U.S. TAXATION
OF FOREIGN NATIONALS
## CONTENTS

**Introduction**  1

1 **Residency**  
   - Lawful Permanent Resident Test  3  
   - Substantial Presence Test  5  
   - Which Test Prevails?  10  
   - Special Considerations  10

2 **Case Study Background**  12

3 **Income Taxation of Residents**  
   - Income Tax Overview  15  
   - Filing Status  16  
   - Gross Income  16  
   - Deductions from Gross Income  17  
   - Itemized Deductions / Standard Deductions  17  
   - Exemptions  19  
   - Tax Credits (Foreign Tax Credit and Other Credits)  20  
   - Filing Requirements and Procedures  24

4 **Sourcing Rules**  
   - Personal Services Income  25  
   - Interest Income  26  
   - Dividend Income  26  
   - Rental and Royalty Income  26  
   - Income from Sale of Personal Property  27  
   - Income from Sale of Real Property  27  
   - Partnerships  27

5 **Taxation of Nonresidents**  
   - Trade or Business Income  28  
   - Passive Income  32  
   - Filing Requirements and Procedures  34

6 **Dual-Status Taxpayers**  
   - Overview  35  
   - Joint Return Election  39  
   - Filing Requirements  40
7 Other Taxes and Filing Requirements
- Social Security Taxes 42
- State Income Taxes 43
- Gift and Estate Taxes 43
- Expatriation Tax 45
- Filing Requirement on Departure 45
- Foreign Bank Account Reporting Requirement 46
- Form 5471 46
- Passive Foreign Investment Corporation (PFIC) 46

8 Income Tax Treaties 47

9 Other Considerations
- Exchange Rate Issues 49
- Moving Expenses 49
- Foreign Earned Income and Housing Exclusions 50
- Capital Gains 51
- Dispositions of U.S. Real Property Interests 52
- Sale of Principal Residence 52
- Rental of a Residence 54
- Investments in Foreign Corporations 55

Appendix A. 2009 U.S. Individual Income Tax Rates 56
Appendix B. List of U.S. Tax Treaties 57
Appendix C. Visas 58
Appendix D. Checklist for Foreign Nationals 60
Appendix E. 2009 U.S. Gift and Estate Tax Rates 62
Appendix F. U.S. Withholding Tax Compliance Checklist 63

This booklet is based upon tax law in effect as of December 31, 2009, including updates for the American Recovery and Reinvestment Act of 2009. The information contained in this booklet is general in nature, and is not a substitute for professional advice about individual tax situations. Please consult with a professional tax advisor whenever specific questions arise.

Any U.S. tax advice contained in the body of this booklet was not intended or written to be used, and cannot be used, by the recipient for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code or applicable state or local tax law provisions. Our advice in this booklet is limited to the conclusions specifically set forth herein and is based on the completeness and accuracy of the facts and assumptions as stated. Our advice may consider tax authorities that are subject to change, retroactively and/or prospectively. Such changes could affect the validity of our advice. Our advice will not be updated for subsequent changes or modifications to applicable law and regulations, or to the judicial and administrative interpretations thereof.

Global Tax Network US, LLC (GTN) can be reached by e-mail at help@GTN.com. Please call us or visit our website at www.GTN.com for information about our services and fees.
Introduction

Life in the United States can be unusually complicated. This is especially true for a foreign national (a citizen or national of a country other than the U.S.) who relocates to the U.S. or earns income from U.S. sources. This book addresses the U.S. tax impacts of accepting an assignment in the U.S. and earning U.S. source income, and provides you with a basic understanding of the U.S. tax system and its application to foreign nationals.

The first and probably most important issue encountered by a foreign national is residency. Whether or not you are considered a U.S. tax resident will have a large impact on your U.S. tax liability. The first chapter of this book is devoted to U.S. tax residency rules.

Since many of the concepts presented in this book will be new to the reader, we have included examples which are based on real-life situations and which apply the rules discussed throughout this book. These examples are based on the case study information contained in Chapter 2. It is our hope that such examples will allow for a clearer and faster understanding of the U.S. tax system.

When you meet the criteria established for tax residency in the U.S., the scope of your income and activities that are subject to U.S. tax reporting increase substantially. Chapter 3 of this book is an overview of the U.S. taxation of residents.

Before moving on to the taxation of U.S. nonresidents, it is important to gain a basic understanding of the U.S. rules that determine whether an item of income is U.S. source or foreign source. Chapter 4 outlines these rules and how they are applied to the more common types of income earned by individual taxpayers.

The fact that a foreign national does not meet the residency requirements does not mean that the individual escapes U.S. tax reporting requirements or a U.S. tax liability. Chapter 5 is dedicated to the U.S. taxation of nonresident foreign nationals. It discusses the different types of income earned by nonresident taxpayers, how each type of income is taxed, and how the tax is collected.

Often, the busiest and most stressful periods of a U.S. assignment are the first and last years of the assignment. These transition years can also be the most complicated from a U.S. tax perspective. Chapter 6 deals with these years and some of the special considerations that require attention.
The majority of this book discusses the federal income taxation of foreign nationals. Besides federal income tax, foreign nationals may encounter state income taxes, social security taxes, estate and gift taxes, and miscellaneous filing requirements. We take a break from federal income taxes in Chapter 7 and address some of these other tax-related concerns.

The U.S. has executed tax treaties with many different countries. Chapter 8 outlines the general terms of a typical tax treaty, how a tax treaty works, and the potential benefits available to many foreign nationals.

Chapter 9 discusses the U.S. tax treatment of activities that are commonly an issue with foreign nationals. These include the tax treatment of home sales, moving expenses, rental activities, U.S. real estate investments, and non-U.S. activities.

This book is based on U.S. tax law as of December 31, 2009 and contains a number of general tax planning tips and suggestions for reducing tax. Due to the complexity of foreign national tax matters and the ever-changing U.S. tax law, you should seek assistance from a U.S. tax professional. This book is intended only to give the reader a basic understanding of the U.S. tax system. It is not intended to be a substitute for the advice and counsel of a professional tax advisor. We strongly recommend that all foreign nationals seek such counsel before, during, and after an assignment in the U.S.

Global Tax Network US, LLC (GTN) provides tax return preparation and consulting services to foreign nationals. E-mail us at help@GTN.com if you have questions or need tax advice. You can also visit our website at www.GTN.com for a full description of our services.
1. Residency

As a foreign national working in the U.S., the first question that must be addressed to determine your U.S. income tax liability is whether you are a U.S. income tax resident. Note that we refer to “tax resident” as opposed to “resident” or “legal resident.” The concepts discussed in this chapter and throughout the book relate only to income tax residency. A determination of tax residency may not bear any relationship to your legal or immigration status. It is possible, and quite common, for a foreign national to be a nonresident for legal or immigration purposes and yet be a resident for tax purposes. Further, residence status for income tax purposes may be different than residency for estate tax and social security tax purposes.

The residency determination is vital in calculating the U.S. income tax liability related to an assignment in the U.S. Tax residents are taxed on worldwide income while nonresidents are taxed only on U.S. source income. A casual reading of the preceding sentence would lead one to believe that it is always better to be considered a nonresident. However this isn’t always true. In some cases it may be more beneficial for an individual to be treated as a U.S. tax resident.

There are two tests used to determine whether you are a U.S. tax resident. These two tests are:

- The lawful permanent resident test
- The substantial presence test

If you meet the requirements of either of these two tests, you will be treated as a U.S. tax resident. These two tests are discussed in greater detail below.

The Lawful Permanent Resident Test

A foreign national is considered a U.S. lawful permanent resident taxpayer if he or she has been issued the official privilege of residing permanently in the U.S. This occurs when the foreign national receives an alien registration card or “green card.” In the initial year that a “green card” is issued, the individual becomes a U.S. resident from the first day of actual physical presence in the U.S. after the “green card” is issued.
Maria, a citizen and resident of Spain, is offered a position with ABC Company (a U.S. company). The position requires that she live and work in the U.S.—specifically Denver, Colorado. Maria applies for permanent residence status and is issued a green card on December 15, 2008. Prior to December 15, she made a preliminary trip to the U.S. in November of 2008. She spent 6 days in the U.S. on this preliminary trip looking for housing. She moves to the U.S. on January 1, 2009 and begins her new job on January 5.

Maria is considered a tax resident in the U.S. under the lawful permanent resident test from January 1, 2009 forward. January 1 is the first day she is physically present in the U.S. while possessing a green card.

After Maria begins her duties with her new U.S. employer, she is put in charge of a project. This project requires engineering expertise that neither Maria nor anyone else in the U.S. company possesses. Maria contacts a former colleague in Spain named Pablo who works for a Spanish engineering firm (XYZ, SA). The Spanish firm agrees to a short-term contract of 4 months and makes arrangements for Pablo to go to the U.S. Pablo is granted a U.S. visa and arrives in Denver on August 1, 2009.

The lawful permanent resident test does not apply to Pablo as he is working in the U.S. on a visa and not a “green card.”

If you achieve tax residency under the lawful permanent resident test, this status continues until one of the following three events occurs:

- You voluntarily surrender the “green card” to immigration authorities; or
- The U.S. immigration authorities revoke the “green card”; or
- A judicial body officially finds that you no longer qualify as a lawful permanent resident under the immigration laws.

If you’ve surrendered your green card, this doesn’t necessarily mean that your status as a lawful permanent resident has changed. Your status will not change unless and until you get an official notice from the U.S. Citizenship and Immigration Service (USCIS) that there has been a final administrative or judicial determination that your green card has been revoked or abandoned. You can contact the USCIS to check the status of your card.
If one of these conditions apply and you do not meet one of the residence tests in the next year, the general rule states that you are resident through the last day of the calendar year in which the event occurs. For example, if you surrender your green card in June of 2009 and you do not meet either residence test in 2010, the general rule results in your U.S. tax residency ending on December 31, 2009. There is an exception to this general rule. If you have established a tax home in a country other than the U.S. and you have closer connections to that other country on the date your green card status ceases, your U.S. residency is deemed to end on that date rather than the end of the calendar year. This exception often allows a foreign national to terminate residency prior to the U.S. tax year-end of December 31.

Due to family matters, Maria decides in April of 2010 to resign her position and return to Spain. She returns to Spain on May 1, 2010. At the same time, she decides to voluntarily surrender her “green card.” She begins this process and her “green card” status is officially abandoned on June 15, 2010. Maria takes a job with a new Spanish employer on July 1, 2010. This job requires her to make a subsequent business trip to the U.S. in 2010. This trip to the U.S. begins on October 5 and ends on October 11 which results in Maria spending 7 additional days in the U.S during 2010.

For 2009, Maria is considered a U.S. tax resident under the lawful permanent residence test from January 1 through December 31.

For 2010, Maria is a U.S. tax resident for the period January 1 through June 15. Maria qualifies for the exception to the general rule for her residency termination date. After surrendering her green card, Maria established a tax home in Spain and has closer connections to Spain as of June 15, 2010. As a result, this is deemed to be the date her U.S. tax residency ends, rather than December 31, 2010.

**Substantial Presence Test**

The other tax residency test is the substantial presence test. This test is more complicated than the lawful permanent resident test. The substantial presence test looks at the number of days you are actually physically present in the U.S. for any purpose over a three-year period of time. If the number of days you are physically present in the U.S. equals or exceeds 183 days in the current tax year, or 183 days during a three-year period which includes the current year and the two years immediately prior to the current year, you are treated as a U.S. tax resident. The three-year period works as follows:
• For the current year, count all of your days physically present in the U.S.;

• For the first year preceding the current year, count one third of your days physically present in the U.S.;

• For the second year preceding the current year, count one-sixth of your days physically present in the U.S..

For this purpose, a day of actual physical presence in the U.S. is any day that you spend any amount of time in the U.S. Therefore, days of arrival and departure each count as a full day of U.S. presence. However, a day of presence does not include time spent in the U.S. under the following circumstances:

• Time spent in the U.S. while in transit between two non-U.S. locations. This time cannot exceed 24 hours nor can you conduct any business while in the U.S.;

• Days spent commuting to work in the U.S. from a residence in Canada or Mexico if you regularly commute from Canada or Mexico;

• Days that you are unable to leave the U.S. due to a medical condition that you developed while you were in the U.S.;

• Days spent in the U.S. as an exempt person. Exempt individuals include certain government officials, teachers, students and athletes.

Maria, first came to the U.S. in late 2008 to look for housing. She spent 6 days in the U.S. on this trip. She moved to the U.S. permanently on January 1, 2009. She left the U.S. on May 1, 2010. She also spent an additional 7 days in the U.S. on business after May 1, 2010. Applying the substantial presence test to her situation results in the following:

<table>
<thead>
<tr>
<th>2009 Tax Year</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>2009 days</td>
<td>(1 X 365)</td>
</tr>
<tr>
<td>2008 days</td>
<td>(1/3 X 6)</td>
</tr>
<tr>
<td>2007 days</td>
<td>(1/6 X 0)</td>
</tr>
<tr>
<td>Total days for substantial presence test</td>
<td>367 days</td>
</tr>
</tbody>
</table>
There are certain exceptions to the substantial presence test.

