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Spidell's Elder Client Letter

Tax issues for nonresident aliens (Part III)

TAX: Rates and exemptions depend on whether foreign countries have income tax treaties with the U.S.

By Monica Haven, EA, J.D., LL.M.

Once a practitioner has determined that a taxpayer is a nonresident alien (NRA), he or she must address various administrative and tax reporting issues. While U.S. citizens and resident aliens (residents) may use Forms 1040, 1040A, or 1040EZ, NRAs must use Form 1040NR.¹ A part-year resident, also known as a dual-status alien, must use:

- Form 1040 if he or she entered the U.S. during the year and is a resident *on December 31*; or
- Form 1040NR if he or she was a U.S. resident who left during the year and no longer resides in the U.S. *on December 31*.

A legend indicating that these returns report the income of dual-status aliens should be placed at the top of Form 1040NR.²

Tax form specifics

Only single, married filing separate, or qualifying widow(er) filing statuses are available to NRAs unless the NRA is married to a U.S. citizen or resident and chooses to file jointly.³ The head of household status is not available to NRAs.⁴ Married NRAs may elect to file as single, only if they reside in Canada, Mexico, or South Korea, or are married to a U.S. national, and have lived apart from their spouse for the last six months of the tax year.

Individual Taxpayer Identification Numbers (ITINs) are issued by the IRS to taxpayers who are otherwise not eligible to apply for Social Security Numbers, and may be used for tax purposes only. They do not affect the taxpayer's immigration status or work eligibility. NRA dependents and spouses must have an ITIN and may use Form W-7, Application for IRS Individual Taxpayer Identification Number, to obtain a valid number.⁵

An NRA may claim only one personal exemption on the tax return, unless he or she is:

- A student or business apprentice from India;⁶
- A South Korean resident whose spouse and children lived with him in the U.S. at some time during the tax year; or
- A resident of Canada, Mexico, American Samoa, or the Northern Mariana Islands whose spouse has no U.S.-sourced income and is not the dependent of another taxpayer. This NRA may also claim exemptions for qualified dependents under the same rules which apply to U.S. residents.⁷

NRAs are subject to tax withholdings on wages earned and must provide their employers with Form W-4 indicating "Single and 1" or preferably "Single and 0," since he or she cannot in all likelihood claim dependency exemptions. NRAs are also subject to Social Security and Medicare withholdings unless they are in the U.S. on a student visa performing only on-campus work. (An NRA who is self-employed is not subject to FICA self-employment tax unless he or she is a

resident of Puerto Rico, the Virgin Islands, Guam, or the Northern Mariana Islands.)

If a Social Security or Totalization Agreement is in effect between the U.S. and a foreign country, the employee will not be subject to double taxation and will only pay Social Security tax to the country in which he or she is working.⁸ If the employee normally works abroad but is sent to the U.S. to work temporarily, the employee will pay Social Security taxes only to his or her home country.

Pension income is subject to an automatic withholdings rate of 30% unless the NRA uses Form W-8ECI, Certificate of Foreign Person's Claim That Income Is Effectively Connected With the Conduct of a Trade or Business in the United States, to elect that his or her pension be treated as effectively connected and taxed at graduated rates. Upon disposition of real property, 10% of the amount realized will be automatically withheld.⁹ Form W-8BEN, Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding, may be filed to request an exemption or reduction from automatic withholdings due to treaty provisions.¹⁰

An NRA must make estimated tax payments (ES) under the same rules as a U.S. resident. If the NRA does not have any wages subject to withholding, the first ES payment may be delayed until June 15 rather than April 15; however, the NRA must then submit one-half of his or her total annual ES liability in the second quarter and pay the remaining balance in quarterly installments on September 15 and January 15.

Like U.S. residents, NRAs must file annually by April 15. If however, an NRA did not receive any wages subject to withholdings, he or she may file as late as June 15.¹¹ Upon proper application, an NRA's return may be extended to October 15. The completed return should be sent to:

Department of the Treasury Internal Revenue Service Austin, TX 73301-0215

Tax treaties

The U.S. has income tax treaties with several foreign countries which provide for reduced tax rates or exemptions from taxation of certain types of income received in the U.S. and abroad by NRAs.¹² If a treaty does not address a particular type of income, or if there is no treaty between the foreign country and the U.S., the income is taxed as per the instructions for Form 1040NR, U.S. Nonresident Alien Income Tax Return. It is important to note that not all states conform to the federal treatment of income; as a result, international tax treaty provisions may not apply at the state level.

