Foreign Students and Scholars
and
The United States Tax System

THELG Monograph
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FOREIGN STUDENTS AND SCHOLARS
AND
THE UNITED STATES TAX SYSTEM
by
David Williams, II

I. INTRODUCTION

During the 1991-1992 school year, more than 400,000 students from other countries were studying in the United States. In addition, hundreds of foreign nationals were in the United States as research scholars, visiting lecturers, visiting scholars and visiting professors. Still more were here for the purposes of various types of on-the-job training which were in some way connected to a United States college or university.

Sixty-seven foreign countries sent 1,000 or more of their citizens to the United States as students,\(^1\) while forty United States academic institutions each enrolled over 1800 foreign students.\(^2\) With all this diversity and size most of the foreign

\(^1\) The Chronicle of Higher Education, August 28, 1991. The figures are for the 1989-90 school year. The countries with 1,000 or more foreign students were:

China, Taiwan, Japan, India, Republic of Korea, Canada, Malaysia, Hong Kong, Indonesia, Iran, United Kingdom, Pakistan, West Germany, Thailand, Mexico, France, Jordan, Philippines, Nigeria, Lebanon, Singapore, Greece, Saudi Arabia, Brazil, Spain, Turkey, Colombia, Israel, Jamaica, Peru, Venezuela, Bangladesh, Nicaragua, Italy, Kuwait, Panama, Sri Lanka, Kenya, Norway, Trinidad & Tobago, South Africa, Ethiopia, Vietnam, Netherlands, Argentina, Cyprus, Australia, Sweden, Egypt, Bahamas, Syria, Haiti, Honduras, United Arab Emirates, Ireland, El Salvador, Cameroon, Switzerland, Ecuador, Morocco, Chile, Yugoslavia, Bolivia, Costa Rica, Ghana, Guatemala, Poland.

\(^2\) Id. The Forty U.S. Institutions with over 1,000 foreign students each were:
nationals here, that are in some way affiliated with a United States academic institution, have the following things in common:

A. Most of them are non-resident aliens for tax purposes.³
B. Unlike United States citizens or resident aliens, they must annually file United States tax returns, even if they owe no money.⁴
C. They have low to no understanding about the United States tax system and their rights and responsibilities under it.
D. They are uneasy, confused and scared as it relates to tax compliance.
E. They receive little to no help or assistance in this task.⁵

Miami-Dade Community College, University of Southern California, University of Texas, University of Wisconsin, Boston University, UCLA, Ohio State University, Columbia, University of Illinois, University of Pennsylvania, Southern Illinois University, University of Minnesota, University of Michigan, University of Maryland, University of Houston, Northeastern University, Purdue University, Michigan State University, University of Arizona, Harvard, George Washington University, State University of New York at Buffalo, Iowa State University, Texas A&M, University of California, (Berkeley), Cornell, Arizona State University, New York University, Stanford University, Indiana University (Bloomington), Penn State University, MIT, California State at Los Angeles, Rutgers, University of Iowa, University of Florida, New Jersey Institute of Technology, University of Hawaii (Manoa), University of Kansas, Oregon State University.

³ It should be noted that non-residents or resident status for tax purposes is determined by a test that will be discussed by a test that will be discussed later. This is different than Immigration Status.

⁴ A United States citizen or resident alien does not have to file a tax return if their income is more then their Personal Exemption plus their Standard Deduction. On the other hand, a non-resident alien must file an annual tax return, if they have any United States Source income during the tax year. This is whether they owe money or not.

⁵ This is not necessarily a knock on the Academic Institutions. In fact, many do try to offer some assistance. However, the tax laws in this area are extremely complex and are not well handled by lay people.
It is my hope that this IHELG Monograph will clear the waters a bit and lessen the task for both the foreign student, or scholar, and those trying to assist them.