**31-Day Exception**

If you are present for less than 31 days in the current year, the substantial presence test is not applied to determine residency. The test is not applied even if the 183-day threshold is met when the two preceding years are considered. Remember that this does not mean that you automatically qualify as a nonresident. If you have a “green card,” under the lawful permanent resident test you are generally a tax resident regardless of the number of days spent in the U.S.
Closer Connection Exception

If you meet the substantial presence test it is still possible to argue that you are a full-year nonresident if the following conditions are satisfied:

- You are present in the U.S. for fewer than 183 days in the current year; and
- You maintain a “tax home” in another country during the entire current year; and
- You maintain a closer connection to the foreign country in which you have a tax home during the current year.

In order to show that you maintained a “tax home” in another country, you must demonstrate that you have “regular or principal place of business” or a “regular place of abode” in that country. To meet the closer connection requirement, it is necessary to show that you have more significant contacts with the foreign country as compared to the U.S. These are rather subjective determinations that consider personal as well as business connections.

When Does Tax Residency Begin?

If you qualify as a resident under the substantial presence test in the current year and you did not qualify in the prior year, your residency period begins on the first day that you are physically present in the U.S. However, certain days can be ignored when determining a residency start date. These days are referred to as “nominal” days of

Maria cannot use the 31 day exception for 2009 or 2010 as she was present for more than 31 days in each of these years.

Maria could not use the closer connection exception for full-year nonresident status for 2009 or 2010. She is present for more than 183 days in 2009. Although she spends less than 183 days in the U.S. in 2010, she did not maintain a tax home in Spain for the entire year. As such, Marie would be a U.S. resident for at least part of the 2010 calendar year.
U.S. presence. A “nominal day” is a day spent in the U.S. while you have a tax home in another country and while you maintain a closer connection to that other country. Up to 10 days of “nominal” presence can be ignored. An example of a “nominal” day is one during a pre-assignment house-hunting trip. However, it is important to note that these days are ignored only for purposes of establishing a residency start date. All days of presence in the U.S. are considered when determining days under the substantial presence test.

Maria’s residency for the substantial presence test is deemed to begin on January 1, 2009 — the day she moved to the U.S. Although she was in the U.S. prior to January 1, these days can be ignored as they are not current year days. These days also qualify for the exception outlined above as they are “nominal” in nature and are fewer than 10 days.

When Does Tax Residency End?

Like the lawful permanent resident test, the general rule for termination of U.S. tax residency is the last day of the calendar year. However, there is an exception to this general rule. Under this exception, your residency is deemed to end on the last day that you are present in the U.S. in the year that you move from the U.S. and establish a residence in another country. You must establish a tax home in another country and also a closer connection to that country from this day forward. Similar to the determination of the residency start date, up to 10 “nominal” days of U.S. presence can be ignored after you move from the U.S.

Maria’s residency terminates under the substantial presence test on May 1, 2010. This is the day Maria moves back to Spain. She establishes a tax home in Spain and closer connections to Spain from this day forward. Although she spends some additional time in the U.S. on a subsequent business trip, these days of U.S. presence are ignored for the purpose of fixing her residency ending date. These days qualify for the “nominal” presence exception outlined above.
Which Test Prevails?

It is common for a person to meet both the lawful permanent resident test and the substantial presence test. This raises the question—which test is used to determine when residency begins and when it ends? The answer is the test that results in the earliest starting date is used to determine the start date. The test that results in the latest ending date is used to determine the residency ending date.

According to the substantial presence test, Maria’s resident status begins on January 1, 2009 and ends on May 1, 2010. Under the lawful permanent resident test, her resident status begins on January 1, 2009 and ends on June 15, 2010.

Both tests result in the same start date so in this case either test can be used for her start date. The lawful permanent resident test results in a later ending date so this test prevails for that purpose. Maria’s U.S. tax residency begins on January 1, 2009 and ends on June 15, 2010.

Special Considerations

First Year Election

Sometimes it is better to be treated as a resident rather than a nonresident. There is an election available that allows foreign nationals to be taxed as a resident in the initial year of a U.S. assignment even if one of the residency tests is not met for that year. To qualify for this election, the following requirements must be satisfied:

- You must have been a U.S. nonresident in the year immediately preceding the initial year of the U.S. assignment.

- You must satisfy the substantial presence test in the year following the initial year of the U.S. assignment.

- You must be present in the U.S. for at least 31 consecutive days in the initial year of the U.S. assignment.

- During this initial year, you must be present in the U.S. for at least 75% of the days from the start of the 31-consecutive-day period (see above) through the end of the year.
Whether or not this election makes sense for you depends on the specific facts of your individual situation. If this is the initial year of your U.S. assignment and you will not meet either of the two residency tests, you should consult with a tax professional to determine whether this election will reduce your U.S. tax liability. If the election is beneficial, a professional tax advisor can also ensure that a valid election is made.

It is also important to consider your foreign tax liability during the first and last years of a U.S. assignment. Your tax advisor must take into account both your U.S. and foreign tax matters to minimize your total worldwide tax burden.

No Lapse Rule

If, after terminating residency in one year, a foreign national returns to the United States and resumes residency at any time during the following year, the residency shall be considered as never having lapsed between the two residency periods.

If an individual interrupts their period of U.S. residence with a period of nonresidence, there are special rules that apply. If you were in the US for the last three years, leave the U.S., but become a resident again within the next three years, you may be subject to U.S. tax under the special rule if the tax is more than it would have been as a nonresident alien.

Impact of Tax Treaties

This chapter has covered the general rules used to determine whether a foreign national is treated as a tax resident in the U.S. Please note that this discussion has not considered the impact of tax treaties on the question of residency. The United States has implemented numerous income tax treaties with other countries. The purpose of a tax treaty is to minimize double taxation which may arise due to differences in the tax laws of each jurisdiction. It is quite possible that you could meet one of the residency tests for the U.S. (outlined above) and also be considered a tax resident in your home country or other country. As a result, both countries could treat you as a resident and you could be subject to double taxation. Income tax treaties usually contain residency tie-breaker rules which can be utilized in this type of situation. These rules determine which of the two countries possess the right to tax you as a resident. Income tax treaties and their impact are discussed in greater detail in Chapter 8.
2. Case Study Background

This chapter provides additional information about Maria’s and Pablo’s U.S. assignments. If you recall from Chapter 1, Maria is a U.S. resident taxpayer in 2009, and a part-year resident in 2010. Pablo is a nonresident taxpayer in 2009. These conclusions and the information outlined below are used in later chapters to provide examples of the U.S. taxation of foreign nationals.

Maria

Maria’s income, expenses, and a brief description of her living and work situation for 2009 and 2010 are outlined below.

2009

Maria’s job in the U.S. started on January 5, 2009. Her salary from this job through the end of 2009 totaled $80,000. Maria had Colorado income tax withholding of $3,500 and U.S. federal income tax withholding of $18,500 deducted from these wages. Maria also made $4,000 of charitable contributions to a qualified U.S. charity in 2009. In addition to her employment income, Maria earned the following income in 2009.

- **Dividends from stock held in a U.S. corporation**: $1,600
  ($400 paid each quarter on March 15, June 15, September 15, and December 15)

- **Interest Income from U.S. bank accounts**: $800

- **Interest Income from Spanish bank accounts**: *$800

  * This represents total 2009 interest income from Spanish bank accounts. $100 of Spanish tax was withheld from this amount so Maria actually received $700.
2010

Maria worked for her U.S. employer through April 30, 2010. After leaving the U.S., she accepted a job with a Spanish employer (effective July 1, 2010). Her wages from her U.S. employer for 2010 were $35,000. U.S. federal income tax of $6,000 and Colorado income tax of $1,200 was withheld from these wages. The wages from her Spanish employer amount to $65,000 of which $3,500 relates to her services performed in the U.S. Spanish income tax of $13,500 was withheld from these wages. Maria made charitable contributions of $2,500 to a qualified U.S. charity in 2010. In addition, Maria earned the following income in 2010:

- Dividends from stock held in a U.S. corporation: $1,600
  ($400 paid March 15, June 15, September 15, and December 15)
- Interest from U.S. bank accounts: $800
- Interest from Spanish bank accounts: $800

* This represents the gross dividends paid to Maria in 2010. There is $180 of U.S. federal tax withheld from these payments so Maria only receives a net amount after withholding of $1,420.

** This represents gross interest paid to Maria in 2010. There is $100 of Spanish tax withheld from this interest so Maria receives the net of $700.

Pablo

Following is a summary of Pablo’s income and expenses in 2009.

2009

Pablo earned a total of $70,000 in 2009. Of this amount, Pablo earned $30,000 for the services provided in the U.S. during the short-term project. Pablo was paid by his Spanish employer (XYZ, SA) for the services performed in the U.S. No U.S. taxes were withheld from Pablo’s wages. While in the U.S., Pablo incurred transportation expenses and temporary living expenses (meals, lodging, etc.) of $6,500. These expenses were reimbursed by XYZ, SA.
In addition to his wage income, Pablo earned the following income:

<table>
<thead>
<tr>
<th>Income Source</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividends from stock held in a U.S. corporation</td>
<td>$400</td>
</tr>
<tr>
<td>($100 paid March 15, June 15, September 15, and December 15)</td>
<td></td>
</tr>
<tr>
<td>Dividends from Spanish investments</td>
<td>$2,000</td>
</tr>
<tr>
<td>Interest from U.S. bank accounts</td>
<td>$600</td>
</tr>
<tr>
<td>Interest from Spanish bank accounts</td>
<td>$2,500</td>
</tr>
</tbody>
</table>

* This represents the gross dividends declared by the U.S. corporation. The corporation withheld $60 of U.S. tax from the amount actually paid Pablo.

Chapters 3, 5, and 6 contain an analysis of the U.S. tax rules associated with Pablo’s and Maria’s activity in the U.S. Chapter 3 discusses the taxation of full-year residents so Maria’s tax situation for 2009 will be discussed first. Pablo’s 2009 U.S. tax situation is analyzed in Chapter 5. Chapter 5 covers the taxation of full-year nonresidents. Maria’s 2010 tax year is addressed in Chapter 6 which discusses the taxation of part-year resident taxpayers, also referred to as “dual-status” taxpayers.

Because this case study includes a future year (2010), we have applied U.S. tax law and tax rates which are in effect as of January, 2009. The intent of this case study is to illustrate the mechanics of the current law. Please keep in mind that changes in tax law could occur that would alter the outcome of this analysis.

### 3. Income Taxation of Residents

If you are a resident taxpayer, you are taxed in the United States as if you are a U.S. citizen. You are taxed on the worldwide income that you earn during your period of residence. Following is a general discussion of the U.S. tax law and how it applies to resident taxpayers. This chapter covers the taxation of a resident taxpayer who is tax resident for the entire year.

Where appropriate, the concepts discussed are applied to the case study information outlined in the previous chapter (Chapter 2).
Income Tax Overview

The flowchart below summarizes the computation of U.S. federal taxable income for a resident taxpayer individual and the resulting tax on that taxable income.

```
Gross Income
  minus
  Deductions from Gross Income
    equals
    Adjusted Gross Income (AGI)
      minus
      Itemized Deductions or
      Standard Deduction
        minus
        Exemptions
          equals
          Taxable Income
            application of tax rates equals
            Tentative Tax Liability
              minus
              Tax Credits
                equals
                Net Tax Liability
```
Filing Status

Your filing status is important in the calculation of many items which affect your tax. Some of these items are the amount of standard deduction available to you; the phase-outs of itemized deductions, exemptions and certain credits (all discussed later); as well as the tax rate schedule which dictates your marginal tax bracket. Following are the filing statuses to choose from:

- Single Individual
- Married Filing Jointly
- Married Filing Separately
- Head of Household

IN OUR CASE STUDY, Maria will file as a single individual as she is not married and has no children or other dependents.

Gross Income

For federal income tax purposes, “gross income” means all income from whatever source, except for those items specifically excluded by law. Gross income includes such items as:

- Wages, salaries and other compensation
- Interest and dividends
- State income tax refund (if claimed as an itemized deduction in prior years)
- Income from a business or profession
- Alimony received
- Rents and royalties
- Gains on sales of property
- S Corporation, trust, and partnership income
Deductions from Gross Income

Deductions from gross income are used to arrive at your adjusted gross income (AGI). These deductions apply even if you use the standard deduction rather than itemizing your deductions. Your AGI will be important in many of the phase-out calculations that are discussed later. Available deductions from gross income include:

- IRA contribution deduction
- Student loan interest deduction
- Tuition and fees deduction
- Medical and health savings account contribution deduction
- Penalty incurred on early withdrawal of savings
- Alimony paid
- Unreimbursed deductible moving expenses
- Self-employed health insurance
- Self-employed SEP, SIMPLE, and qualified plans
- One half of self-employment tax

IN OUR CASE STUDY, Maria does not have any of these items in 2009 and has no deductions from gross income.

