Payroll for U.S. Employees Abroad and Aliens in the U.S.

Charlotte N. Hodges, CPP
August 23, 2014
Federal Income Tax Withholding

- U.S. citizens & resident aliens are subject to income tax withholding on worldwide income
- May qualify for exclusions under IRC §911
  - Foreign earned income exclusion
  - Housing cost exclusion
  - Employees who believe they qualify for either exclusion must give their employer a signed statement to that effect
    - Can prepare their own statement or use Form 673, Statement For Claiming Exemption From Withholding on Foreign Earned Income Eligible for the Exclusion(s) Provided by Section 911
Federal Income Tax Withholding

673 Statement for Claiming Exemption From Withholding on Foreign Earned Income Eligible for the Exclusion(s) Provided by Section 911

Part I - Qualification Information for Foreign Earned Income Exclusion

I certify that the foreign earned income exclusion is not available to me or to any of my spouse or dependents.

Name (print or type)

Social security number

Part II - Bona Fide Residence Test

I have been a bona fide resident of a foreign country for at least 30 days in each calendar year for the period beginning on [date] and ending on [date].

[Signature]

Date

Part II - Physical Presence Test

I am a citizen of the United States. Except for occasional absences that will not disqualify me for the benefit of section 911, I have been present in and maintained my principal abode in a foreign country or countries for at least 30 days in each calendar year for the period beginning on [date] and ending on [date].

[Signature]

Date

Part II - Estimated Housing Cost Amount for Foreign Housing Exclusion (See Instructions)

1. Rent
2. Utilities (other than telephone charges)
3. Real and personal property insurance
4. Occupancy tax not deductible under section 156
5. Homeowner's association fees paid for securing a leasehold
6. Maintenance/repairs
7. Estimated qualified housing expenses, plus line 6
8. Estimated housing cost amount for qualifying period
9. Subtract line 7 from line 8. This is your estimated housing cost amount

Part II - Certification

I, [Name], hereby declare that the above statements are true to the best of my knowledge and belief.

[Signature]

Date
Federal Income Tax Withholding

14.1-1

- Wages subject to federal income tax withholding
  - Employer not required to withhold federal income tax from an expatriate’s wages if the employer is required by foreign law to withhold foreign income tax from those wages
    - The withholding must be required by foreign law
    - A signed statement attesting to the foreign withholding requirement should be kept on file by the employer
    - The exemption does not apply to federal government employees

- Wages for work in U.S. possessions other than Puerto Rico
  - If the employer reasonably believes at least 80% of wages paid to the employee during the year will be for work done in a U.S. possession other than Puerto Rico the employer does not have to withhold federal income tax from the employee’s wages
Wages for work in Puerto Rico
- If the employer reasonably believes an employee will be a bona fide resident of Puerto Rico for the entire year, wages paid to the employee are not subject to federal income tax withholding
  - Refer to page 14-3 for criteria to determine who is a resident of a possession

Foreign Tax Credit
- Employees who expect to take a credit or deductions for foreign taxes paid on income that is not subject to the foreign earned income or housing cost exclusion can take extra withholding allowances on their Form W-4
Federal Income Tax Withholding

14.1-1

- Filing and Reporting Rules
  - The employer must follow the regular deposit, payment, and return rules for employees working abroad and subject to federal income, social security, Medicare, and federal employment taxes.

- In general, wages paid to U.S. citizens and resident aliens working abroad for a U.S. employer are subject to social security and Medicare tax withholding which the employer must match.
  - Expatriate employees may also be subject to the foreign country’s social security taxes.
Employees who work abroad for a foreign affiliate of a U.S. employer are not subject to social security and Medicare coverage and taxes unless the employer elects coverage.

- To elect coverage, the U.S. employer enters into an agreement with the IRS by completing Form 2032, Contract Coverage Under Title II of the Social Security Act.

