are considered a nonresident alien unless you meet one of the two tests described next, under *Resident Aliens*.

Resident Aliens

You are a resident alien of the United States for tax purposes if you meet either the **green card test** or the **substantial presence test** for the calendar year (January 1-December 31). Even if you do not meet either of these tests, you may be able to choose to be treated as a U.S. resident for part of the year.

Green Card Test

You are a resident for tax purposes if you are a lawful permanent resident of the United States **at any time** during the calendar year. This is known as the *green card* test. You are a lawful permanent resident of the United States at any time if you have been given the privilege, according to the immigration laws, of residing permanently in the United States as an immigrant. You generally have this status if the Immigration and Naturalization Service (INS) has issued you an alien registration card, also known as a *green card*. You continue to have resident status under this test unless the status is taken away from you or is administratively or judicially determined to have been abandoned.

Substantial Presence Test

You will be considered a U.S. resident for tax purposes if you meet the substantial presence test for the calendar year. To meet this test, you must be physically present in the United States on at least:

1. 31 days during the current year, **and**
2. 183 days during the 3-year period that includes the current year and the 2 years immediately before that, counting:
 1. All the days you were present in the current year, and
 2. 1/3 of the days you were present in the first year before the current year, and

3. 1/6 of the days you were present in the second year before the current year.

Example. *You were physically present in the United States on 120 days in each of the years 2000, 2001, and 2002. To determine if you meet the substantial presence test for 2002, count the full 120 days of presence in 2002, 40 days in 2001 (1/3 of 120), and 20 days in 2000 (1/6 of 120). Since the total for the 3-year period is 180 days, you are not considered a resident under the substantial presence test for 2002.*

Exempt individual. Do not count days for which you are an exempt individual. The term *exempt individual* does not refer to someone exempt from U.S. tax, but to anyone in the following categories.

1. An individual temporarily present in the United States as a foreign government-related individual.
2. A teacher or trainee temporarily present in the United States under a J or Q visa, who substantially complies with the requirements of the visa.
3. A student temporarily present in the United States under an F, J, M, or Q visa, who substantially complies with the requirements of the visa.
4. A professional athlete temporarily in the United States to compete in a charitable sports event.

Closer Connection to a Foreign Country

Even if you meet the substantial presence test, you can be treated as a nonresident alien if you:

1. Are present in the United States for less than 183 days during the year,
2. Maintain a tax home in a foreign country during the year, and
1. Have a closer connection during the year to one foreign country in which you have a tax home than to the United States

Tax home. Your tax home is the general area of your main place of business, employment, or post of duty, regardless of where you maintain your family home. Your tax home is the place where you permanently or indefinitely work as an employee or a self-employed individual. If you do not have a regular or main place of business because of the nature of your work, then your tax home is the place where you regularly live. If you do not fit either of these categories, you are considered an itinerant and your tax home is wherever you work.

For determining whether you have a closer connection to a foreign country, your tax home must also be in existence for the **entire** current year, and must be

located in the same foreign country to which you are claiming to have a closer connection.

Effect of Tax Treaties

The rules given here to determine if you are a U.S. resident do not override tax treaty definitions of residency. If your residency is determined under a treaty and not under the rules discussed here, you must file a fully completed Form 8833 if the payments or income items reportable because of that determination are more than \$100,000. If you are a dual-resident taxpayer, you can still claim the benefits under an income tax treaty. A **dual-resident taxpayer** is one who is a resident of both the United States and another country under each country's tax laws. The income tax treaty between the two countries must contain a provision that provides for resolution of conflicting claims of residence. If you are treated as a resident of a foreign country under a tax treaty, you are treated as a nonresident alien in figuring your U.S. income tax. For purposes other than figuring your tax, you will be treated as a U.S. resident.

2. Source of Income

Introduction

After you have determined your alien status, you must determine the source of your income. This chapter will help you determine the source of different types of income you may receive during the tax year. This chapter also discusses special rules for married individuals who are domiciled in a country with community property laws.

Resident Aliens

A resident alien's income is generally subject to tax in the same manner as a U.S. citizen. If you are a resident alien, you must report all interest, dividends, wages, or other compensation for services, income from rental property or royalties, and other types of income on your U.S. tax return. You must report these amounts whether from sources within or outside the United States.