Itemized Deductions/Standard Deduction

Taxpayers have the choice of either taking a standard deduction or itemizing their deductions, whichever will result in a larger deduction. The amount of the standard deduction varies depending on your filing status. For 2009, the standard deduction amounts are as follows:

- Single Individual ........................................ $5,700
- Married Filing Jointly.................................... 11,400
- Married Filing Separately................................. 5,700
- Head of Household ....................................... 8,350
If the sum of your allowable itemized deductions is greater than the standard deduction allowed based on your filing status, you should itemize. The following are examples of amounts that can qualify as itemized deductions:

- State and local income taxes
- Real estate taxes
- New motor vehicle taxes
- Other personal property taxes
- Qualified home mortgage interest
- Charitable contributions to qualified U.S. charities
- Investment interest, if applicable

As a general rule, homeowners will typically itemize their deductions while renters will often find the standard deduction more beneficial.

**IN OUR CASE STUDY, Maria has the following 2009 expenses which qualify as itemized deductions:**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Colorado Income Tax</td>
<td>$3,500</td>
</tr>
<tr>
<td>Charitable Contributions</td>
<td>4,000</td>
</tr>
<tr>
<td><strong>Total Itemized Deductions</strong></td>
<td><strong>$7,500</strong></td>
</tr>
</tbody>
</table>

At first glance, it appears that Maria should itemize her deductions rather than claim the standard deduction of $5,700. However, before this decision is made it is necessary to consider the itemized deduction phase-out rules discussed next.

**PHASE-OUT OF ITEMIZED DEDUCTIONS**

If your AGI exceeds a threshold amount, you are required to reduce your allowable itemized deductions by 3% of the excess over the threshold amount. This phase-out of allowable itemized deductions is slated for repeal in 2010. For 2009, the reduction can not exceed 80% of allowable itemized deductions, and you will only lose one-third of the normal phase-out. For 2009, the threshold amount is $83,400 for married filing separately, and $166,800 for all other filing statuses.

**IN OUR CASE STUDY, Maria’s AGI in 2009 is $83,200. This is less than the phase-out threshold of $166,800 so her itemized deductions for 2009 will not be reduced. It is clearly better for Maria to itemize her deductions in 2009.**
Exemptions

In 2009, you can deduct $3,650 for each exemption allowed. You are allowed one exemption for yourself, and if you are married and file a joint return, one exemption for your spouse. You are also allowed one exemption for each person you can claim as a dependent.

Certain dependency tests need to be met for each dependent you claim:

- You must have furnished over half of their total support for the calendar year,
- They must have less than $3,650 of gross income, unless they are a child under age 19 or a full-time student under age 24,
- They must live with you for the entire year or be related to you,
- A related individual must have lived with you for more than half of 2009,
- They cannot file a joint tax return with their spouse, and
- They must be a citizen, national, or resident of the United States, Canada, or Mexico.

In our case study, Maria can only claim one exemption (for herself) in 2009 as she is not married and does not have any children or dependents.

Phase-out of Exemptions

The amount you can claim as an exemption deduction begins to phase out once your AGI exceeds a certain threshold amount. Similar to the itemized deductions phase-out calculation, this threshold depends on your filing status. The threshold amounts for 2009 begins at the following:

- Single Individual .................................................. $166,800
- Married Filing Jointly.............................................250,200
- Married Filing Separately .....................................125,100
- Head of Household ...............................................208,500

If your AGI exceeds the threshold amount for your filing status, you must reduce your total exemption deduction by 2% for each $2,500, or part of $2,500, of the excess (for each $1,250, or part of $1,250, if married filing separately). This phase-out of allowable exemptions is slated for repeal in 2010. For 2009, the exemption amount for taxpayers with AGI in excess of the maximum phase-out amount is $2,433.
Once you have calculated your taxable income, the next step is to calculate your tax. The Federal tax rate schedules for 2009 are included in Appendix A.

Maria’s AGI ($83,200) is lower than the phase-out threshold of $166,800.

Maria can claim an exemption amount of $3,650 in 2009.

**Case Study Summary**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjusted Gross Income</td>
<td>$83,200</td>
</tr>
<tr>
<td>Deductions from AGI</td>
<td>(0)</td>
</tr>
<tr>
<td>Itemized Deductions</td>
<td>(7,500)</td>
</tr>
<tr>
<td>Exemptions</td>
<td>(3,650)</td>
</tr>
<tr>
<td>Taxable Income</td>
<td>$72,050</td>
</tr>
</tbody>
</table>

Once you have calculated your taxable income, the next step is to calculate your tax. The Federal tax rate schedules for 2009 are included in Appendix A.

Maria’s tentative U.S. federal income tax liability for 2009 is $14,200. This is calculated using the “single individual” tax rate schedule provided in Appendix A.

**Tax Credits**

**Foreign Tax Credit**

The U.S. allows for a credit against the U.S. income tax paid on income which is also subject to foreign income tax. This is referred to as the foreign tax credit. To qualify for the credit, the foreign tax incurred must be imposed on you and levied on your income.

The foreign tax credit is limited to the lesser of the actual foreign tax paid or accrued or the U.S. tax liability associated with the income that attracts the foreign tax (foreign source taxable income). This limitation is calculated by applying the following formula:

\[
\text{Foreign Source Taxable Income} \times \frac{\text{U.S. Tax Liability}}{\text{Total Taxable Income}} = \text{Foreign Tax Credit Limitation}
\]

Before exemptions
Please note the use of the phrase “foreign source” in the above formula. Income sourcing and the rules for distinguishing U.S. source income from foreign source income are covered in Chapter 4. Also note that the formula considers foreign source taxable income rather than foreign source gross income. Foreign source taxable income is calculated by allocating a portion of the various deductions used to arrive at overall taxable income to your foreign source gross income. If the total foreign taxes incurred in a given year cannot be used as a credit due to this limitation, the unused portion may be carried back one year and then carried forward to the next ten years.

To further complicate matters, the foreign tax credit limitation is applied separately to statutorily defined classifications of income. These classifications are often referred to as “baskets” in discussions regarding the U.S. foreign tax credit. Two common classifications encountered by foreign nationals are the “general” basket which includes business income, salary, and wages and the “passive” basket which includes dividends, interest, and capital gains.

In 2009 Maria does pay some foreign tax. This is the Spanish tax of $100 that is withheld on the interest income from Spanish bank accounts. All of her foreign source income falls within one basket so it will only be necessary to perform one calculation for her foreign tax credit. Maria’s total 2009 foreign source income consists of the interest earned from her Spanish bank accounts. This item falls within the passive basket.

The first step in the overall computation is calculating her foreign source taxable income. We know that her gross foreign source income is $800. It is necessary to allocate a portion of the deductions used to arrive at taxable income (before the deduction for personal exemptions) to her gross foreign source income. We will do this based on her ratio of gross foreign source income to total gross income which equals $800 / $83,200 or .96%. Applying this ratio to her total itemized deductions of $7,500 results in $72. Maria’s foreign-source taxable income equals $728 ($800 - $72).

The next step is calculating Maria’s 2009 foreign tax credit limitation. Using the formula provided above, Maria’s 2009 limitation is calculated as follows:

\[
\frac{728}{75,700} \times 14,200 = 137
\]
Another important aspect related to the foreign tax credit is an election to deduct the foreign taxes as an itemized deduction. If this election is made, the taxes are no longer available for credit. In most cases it is more beneficial to elect the credit as this can provide a dollar-for-dollar benefit. However, in limited cases, deducting the taxes results in a greater benefit. You should always consult a tax advisor before claiming the foreign tax credit or before making the deduction election to help ensure you receive the maximum available benefit.

Other Credits

Child Tax Credit and Additional Child Tax Credit

During 2009, you may be entitled to a child tax credit of up to $1,000 for each of your qualifying children. To qualify, the child must be:

- under age 17,
- a citizen or resident of the U.S.,
- someone you can claim as a dependent,
- your child, stepchild, grandchild or eligible foster child,
- someone who did not provide over half of their own support, and
- someone who lived with you for more than half of 2009.

**Phase-out of Child Tax Credit**

The amount of your child tax credit starts to phase-out once your modified AGI exceeds a threshold amount for your filing status. The threshold amounts for 2009 are as follows:

- Single individuals .............................................. $ 75,000
- Married filing jointly........................................... $ 110,000
- Married filing separately................................. $ 55,000
- Head of household............................................. $ 75,000

If your modified AGI is above the threshold amount for your filing status, you must reduce your credit by $50 for each $1,000, or part of $1,000, that your AGI exceeds the threshold amount. Unlike other phase-outs (e.g., for itemized deductions and personal exemptions), the income level at which the child tax credit is completely phased out is higher for each additional child.
For the additional Child Tax Credit, if the usable child tax credit is greater than your tax liability and taxable earned income is greater than $3,000, or if you have three or more qualifying children, and the Social Security and Medicare tax you paid is more than your Earned Income Credit, a portion of the credit may be refundable.

**Higher Education Tax Credits**

For 2009 and 2010, there is a new education credit called the American Opportunity tax credit (AOC). This is a modification of the HOPE Credit.

- The maximum amount of AOC is $2,500 per student. The credit is phased out (gradually reduced) if your modified adjusted gross income (AGI) is between $80,000 and $90,000 ($160,000 and $180,000 if you file a joint return).

- The credit can be claimed for the first four years of post-secondary education. Previously, the credit could be claimed for only the first two years of post-secondary education.

- Generally, 40% of the AOC is now a refundable credit for most taxpayers, which means that you can receive up to $1,000 even if you owe no taxes.

- The term “qualified tuition and related expenses” has been expanded to include expenditures for “course materials.” For this purpose, the term “course materials” means books, supplies, and equipment needed for a course of study, whether or not the materials must be purchased from the educational institution as a condition of enrollment or attendance.

The **Lifetime Learning** credit is not limited to students in the first four years of post-secondary education. Qualified expenses for this credit include the cost of instruction taken to acquire or improve existing job skills, if taken at a qualified educational institution. The amount of the credit is 20% of the first $10,000 you pay for qualified expenses. The maximum **Lifetime Learning** credit you can claim per year is $2,000 (20% x $10,000). This credit applies to expenses paid after June 30, 1998.
PHASE-OUT OF HIGHER EDUCATION TAX CREDITS

The allowable amount of these credits is reduced for taxpayers who have AGI above certain limits. For 2009, the phase-out begins for single individuals, and head of household filing statuses when modified AGI reaches $48,000; the credits are completely phased out when modified AGI reaches $58,000. For married filing jointly, the phase-out range is $96,000 to $116,000.

IN OUR CASE STUDY, Maria did not incur any costs related to higher education and cannot claim any higher education tax credits.

Filing Requirements and Procedures

As a full-year U.S. tax resident you are required to file Form 1040 and pay any taxes due with the return by April 15 of the year following the reporting year. If you are not ready by April 15 to file your return because of missing information, you can get an automatic extension of six months (to October 15) to file your return. This extension only applies to the filing of your Form 1040 and not to the payment of any tax liability. Therefore, it is necessary to estimate your tax liability by April 15 and pay any remaining tax owed in order to avoid penalties and interest charges. The automatic extension can be obtained by filing Form 4868 by April 15. Any estimated tax liability should be remitted with Form 4868. A separate extension request may be required if you have a state tax filing requirement.
In most cases, there are no available extensions beyond October 15. Note that if you are residing outside the U.S. on April 15, you are allowed an automatic two-month extension of time to file your U.S. federal tax return. It is not necessary to file any forms to receive this extension.

Your tax advisor can file extension requests on your behalf, so this process can be relatively easy and pain-free, unless, of course, you owe money.

Where you file your U.S. tax return depends on where you reside in the U.S. Check with your tax advisor or with the Internal Revenue Service for the locations of the service centers where you should send your tax return, extension requests, and any necessary tax payments.

4. Sourcing Rules

Before we get into the rules regarding the taxation of nonresidents, it is necessary to spend some time on the topic of “sourcing”. Up to this point we have mentioned that nonresidents are generally taxed in the U.S. only on U.S. source income that they receive. We have also referred to the concept of foreign source income in our discussion of foreign tax credits. How does one determine what constitutes U.S. source income versus that which is treated as foreign source income? This chapter will go over the sourcing rules for the most common types of income.

Personal Services Income

This category of income includes wages, salary, bonuses, and deferred compensation such as pensions that are paid by an employer. It also includes fees and other compensation earned by self-employed individuals.

The determining factor for the source of this type of income is typically where the services are physically performed. Compensation earned for services physically performed in the United States is considered U.S. source income, regardless of who the employer is or what payroll the income is paid from. Likewise, compensation for services physically performed outside the United States is considered foreign source income. If compensation is related to the work performed both in the U.S. and outside the U.S., the compensation is typically sourced based on the relative workdays in the various locations. For example, if you worked 50% of the time in the U.S., then 50% of your compensation would be U.S. source income. In certain cases, exceptions may apply (e.g., certain compensation may be sourced based on geographical location).
An exception exists for certain amounts earned by foreign nationals. Under this exception, compensation for services performed in the U.S. is not considered U.S. source income if the following conditions are satisfied:

- The services must be performed by a nonresident taxpayer who is temporarily present in the U.S. for a period of 90 days or less.
- The total compensation for these services does not exceed $3,000.
- The services must be performed as an employee of or under contract (in the case of a self-employed contractor) with one of the following:
  - A nonresident individual, foreign partnership or foreign corporation which is not engaged in a trade or business in the U.S., or
  - A foreign office or foreign branch of a U.S. resident, U.S. partnership, or U.S. corporation.