Totalization Agreements

- To alleviate the burden of double social security taxation and to integrate coverage of employees, the U.S. government has entered into bilateral agreements, also known as “totalization” agreements with 25 countries.
  - In addition to the 24 countries listed in this section, there was an agreement signed with the Slovak Republic on May 1, 2014.
Social Security and Medicare Taxes

Under a totalization agreement expatriate employees working “temporarily” in the foreign country (generally up to 5 years) are subject to U.S. social security and Medicare taxes only

- To the same extent their compensation would be subject to those taxes had they remained in the U.S.
- The agreement with Italy allows temporary assignments to run for an indefinite period of time

Establishing U.S. Social Security Coverage

- To establish that an employee’s wages are subject to U.S. social security and Medicare taxes but are exempt from foreign social security tax, the employer must get a certificate of U.S. coverage for the country where the employee will be assigned
  - The employer can apply for the certificate of coverage online at the SSA’s website
Establishing Foreign Social Security Coverage

- The employer must get a certificate of coverage from an authorized social security official or agency of the foreign country if an employee will be permanently working in the foreign country and will be exempt from U.S. social security and Medicare taxes under a totalization agreement.

- The employee or employer should get a statement from the SSA's Office of International Programs stating the employee’s wages are not covered by the U.S. social security system if the authorities of the foreign country will not provide such a statement.
Federal Unemployment Tax
14.1-3

- Employment by U.S. citizens working abroad for a U.S. employer is covered by the Federal Unemployment Tax Act (FUTA) if the work performed would be covered in the U.S.
- FUTA tax does not apply to resident aliens working abroad or to American employees of foreign affiliates (no coverage election is available)
- Employees working for a U.S. employer in Canada and the Virgin Islands are covered by local unemployment laws
- If no state payments are made, no credit against FUTA liability can be taken
Under IRC §911, U.S. citizens and resident alien employees working outside the U.S. (i.e. expatriates) who qualify for the foreign earned income exclusion can choose to exclude the first $99,200 of foreign earned income in 2014 from their gross income.

Employees may also exclude certain housing cost amounts from their gross income.

An employer need not withhold federal income tax from any wages paid to a qualifying employee it reasonably believes will be excluded from income under the §911 exclusions.
Foreign Earned Income and Housing Exclusions
14.1-4

- The maximum exclusion amount is adjusted annually for inflation to the next lowest multiple of $100
- To qualify for the foreign earned income exclusion the employee must:
  - Have foreign earned income
  - Have a “tax home” in a foreign country
  - The employee must meet either a bona fide residence or physical presence test that proves the employee is not living in the U.S. during the year in question
What is a foreign country?

For purposes of the §911 exclusions, a foreign country is any territory under the sovereignty of a government other than the U.S.

All territories and possessions of the U.S. are not foreign countries, including Puerto Rico, Guam, the Virgin Islands, the Northern Mariana Islands, American Samoa, and others (IRS Publication 54, page 13)

Antarctica is also not a foreign country because of a treaty signed by the U.S. and other countries that leaves open all questions of sovereignty over Antarctica

International waters and airspace are also not a foreign country under §911
Foreign Earned Income and Housing Exclusions
14.1-4

- **Foreign Tax Home**
  - The employee’s tax home must be in a foreign country for the entire period of residence or physical presence in that country during that year.
  - The employee’s tax home is the location of his or her regular or principal place of business or employment.
  - If there is no principal place of business, the employee’s tax home is where the employee regularly lives (i.e., has an abode).
  - An employee cannot have a foreign tax home if he or she regularly lives in the U.S.
The expatriate employee is not considered to regularly live in the U.S. if the employee temporarily spends time in the U.S. (e.g., vacations) or maintains a house or apartment in the U.S. that is occupied by the employee’s spouse and/or dependents.

Another factor in determining if the employee’s tax home is in a foreign country is whether the employee is on a temporary or indefinite assignment.