Nonresident Aliens

A nonresident alien usually is subject to U.S. income tax only on U.S. source income. Under limited circumstances, certain foreign source income is subject to U.S. tax.

The general rules for determining U.S. source income that apply to most nonresident aliens are shown in *Table 2-1*. The following discussions cover the general rules as well as the exceptions to these rules.

Not all items of U.S. source income are taxable. See chapter 3.

Interest Income. Generally, U.S. source interest income includes the following items.

- Interest on bonds, notes, or other interest-bearing obligations of U.S. residents or domestic corporations.
- Interest paid by a domestic or foreign partnership or foreign corporation engaged in a U.S. trade or business at any time during the tax year.
- Original issue discount.
- Interest from a state, the District of Columbia, or the U.S. Government.

The place or manner of payment is immaterial in determining the source of the income.

A substitute interest payment made to the transferor of a security in a securities lending transaction or a sale-repurchase transaction is sourced in the same manner as the interest on the transferred security.

Exceptions. U.S. source interest income does not include the following items.

1. Interest paid by a resident alien or a domestic corporation if for the 3-year period ending with the close of the payer's tax year preceding the interest payment at least 80% of the payer's total gross income:
 1. Is from sources outside the United States, and
 2. Is attributable to the active conduct of a trade or business by the individual or corporation in a foreign country or a U.S. possession.
2. Interest paid by a foreign branch of a domestic corporation or a domestic partnership on deposits or withdrawable accounts with mutual savings banks, cooperative banks, credit unions, domestic building and loan associations, and other savings institutions chartered and supervised as savings and loan or similar associations under federal or state law if the interest paid or credited can be deducted by the association.
3. Interest on deposits with a foreign branch of a domestic corporation or domestic partnership, but only if the branch is in the commercial banking business.

Dividends. In most cases, dividend income received from domestic corporations is U.S. source income. Dividend income from foreign corporations is usually foreign source income. There are exceptions to this rule for non-U.S. companies that carry on substantial business in the U.S., and for non-U.S. companies which are based in Puerto Rico.

A substitute dividend payment made to the transferor of a security in a securities lending transaction or a sale-repurchase transaction is sourced in the same manner as a distribution on the transferred security.

Personal Services. All wages and any other compensation for services performed in the United States are considered to be from sources in the United States. The only exception to this rule is discussed in chapter 3 under *Employees of foreign persons, organizations, or offices*.

If your compensation is for personal services performed both inside and outside the United States, you must figure the amount of income that is for services performed in the United States. You usually do this on a time basis. That is, you must include in gross income as U.S. source income the amount that results from multiplying the total amount of compensation by the following fraction.

$$\frac{\text{Number of days you performed services in the United States}}{\text{Total number of days of service for which you receive payment}}$$

Number of days you performed services in the United States divided by Total number of days of service for which you receive payment

Example. *Jean Blanc, a nonresident alien, is a professional hockey player with a U.S. hockey club. Under Jean's contract, he received \$98,500 for 242 days of play during the year. This includes days spent at pre-season training camp, days during the regular season, and playoff game days. Of the 242 days, Jean spent 194 days performing services in the United States and 48 days playing hockey in Canada. Jean's U.S. source income is \$78,963, figured as follows:*

$$\frac{194}{242} \times \$98,500 = \$78,963$$

194 divided by 242 times \$98,500 equals \$78,963

Transportation Income. Transportation income is income from the use of a vessel or aircraft or for the performance of services directly related to the use of any vessel or aircraft. This is true whether the vessel or aircraft is owned, hired, or leased. The term *vessel or aircraft* includes any container used in connection with a vessel or aircraft.

All income from transportation that begins **and** ends in the United States is treated as derived from sources in the United States. If the transportation begins **or** ends in the United States, 50% of the transportation income is treated as derived from sources in the United States.

For transportation income from personal services, 50% of the income is U.S. source income if the transportation is between the United States and a U.S. possession. For nonresident aliens, this only applies to income derived from, or in connection with, an aircraft.