**Interest Income**

The general rule for determining the source of interest income looks at the residence of the payor. Interest which is paid by a U.S. resident, partnership, or corporation is deemed to be U.S. source income. Interest paid on obligations issued by the U.S. government or by any political subdivision in the United States such as a state government is also considered to be U.S. source income.

Interest paid by a foreign entity (corporation, partnership, individual, government, etc.) is classified as foreign source income.

**Dividend Income**

Similar to interest, the general rule for dividends looks at the residence of the corporation paying the dividend. If the dividend is paid by a U.S. corporation it is deemed to be U.S. source income. Conversely, dividends paid by a foreign corporation are deemed to be foreign source income.

**Rental and Royalty Income**

The source of rental and royalty income depends on the location of the property which generates the income. If the property is located in the United States, the rental or royalty payment is deemed to be U.S. source. For property which is located outside the U.S., the rental or royalty payment is treated as foreign source income.
Income from the Sale of Personal Property

Income generated from the sale of personal property is sourced according to the residence of the seller. Personal property includes assets such as stocks, bonds, cars, equipment, and furniture. Residence for this purpose is based on the “tax home” concept which was discussed briefly in Chapter 1. Generally speaking, gain from the sale of personal property by a U.S. nonresident will not be considered U.S. source income.

Income from the Sale of Real Property

The source of this type of income depends on the location of the property. Real Property generally includes land and buildings. Gain on the sale of real property which is located in the United States is considered to be U.S. source income regardless of the residency of the seller. The sale of real property located outside the U.S. generates foreign source income.

There are special rules related to the disposition of an interest in U.S. real property. Please see Chapter 9 for an analysis of these rules.

Partnerships

If you own an interest in a partnership, the source of the income is determined at the partnership level. The income retains this source when it flows into your individual tax return.

5. Taxation of Nonresidents

As a general rule, nonresident taxpayers are taxed in the U.S. only on income from U.S. sources. There are limited situations where the U.S. will also tax certain types of foreign source income earned by nonresidents. However, this is beyond the scope of this book so the remainder of this chapter is devoted to a discussion of U.S. source income and the U.S. tax impact to nonresident taxpayers.

There are two separate classifications in U.S. tax law for U.S. source income. In the previous chapter we covered the most common types of income earned by nonresident individuals and the rules for determining whether it is U.S. source income or foreign source income. Once the source of each category of income is determined, it is necessary to further categorize all items which are U.S. source into one of the following two categories:

- Trade or business income, or
- Passive income (e.g., non-trade or business income)
The distinction between these two types of income is important because trade or business income is taxed differently than income from other sources.

**Trade or Business Income**

Trade or business income is income generated in the U.S. through an activity which demands a certain level of active participation. Compensation for the performance of personal services as an employee is an example of trade or business income. In addition, compensation for the performance of services as an independent contractor (self-employed individual) is trade or business income. Other activities are also considered U.S. trade or business income, including selling products in the U.S. through a U.S. based office, ownership of a U.S. business, and ownership in a partnership with a U.S. business.

Income which is trade or business income is taxed on a net income basis using graduated tax rates. Net income is determined by accumulating the gross trade or business income and reducing it by allowable deductions which are attributable to this gross income.

**Allowable Deductions**

**Business Deductions**

If you have a business in the U.S., you may typically deduct most expenses that are directly related to the business. These business deductions could include wages paid to employees, depreciation of assets, marketing and advertising costs, taxes, insurance, interest, etc. Employee compensation income is generally not considered “business” income for business deduction purposes. Expenses incurred as an employee are considered “itemized deductions”.

Any expense that is personal in nature is usually not deductible unless it qualifies as an adjustment to gross income or is an itemized deduction.

**Adjustments to Gross Income**

Similar to U.S. residents, nonresidents can claim certain deductions from gross income. Allowable deductions from gross income include:

- Educator expenses
- IRA contribution deduction
- Medical savings account contribution deduction
- Self-employed SEP, SIMPLE, and qualified plans
- One half of self-employment tax
- Alimony paid
- Tuition and fees deduction
• Domestic production activities deduction
• Student loan interest deduction
• Unreimbursed deductible moving expenses
• Penalty incurred on early withdrawal of savings
• Self-employed health insurance deduction
• Scholarship and fellowship grants excluded

It is uncommon for nonresidents to have these types of deductions. Also note that these expenses must relate to income earned from a U.S. trade or business to be deductible.

**Itemized Deductions**

Nonresidents can also claim the following itemized deductions:

• State and local income taxes
• Gifts to qualified U.S. charities
• Casualty and theft losses
• Unreimbursed employee business expenses and miscellaneous deductions (subject to limitations)

Please note that many of the itemized deductions which are available to residents (see chapter 3) cannot be claimed by a nonresident taxpayer. Nonresidents are also not allowed to take the standard deduction.

**Personal Exemptions**

In addition to the business deductions, deductions from gross income, and itemized deductions, each nonresident is allowed one personal exemption deduction. For 2009, the personal exemption amount is $3,650.

Residents of Canada and Mexico are not subject to the general rule of only one exemption. These nonresidents may claim additional exemptions for those individuals who qualify as a dependent (see page 19). Note that any individual (including yourself) that you claim as an exemption must have a U.S. social security number or taxpayer identification number.

**IN OUR CASE STUDY, Pablo cannot claim any itemized deductions as he did not incur any of the above-mentioned expenses.**

**IN OUR CASE STUDY, Pablo can claim one personal exemption.**
**Short-Term Assignments**

Not all foreign nationals who accept a U.S. assignment establish a tax home in the U.S. In those cases where a U.S. tax home is not established, the individual is treated for tax purposes as being on a “temporary assignment” in the U.S. A temporary assignment is defined as an assignment where the tax home (principal place of work or employment) does not change. If the intent of the assignment is to return to the original work location within one year, the assignment is considered a temporary assignment (all other assignments are considered indefinite or long-term).

The tax advantage of a temporary assignment is that employer-provided benefits such as lodging, meals, travel, and certain other items related to the assignment might not be (if properly structured) considered taxable wages to the employee. In the case of a long-term assignment, these items are typically considered taxable wages.

**IN OUR CASE STUDY, Pablo is on a temporary assignment in the U.S. The $6,500 of related meals and lodging that were reimbursed by XYZ, SA are not taxable compensation and can be ignored when calculating his U.S. tax liability.**

If these expenses are not paid or reimbursed by the employer, the individual might be allowed to deduct those costs related to the assignment (lodging, meals, transportation, etc.) as an itemized deduction (subject to certain limitations).  

**IN OUR CASE STUDY, Pablo cannot deduct these costs as they are not included in his compensation for U.S. tax purposes.**

**Tax Rates**

After reducing the trade or business income by any allowable deductions and the personal exemption, the net trade or business income is subject to graduated tax rates. The rates at which net trade or business income is taxed depends on whether or not you are married. If you are a married nonresident, generally the married filing separately rate schedule (see Appendix A) applies to your net trade or business income.
Please note that the “married filing separately” tax rates must be used because nonresidents are not allowed to file a joint tax return with a spouse. However, if you find yourself in the situation that you are married to a U.S. citizen or resident and you do not meet the U.S. residency requirements, you can elect to be treated as a resident and therefore file a joint return with your spouse.

If you are not married, you must use the ‘single taxpayer’ tax rate schedule (see Appendix A).

In our case study, Pablo does have U.S. trade or business income in 2009. The trade or business income is the compensation he receives while working in the U.S. on the short-term project. Note that this income does not qualify for the personal services exception outlined on page 26 as it exceeds the $3,000 threshold and Pablo is present in the U.S. for more than 90 days. Pablo should file a U.S. tax return and include this income in his return. Pablo’s U.S. tax return would include the trade or business compensation of $30,000, but would not include the assignment related expenses of $6,500 that are reimbursed by XYZ, SA.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade or business income</td>
<td>$30,000</td>
</tr>
<tr>
<td>Less:</td>
<td></td>
</tr>
<tr>
<td>Business Deductions</td>
<td>(        0)</td>
</tr>
<tr>
<td>Deductions from gross Income</td>
<td>(        0)</td>
</tr>
<tr>
<td>Itemized Deductions</td>
<td>(        0)</td>
</tr>
<tr>
<td>Net Trade or Business Income</td>
<td>$30,000</td>
</tr>
<tr>
<td>Personal exemptions</td>
<td>(3,650)</td>
</tr>
<tr>
<td>Taxable income from U.S. trade or business</td>
<td>$26,350</td>
</tr>
</tbody>
</table>

As Pablo is unmarried, this income is taxed according to the single taxpayer rate schedule.

It is very important to note that this conclusion does not take into account a more favorable treatment that might be available to Pablo under an income tax treaty. We will revisit this when we discuss tax treaties in Chapter 8.
Passive Income

Unlike trade or business income, U.S. source passive income is taxed on a gross basis at a flat tax rate of 30%. “Gross basis” means that no deductions or exemptions are allowed against this income. For purposes of this discussion, the most typical types of income which fall into the “Passive Income” category are interest, dividends, royalty, rents, alimony, certain capital gains, and 85% of U.S. social security benefits.

The flat tax of 30% is usually collected through a withholding mechanism with the burden to withhold placed upon the payor of the income. For example, a U.S. corporation is generally required to withhold the 30% tax from any dividends it pays to nonresident taxpayers and remit this withholding to the U.S. government on behalf of the individual.

The 30% tax rate can be reduced or in some cases eliminated if a tax treaty is in place between the U.S. and the country of residence of the taxpayer. Please see Appendix B to determine whether a treaty exists between your home country and the U.S. A more thorough discussion of treaties can be found in Chapter 8.

If you are a nonresident taxpayer and your only U.S. source income consists of passive income, you are not required to file a U.S. tax return. The withholding tax generally satisfies any U.S. tax liability.

In Our Case Study, Pablo does have U.S. source income which meets the definition of passive income in 2009. The income consists of the dividends of $400 he received from the U.S. corporation. U.S. tax in the amount of $60 was withheld from the actual cash paid to him. Why doesn’t this tax equal 30% of the gross amount? The answer is that the income tax treaty between Spain and the U.S. provides for a 15% withholding tax rate on dividends. Again, see Chapter 8 for a more thorough discussion of tax treaties.

Pablo also earned $600 of interest income from a U.S. bank account in 2009. The reason that there is no tax withheld on these earnings is discussed in the next section.

Special Rules for Passive Income

Portfolio Interest Exemption - For many nonresidents, interest earned from certain debt instruments that have been issued by a U.S. resident entity will not be subject to the withholding tax. To qualify for this exemption the following requirements must be satisfied:
• The nonresident taxpayer cannot have a substantial ownership stake (10% ownership or more) in the U.S. entity paying the interest.

• The obligation that generates the interest income must have been issued after July 18, 1984.

• The recipient of the income must not be a resident of a country which is on a list issued by the IRS. This list includes those countries which do not have an adequate system of information exchange with the U.S. to prevent tax evasion by U.S. taxpayers. Most developed countries are not on this list so this will not present a problem in most cases.

**U.S. Bank Deposits** - Interest earned by nonresidents from deposits in U.S. banking institutions is exempt from U.S. income tax. This income must not be connected to a U.S. trade or business to qualify for this exemption.

**Real Estate Rental Income** - This type of income is usually classified as passive income. As a result, the gross rental income is subject to the 30% withholding tax (unless reduced by a treaty). Because this could present an undue tax burden on many nonresidents and discourage foreign investment in U.S. real property, there is an election available to treat the rental activity as trade or business income. This allows the nonresident landlord to be taxed on a net basis using graduated tax rates. Because the landlord is taxed on a net basis (gross rental income less associated deductible costs) this will often result in a lower U.S. tax liability. If you own U.S. real property and lease this property, you should seek the advice of a U.S. tax advisor regarding this election and whether it is beneficial in your specific situation.

**Disposition of U.S. Real Property** - Unlike other types of capital gains or losses, any gain or loss from the sale of a real property interest located in the U.S. is automatically deemed to be trade or business income. The gain or loss is therefore taxed on a net basis at graduated tax rates. Even though the gain or loss is taxed on a net basis, in many cases a withholding tax of 10% is levied on the gross receipts of the transaction. A more detailed discussion on the disposition of U.S. real property can be found on page 52.
Filing Requirements and Procedures

The filing requirements for nonresidents depend on whether wages were received that are subject to U.S. income tax withholding. If you received wages which were subject to U.S. income tax withholding, then you should file your U.S. tax return (Form 1040NR) by April 15 of the year following the reporting year. If you did not receive wages subject to withholding, you have until June 15 to file Form 1040NR. If you cannot file your return by these due dates, you may file Form 4868 to get an automatic extension until October 15th. Form 4868 must be filed by the original due date for your return to obtain a valid extension. Note that this extension does not apply to the payment of any tax due. If you owe tax, you must pay it by the original due date of your tax return to avoid penalty and interest charges. Check with your U.S. tax advisor if you need additional time to file your tax return.