II. DETERMINING TAX STATUS

The first thing that must be understood is that tax status for foreign nationals has little to nothing to do with the individual's status for immigration purposes. In fact, tax status as a resident or non-resident alien is determined by Section 7701(b) of the Internal Revenue Code of 1986 (hereinafter called the Code). Under Section 7701(b), a resident alien is defined as any individual who meets the requirements of:

A. Being lawfully admitted for permanent residence
B. Making the first year election, or
C. Passing the substantial presence test.\(^6\)

The Code goes further and defines a non-resident alien as any individual who is neither a United States citizen or a resident alien during any calendar year. Since this tax status is based on each calendar year, it is entirely possible for an individual to be a non-resident alien during 1991, a resident alien during 1992 and non-resident during 1993.\(^7\) Therefore the tax status of each foreign student, scholar, researcher, lecturer and professor must be determined each year to allow them to correctly comply with United States tax laws.

\(^6\). Section 7701(b)(1)(A) of the Internal Revenue Code.

\(^7\). Id. See §7701(b)(1)(B).
A. Lawfully Admitted For Permanent Residence

The one instance in which tax status and immigration status merge is in the lawfully admitted for permanent residence test. Under this test, a foreign national will be deemed a resident alien for tax purposes if the individual has been issued a "green card" by the Immigration and Nationality Service (INS)\(^8\) and that card has neither been revoked or administratively or judicially deemed abandoned.\(^9\) Within this area, an individual's "green card" is deemed to be revoked if a final administrative or judicial order of exclusion or deportation has been issued regarding the alien.\(^10\)

Determination of abandonment is based on who initiates the action. If the INS or a consular officer initiates the action, then abandonment is deemed to have occurred upon the issuance of a final administrative order of abandonment.\(^11\) On the other hand if the action is initiated by the alien, then abandonment is deemed to occur on the filing of the application for abandonment by the alien individual with INS or a consular officer.\(^12\)

As one can see, resident alien tax status, under this test can extend beyond the individual's stay in the United States and

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\(^8\) Id. See §7701(b)(6)(A). While this is referred to as a "Green Card", the card actually is not Green.

\(^9\) Id. See §7701(b)(6)(B).

\(^10\) Proposed Treas. Regulation §301.7701(b)-1(b)(3).

\(^11\) Id.

\(^12\) Id.
if proper action has not been taken even after the individual's desire to be a resident alien.

B. First Year Election

An alien individual can elect to be treated as a resident alien for tax purposes under this test if the following requirements are met. First, the alien cannot be a resident alien of the United States by way of the lawfully admitted test or the substantial presence in the year effected by the election (hereinafter called the election year).\(^{13}\) Second, the alien individual cannot have been a resident alien of the United States the year immediately preceding the election year.\(^{14}\) Third, the alien individual must be a resident alien of the United States, by way of the substantial presence test, the year immediately following the election year.\(^{15}\) Finally, the alien individual must both be present in the United States for a period of at least 31 consecutive days in the election year and be present in the United States at least 75% of the days in what is referred to as the 'test period'.\(^{16}\) The 'test period' begins on the first day of the 31 consecutive day period and ends on the last day of the taxable year.\(^{17}\)

**EXAMPLE A**

\(^{13}\) Section 7701(b)(4)(A)(i).

\(^{14}\) Id. See §7701(b)(4)(A)(ii).

\(^{15}\) Id. See §7701(b)(4)(A)(iii).

\(^{16}\) Id. See §7701(b)(4)(A)(iv).

\(^{17}\) Id. See §7701(b)(4)(A)(iv)(II).
X, an alien individual, is present in the United States from May 1, 1992 to May 31, 1992. X has passed the 31 consecutive days test. In order to pass the second part X must be present in the United States 75% of the days in the testing period, which is from May 1, 1992 to December 31, 1992.

C. Substantial Presence

The final and biggest test is the day counting substantial presence test. This is also the test in which most foreign students, scholars, researchers, lectures and professors will be concerned with. Under the substantial presence test, an alien individual will be treated as a resident alien for the taxable year if:

A. They are present in the United States at least 31 days in the current year, and
B. The sum of the number of days they were present in the United States during the current year and the two preceding calendar years equals or exceeds 183 days.  

In arriving at the 183 day total the Code employs a modified formula for the counting of days. During the current year, all days present are counted while only 1/3 of the days present in the first preceding year and 1/6 of the days present in the second preceding year are counted in arriving at the 183 portion of the test.  