Scholarships, Grants, Prizes, and Awards. Generally, the source of scholarships, fellowship grants, grants, prizes, and awards is the residence of the payer regardless of who actually disburses the funds. However, see *Activities to be performed outside the United States*, later.

For example, payments for research or study in the United States made by the United States, a noncorporate U.S. resident, or a domestic corporation, are from U.S. sources. Similar payments from a foreign government or foreign corporation are foreign source payments even though the funds may be disbursed through a U.S. agent.

Payments made by an entity designated as a public international organization under the International Organizations Immunities Act are from foreign sources.

Activities to be performed outside the United States. Scholarships, fellowship grants, targeted grants, and achievement awards received by nonresident aliens for activities performed, or to be performed, outside the United States are not U.S. source income.

These rules do not apply to amounts paid as salary or other compensation for services. See Personal Services, earlier, for the source rules that apply.

Pensions and Annuities. When you receive a pension from a domestic trust for services performed both in and outside the United States, part of the pension payment is from U.S. sources. That part is the amount

attributable to earnings of the trust and the employer contributions made for services performed in the United States. This applies whether the distribution is made under a qualified or nonqualified stock bonus, pension, profit-sharing, or annuity plan (whether or not funded).

If you performed services as an employee of the United States, you may receive a distribution from the U.S. Government under a plan, such as the Civil Service Retirement System, that is treated as a qualified pension plan. Your U.S. source income is the otherwise taxable amount of the distribution that is attributable to your total U.S. Government basic pay other than tax-exempt pay for services performed outside the United States.

Rents or Royalties. Your U.S. source income includes rent and royalty income received during the tax year from property located in the United States or from any interest in that property.

U.S. source income also includes rents or royalties for the use of, or for the privilege of using, in the United States, intangible property such as patents, copyrights, secret processes and formulas, goodwill, trademarks, franchises, and similar property.

Real Property. Real property is land and buildings and generally anything built on, growing on, or attached to land.

Gross income from sources in the United States includes gains, profits, and income from the sale or other disposition of real property located in the United States.

Natural resources. The income from the sale of products of any farm, mine, oil or gas well, other natural deposit, or timber located in the United States and sold in a foreign country, or located in a foreign country and sold in the United States, is partly from sources in the United States. For information on determining that part, see section 1.863-1(b) of the regulations.

Personal Property. Personal property is property, such as machinery, equipment, or furniture, that is not real property.

Gain or loss from the sale or exchange of personal property generally has its source in the United States if you have a **tax home** in the United States. If you do not have a tax home in the United States, the gain or loss generally is considered to be from sources outside the United States.

Table 2-1. Summary of Source Rules for Income of Nonresident Aliens

Item of Income	Factor Determining Source
Salaries, wages, other compensation	Where services performed
Business income:	
Personal services	Where services performed
Sale of inventory - purchased	Where sold
Sale of inventory - produced	Allocation
Interest	Residence of payer
Dividends	Whether a U.S. or foreign corporation*
Rents	Location of property
Royalties:	
Natural resources	Location of property
Patents, copyrights, etc.	Where property is used
Sale of real property	Location of property
Sale of personal property	Seller's tax home (but see <i>Personal Property</i> , later, for exceptions)
Pensions	Where services were performed that earned the pension
Sale of natural resources	Allocation based on fair market value of product at export terminal. For more information, see section 1.863-1(b) of the regulations.

3. Exclusions From Gross Income

Introduction

Non-Resident aliens are allowed exclusions from gross income if they meet certain conditions. An exclusion from gross income is generally income you receive that is not included in your U.S. income and is not subject to U.S. tax.

This chapter covers some of the more common exclusions allowed to resident and nonresident aliens.

Nonresident aliens can exclude the following items from their gross income.

Interest Income

U.S. source interest income that is not connected with a U.S. trade or business is excluded from income if it is from:

1. Deposits (including certificates of deposit) with persons in the banking business,
2. Deposits or withdrawable accounts with mutual savings banks, cooperative banks, credit unions, domestic building and loan associations, and other savings institutions chartered and supervised as savings and loan or similar associations under federal or state law (if the interest paid or credited can be deducted by the association), and
3. Amounts held by an insurance company under an agreement to pay interest on them.