Form 1040NR and any supporting schedules should be filed at the following location:

Internal Revenue Service Center
Austin, TX 73301-0215
U.S.A.
6. Dual-Status Taxpayers

The U.S. tax rules would be much simpler if everyone fit neatly into a certain category such as a resident or a nonresident. Unfortunately, it is possible, and quite common, for someone to be a U.S. resident and a nonresident in the same tax year. This can occur in the year that a foreign national moves to the U.S. and in the year that he or she departs the U.S. to resume residence in another country. Individuals in this category are referred to as “dual-status taxpayers”. This chapter covers the rules that apply to dual-status taxpayers and some opportunities for these individuals to minimize their U.S. tax liability.

Overview

If you are a dual-status taxpayer, you are treated as a nonresident for one portion of the tax year and as a resident for the other portion of the year. The tax rules for residents discussed in Chapter 3 apply to that part of the year that you are considered resident. For the nonresident part of the year, the rules covered in Chapter 5 apply.

Income

Your income for the entire year needs to be allocated between the residency and nonresidency periods. You will be taxed on the worldwide income you received in the period of residence. Only your U.S. source income will be taxed in the period of nonresidence. In addition, the U.S. source income in the period of nonresidence must be split between that which is “trade or business income” and that which is “passive income” (see Chapter 5 for more details).

Maria is a dual-status taxpayer in the final year of her job with the U.S. company. Maria is a U.S. resident at the start of 2010. Her residency ends on June 15, 2010. She is taxed on her worldwide income from January 1, 2010 through June 15, 2010. Her worldwide income consists of the following:

(continues on page 36)
The trade or business income earned in the period of nonresidence is pooled with the worldwide income earned during the period of residence. This income pool is taxed at graduated rates. The passive income earned during the nonresidence period is taxed at the withholding tax rate of 30% (or lower rate if a treaty applies).
Maria’s total 2010 income which is taxed at the graduated rates is $39,634. This includes her worldwide income she earns during her residence period of $36,134 and the trade or business income of $3,500 she earns during the period of nonresidence.

Note again that this does not take into account more favorable treatment that might result from the application of a tax treaty. Go to Chapter 8 for a discussion of tax treaties as well as a case study update which applies the U.S. / Spain treaty to Maria’s 2010 U.S. tax situation.

The passive income that Maria earns during the nonresidency period is potentially subject to the 30% flat tax. Again, the Spain/U.S. tax treaty provides for a reduced withholding rate of 15%. This tax is withheld by the U.S. corporation which pays the dividends.

### Deductions

A dual-status taxpayer faces certain limitations related to deductions and personal exemptions. Dual-status taxpayers are not allowed the standard deduction but instead are limited to actual itemized deductions that are paid in the period of residency, and deductions attributable to trade or business income earned during the period of nonresidency. If you are a dual-status taxpayer and you have taxable income during the period of residency, or if you have trade or business income during the nonresidence period, you are allowed one personal exemption. If you have taxable income during the residence period, you may also claim exemptions for your spouse and other dependents if they are residents and if they meet the rules discussed in Chapter 3 regarding qualifying dependents. These additional exemptions can not exceed the taxable income earned during the residence period.

Unless a special election is made (discussed below), dual-status taxpayers are not allowed to file joint returns. If you are married, you must use the “married filing separately” tax rates.

Maria has the following itemized deductions in 2010:

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>State taxes</td>
<td>$1,200</td>
</tr>
<tr>
<td>Charitable Contributions</td>
<td>$2,500</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$3,700</strong></td>
</tr>
</tbody>
</table>
The standard deduction ($5,700) is greater than the $3,700 of itemized deductions, but Maria is not allowed to use the standard deduction in 2010 as she is a dual-status taxpayer. Maria is allowed to claim one exemption.

### 2010 Case Study Summary
(Using 2009 tax laws and tax rate tables)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Worldwide income earned during residence</td>
<td>$36,134</td>
</tr>
<tr>
<td>Trade or business income - nonresidence</td>
<td>$3,500</td>
</tr>
<tr>
<td>Total Income</td>
<td>$39,634</td>
</tr>
<tr>
<td>Itemized deductions</td>
<td>$(3,700)</td>
</tr>
<tr>
<td>Personal exemptions</td>
<td>$(3,650)</td>
</tr>
<tr>
<td>Taxable income subject to graduated rates</td>
<td>$32,284</td>
</tr>
<tr>
<td>Tentative tax</td>
<td>$4,425</td>
</tr>
<tr>
<td>Passive income</td>
<td>$1,200</td>
</tr>
<tr>
<td>Treaty withholding tax rate</td>
<td>15%</td>
</tr>
<tr>
<td>Tax on Passive income</td>
<td>$180</td>
</tr>
</tbody>
</table>

(see single taxpayer rate schedule at Appendix A)

### Credits

Dual-status taxpayers are allowed to take certain credits against the U.S. tax attributable to income earned during the period of residence. These credits are discussed in greater detail in Chapter 3. The most important credit to dual-status taxpayers is the foreign tax credit.

Maria has some foreign income tax withheld on the Spanish interest she receives during her period of residence in 2010. These taxes total $100. Maria has Spanish source income during this period of $367 related to interest earnings.

Referring to the detailed discussion in Chapter 3, the first step in this calculation is computing foreign-source taxable income.
To arrive at foreign-source taxable income we need to allocate a portion of the deductions to her gross foreign source income. The deductions allocable to this income and other Spanish income equal $34 (\$367 / \$39,634 \times \$3,700). Maria’s foreign-source taxable income is therefore $333 (\$367 - \$34).

To arrive at Maria’s 2010 foreign tax credit limitation amount, it is necessary to apply the formula outlined in Chapter 3. This is done below.

\[
\frac{\$333}{\$36,134} \times \$4,425 = \$41
\]

The actual foreign taxes that Maria paid are greater than her 2010 limitation of $41. As such, she can claim a foreign tax credit equal to the limitation of $41.

**Case Study Summary**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax on Income subject to graduated tax rates</td>
<td>$4,425</td>
</tr>
<tr>
<td>Less: Foreign Tax Credit</td>
<td>( 41)</td>
</tr>
<tr>
<td>Net Tax Liability on Trade or Business Income</td>
<td>$4,384</td>
</tr>
<tr>
<td>Tax On Passive Income</td>
<td>180</td>
</tr>
<tr>
<td>Total Net Tax liability</td>
<td>$4,564</td>
</tr>
<tr>
<td>Income Tax withheld on Salary</td>
<td>(6,000)</td>
</tr>
<tr>
<td>Withholding Tax on Interest</td>
<td>( 100)</td>
</tr>
<tr>
<td>Federal Tax Refund Due Maria</td>
<td>$ 1,536</td>
</tr>
</tbody>
</table>

Again, note that Maria may be able to claim tax treaty benefits to reduce her U.S. tax burden. See Chapter 8.

**Joint Return Election**

The general rule reads that a joint return is not allowed when either spouse is a nonresident at any time during the year. However, an election can be made to file a joint return if you are a nonresident during the year if the following conditions are satisfied:
• You have achieved residency status at the end of the year; and
• Your spouse is either a U.S. citizen or a U.S. resident at the end of the year.

This election can have profound effects on your U.S. tax liability. If the election is made, your worldwide income for the entire year (and that of your spouse) is subject to U.S. tax. The rules discussed in Chapter 3 would dictate your tax treatment. It is also worth noting that the various limitations accompanying a dual-status taxpayer disappear. For instance, the election not only allows you to file a joint tax return and be taxed at the married filing joint rates, it also allows you to claim the standard deduction or other deductions related to your nonresident period.

So when is it appropriate for you to make the election? The only way to know for sure is to calculate your tax under an election scenario and under a scenario with no election and compare the results. This election can effect your tax situation for future years so this must also factor into your decision. This is another area where the advice of an experienced tax advisor can be especially helpful.

**Filing Requirements**

The filing requirements for dual-status taxpayers depend on whether a joint return election (discussed above) is made and whether it is the initial year or final year of the residence period.

**Initial Year of Residency**

If you forego the joint return election or it does not apply to you, then you have to file Form 1040 to report your income and deductions for the period of residency. You will also need to attach a Form 1040NR statement to the Form 1040. The Form 1040NR is used to report any U.S. source income and related deductions for the period of nonresidence.

If it is the initial year of your U.S. residence and you decide to make the joint return election, you need only file Form 1040. However, you and your spouse’s worldwide income for the entire year must be reported rather than just that earned during the period of actual U.S. residence. The joint return election is made by attaching a statement to your return (Form 1040) which declares you and your spouse’s intent.
Final Year of Residency

These filing requirements are very similar to those for the initial year of residency. Your income and deductions for the period of residence are reported on Form 1040. The U.S. source income and deductions earned during the period of nonresidence are reported on Form 1040NR. However, under this scenario, Form 1040NR is the lead form which you need to file, with the Form 1040 statement included as an attachment instead of the other way around.

When and Where to File

Regardless of whether it is the initial or final year of your assignment, you must file your tax return by April 15 of the year following the tax reporting year. If you are a dual-status taxpayer your return should be filed at the following location:

Internal Revenue Service
Austin, TX 73301-0215
U.S.A.

If you make the joint return election check with your U.S. tax advisor or with the Internal Revenue service to determine where your return should be filed.

If you are unable to file a complete and accurate tax return by April 15, you can receive an automatic extension of six months (until October 15) to file your return by filing Form 4868. Form 4868 must be filed by April 15 to receive the extension. Please note that this extension only applies to filing the return. It does not extend the due date for paying any tax liability. Therefore, it is necessary to estimate your liability and balance of tax owing (if any) by April 15, even if you can’t file a complete return. If you estimate that tax is due, you should pay in the estimated shortfall along with Form 4868 by April 15. This will avoid most of the unnecessary interest or penalties. If it is the initial year of your assignment or transfer to the U.S., and you will make the first year election described in Chapter 1, it will be necessary to file for the extension as you will not meet the substantial presence test for the subsequent year until after April 15 (see page 10 for an explanation of the first year election).
7. Other Taxes and Filing Requirements

Social Security Taxes

Another concern for foreign nationals relates to U.S. social security taxes. Any foreign national earning wages or self-employment income from U.S. work or employment is potentially subject to U.S. social security taxes. This includes nonresidents as well as residents. The U.S. social security system is made up of two components, a social security tax and a medicare tax. These taxes are imposed on both the employer and the employee. In the case of self-employment, the individual bears the total tax burden. The social security tax is levied on annual wages up to $106,800 (for 2010) and is collected from the employee through withholding; the employee portion of this tax is 6.2% of qualifying wages. The medicare tax is also collected through withholding; the medicare tax is levied at 1.45% of qualifying wages, but unlike the social security portion there is no ceiling on the total annual wages subject to this tax. The employer also makes a matching contribution equal to the total amount withheld from the employee.

Certain nonresident taxpayers may be exempt from social security taxes. If you are in the U.S. under an F-1, J-1, M-1, or O-1 visa, you may be exempt from U.S. social security taxes. Check with your tax advisor if you are working in the U.S. under one of these visas.

Even if you are in the U.S. under a different visa there is a chance that you may be exempt from U.S. social security taxes under one of the Totalization Agreements that the U.S. has executed with other countries. A Totalization Agreement is an agreement between two countries concerning the application of social security tax and benefits. Totalization Agreements have two principal purposes:

- Relief from double taxation - The agreements will provide that a taxpayer is subject to social security tax in only one of the two countries party to the agreement. The country which has this right is decided by the terms of the agreement.

- Coordination of benefits - The agreements provide that if you pay social security tax in one country, but you claim benefits in the other country, you can count coverage periods in the other country when determining your benefits.

At present, the U.S. has totalization agreements with Australia, Austria, Belgium, Canada, Chile, Czech Republic, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands,
Norway, Poland, Portugal, South Korea, Spain, Sweden, Switzerland, and the United Kingdom. If you are a former resident of one of these countries you should consult with a tax advisor about the potential benefits of the totalization agreement and how to apply for these benefits.

**State Income Taxes**

In addition to federal income and social security taxes, foreign nationals who are working and/or living in the U.S. also have to contend with state and possibly local (city or county) taxes. The rules governing income taxation vary from state to state. There are some states, such as Florida, which do not have an individual income tax, but these states are the exception.

Generally, most states follow the same or similar rules as U.S. federal tax law to determine whether someone is subject to income tax in that state. Even if you are not a resident in a certain state, the fact that you perform services in that state is often enough to subject you to some level of state taxation.

**Gift and Estate Taxes**

Foreign nationals working or living in the U.S. also need to be aware of non-income related taxes. Estate and gift taxes deserve careful attention. When is a foreign national exposed to U.S. gift and estate taxes? Unlike the income tax rules covered earlier, estate and gift taxes are not based on the concept of residence. Foreign nationals who are domiciled in the U.S. are subject to gift and estate tax rules. Domicile in the U.S. occurs when a foreign national maintains a permanent home in the U.S. A permanent home can exist, for example, when the individual lives in the U.S. and has no intention of leaving.

Gift tax can be levied anytime that an individual, who has a U.S. domicile, transfers property for less than adequate consideration. Gift tax can apply regardless of the type of property or where the property is located. Both tangible and intangible property qualify. Property which is located in a foreign country qualifies as well as property which is in the U.S.
In 2009 and 2010, an individual is allowed to make $13,000 of annual gifts to a specific donee without incurring gift tax. The number of donees can be unlimited as long as each does not receive more than $13,000 in a given year. If the individual has a spouse who is a U.S. citizen, the individual and the spouse can elect to pool their gifts and split the gifts evenly between themselves. Using this election a couple can gift up to $26,000 annually to a specific donee without incurring a gift tax. In addition to the $13,000 threshold, certain types of gifts are exempt from the tax. These exemptions include an unlimited amount of gifts made to a spouse who is a U.S. citizen and gifts to qualified charitable organizations.