- Employee generally treated as if on an extended business trip, not unlike a domestic employee.
- Assignments in a single location that are expected to last 1 year or less are temporary unless facts and circumstances indicate otherwise.
Foreign Earned Income and Housing Exclusions

14.1-4

- Assignments in a single location that are expected to last more than 1 year are indefinite.
- Assignments in a single location that are expected to last 1 year or less, but at some later date are expected to last longer than 1 year, are temporary (in the absence of facts and circumstances indicating otherwise), until the expectation of the assignment duration changes.
- Once the expectation changes, the assignment is deemed indefinite.

- Bona Fide Residence Test
  - To qualify for the §911 exclusion under the bona fide residence test the employee must be a bona fide resident of a foreign country for an uninterrupted period that includes at least one full taxable year (January 1 through December 31).
Foreign Earned Income and Housing Exclusions

14.1-4

- An employee can be a bona fide resident of a foreign country even though he or she intends to return to the U.S. at the end of the foreign assignment.
- The place the employee intend to return to is the employee’s “domicile,” which is not necessarily the same as the employee’s residence.
- Employees can make temporary visits to the U.S. while on foreign assignment for vacation or business without losing the exclusions.
- An employee who makes a statement to the tax authorities in a foreign country claiming to be a nonresident of that country, and is not taxed as a resident of that country, does not qualify under the bona fide residence test.
Foreign Earned Income and Housing Exclusions

Citizens of the U.S. can qualify for the foreign earned income and housing cost exclusions.

Resident aliens can also qualify for the exclusions if they are citizens or nationals of a country with which the U.S. has an income tax treaty with a clause prohibiting the U.S. from imposing more burdensome restrictions on citizens of the foreign country than on U.S. citizens.

Once an employee has established bona fide residence in a foreign country for a full tax year, the employee qualifies as a bona fide resident for the entire period, from the first day of resident to the last.

Therefore, the employee can qualify as a bona fide resident for part of a year.
Foreign Earned Income and Housing Exclusions

14.1-4

- An employee who is given another foreign assignment by the employer after finishing the previous assignment may or may not have a break in foreign resident between assignments that could disqualify the employee from attaining bona fide resident status (depending on the facts and circumstances)

- Physical Presence Test
  - To qualify for the §911 exclusion under the physical presence test (both U.S. citizens and resident aliens) the expatriate employee must be physically present in a foreign country (or countries) for 330 full days during any consecutive 12-month period
Foreign Earned Income and Housing Exclusions

- The 330 qualifying days do not have to be consecutive and all periods spent in foreign countries (whether for employment or personal reasons) during the 12-month period are totaled to determine whether the test has been met.
- Qualifying under the physical presence test does not depend on the employee’s purpose in staying in a foreign country.
- No intention as to residence or other factors need to be considered.
- A full day is a continuous period of 24 hours beginning at midnight and ending with the following midnight.
  - If an employee leaves the U.S. for a foreign country, time spent over international waters does not count as time spent in a foreign country.
The employee determines the consecutive 12-month period used for meeting the physical presence test

- Any consecutive 12-month period can be used so long as the 330 full days in a foreign country fall within the period
- The 12-month period does not have to begin with the first full day in a foreign country and end with the last full day the employee leaves the foreign country; it can begin before or after any of those days to give the employee the greatest income exclusion

- When an employee has been in a foreign country for longer than 12 months, overlapping 12-month periods can be chosen to benefit the employee
The minimum time requirements for both the bona fide residence test and the physical presence test do not apply where the employee is forced to leave a foreign country because of war, civil unrest, or similar adverse conditions.