Government obligations. Interest on obligations of a state or political subdivision, the District of Columbia, or a U.S. possession, generally is not included in income. However, interest on certain private activity bonds, arbitrage bonds, and certain bonds not in registered form is included in income.

Portfolio interest. U.S. source interest income that is not connected with a U.S. trade or business and that is portfolio interest on obligations issued after July 18, 1984, is excluded from income. Portfolio interest is interest (including original issue discount) that is paid on obligations:

1. Not in registered form (bearer obligations) that are sold only to foreign investors, and the interest on which is payable only outside the United States and its possessions, and that has on its face a statement that any U.S. person holding the obligation will be subject to limitations under the U.S. income tax laws,
2. In registered form that are targeted to foreign markets and the interest on which is paid through financial institutions outside the United States, or
3. In registered form that are **not** targeted to foreign markets, if you furnished the payer of the interest (or the withholding agent) a statement that you are not a U.S. person. You should have made this statement on a Form W-8BEN or on a substitute form similar to Form W-8BEN. In either case, the statement should have been signed under

penalties of perjury, should have certified that you are not a U.S. citizen or resident, and should have included your name and address.

Portfolio interest does not include the following types of interest.

1. Interest you receive on an obligation issued by a corporation of which you own, directly or indirectly, 10% or more of the total voting power of all classes of voting stock.
2. Interest you receive on an obligation issued by a partnership of which you own, directly or indirectly, 10% or more of the capital or profits interests.
3. Contingent interest.

Contingent interest. Portfolio interest does not include contingent interest. Contingent interest is either of the following:

1. Interest that is determined by reference to:
 1. Any receipts, sales, or other cash flow of the debtor or related person,
 2. Income or profits of the debtor or related person,
 3. Any change in value of any property of the debtor or a related person, or
 4. Any dividend, partnership distributions, or similar payments made by the debtor or a related person.
2. Any other type of contingent interest that is identified by the Secretary of the Treasury in regulations.

For the definition of *related person* in connection with any contingent interest, and for the exceptions that apply to interest described in item (1), see subparagraphs (B) and (C) of Internal Revenue Code section 871(h)(4).

Exception for existing debt. Contingent interest does not include interest paid or accrued on any debt with a fixed term that was issued:

1. On or before April 7, 1993, or
2. After April 7, 1993, pursuant to a written binding contract in effect on that date and at all times thereafter before that debt was issued.

Services Performed for Foreign Employer

If you were paid by a foreign employer, your U.S. source income may be exempt from U.S. tax, but only if you meet one of the situations discussed next.

Employees of foreign persons, organizations, or offices. Income for personal services performed in the United States as a nonresident alien is not considered to be from U.S. sources and is tax exempt if you meet **all three** of the following conditions.

1. You perform personal services as an employee of or under a contract with a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in a trade or business in the United States; or you work for an office or place of business maintained in a foreign country or possession of the United States by a U.S. corporation, a U.S. partnership, or a U.S. citizen or resident.
2. You perform these services while you are a nonresident alien temporarily present in the United States for a period or periods of not more than a total of 90 days during the tax year.
3. Your pay for these services is not more than \$3,000.

If you do not meet all three conditions, your income from personal services performed in the United States is U.S. source income and is taxed according to the rules in chapter 4.

If your pay for these services is more than \$3,000, the entire amount is income from a trade or business within the United States. To find if your pay is more than \$3,000, do not include any amounts you get from your employer for advances or reimbursements of business travel expenses, if you were required to and did account to your employer for those expenses. If the advances or reimbursements are more than your expenses, include the excess in your pay for these services.

A day means a calendar day during any part of which you are physically present in the United States.

Example 1. *During 2002, Henry Smythe, a nonresident alien from a nontreaty country, worked for an overseas office of a U.S. partnership. Henry, who uses the calendar year as his tax year, was temporarily present in the United States for 60 days during 2002 performing personal services for the overseas office of the partnership. That office paid him a total gross salary of \$2,800 for those services. During 2002, he was not engaged in a trade or business in the United States. The salary is not considered U.S. source income and is exempt from U.S. tax.*

Example 2. *The facts are the same as in Example 1, except that Henry's total gross salary for the services performed in the United States during 2002 was \$4,500. He received \$2,875 in 2002, and \$1,625 in 2003. During 2002, he was engaged in a trade or business in the United States because the compensation*

for his personal services in the United States was more than \$3,000. Henry's salary is U.S. source income and is taxed under the rules in chapter 4.