Any non-exempt gifts (those that exceed the annual thresholds listed above) are then subject to gift tax. The gift tax is calculated by accumulating all taxable gifts made by an individual during his or her lifetime. A tentative tax is determined by applying this lifetime total to the tax rates found at Appendix E. A credit is allowed for any gift tax paid by the individual in prior years. In addition, a unified credit is available to reduce any remaining tax liability. The total lifetime credit available to an individual taxpayer covers gifts totalling $1 million. Only resident taxpayers can claim the unified credit for gift tax.

If you are a foreign national and have a domicile in the U.S. you should always consult a tax advisor before making a gift which exceeds $13,000.

As of January 1, 2010, the U.S. federal estate tax and generation skipping taxes were repealed. Unless the U.S. Congress takes action, these taxes will be reinstated on January 1, 2011. Due to the current uncertainty regarding the future of estate taxes, you should consult a qualified tax advisor to obtain up-to-date estate tax advice.

The U.S. has executed many estate and gift tax treaties with other countries. These treaties potentially expand the exemption benefits available to foreign nationals in the estate and gift tax area. A list of the countries with which the U.S. has executed both estate tax and gift tax treaties is included at Appendix B.
Expatriation Tax

Resident taxpayers who meet the lawful permanent resident test (green card test) should also be aware of the expatriation tax provisions. This tax applies to long-term holders of green cards who voluntarily surrender the green card to avoid U.S. income tax. A long-term holder is an individual who has held a green card in at least 8 of the last 15 years, ending with the year your residency ends. The 15-year period ends on the date that the green card is surrendered. These individuals are presumed to have surrendered the card for the purpose of avoiding tax if one of the following three conditions exist:

- The individual had an average annual U.S. income tax liability which exceeded $145,000 for the five year period preceding the termination, if you expatriated or terminated residency.

- The individual has a net worth at the termination date of $2,000,000 or more.

- The individual fails to certify on Form 8854 that they have complied with all U.S. federal tax obligations for the 5 preceding years.

The expatriation tax rules impose a tax on the net unrealized gain (or loss) of the individual’s property as if the property had been sold at fair market value on the day before expatriation.

This mark to market approach does provide an exemption of $600,000 (2009) or $627,000 (2010). The mark to market approach doesn’t incorporate deferred compensation vehicles, but this income is captured in other ways.

If you are a long-term green card holder you should speak with a tax advisor prior to surrendering your green card.

Filing Requirement on Departure

As a general rule, foreign nationals who work in the U.S. must secure a tax compliance certificate before leaving the U.S. This rule applies to both resident and nonresident taxpayers. To receive this certificate, commonly called a “sailing” or “exit” permit, the individual must file a Form 1040C (Departing Taxpayer Income Tax Return) or Form 2063 (Departing Taxpayer Income Tax Statement).

In many cases, an employer will file a form with the appropriate authorities which will enable the foreign national to depart the U.S. without an exit permit. This form verifies that the employer guarantees that the foreign national will comply with his U.S. tax filing requirements.
Foreign Bank Account Reporting Requirement

If you are a resident taxpayer, you may be required to file Form TD F 90-22.1 with the U.S. Department of Treasury. This form is used to report any foreign financial accounts (this includes bank accounts, brokerage accounts, mutual funds, unit trusts, and other types of financial accounts) with which you have a financial interest or have signature authority. If the aggregate balance of these accounts does not exceed $10,000 at any time during the year no report needs to be filed. If the aggregate balance does exceed $10,000 at any time during the year, this form must be completed and filed by June 30 of the following year. This is merely a reporting requirement and will not result in any type of tax liability. However, the penalties that can be imposed for failing to file this particular form can be very severe (including potential jail time), so compliance with this requirement is imperative.

Form 5471
“Information Return of U.S. Persons With Respect to Certain Foreign Corporations”

If you are a U.S. tax resident and you are an officer, director, or greater than 5% shareholder in a foreign (non-U.S.) corporation, you may have to file Form 5471 with your individual income tax return. This is an informational form which discloses certain information about the foreign corporation, your relationship to the foreign corporation, and any transactions which occurred between you and the foreign corporation. If you think this requirement might apply to you, check with your tax advisor to determine if disclosure is necessary and what information needs to be disclosed given your specific situation. If required, Form 5471 should be attached to the individual income tax return that you file (Form 1040 or 1040NR).

Passive Foreign Investment Corporations (PFICs)

A Passive Foreign Investment Corporation (PFIC) is a non-US company that derives income from investments (passive income). A PFIC is defined as a company where 75% or more of the company’s income is passive, or where more than 50% of the company’s assets are in investments earning interest, dividends, and/or capital gains.

A US citizen, green card holder or resident who holds shares in a PFIC is subject to arduous reporting and taxation rules on their share of the income within the PFIC. These rules can be mitigated by making an appropriate election (QEF election). This election enables the individual to report their share of the company’s income on a year on year basis. Unfortunately, many foreign companies are unwilling or unable to provide the necessary information to allow the election to be made.
The most commonly seen PFICs are non-US based mutual funds. There will often be a notice on such funds that they are not open to US residents for these very reasons. This does not, however, provide protection for the non-US individual who becomes a US resident after investing in such a fund.

It is beyond the remit of this document to provide a full description of the tax implications of PFICs. If you believe you are invested in a PFIC, you should contact your tax advisor to discuss your options.

8. Income Tax Treaties

Up to this point, this book has covered the U.S. domestic tax law and how it applies to foreign nationals. However, the U.S. has executed numerous tax treaties with various countries. The goal of these agreements is to eliminate the double taxation of income which can occur due to differences between the domestic tax laws of two countries. It is not uncommon for a foreign national to find that income he has earned while in the U.S. is subject to tax in both the U.S. and his or her home country. While many countries have integrated mechanisms within their domestic law to alleviate this double burden, for instance, the foreign tax credit, these mechanisms do not always completely remedy the problem. This chapter presents an overview of income tax treaties and how a treaty can be used to a foreign national's benefit.

Tax Residence

One of the most important elements of an income tax treaty are guidelines which are used to determine residency. These guidelines are often referred to as “tie-breaker rules” and can be implemented when an individual is considered a tax resident in two or more countries. If a treaty is in place between the U.S. and another country, which have both determined that an individual is tax resident, the individual may be able to implement the tie-breaker rules to his or her advantage.

If an individual can argue that he or she is a resident of a foreign country and not the U.S., then he or she would be taxed as a nonresident in the U.S. The U.S. would then only tax U.S. source income rather than worldwide income. Remember, however, that it is not always better to be treated as a nonresident.

Compensation

Income tax treaties often provide benefits for individuals who have trade or business income such as compensation for personal services. These terms usually don’t include reduced tax rates but instead enlarge the potential pool of trade or business income which doesn’t
attract any income tax at all. If you will remember from the chapter on sourcing (Chapter 4), U.S. domestic law excludes certain personal services income from the definition of U.S. source income. This exclusion covers income that is less than $3,000, that is paid by a non-U.S. entity, and that is earned by an individual who is present in the U.S. for fewer than 90 days. Many treaties effectively expand this exclusion by providing for larger amounts of allowable earnings and longer periods of U.S. presence.

In our case study, Pablo can use the U.S./Spain income tax treaty to his advantage in 2009. The U.S. / Spain income tax treaty places no limit on the amount of compensation and provides for a period of presence up to 183 days in any 12-month period. Since Pablo is in the U.S. for less than 183 days in any 12-month period, and because he is paid by XYZ, SA, a non-U.S. entity, he can exclude the compensation he earns during the short-term project in the U.S. under this treaty provision. This will almost eliminate his 2009 U.S. tax liability. The only item that would continue to attract U.S. tax are the U.S. source dividends that he receives.

Maria cannot use the U.S./Spain tax treaty to her advantage in 2010. This is the year that she is a dual-status taxpayer. She earns some trade or business income in 2010 during the period of nonresidence. This is the $3,500 of compensation related to services performed in the U.S. while on a business trip in late 2010. This income is taxed in the U.S. under U.S. tax law because it does not qualify for the U.S. source exclusion. Maria left the US on May 1, 2010 and returned on October 5, 2010 for 6 days on business. Because the U.S./Spain tax treaty is based on 183 days in any 12 month period, Maria can not use the treaty to exempt the $3,500 she earned in the US. She was in the U.S. from October 11, 2009 to October 10, 2010 for 208 days.

Passive Income

Another important aspect of treaties is that they often provide for a reduced withholding tax rate on certain types of income. These reduced withholding tax rates apply to income which is sourced in one of the treaty countries and is earned by a resident of the other treaty country. These rates typically apply to income which is of the type that is considered “passive income” for U.S. tax purposes (see Chapter 5).
If you are a citizen or resident of a country which has executed a treaty with the U.S., you should seek the advice of a professional tax advisor to determine whether you can benefit from the provisions of the specific treaty which may apply to your situation. Although most treaties are very similar in structure, the specific terms, such as reduced withholding rates, vary from treaty to treaty.

9. Other Income Tax Considerations

Exchange Rate Issues

When a foreign national prepares a U.S. tax return, the income and expenses reported on the tax return must be stated in U.S. dollars regardless of the currency in which income was earned or expenses were paid. As such, it is important that you track taxable income and deductible expenses that are paid in anything other than the U.S. dollar. We recommend tracking the amounts paid in foreign currency and the date paid so that your tax advisor can accurately prepare your U.S. tax returns using applicable exchange rates.

Further, when a U.S. resident taxpayer enters into lending arrangements, purchases, sales, or other agreements that are denominated in a currency other than the U.S. dollar, taxable exchange gains or non-deductible exchange losses may result. These taxable gains and non-deductible losses can arise due to changes in the relative value of currencies. You should consult your tax advisor if you enter into a large transaction that is denominated in foreign currency, particularly the purchase or sale of a foreign home and payment of a mortgage.

Moving Expenses

Certain types of moving expenses are afforded special treatment from a U.S. tax perspective for U.S. tax residents. If you incur moving expenses because of a new job you may be able to deduct a portion of these relocation costs. This is not an itemized deduction but rather a deduction from gross income. The following conditions must be met in order to take a deduction:
• The new job or principal place of work must be at least 50 miles farther from your old residence relative to your old job or principal place of work.

• If you are an employee, you must continue with your new employer or new job for at least 39 weeks during the 12 month period following the move. If you leave before satisfying this requirement because of involuntary termination or because your employer transfers you to a new location then this condition does not apply. If you are self-employed, you must stay in the new location for at least 78 weeks during the 24 month period following the move.

If these conditions are met you are allowed a deduction for the costs related to transportation for yourself and your family, the transportation of household goods, lodging during the actual move, and storage for up to 30 days. You are not allowed a deduction for meals during the move.

Often, an employer will reimburse an employee for qualified moving costs. If this is a direct reimbursement under an accountable plan, this reimbursement of otherwise deductible moving expenses will be excluded from taxable compensation by the employer. If you are reimbursed under an accountable plan, you are not allowed to deduct these costs, as the reimbursement is not included in your income.

Other companies will provide employees with a lump-sum allowance to cover moving costs. This is not a reimbursement according to an accountable plan so the employer must report this as wages to the employee. If you are given a lump-sum allowance instead of direct reimbursements, you must declare the allowance as income but you are allowed to take a deduction for the actual out-of-pocket costs related to qualified transportation, lodging, and storage amounts.

Foreign Earned Income and Housing Exclusions

Under certain circumstances, the U.S. grants tax privileges to U.S. citizens and residents who are living and working in foreign countries. Taxpayers who qualify for these privileges are allowed to exclude foreign source earned income (up to $91,400 for 2009). Starting in 2006, a qualifying taxpayer can claim an exclusion for eligible foreign housing costs but the exclusion is generally limited to 30% of the maximum foreign earned income exclusion ($27,420 [30% x $91,400]). This limitation amount will be adjusted to the extent that qualifying taxpayer resides in certain high-cost geographic areas. These exclusions generally do not apply to resident taxpayers living and working in the U.S. (i.e., residents of the U.S. under the Substantial Presence test).
Some foreign nationals are U.S. resident taxpayers solely because they hold a “green card” (they meet the lawful permanent resident test). In certain cases, these individuals are able to claim these exclusions. If you are a U.S. tax resident because you hold a “green card” and your principal residence and place of business is in another country, you should consult a U.S. tax advisor to see if you qualify for these benefits. More information on these exclusions can be obtained in our booklet Taxation of U.S. Expatriates. Please contact GTN if you want a copy of this booklet.

**Capital Gains**

Capital gains are gains from the sale of capital assets such as stocks, bonds, real estate, and other investment property. The U.S. taxation of capital gains depends on the length of time that a taxpayer holds the property. If you hold the asset for more than one year before you dispose of it, your capital gain or loss is long-term. If you hold it one year or less, your capital gain or loss is short-term. All long term capital gains and losses are netted together and all short-term capital gains and losses are netted together. If there is a net long-term gain and this gain exceeds any net short-term loss, this excess is subject to the capital gains tax instead of being taxed at the normal graduated rates. For 2009 the capital gains tax rate is 15% for taxpayers who are in the 25% or higher marginal tax brackets. For individuals in all other tax brackets, the capital gains tax rate is 5%. If net short-term capital gains exceed net long-term losses (if any), the excess is subject to income tax at the normal graduated rates.