- The employee must show one of the tests would have been met had the adverse conditions not existed.
- The determination of whether such adverse conditions exist is up to the IRS.
Foreign Earned Income and Housing Exclusions

14.1-4

- Foreign Earned Income Exclusion
  - Foreign earned income is income earned by an employee from sources within a foreign country while the employee has a foreign tax home and qualifies for the exclusion under the bona fide residence or physical presence test.
  - Earned income includes all compensation paid for personal services rendered:
    - Wages, salaries, commissions, tips, bonuses, tax reimbursements, cost of living allowances, education reimbursements, professional fees, noncash payments, etc.
  - The source of earned income is determined by where the employee performed the services that produce the income.
Foreign Earned Income and Housing Exclusions
14.1-4

- Where or how the employee is paid has no bearing on the source of income.
- The amount of U.S. and/or foreign source income must be determined by using the method that most correctly shows the proper source.
- Foreign earned income must be attributed to the year the services were performed giving rise to the income.
  - This means bonuses, tax equalization payments, or tax reimbursements received by an employee in a year after they were earned must be considered income in the year they were earned, not in the year paid.
  - The income can be excluded in the year it is received only to the extent it would have been eligible for the exclusion in the year in which it was earned – in essence, this rule allows the unused exclusion from the year in which the income was earned to be carried forward to the year in which the income is paid.
Foreign Earned Income and Housing Exclusions
14.1-4

- Eligibility ends after one year
  - Income received after the end of the year following the tax year in which the services were performed giving rise to the income is not eligible for the foreign earned income exclusion

- Foreign Housing Cost Exclusion
  - In addition to the foreign earned income exclusion, employees who have a foreign tax home and qualify under the bona fide residence or physical presence test can take an exclusion for a limited amount of reasonable foreign housing expenses (see page 14-14) exceeding a base housing amount
Foreign Earned Income and Housing Exclusions

14.1-4

- **Base Housing Amount**
  - 16% of the maximum foreign earned income exclusion
  - Computed on a daily basis
  - Multiplied by the number of days during the year the employee met the bona fide residence or physical presence test

- **Housing Cost Exclusion**
  - Limited to 30% of the maximum foreign earned income exclusion
  - Computed on a daily basis
  - Multiplied by the number of days during the year the employee met the bona fide residence or physical presence test
Foreign Earned Income and Housing Exclusions
14.1-4

- 2014 maximum foreign housing cost exclusion
  $29,760 ($99,200 x 30%) – Housing Cost Exclusion
  $15,872 ($99,200 x 16%) – Base Housing Amount
  $13,888 – Maximum Foreign Housing Cost Exclusion

- The Treasury Secretary, through the IRS, can adjust the housing exclusion limitation for specific locations with significantly higher housing costs
  - For 2013 the IRS issued a list of adjusted housing cost exclusion limitations in Notice 2013-31 (Notice 2014-29 for 2014)

- The employee’s foreign earned income exclusion is limited to the lesser of $99,200 (for 2014) or the excess of the employee’s total foreign earned income over the elected housing cost exclusion
  - Prorated daily for each qualifying day if the employee is not a bona fide resident or physically present for the full year
Example:

- Employee was physically present in a foreign country for all of 2014 and earned $100,000, all of which is qualified foreign earned income
- Foreign housing cost exclusion is $9,128
- Employee is able to exclude the lesser of the foreign earned income exclusion or the qualified foreign earned income minus the housing cost exclusion
- Employee is able to exclude $90,872 in 2014

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<table>
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<tr>
<th>$100,000.00</th>
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<tr>
<td>$90,872.00</td>
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Foreign Earned Income and Housing Exclusions
14.1-4

- Tax Rates on Income Not Excluded
  - If an employee takes the foreign earned income and/or the foreign housing cost exclusion, amounts earned in excess of the exclusions is taxed by applying the tax rates that would have been applied had the individual not elected the exclusion(s)
  - IRS Publication 54 instructs the employee to see the instructions for Form 1040 and complete the Foreign Earned Income Tax Worksheet to figure the amount of tax to enter on 1040, line 44.
Two-Earner Families

- The foreign earned income exclusion is available to each spouse to the extent each spouse actually has foreign earned income and otherwise qualifies for the exclusion.

- Each spouse is eligible for the exclusion based on his or her earned income.

- A couple may not use one spouse’s unused exclusion against the foreign earned income of the other spouse to increase the other spouse’s exclusion.