Students and exchange visitors. Nonresident alien students and exchange visitors present in the United States under *F*, *J*, or *Q* visas can exclude from gross income pay received from a foreign employer.

This group includes bona fide students, scholars, trainees, teachers, professors, research assistants, specialists, or leaders in a field of specialized knowledge or skill, or persons of similar description. It also includes the alien's spouse and minor children if they come with the alien or come later to join the alien.

A nonresident alien temporarily present in the United States under a *J* visa includes an alien individual entering the United States as an **exchange visitor** under the Mutual Educational and Cultural Exchange Act of 1961.

Foreign employer. A foreign employer is:

1. A nonresident alien individual, foreign partnership, or foreign corporation, or
2. An office or place of business maintained in a foreign country or in a U.S. possession by a U.S. corporation, a U.S. partnership, or an individual who is a U.S. citizen or resident.

The term *foreign employer* does not include a foreign government. Pay from a foreign government that is exempt from U.S. income tax is discussed in chapter 10.

Income from certain annuities. Do not include in income any annuity received under a **qualified annuity plan** or from a **qualified trust** exempt from U.S. income tax if you meet both of the following conditions.

1. You receive the annuity only because:
 1. You performed personal services outside the United States while you were a nonresident alien, or
 2. You performed personal services inside the United States while you were a nonresident alien for a foreign person or organization.
2. At the time the first amount is paid as an annuity under the plan (or by the trust), 90% or more of the employees for whom contributions or benefits are provided under the annuity plan (or under the plan of which the trust is a part) are U.S. citizens or residents.

If the annuity qualifies under condition (1) but not condition (2) above, you do not have to include the amount in income if:

1. You are a resident of a country that gives a substantially equal exclusion to U.S. citizens and residents, or
2. You are a resident of a beneficiary developing country under the Trade Act of 1974.

If you are not sure whether the annuity is from a qualified annuity plan or qualified trust, ask the person who made the payment.

Income affected by treaties. Income of any kind that is exempt from U.S. tax under a treaty to which the United States is a party is excluded from your gross income. Income on which the tax is only limited by treaty, however, is included in gross income. See chapter 9.

Gain From the Sale of Your Main Home

If you sold your main home, you may be able to exclude up to \$250,000 of the gain on the sale of your home. If you are married and file a joint return, you may be able to exclude up to \$500,000.

Scholarships and Fellowship Grants

If you are a candidate for a degree, you may be able to exclude from your income part or all of the amounts you receive as a qualified scholarship. The rules discussed here apply to both resident and nonresident aliens.

If a nonresident alien receives a grant that is not from U.S. sources, it is not subject to U.S. tax. See Scholarships, Grants, Prizes, and Awards in chapter 2 to determine whether your grant is from U.S. sources.

Qualified scholarship. A qualified scholarship is any amount you receive as a scholarship or fellowship grant that you use according to the terms of the grant for:

1. Tuition and fees required to enroll in, or to attend, an educational institution, or
2. Fees, books, supplies, and equipment that the educational institution requires of **all** students for the courses of instruction.

Amounts you receive from a scholarship or fellowship that you use for other expenses, such as room and board or travel, are not excludable from income.

ESTATE TAX

Estate tax may apply to your taxable estate at your death. Your taxable estate is your gross estate less allowable deductions.

Gross Estate

Your gross estate includes the value of all U.S. property in which you had an interest at the time of death. Your gross estate also will include the following.

- U.S. real estate owned under your own name
- Stock of U.S. companies / businesses

Taxable Estate

Your taxable estate is any amounts which exceed \$65,000 after subtracting allowable deductions from the Gross Estate. The allowable deductions used in determining your taxable estate include:

1. Funeral expenses paid out of your estate,
2. Debts you owed at the time of death, and
3. The marital deduction (generally, the value of the property that passes from your estate to your surviving spouse).

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