If there is a net overall capital loss, the taxpayer is allowed to take a deduction of $3,000 per year. Any unused loss can be carried forward to be used in future years.

Nonresident taxpayers are not subject to U.S. tax on gain resulting from the sale of a capital asset. An exception to this rule is when the property that is sold is an interest in U.S. real property. This is discussed in more detail below.

It is also important to note that, unlike other countries, the U.S. does not allow a step-up in the basis of assets as of the day you begin or cease tax residency. Therefore, you will be taxed on the entire gain associated with an asset rather than the portion of the gain related to appreciation during the residence period.

If you will be accepting a U.S. assignment or will be coming to the U.S. to live and you anticipate selling certain capital assets in the near future, you may want to consider selling the assets before you become a U.S. tax resident.
Dispositions of U.S. Real Property Interests

Foreign nationals who own an interest in real property located in the U.S. should be aware of special U.S. tax rules that can affect the sale or other disposition of real property. If you do own an interest in U.S. real property, you will want to pay particular attention to this section. An interest in U.S. real property includes any ownership in U.S. real estate, ownership in a mine, well, or other natural deposit, and ownership in certain corporations that have a substantial investment in U.S. real property. Ownership not only includes direct investments but indirect investments held through a partnership or trust.

These rules only apply to dispositions by nonresident taxpayers. As stated in the chapter on the taxation of nonresidents, any gain is treated as if it is trade or business income. It is taxed on a net basis at the appropriate graduated tax rates. However, similar to passive income, these transactions are often subject to a U.S. withholding tax. This withholding tax is collected by the purchaser of the property and remitted on behalf of the nonresident seller. The tax is withheld at a rate of 10% of the gross sale proceeds. The nonresident seller should also file a U.S. tax return (Form 1040NR) to report the gain. Any additional tax due on the transaction is paid with the return or, if the 10% withholding exceeds the actual liability, the taxpayer will receive a refund of this excess. It is necessary to file a return to claim any refund.

It is possible to reduce or eliminate the 10% withholding tax. However, you must make certain filings prior to the sale to obtain permission to not have the tax withheld.

If you are a nonresident taxpayer who owns a U.S. real property interest, you should always consult a U.S. tax advisor before disposing of the interest to gain a full understanding of how these rules will impact the transaction and your U.S. tax situation.

Sale of Principal Residence

Foreign nationals should be aware of the U.S. tax consequences of selling a foreign principal residence or a principal residence in the U.S. If a sale of a residence results in a loss, whether located in a foreign country or in the U.S., the loss is treated as a personal loss and no deduction is allowed for U.S. tax purposes. Any gain resulting from a sale of a principal residence can be subject to U.S. tax. Whether or not such gain is subject to U.S. tax largely depends upon whether you are a resident or nonresident, the amount of the gain, and the length of time that you occupied the home as your principal residence. We first address the sale of a residence located in the U.S. and then move on to the sale of a foreign residence.
U.S. Residence

For sales after May 6, 1997, gain on the sale of a U.S. residence constitutes taxable income in the U.S. and is subject to U.S. tax. However, the U.S. grants an exclusion from income for gain up to $500,000 on the sale of a principal residence if you meet the following conditions:

- You file a joint return with your spouse in the year of the sale.
- You have owned the home for two of the last five years prior to the date of the sale.
- You have occupied the home as your primary residence for two of the last five years prior to the date of the sale.
- During the entire period you have owned the property, it has not been used for business purposes (such as office-in-home) or as a rental property.
- You or your spouse have not claimed this exclusion on the sale of another home within two years prior to the date of the sale of the current home.

Please note that if any of the conditions above are not met, it may still be possible to claim a pro-rated portion of the $500,000 maximum exclusion amount. It may also be possible (depending on your exact circumstances) to fully exclude the entire gain, if the gain is less than $500,000.

If you are a nonresident taxpayer at the time that you dispose of the U.S. residence, you may be subject to U.S. tax on the sale of the residence. This tax will be collected through the withholding provisions described in the section above on “Dispositions of U.S. Real Property Interests”. However, if the buyer of the home is an individual who will use the home as a residence and the sale price does not exceed $300,000, no withholding is necessary (but the gain will still be subject to tax). In any case, the sale by a nonresident should be reported on Form 1040NR. Any additional tax owed above and beyond the amount withheld is paid with the return. Likewise, any excessive withholding will be refunded after filing the return. If you purchase a U.S. home while you are on a U.S. assignment, you should sell the home while you are still a U.S. resident. Waiting until after you break residency may subject any gain on the sale to U.S. tax.
Foreign Residence

The U.S. taxation of the sale of a foreign principal residence depends on whether or not you are a U.S. resident on the date of the sale. If you are a U.S. nonresident when you sell a foreign residence, there are no U.S. tax consequences as a result of the transaction. Any gain is considered foreign source income and completely escapes U.S. taxation. If you are considering the sale of a foreign principal residence or, for that matter, any foreign property, it is best (from a U.S. tax perspective) to sell at a time when you are a nonresident.

If you are a U.S. resident at the time the foreign home is sold then any gain could be taxed in the U.S. The gain exclusion (discussed above) is available for foreign residences as well as U.S. residences, so if you meet the requirements above, you may be able to exclude up to $500,000 of the gain. Any taxable gain, as a result of not qualifying for the exclusion or exceeding the exclusion threshold, is reported on the resident portion of your tax return (Form 1040). Note that even though the gain would be taxed, it would represent foreign source income and any foreign tax paid on the gain will be available for foreign tax credit in the U.S. Note also that the gain related to depreciation during a rental period cannot be excluded and will be subject to tax at graduated tax rates, not to exceed 25%.

Finally, note that exchange gains and losses need to be considered on the sale of a foreign residence and the retirement of a mortgage denominated in a foreign currency. See page 49 for a discussion regarding exchange rate gains and losses.

Rental of Residence

It is common for foreign nationals to rent their foreign residence while on assignment in the U.S. It is also possible that a foreign national may own a residence in the U.S. which is rented out while away from the U.S.

The rental of a foreign residence will only be taxed in the U.S. during the time that a foreign national is a U.S. tax resident. Referring back to the rules on sourcing, the rental of foreign real property is foreign source income. However, U.S. residents are taxed on worldwide income so this activity is subject to U.S. tax while the owner/lessor is a resident. Rental activity is taxed on a net basis in the U.S. You are allowed to deduct ordinary and necessary expenses incurred on the rental property. These expenses include mortgage interest, property taxes, repairs, and maintenance costs. A deduction for depreciation of
the house and furniture and fixtures is also allowed. Rental activities are subject to the U.S. passive loss rules. These rules usually only allow a taxpayer to recognize passive losses to the extent of any passive income. However, the rules do contain an exception for rental activities. If you actively participate in a real estate rental activity you are permitted to deduct related excess passive loss up to an annual maximum of $25,000. This $25,000 maximum is completely phased out if your modified AGI exceeds $150,000.

The rental of a U.S. residence will always be taxed in the U.S. regardless of whether you are a resident or a nonresident because this is considered U.S. source income. If you are a resident, you are taxed on a net basis as described above. The activity is also subject to the passive loss rules as described above.

If you are a nonresident, you are only taxed in the U.S. on the rental of a U.S. residence. The taxation of this activity depends on whether you make the election described on page 33. If you do make the election, you are taxed on a net basis at the graduated income tax rates. If you forego the election, you are taxed at the flat withholding rate that applies to passive income on the gross rental income.

If you have rental properties in the U.S. or you are a resident and have foreign rental property, seek the advice of a U.S. tax advisor to ensure that you comply with the law concerning this activity and take the right course of action to minimize any resulting tax liability or maximize the use of any resulting loss.

**Investments in Foreign Corporations**

If you are a resident in the U.S., and you own shares in a foreign corporation, it is possible that you may have to pay U.S. tax on your share of the corporation’s current year earnings even if these earnings are not distributed to you. These rules apply to foreign corporations that earn a high proportion of passive type income such as dividends, interest, and royalties or other types of transitory income. If you have invested in a foreign corporation you should consult with a professional to see if these rules will apply to you. If so, you may want to sell these shares or restructure your investment prior to becoming a U.S. resident.

Please note that you might also have to file Form 5471 or other forms if you have an interest in a foreign corporation. Please see page 46 for a discussion of Form 5471 and to whom it applies.
## Appendix A

### 2009 Federal Tax Rate Schedules

#### SINGLE INDIVIDUALS

<table>
<thead>
<tr>
<th>TAXABLE INCOME</th>
<th>If Over</th>
<th>But Not Over</th>
<th>Tax Is</th>
<th>+ Excess</th>
<th>% on</th>
<th>of the Amount Over</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ 0</td>
<td>$ 8,350</td>
<td>$ 0</td>
<td>10%</td>
<td>$ 0</td>
<td></td>
<td>$ 0</td>
</tr>
<tr>
<td>8,350</td>
<td>33,950</td>
<td>835.00</td>
<td>15%</td>
<td>8,350</td>
<td></td>
<td></td>
</tr>
<tr>
<td>33,950</td>
<td>82,250</td>
<td>4,675.00</td>
<td>25%</td>
<td>33,950</td>
<td></td>
<td></td>
</tr>
<tr>
<td>82,250</td>
<td>171,550</td>
<td>16,750.00</td>
<td>28%</td>
<td>82,250</td>
<td></td>
<td></td>
</tr>
<tr>
<td>171,550</td>
<td>372,950</td>
<td>41,754.00</td>
<td>33%</td>
<td>171,550</td>
<td></td>
<td></td>
</tr>
<tr>
<td>372,950</td>
<td>no limit</td>
<td>108,216.00</td>
<td>35%</td>
<td>372,950</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

#### MARRIED FILING JOINTLY

<table>
<thead>
<tr>
<th>TAXABLE INCOME</th>
<th>If Over</th>
<th>But Not Over</th>
<th>Tax Is</th>
<th>+ Excess</th>
<th>% on</th>
<th>of the Amount Over</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ 0</td>
<td>$ 16,700</td>
<td>$ 0</td>
<td>10%</td>
<td>$ 0</td>
<td></td>
<td>$ 0</td>
</tr>
<tr>
<td>16,700</td>
<td>67,900</td>
<td>1,670.00</td>
<td>15%</td>
<td>16,700</td>
<td></td>
<td></td>
</tr>
<tr>
<td>67,900</td>
<td>137,050</td>
<td>9,350.00</td>
<td>25%</td>
<td>67,900</td>
<td></td>
<td></td>
</tr>
<tr>
<td>137,050</td>
<td>208,850</td>
<td>26,637.50</td>
<td>28%</td>
<td>137,050</td>
<td></td>
<td></td>
</tr>
<tr>
<td>208,850</td>
<td>372,950</td>
<td>46,741.50</td>
<td>33%</td>
<td>208,850</td>
<td></td>
<td></td>
</tr>
<tr>
<td>372,950</td>
<td>no limit</td>
<td>100,894.50</td>
<td>35%</td>
<td>372,950</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

#### MARRIED FILING SEPARATELY

<table>
<thead>
<tr>
<th>TAXABLE INCOME</th>
<th>If Over</th>
<th>But Not Over</th>
<th>Tax Is</th>
<th>+ Excess</th>
<th>% on</th>
<th>of the Amount Over</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ 0</td>
<td>$ 8,350</td>
<td>$ 0</td>
<td>10%</td>
<td>$ 0</td>
<td></td>
<td>$ 0</td>
</tr>
<tr>
<td>8,350</td>
<td>33,950</td>
<td>835.00</td>
<td>15%</td>
<td>8,350</td>
<td></td>
<td></td>
</tr>
<tr>
<td>33,950</td>
<td>68,525</td>
<td>4,675.00</td>
<td>25%</td>
<td>33,950</td>
<td></td>
<td></td>
</tr>
<tr>
<td>68,525</td>
<td>104,425</td>
<td>13,318.75</td>
<td>28%</td>
<td>68,525</td>
<td></td>
<td></td>
</tr>
<tr>
<td>104,425</td>
<td>186,475</td>
<td>23,370.75</td>
<td>33%</td>
<td>104,425</td>
<td></td>
<td></td>
</tr>
<tr>
<td>186,475</td>
<td>no limit</td>
<td>50,447.25</td>
<td>35%</td>
<td>186,475</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