- If the spouses live together, the housing cost exclusion may be apportioned between them as they wish (if they live apart special rules apply).
Foreign Earned Income and Housing Exclusions
14.1-4

- Disallowance of Double Benefits
  - If an employee elects to take the foreign earned income or housing cost exclusion, the employee cannot claim any credit or take any deduction that can be allocated to the excluded income

- Exclusion Elections & Revocations
  - The facts supporting the claim of bona fide residence or physical presence in a foreign country are reported by the employee to the IRS on Form 2555, Foreign Earned Income
  - The election stays in effect for that year and all subsequent years until revoked
  - Once revoked, the same election cannot be made again until the 6th year following the year for which the revocation was effective (absent IRS consent through a letter ruling)
Foreign Earned Income and Housing Exclusions

14.1-4

- **Foreign Tax Credit or Deduction**
  - Expatriate employees may take a credit against U.S. tax for qualifying foreign income taxes
    - Limited to the U.S. tax on the employee’s foreign source income and cannot exceed the foreign taxes actually paid
    - The foreign tax credit is claimed by the employee by completing Form 1116, *Computations of Foreign Tax Credit* (included with the Form 1040)
  - Alternatively, the employee can take a deduction from income for the foreign taxes on their personal income tax return
    - The foreign tax deduction is claimed on Schedule A of Form 1040
  - Generally the credit option will provide larger tax savings since it is a dollar-for-dollar reduction in tax liability
The U.S. has entered into more than 55 income tax treaties with foreign countries.

- Generally, reductions in U.S. taxes are not possible because of “tax savings” clauses in the treaties that allow the U.S. to tax its citizens and residents as if there were no treaty.

- One benefit for resident aliens working abroad is that the nondiscrimination clauses in most treaties allow them to qualify for the foreign earned income and housing cost exclusions under the bona fide residence test as well as the physical presence test.

- To claim a treaty benefit for services performed in a foreign country the employee will have to produce proof of U.S. residency in the form of a letter from the IRS – Form 6166, Certification of U.S. Residency.
Compensation Components

- Policies for overseas assignments are generally designed to ensure employees receive total compensation that will provide a standard of living comparable to what they would have if they remained in the U.S.

- Additions to, and subtractions from, an expatriate’s compensation may include relocation allowance, goods and services (cost of living allowance), housing, schooling, home leave, hardship pay, hazard pay, foreign service premiums, tax reimbursements, etc.
Tax Protection Plans

- The employee is reimbursed by the employer to the extent the employee’s combined income and social security taxes in the U.S. and the foreign country exceed the amount the employee would have paid if living and working in the U.S.

- The employee gets a tax benefit if the combined actual taxes are lower because the foreign taxes are low or nonexistent (e.g., Saudi Arabia) or the employee qualifies for exclusions from U.S. tax.

- In practice, the employee pays the foreign taxes that equal its U.S. tax liability while the employer pays any excess foreign taxes owed as well as the employee’s U.S. tax liability.
Tax Equalization Plans
- Designed to make taxes a neutral factor when determining an expatriate employee’s compensation package
- The employee continues to incur a tax burden equal to what they would incur if they were living and working in the U.S.
- The employee gets no tax benefit while the employer can take advantage of employee assignments in low tax countries

Hypothetical Taxes
- Projected tax that a U.S. employee would incur if the employee had remained in the U.S. (also known as stay-at-home tax)
Employer Tax Reimbursement Policies

14.1-6

- The hypothetical tax is not an actual income tax withholding amount.
- Its purpose is to keep the employee’s take home pay on base income the same as it would be for a U.S. assignment.
- When determining the hypothetical tax, the employer may consider outside income (such as income from a spouse or investments) either in full or subject to limits.
- Income is reduced by the hypothetical tax and then increased by the host tax (grossed up).
Resident & Nonresident Aliens Working in the U.S.

Taxation and reporting of income earned by foreign citizens (aliens) working in the U.S. depends on whether the employee is a resident or nonresident alien.