EXAMPLE B

X, an alien individual is actually present in the United States only 115 days in 1992. However, X was present in the United States 120 days in 1991 and 180 days in 1990. Under the substantial presence test the following would occur:

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18. Id. See §7701(b)(3)(A).

19. Id.
<table>
<thead>
<tr>
<th>Year</th>
<th>Days present for SPT</th>
</tr>
</thead>
<tbody>
<tr>
<td>1992</td>
<td>115</td>
</tr>
<tr>
<td>1991</td>
<td>40 (1/3 of 120)</td>
</tr>
<tr>
<td>1990</td>
<td>30 (1/6 of 180)</td>
</tr>
<tr>
<td>Total</td>
<td>185</td>
</tr>
</tbody>
</table>

Since X was present in the United States 31 days in 1992 and her total days for 1992, 1991 and 1990 equal or exceed 183, she would be treated as resident alien for 1992.

While the substantial presence test appears on its face to be an absolute all or nothing proposition, there is some relief from its strictness. Even if an individual meets the substantial presence test there are ways in which they may still be classified as a non-resident for tax purposes. If the individual is present in the United States for less than 183 days in the current year and can establish that, for the current year, he has a tax home in a foreign country and he has a closer connection to that foreign country, than the United States, then the fact that his three year total equal or exceed 183 will be ignored and he will not pass the substantial presence test for the taxable year.\(^{20}\) While this might seem like a fairly easy exception to fit under, in fact, it is quite difficult. First, the individual must be in a position to show that under United States tax law he has a tax home in another country.\(^{21}\) Then, the individual must

\(^{20}\) Id. See §7701(b)(3)(B).

\(^{21}\) Id. See §7701(b)(3)(B)(ii). The test used to determine tax home for this purpose is the same used to determine tax home under §911(d)(3).
be able to establish that he has a closer connection to that foreign country than he has to the United States.\textsuperscript{22}

The second measure of relief from the substantial presence test and the one most applicable to foreign students, scholars, researchers, lectures and professors involves the concept of exempt days. Under this procedure, certain individuals can actually be physically present in the United States but will not have those days count against them in calculating the substantial presence test.\textsuperscript{23} Four groups of individual fit within this exempt day provision.

They are:

A. Individuals unable to leave the United States because of a medical condition.\textsuperscript{24}

B. Foreign government-related individuals.\textsuperscript{25}

C. Certain professional athletes.\textsuperscript{26}

D. Teachers, Trainees and students.\textsuperscript{27}

Since the scope of this Monograph involves the fourth group, definitions of those terms must be given. For purposes of the substantial presence test and the exempt days provision, a teacher or trainer is defined as any individual who:

\textsuperscript{22} Id. For the definition of closer connection see Proposed Treasury Regulation §301.7701(b)-2.

\textsuperscript{23} Id. For the definition of closer connection see Proposed Treasury Regulation §301.7701(b)-2.

\textsuperscript{24} §7701(b)(3)(D)(ii).

\textsuperscript{25} §7701(b)(5)(A)(i).

\textsuperscript{26} §7701(b)(5)(A)(iv).

\textsuperscript{27} §7701(b)(5)(A)(ii), (iii).
i) is temporarily present in the United States under a J-Visa (but not as a student), and

ii) substantially complies with the requirements of the Visa for being present.²⁸

It should be noted that an individual cannot use this status to exempt days for any current year, if the individual had exempt days, as a teacher, trainee or student, for any two years during the last six years.²⁹ However, this two year limitation will be expanded to four of the last six years if the individual's total compensation for the current year comes from a foreign employer.³⁰

EXAMPLE C

X, an alien individual, has been physically present in the United States for 200 days during 1992. Normally X would pass the substantial presence test and be treated as a resident alien for tax purposes for 1992. However, X is a visiting professor who is here on a J-Visa. If this is the first year X has been in the United States then he will be able to exempt all 200 days and will be treated as a non-resident alien for 1992. On the other hand if X was in the United States during 1991, 1990, 1989 and 1988 and exempt days as a teacher, trainee or student during any two of those years, then she can not exempt days as a teacher/trainee in 1992. However, if her total compensation in 1992 is being paid by a foreign employer, then she must have exempt days in all four years before she is forced out of the exempt position for 1992.