#### HEAD OF HOUSEHOLD

<table>
<thead>
<tr>
<th>TAXABLE INCOME</th>
<th>If Over</th>
<th>But Not Over</th>
<th>Tax Is</th>
<th>+ Excess</th>
<th>% on</th>
<th>of the Amount Over</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ 0</td>
<td>$ 11,950</td>
<td>$ 0</td>
<td>10%</td>
<td>$ 0</td>
<td></td>
<td>$ 0</td>
</tr>
<tr>
<td>11,950</td>
<td>45,500</td>
<td>1,195.00</td>
<td>15%</td>
<td>11,950</td>
<td></td>
<td></td>
</tr>
<tr>
<td>45,500</td>
<td>117,450</td>
<td>6,227.50</td>
<td>25%</td>
<td>45,500</td>
<td></td>
<td></td>
</tr>
<tr>
<td>117,450</td>
<td>190,200</td>
<td>24,215.00</td>
<td>28%</td>
<td>117,450</td>
<td></td>
<td></td>
</tr>
<tr>
<td>190,200</td>
<td>372,950</td>
<td>44,585.00</td>
<td>33%</td>
<td>190,200</td>
<td></td>
<td></td>
</tr>
<tr>
<td>372,950</td>
<td>no limit</td>
<td>104,892.50</td>
<td>35%</td>
<td>372,950</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
## Appendix B

### Treaties

**U.S. Income Tax Treaties**

- Armenia
- Austria
- Azerbaijan
- Bangladesh
- Barbados
- Belarus
- Belgium
- Bulgaria
- Canada
- Peoples Republic of China
- Cyprus
- Czech Republic
- Denmark
- Egypt
- Estonia
- Finland
- France
- Georgia
- Germany
- Greece
- Hungary
- Iceland
- India
- Indonesia
- Ireland
- Israel
- Italy
- Jamaica
- Japan
- Kazakhstan
- Korea, Republic of
- Kyrgyzstan
- Latvia
- Lithuania
- Luxembourg
- Mexico
- Moldova
- Morocco
- Netherlands
- New Zealand
- Norway

**U.S. Income Tax Treaties (cont’d)**

- Pakistan
- Phillipines
- Poland
- Portugal
- Romania
- Russia
- Slovak Republic
- Slovenia
- South Africa
- Spain
- Sri Lanka
- Sweden
- Switzerland
- Tajikistan
- Thailand
- Trinidad & Tobago
- Turkmenistan
- Tunisia
- Turkey
- Ukraine
- United Kingdom
- Uzbekistan
- Venezuela

**U.S. Estate and Gift Tax Treaties**

- Australia
- Austria
- Canada*
- Denmark
- Finland
- France
- Germany
- Greece
- Ireland
- Italy
- Japan
- Netherlands
- Norway
- South Africa
- Switzerland

* Included in Canada Income Tax Treaty
Appendix C

Visas

The main thrust of this book is aimed at the U.S. tax concerns of foreign nationals. However, it is also worthwhile to spend a few minutes on the various types of visas available to foreign nationals. The various types of visas not only govern the type of activity that is permitted and the length of stay but also carry varying tax implications. Following is a brief description of the most common work visas available and the general tax characteristics associated with each.

L Visa

L visas are the preferred visas for employees who are entering the U.S. to work for extended periods of time. L visas are issued to intracompany transferences - those employees who are transferred from a foreign company to a related U.S. entity. Depending on the type of L visa that is issued, individuals who secure an L visa can stay in the U.S. for a period of 5 to 7 years.

To qualify for an L visa, both the individual and the employer must meet certain requirements:

• The individual must be an executive, or in a management position, or have specialized skills or knowledge.

• The individual must have worked for the foreign company for at least 1 out of the 3 years previous to the transfer.

• The foreign company and the U.S. company to which the employee is transferred must have a certain level of common ownership.

B-1 Visa

Foreign nationals who are visiting the U.S. on a temporary basis are often issued a B visa. For those who are on short term business assignments, a B-1 visa is available. The difference between a B-1 visa and an L visa relates to the length of stay and purpose of work. A B-1 visa is issued to employees who remain on a foreign payroll and who are in the U.S. for reasons such as business meetings, conferences, seminars, and training courses, whereas an L visa is issued to individuals who will be performing services similar to actual local employment in the U.S.
Stays in the U.S. under B-1 visas cover very specific periods of time which depend on the business purpose for the visit.

**H1-B Visa**

H1-B visas are issued to foreign nationals who will be employed in the U.S. in certain types of professions. A successful applicant for an H1-B visa must have a certain level of education or experience that is relevant to the position that the visa holder will be assuming. An H1-B holder may remain on a foreign or U.S. payroll during his or her employment in the U.S.

**J-1 Visa**

Foreign nationals who will be visiting the U.S. as a student, teacher, or a trainee in certain types of training programs is usually issued a J visa. Individuals who hold J visas are allowed to work for limited periods of time in the U.S. These periods of work, which are referred to as academic training, are usually limited to a period of 18 months. In certain cases the period can be extended to 36 months. J visa holders from certain countries or in specific cases are required to return to their home country for a period of at least two years before they can apply for long-term work visas (L or H visas) or for permanent resident status. In some cases, J visas can be an attractive option because a J visa holder is exempt from U.S. social security tax on income received during the period of academic training.
Appendix D

Checklist for Foreign Nationals

Below is a list of items that a foreign national may want to consider before coming to the U.S. for a work related assignment.

1. Gather copies of the last 2 years of foreign tax returns and U.S. tax returns (if any) and bring these with you to the U.S. Your U.S. tax advisor may need these to properly prepare your U.S. income tax returns.

2. During the assignment, keep a daily log that records where you are physically present on each day and whether the day is a work day, non-work day, or a travel day. This information will be used to determine whether you are a U.S. tax resident and also for certain tax calculations.

3. If you continue to earn income from foreign (non-U.S.) sources during your assignment, keep careful track of the amounts earned, the currency in which they are paid, and the exact date received. This is especially important if you remain on a foreign payroll and continue to be paid in non-U.S. currency.

4. If you rent out your foreign home during your assignment or you have other foreign rental properties, gather information related to the cost basis in the property (purchase price plus subsequent improvements). Your tax preparer will need this information along with records of income received and costs incurred to accurately prepare your U.S. return.

5. During your move to the U.S. keep detailed records of the expenses you incur such as transportation, storage, lodging, meals, and other incidentals. Also keep track of those expenses which are reimbursed by your employer.

6. If you are on a temporary assignment in the U.S., keep track of all assignment-related expenses that you incur. These could include transportation, lodging, laundry, utilities, meals, and other incidental expenses. Most reimbursed temporary assignment expenses will not be taxable in the U.S. Generally speaking, a temporary assignment is one that will last less than one year.
7. Before coming to the U.S., you may want to make a list of bank accounts, investments, and other income producing activities that you possess. It is often easy to forget about certain accounts or investments while on assignment. Making a list and keeping it updated will help ensure that all relevant items are addressed when it becomes time to prepare your tax returns.

8. If you will remain on a foreign company payroll, carefully keep track of the various components of your compensation (the type and amount of each). The foreign payroll reporting practices may not be set up to track all of the various items that are needed to correctly file your U.S. income tax return.

9. Speak with your foreign and U.S. tax advisors prior to relocating to the U.S. to gain a complete understanding of the foreign country tax implications of your U.S. assignment, as well as gain an understanding of your U.S. tax situation and to discuss any available tax planning techniques. It should be noted that some planning techniques can only be accomplished if done prior to your arrival in the U.S.
### 2009 Federal Estate and Gift Tax Rates

<table>
<thead>
<tr>
<th>If the amount with respect to which the tentative tax to be computed is:</th>
<th>The tentative tax is:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not over $10,000</td>
<td>18% of that amount</td>
</tr>
<tr>
<td>Over $10,000 but not over $20,000</td>
<td>$1,800 + 20% of excess over $10,000</td>
</tr>
<tr>
<td>Over $20,000 but not over $40,000</td>
<td>$3,800 + 22% of excess over $20,000</td>
</tr>
<tr>
<td>Over $40,000 but not over $60,000</td>
<td>$8,200 + 24% of excess over $40,000</td>
</tr>
<tr>
<td>Over $60,000 but not over $80,000</td>
<td>$13,000 + 26% of excess over $60,000</td>
</tr>
<tr>
<td>Over $80,000 but not over $100,000</td>
<td>$18,200 + 28% of excess over $80,000</td>
</tr>
<tr>
<td>Over $100,000 but not over $150,000</td>
<td>$23,800 + 30% of excess over $100,000</td>
</tr>
<tr>
<td>Over $150,000 but not over $250,000</td>
<td>$38,800 + 32% of excess over $150,000</td>
</tr>
<tr>
<td>Over $250,000 but not over $500,000</td>
<td>$70,800 + 34% of excess over $250,000</td>
</tr>
<tr>
<td>Over $500,000 but not over $750,000</td>
<td>$155,800 + 37% of excess over $500,000</td>
</tr>
<tr>
<td>Over $750,000 but not over $1,000,000</td>
<td>$248,300 + 39% of excess over $750,000</td>
</tr>
<tr>
<td>Over $1,000,000 but not over $1,250,000</td>
<td>$345,800 + 41% of excess over $1,000,000</td>
</tr>
<tr>
<td>Over $1,250,000 but not over $1,500,000</td>
<td>$448,300 + 43% of excess over $1,250,000</td>
</tr>
<tr>
<td>Over $1,500,000</td>
<td>$555,800 + 45% of excess over $1,500,000</td>
</tr>
</tbody>
</table>
Appendix F

U.S. Withholding Tax Compliance Checklist

U.S. withholding tax is one concern that the majority of foreign nationals, whether resident or nonresident, will have to deal with when living in the U.S. or when earning income from U.S. sources. Following are some of the more common U.S. tax compliance forms. This list will help ensure that you comply with the U.S. withholding tax rules and minimize the impact of withholding tax.

- **Form W-7**

  If you are a nonresident taxpayer or a resident foreign national who is not subject to the U.S. social security system, it is necessary to apply for an individual taxpayer identification number (ITIN). The ITIN is used only for tax purposes and does not have any effect on your social security status, employment status, or immigration status. Form W-7 “Application for IRS Individual Taxpayer Identification Number” is the form through which an ITIN is obtained. This form is also used to apply for ITIN’s for any dependents that will be listed on your tax return.

- **Form W-4**

  If you are a nonresident or a resident who is employed and is providing services in the U.S., your income from these services will be taxed as trade or business income according to the appropriate graduated tax rates. This statement assumes that income from these services is not covered under the exception outlined on page 26 and that this income is not covered under any treaty exemption. If you are employed by a U.S. employer, your wages or salary will be subject to the U.S. income tax withholding. Form W-4 “Employee’s Withholding Allowance Certificate” will provide the necessary information to your U.S. employer to ensure that a proper amount of tax is withheld. You should complete this form according to the provided instructions and submit it to your employer. Note that nonresidents should also consult the special instructions provided in IRS Publication 519, “U.S. Tax Guide for Aliens,” when completing this form.
• **Form W-9**

If you are a foreign national who has become or will become a U.S. tax resident, and you previously earned U.S. source income which was subject to withholding tax (because of your prior nonresident status) you will need to inform the payors of these income items of the change in your status and of your correct social security or tax identification number. This can be done by completing Form W-9 “Request for Taxpayer Identification Number and Certification” and submitting this form to the payor(s) of these income items.

• **Form W-8ECI**

If you are a nonresident taxpayer who has a U.S. trade or business you can use Form W-8ECI to inform the payor(s) of income items which are connected to this trade or business of this fact. This will allow the payor to remit payment of this income without withholding any tax based on the premise that you will report this income on your annual return and will pay tax on any net income resulting from the trade or business. Form W-8ECI “Certificate of Foreign Person’s Claim for Exemption from Withholding on Income Effectively Connected with the Conduct of a Trade or Business in the United States” should be completed and sent to each payor of an income item which is connected to your U.S. trade or business.

• **Form 8233**

If you are a nonresident who earns self-employment income, you can use Form 8233 “Exemption from Withholding on Compensation for Independent Personal Services of a Nonresident Alien Individual” to inform the payor of any treaty exemption from withholding that applies to your situation. See Chapter 8 for a discussion of treaties and when such benefits apply. If you can claim a treaty benefit for withholding on such earnings, this form should be completed and given to the payor of your self-employment earnings. The payor will review the form, sign it, and send it to the IRS for final approval. Note that Form 8233 can also be used to claim a treaty exemption that may apply if you are a student, trainee, teacher, or researcher working in the U.S.
• **Form W-8BEN**

If you are a nonresident who earns income from U.S. sources other than income from personal services, this form is used to inform the payor of such income that you are entitled to a reduced withholding rate under an income tax treaty (see Chapter 8 for a discussion of treaties). This income includes US sourced income from interest, dividends, rents, royalties, premiums, annuities, compensation for services performed, and other fixed or determinable annual or periodical gains, profits or income. Form W-8BEN “Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding,” should be completed and filed with each payor of income items for which a reduced treaty rate applies.

• **Statement for Employment Earnings**

If you are a nonresident who earns wages from employment in the U.S. and these wages are covered under a treaty exemption you should file a statement with your employer to claim the exemption. This statement should include the following information:

1. Your name

2. Your address

3. Your Individual Taxpayer Identification Number

4. A statement that you are not a citizen or resident of the U.S.

5. A statement that your compensation is, or will be, exempt from U.S. income tax and why it is exempt.

6. The statement should be specific as to which compensation is exempt and the year to which it applies.

7. The statement should contain a declaration that you are providing this information under the penalties of perjury.

8. The statement should be signed by you and dated.

It is necessary to file this statement in duplicate. Your employer will keep one copy and will file the other copy with the IRS.