- Resident aliens are taxed on worldwide income and employers treat them the same way as U.S. citizens.
- Nonresident aliens are taxed only on income from U.S. sources, with some exceptions.
- The alien can be both a resident and nonresident alien and be taxed as one or the other for part of the year in the year in which an alien arrives in or departs from the U.S.
Determining Resident/Nonresident Alien Status

Foreign citizens working in the U.S. are considered nonresident aliens unless they qualify as residents.

The determination of residency made under the Internal Revenue Code applies only to the alien’s status for U.S. income tax purposes, not immigration or other federal and state taxes.

Under the Code, an alien qualifies as a resident if he or she meets either one of two tests:

- Lawful permanent resident test
- Substantial presence test
Lawful Permanent Resident Test

- Under the “green card” or lawful permanent resident test aliens who are lawful permanent residents of the U.S. are considered residents for income tax purposes.
- A green card holder is treated as a U.S. resident until the status is revoked or abandoned.
- Resident aliens are taxed on their worldwide income in much the same way as U.S. citizens.
- If an alien is a lawful permanent resident of the U.S. for any part of a calendar year the alien is a resident for the entire calendar year.
Resident & Nonresident Aliens Working in the U.S.

**14.2-1**

- **Substantial Presence Test**
  - The substantial presence test states that an alien is considered a U.S. resident for income tax purposes if:
    - The alien is present in the US. for at least 31 days during the current calendar year
    - The total number of days of U.S. presence during the current calendar year, plus one-third of the U.S. days during the first preceding calendar year, plus one-sixth of the U.S. days during the second preceding calendar year, is at least 183 days (no rounding allowed – fractions must be used)
      - See page 14-22 for information on certain days spent in the U.S. that do not count when determining residency under the substantial presence test
    - Aliens who qualify as residents under the physical presence test are generally considered to be residents from the first day through the last day they are physically present in the U.S.
Federal Income Tax Withholding & Employment Taxes for Resident Aliens

- Wages paid to U.S. resident aliens are subject to federal and state income tax withholding and employment taxes to the same extent as wages paid to U.S. citizens.
- Resident aliens must obtain a social security number and complete a Form W-4, Employee Withholding Allowance Certificate.
- Under the Immigration Reform and Control Act the employer must retain a completed Form I-9, Employment Eligibility Verification, attesting to the resident alien’s identity and authorization to work in the U.S.
Federal Income Tax Withholding for Nonresident Aliens
14.2-3

- Nonresident aliens are subject to the same federal income tax withholding requirements as other employees for all of their income that is from U.S. sources.
- Nonresident aliens must obtain a social security number and complete a Form W-4, Employee Withholding Allowance Certificate.
- Under the Immigration Reform and Control Act the employer must retain a completed Form I-9, Employment Eligibility Verification, attesting to the nonresident alien’s identity and authorization to work in the U.S.
Federal Income Tax Withholding for Nonresident Aliens
14.2-3

- Special Instructions for Form W-4
  - There are special instructions that must be followed because of certain restrictions nonresident aliens face regarding their filing status, number of allowances, and inability to claim the standard deduction on their personal tax return.
  - When completing Forms W-4, nonresident aliens are required to:
    - Not claim exemption from income tax withholding
    - Request withholding as if they are single, regardless of their actual marital status
    - Claim only one allowance (if the nonresident alien is a resident of Canada, Mexico, or South Korea, or a student or business apprentice from India, he or she may claim more than one allowance)
Federal Income Tax Withholding for Nonresident Aliens

14.2-3

- Write “Nonresident Alien” or “NRA” above the dotted line on line 6 of Form W-4
- If you maintain an electronic Form W-4 system, you should provide a field for nonresident aliens to enter nonresident alien status in lieu of writing “Nonresident Alien” or “NRA” above the dotted line on line 6
- A nonresident alien employee may request additional withholding at his or her option for other purposes, although such additions should not be necessary for withholding to cover federal income tax liability related to employment
  - The IRS has published Notice 1392, Supplemental Form W-4 Instructions for Nonresident Aliens, to help nonresident aliens complete Form W-4
Federal Income Tax Withholding for Nonresident Aliens
14.2-3