For purposes of this provision, a student is defined as any individual who;

i) is temporarily present in the United States under a F, J or M Visa, and

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²⁸ §7701(b)(5)(A)(ii),(iii).
²⁹ §7701(b)(5)(E)(i).
³⁰ Id.
ii) substantially complies with the requirements of the Visa for being present.\textsuperscript{31}

Like the teacher/trainee rule, the student exempt rule has a limitation. After an individual has exempt days for five years as a student, teacher, trainee or any combination of the three, then that individual can no longer exempt days under the student status.\textsuperscript{32} However, the five year limitation rule can be waived for any year that the foreign student can establish that they do not intend to permanently reside in the United States.\textsuperscript{33}

Under the Treasury Department's regulations, any immediate family member of the student, teacher or trainee will be allowed to exempt the same days as the student, teacher or trainee.\textsuperscript{34} For purpose of this "piggy-back" rule, immediate family is given the same definition that it has in everyday United States jargon. In addition, the individual who is to be considered a member of one's immediate family must be under 21 years of age, reside regularly in the household of the exempt individual and not be a member of anyone else's household.\textsuperscript{35}

Section 7701(b)(8) of the Code requires an individual who will be exempting days pursuant to an exempt category to provide

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{31} §7701(b)(5)(D).
\item \textsuperscript{32} §7701(b0(5)(E)(ii).
\item \textsuperscript{33} Id.
\item \textsuperscript{34} Proposed Treasury Regulations §301.7701(b)-3(a)(8).
\item \textsuperscript{35} Id.
\end{itemize}
\end{footnotesize}
the Internal Revenue Service with a Exempt Day Statement.\textsuperscript{36} While the IRS does not provide a form for this statement, the regulations are clear as what must be included in the statement for it to have validity.\textsuperscript{37} The regulations require the statement, which must be submit with the individual's tax return, to include the following:

1. The individual's name, address, U.S. taxpayer identification number (if any), and U.S. Visa number.
2. The country that issued the individual her passport and the passport number.
3. The taxable year that the statement is pertaining to.
4. The number of days the individual was physically present in the United States during the current year and the preceding two years.
5. The name, address and telephone number of the academic institution attended during the current year.
6. The name, address and telephone number of the director of the academic or other specialized program that the individual has participated in during the current year.
7. The type of visa held by the individual during the six preceding calendar years.\textsuperscript{38}

What is extremely interesting about this statement requirement is that it seems to be a condition precedent for the exemption of days as a student, teacher or trainee. The regulations state that if an individual fails to submit this statement, they will not be able to exempt any days even if they are in fact in the United States as a student, teacher or trainee.\textsuperscript{39} If this is in fact the case, it appears that the exempting of days rise to the

\textsuperscript{36}§7701(b)(8).
\textsuperscript{37}Proposed Treasury Regulations §301.7701(b)-8(b).
\textsuperscript{38}Id.
\textsuperscript{39}Proposed Treasury Regulations §301.7701(b)-8(d).
level of an election and if a student, teacher or trainee wishes to have his days counted, he may do so and thereby become a resident alien for tax purposes under the substantial presence test. If this is true it appears to leave an excellent planning opportunity for foreign students, teachers, trainees and their advisors.\textsuperscript{40}

E. Tax Status By Marriage And Dual Status

Non-resident aliens who are married to a U.S. citizen, a U.S. permanent resident, or a resident alien may elect to be taxed as a resident alien.\textsuperscript{41} If this election is made the couple must file a joint return and the election will be suspended for years when neither spouse is a U.S. citizen or resident alien.\textsuperscript{42} In addition, either spouse may revoke the election without the other's consent.

During an alien's first and last year as a resident alien a determination of starting and ending days must be made.\textsuperscript{43} Because of this procedure, an alien taxpayer may actually be classify as non-resident alien for part of the taxable year and a

\textsuperscript{40}. If this is the case, an alien individual with enough U.S. source to cause a problem and enough possible exempt days to be a non-resident alien could fail to file the statement and therefore become a resident alien and increases his possible personal exemptions, increase his possible itemized deductions and allow the taking of the standard deduction.