Tax treaties reduce the U.S. tax of NRAs. With certain exceptions, they do not reduce the tax of U.S. citizens or residents. Treaty provisions generally are reciprocal and apply to both treaty countries. Treaty-based positions must be disclosed on Form 8833, Treaty-based Return Position Disclosure, which should be attached to a timely filed return.¹³ A return must be filed even if a treaty-based position eliminates all taxable income. Failure to file Form 8833 may result in a \$1,000 penalty.

<p>Example: Yoshi is a single NRA and resident of a foreign country that has a tax treaty with the U.S. He received the following U.S.-sourced income: \$1,400 dividends, on which a treaty limits the tax to 15%, and \$23,750 personal service compensation, on which the tax is not limited by treaty. Yoshi's dividends are not effectively connected and he has no deductions other than his own personal exemption. His tax liability is determined as follows:</p>
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Total compensation	\$23,750	Tax as per tax table for single	\$2,579
Less personal exemption	3,700	Plus tax on gross dividends	210
Taxable income	\$20,050	Total tax due	\$2,789

Foreign government employees may exempt their wage (not pension) income from U.S. taxation either by treaty or by U.S. law if the NRA performs services for a foreign government similar to those services that would be required by U.S. government counterparts.¹⁴

Leaving the U.S.

Aliens leaving the U.S. must apply for an exit permit 30 days or fewer before their scheduled departure by filing Form 1040C, U.S. Departing Alien Income Tax Return, and paying any tax due. The taxpayer may instead file the shorter Form 2063, U.S. Departing Alien Income Tax Statement, if he or she has previously filed all requisite income tax returns, paid all taxes due, and does not have any taxable income in the year of departure or the preceding year.¹⁵ Filing Form 1040C or Form 2063 does not, however, satisfy the taxpayer's final tax return filing requirement; he or she must, therefore, file the normal U.S. return on Form 1040 or Form 1040NR, whichever is applicable. Any amounts paid with Form 1040C may be deducted against final tax liability.

Aliens exempt from reporting

The following aliens are exempt from the Form 1040C and Form 2063 filing requirements:

- Foreign government diplomats and accompanying members of their households;
- Employees of international organizations whose wages are tax exempt and who receive no other income from U.S. sources;
- Students who entered the U.S. on "F2," "H3," "H4," "J1," "J2," or "Q" visas, and who receive no U.S.-sourced income;
- Students on "M1" or "M2" visas who receive only interest income that is not effectively connected;
- NRAs only temporarily in the U.S. who receive no taxable income during their stay in the U.S.; and
- Residents of Canada or Mexico who commute into and out of the U.S. and whose U.S. wages are subject to withholding.¹⁶

About the author

Monica Haven, E.A., J.D., LL.M., has a Masters in Taxation and decades-long experience as a solo practitioner with a burgeoning practice in Southern California. She is an alum and former faculty member of the National Tax Practice Institute, a recognized speaker on the "professional" circuit, and a guest lecturer on college campuses. Monica is also part-owner of an investment advisory firm and a practicing financial planner. Always eager to share her expertise, Monica may be contacted at

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- ¹ Treas. Regs. §1.6012-1(b)
- ² 2011 Instructions for Form 1040NR (2011)
- ³ IRC §6013(g)
- ⁴ IRC 2(b)(3)(A)
- ⁵ Treas. Regs. §301.6109-1(a)
- ⁶ Article 21(2) of the U.S.-India Treaty
- ⁷ IRC §873(b)(3)
- ⁸ Treas. Regs. §301.6114-1(c)(vi)
- ⁹ IRC §1445(a)
- ¹⁰ Treas. Regs. §1.1441-1(d)
- ¹¹ Treas. Regs. §1.6072-1(c)
- ¹² IRC §894(a)
- ¹³ IRC §301.6114-1
- ¹⁴ Treas. Regs. §1.1441-4(b)(1)
- ¹⁵ Treas. Regs. §1.6851-2(b)
- ¹⁶ IRC §6851(d)(1)

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