- Special Withholding Calculation Rules
  - Employers are required to calculate income tax withholding on wages of nonresident alien employees (except for students and apprentices from India) using a special procedure
  - For wages paid after January 1, 2014, employers must take the following steps when withholding federal income tax from the wages of nonresident alien employees
    - Step 1: Add to the wages paid to the nonresident alien employee for the payroll period the amount shown in the following chart for the applicable payroll period
Federal Income Tax Withholding for Nonresident Aliens

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<tr>
<th>Payroll Period</th>
<th>Add Additional</th>
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<tr>
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<td>Biweekly</td>
<td>86.50</td>
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<tr>
<td>Semimonthly</td>
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<td>Monthly</td>
<td>187.50</td>
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<td>Quarterly</td>
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<td>Semiannually</td>
<td>1,125.00</td>
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<tr>
<td>Annually</td>
<td>2,250.00</td>
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<td>Daily or Miscellaneous</td>
<td>8.70</td>
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<tr>
<td>(each day of the payroll period)</td>
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</table>
Federal Income Tax Withholding for Nonresident Aliens
14.2-3

- Step 2: Use the amount figured in Step 1 and the number of withholding allowances claimed (generally limited to one allowance) to figure income tax withholding.
- Determine the value of withholding allowances by multiplying the number of withholding allowances claimed by the appropriate amount from the percentage method table.
- Reduce the amount figured in Step 1 by the value of withholding allowances and use that reduced amount to figure the income tax withholding.
- If you are using the Wage Bracket Method for Income Tax Withholding use the amount figured in Step 1 and the number of withholding allowances to figure income tax withholding.
- The amounts from the chart are added to wages solely for calculating income tax withholding on the wages of the nonresident alien employee.
### Federal Income Tax Withholding for Nonresident Aliens

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<th>14.2-3</th>
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- The amounts from the chart should not be included in any box on the employee's Form W-2 and do not increase the income tax liability of the employee.
- The amounts from the chart do not increase the social security tax or Medicare tax liability of the employer or the employee, or the FUTA tax liability of the employer.
- This procedure only applies to nonresident alien employees who have wages subject to income tax withholding.

- Nonresident aliens in the U.S. are subject to federal income tax withholding on their U.S. source income.
- Compensation paid to a nonresident alien for services performed outside of the U.S. is not U.S. source income and is not subject to federal income tax withholding.
Federal Income Tax Withholding for Nonresident Aliens

14.2-3

- Compensation received by a nonresident alien employee before or after the year it is earned is considered U.S. source income if it would have been U.S. source income if paid in the year earned

- Exceptions to the Withholding Rules
  - There are several exceptions to the general withholding rules governing nonresident aliens, as well as special rules for residents of certain countries and U.S. possessions
  - These include commercial travelers, residents of Canada or Mexico, residents of Puerto Rico, and residents of South Korea
    - See pages 14-31 & 14-32 for more information on these exceptions
Tax Treaty Exemptions

- The U.S. has income tax treaties with more than 55 countries that exempt or reduce the amount of withholding from wages earned by nonresident aliens in the U.S. if certain conditions are met
  - Reference IRS Publication 515, Withholding of Tax on Nonresident Aliens and Foreign Entities
- A nonresident alien employee who claims an exemption from the tax under a provision of an income tax treaty must file Form 8233, Exemption from Withholding on Compensation for Independent (and Certain Dependent) Personal Services of a Nonresident Alien Individual, with the employer or payer of the compensation for services
With several important exceptions social security and Medicare taxes generally apply to all wages paid for work performed in the U.S. regardless of the citizenship or residency status of the employee or the employer.

Nonresident Alien Students

Amounts paid to nonresident aliens who are temporarily in the U.S. as students, scholars, or exchange visitors under an “F,” “J,” “M,” or “Q” visa are not subject to social security or Medicare tax if the work they perform is carried out to further the purpose for which they entered the U.S.