\textsuperscript{41}. See I.R.S. Publication 519 & §6013(g), (h).

\textsuperscript{42}. Id.

\textsuperscript{43}. §7701(b)(2).
resident alien for the other part of the taxable year. 44 If this is the case that individual is deemed to be a dual status taxpayer for that year. 45

III. TAX COMPLIANCE FOR ALIENS

A. Resident Aliens

If an alien individual is a resident alien for any given year, then his compliance requirements are the same as a U.S. citizen. The resident alien may file a 1040EZ, a 1040A, or a 1040 tax form. In addition, his return is due by April 15 and he may obtain extension to August 15 and October 15 under certain situations. 46 Finally the completed tax return should be sent to the applicable Internal Revenue Service Center for the city in which the resident alien is residing.

B. Non Resident Aliens

If the alien individual is a non-resident for any given year the compliance requirements are very different. First, the proper tax form to be filled out is the 1040NR. This form should be filled out completely and the required exempt day statement attached if the alien is exempting any days during the year. 47 If the non-resident alien has any earned wages subject to withholding, then the 1040NR is due on April 15. All other

44. Supra see Footnote 41.

45. Id.

46. §6072(a); §6081(a).

47. Supra see Footnote 39.
1040NRs are not due until June 15. All 1040NRs are to be sent to:

Internal Revenue Service Center
Philadelphia, Pennsylvania 19255

One big concern of alien individuals involves the mistaken filing of the wrong form for prior tax years. If an individual has filed a 1040EZ, 1040A, or 1040 for a prior taxable year and now realizes that she should have filed a 1040NR, an amended return is in order. However, the IRS has no amended forms to correct this problem. The individual must amend it by now filing a 1040NR for the year in question and writing amending across the face of the return. In addition, a copy of the wrong return should be included when the new, amended one, is forwarded to the IRS. This same procedure should be used if a 1040NR was filed for a prior taxable year and now the taxpayer realizes that, while that was the correct form to file, there was a mistake on the 1040NR.

If an alien individual is deemed to be a dual status taxpayer for a taxable year, his compliance requires are somewhat mixed. The determination of the proper form to complete is made based on his status on the last day of the year. If he was a non-resident alien on 12/31, then he must file the 1040NR. If he was a resident alien on 12/31, then he must file a 1040EZ, a 1040A, or a 1040. Regardless of which form is filed, the individual must also file a statement covering the portion of the year when his status was other than that on the last day of the taxable year. As a practical matter, this statement can actually
be made in the form of the completion of the other type of return.

Example D

If a foreign scholar is deemed to be a dual status taxpayer for 1992 and a resident alien as 12/31/92, the required form is a 1040EZ, 1040A, or 1040. For the portion of 1992 that the foreign scholar was a non-resident alien a separate statement must be filed. The foreign scholar may actually fill out a 1040NR for that portion in lieu of the statement. The word statement should be written across the 1040NR.

IV. TAXATION OF THE FOREIGN TEACHER, SCHOLAR OR STUDENT

If the foreign teacher, scholar, student or lecturer is classified as a resident alien during a given taxable year, the actual method of taxation is relatively straightforward. In this case, the individual will be taxed just like a United States citizen with all the rights to deductions, exemptions and credits afforded United States citizens. In addition, the individual will be required to pay taxes to the United States on all his income for the year, regardless of the fact that it was earned in, or outside, of the United States. On the other hand, if the foreign teacher, scholar, student or lecturer is a non-resident during any given taxable year, the method of taxation becomes somewhat more complex. In this case the individual will have restrictions as to her deductions, exemption and credits, as well as a potential higher tax rate on certain types of income. However, an individual who is a non-resident alien will only be required to pay taxes to the United States on income earned in the United States, or U.S. source income.