Scholarships and fellowships granted to nonresident students are exempt from social security and Medicare taxes to the same extent they are exempt from federal income tax withholding.
Social Security & Medicare Taxes for Nonresident Aliens
14.2-4

- Agricultural Workers
  - See page 14-35

- Work Performed on Foreign Ships or Planes
  - See page 14-35

- Worked Performed for a Foreign Government
  - See page 14-35

- International Organizations
  - See page 14-35

- Totalization Agreements
  - Discussed earlier in section 14.1-2
Federal Unemployment Tax for Nonresident Aliens

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- In general federal unemployment (FUTA) tax applies to all wages paid for work performed in the U.S. regardless of the citizenship or residency status of the employee or employer
  - This is true for nonresident aliens even though the particular employee may be exempt from federal income tax under the IRC
  - The exemptions from FUTA for wages received and work performed by nonresident aliens in the U.S. are generally the same as those under social security and Medicare taxes
    - There are no international agreements, such as totalization agreements, exempting temporary employment by a nonresident alien in the U.S.
Wages Paid to Nonresident Employees

- The amounts withheld for federal income, social security, and Medicare taxes, including the employer share of social security and Medicare taxes, must be deposited according to general rules.

- Wages paid and taxes withheld and deposited must be reported on Form 941, Employer’s Quarterly Federal Tax Return along with amounts related to the employer’s other employees.

- Each employee must be sent a Form W-2, Wage and Tax Statement, reporting the individual employee’s wages and withheld taxes.
Types of Visas

There are basically two types of visas for foreign nationals seeking admission to the U.S.

- **Immigrant Visas (“Green Cards”)**
  - Issued to foreign nationals entering the U.S. as lawful permanent residents or who become lawful permanent residents
  - An immigrant visa is an I-551 Permanent Resident Card and is valid until the expiration date
  - When presented by a newly hired employee it proves both identity and authorization to work under IRCA

- **Nonimmigrant Visas**
  - Issued to foreign nationals who wish to enter the U.S. for a specific purpose and will not be in the country indefinitely
Types of Visas

14.3

- They may, however, qualify as resident aliens under the substantial presence test so employers should not assume they are nonresident aliens for tax purposes

- Nonimmigrant Visas
  - F-1, Students
    - Used by full-time students at an approved U.S. educational institution
    - Students can work in work-study programs that further their academic program with the earnings being exempt from social security, Medicare, and FUTA taxes
  - H-1B, Specialty Workers
    - Open to college-educated or experienced professionals in specialty occupations and lasts for one year with one-year extensions available
**Types of Visas**

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- **J-1, Exchange Visitors**
  - Available to students, trainees, and teachers who are in the U.S. to participate in an exchange program
  - The visa lasts for 1-5 years and exempts the holder from social security, Medicare, and FUTA taxes

- **M-1, Nonacademic or Vocational Students**
  - M-1 visa holders can take temporary jobs for practical training related to their course of study
  - The visa is available for 1 year or the period of time it takes to complete the course of study, plus 30 days to depart

- **Q, Cultural Exchange Visitors**
  - Nonimmigrants entering the U.S. as part of a cultural exchange program can work for the employer seeking the visa if the program provides training and employment and shares the history and culture of the alien's country
  - Valid for the duration the program, extensions are available
Social security and Medicare tax*

A nonresident alien temporarily in the United States on an “F1,” “J1,” “M1,” or “Q1” visa is not subject to social security and Medicare taxes on pay for services performed to carry out the purpose for which the alien was admitted to the United States.

Social security and Medicare taxes should not be withheld or paid on this amount.

This exemption from social security and Medicare taxes also applies to employment performed under Curricular Practical Training and Optional Practical Training, on or off campus, by foreign students in “F1,” “J1,” “M1,” or “Q” status as long as the employment is authorized by the U.S. Citizenship and Immigration Services.

* IRS Publication 515, Withholding of Tax on Nonresident Aliens and Foreign Entities.
Questions?

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