A. Sourcing and Taxation

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Under U.S. tax law a complex system of rules concerning the concept of sourcing of different types of income exist.\textsuperscript{48} These rules are very important for non-resident aliens, since any income that is non United States source is income that the non-resident alien does not report or pay United States tax on. In the case of unearned income such as dividends and interest, the Code generally requires these items to be sourced based on the residence of the entity making the payments. Therefore, interest paid to a non-resident alien, by a bank in his home country would be non-United States source and not subject to U.S. tax. On the other hand, interest paid to a non-resident alien, by a bank in the United States would be United States source and generally subject to U.S. tax. However, a special Code section exempts from taxation, any interest a non-resident alien is paid from a United States bank, a United States savings and loan institution and most United States insurance companies.\textsuperscript{49} Dividends paid to a non-resident alien by a domestic corporations\textsuperscript{50} will be U.S. source and subject to tax while dividends paid to a non-resident

\textsuperscript{48} See §§861-865 and the regulations under these sections.

\textsuperscript{49} §871(i).

\textsuperscript{50} §7701(a)(4) defines a domestic corporation as one organized or created in the U.S. or under the laws of the U.S. or any of its states.
alien by a foreign corporations\textsuperscript{51} are generally classified as foreign source and outside the United States taxing regime.\textsuperscript{52}

**EXAMPLE E**

X, a visiting scholar from Mexico has been in the United States for the entire year of 1991. However, she has been able to exclude days as a teacher/trainee, therefore she is a non-resident alien for 1991. During 1991 X has the following unearned income:

a. interest from Bank in Mexico,
b. interest from United States bank,
c. dividends from a U.S. corporation,
d. dividends from a Canada corporation.

For United States tax purposes the interest paid to X by the bank in Mexico, as well as the dividends paid to X by the Canadian corporation are foreign source (non U.S. source) and therefore not subject to U.S. tax. The dividends paid to X by the U.S. corporation, as well as the interest paid to X by the U.S. bank, are United States source and generally subject to U.S. tax. However, the interest paid to X by the U.S. bank is exempt from taxation for X by a special section of the Code. Therefore, X will only have to pay tax to the United States on the dividends paid to her by the U.S. corporation.

The tax rate for non-resident aliens on most unearned U.S. source income, such as interest, dividends and capital gains, is a flat 30\textsuperscript{\%}\textsuperscript{53} However, in the area of capital gains special rules come into play. First, capital gains from the sale of real property located in the United States, or of a United States Real Property Interest, while U.S. source, will be actually taxed, not at a

\textsuperscript{51} §7701(a)(5) defines any corporation, which is not a domestic corporation, as a foreign corporation.

\textsuperscript{52} §872(a).

\textsuperscript{53} §871(a).
flat 30%, but as if the gain was earned income from the conduct of a trade or business in the United States.\textsuperscript{54} Next, capital gains from other than real estate, realized by a non-resident alien who has been in the United States less than 183 days in the given taxable year, are totally exempt from U.S. tax, even though this income is U.S. source.\textsuperscript{55} For the purpose of this last special rule, actual physical presence is the key to determining the number of days present in the United States and the concept of exempt days used in tax status determination is ignored. Therefore, while a foreign student who was present in the United States all of 1992 may exempt all those days and be classified as a non-resident alien for 1992, he will not be able to claim he was in the United States less than 183 days for the purpose of this special capital gain provision.

Earned income, such as wages, salaries, professional fees and honoraria, from performing services, are sourced by where the services are actually performed.\textsuperscript{56} Therefore, a professor from a foreign country who visits at a U.S. educational institution will be performing his services in the United States and his income will be U.S. source and thus taxed by the United States. Since this income would be connected to the professor's trade or business (teaching), that is being conducted in the United States, it will be taxed at the same graduated rates which apply

\textsuperscript{54} §884.

\textsuperscript{55} §871(a)(2) and the regulations under it.

\textsuperscript{56} §861(a)(3).
to U.S. citizens and resident aliens.\textsuperscript{57} While this income is U.S. source and generally subject to U.S. taxation there are three major exceptions to this treatment.

First, income paid by a foreign employer to a non-resident alien who is present in the United States under a F, J, or M visa is exempt from United States taxation.\textsuperscript{58} For purposes of this rule, a foreign government is not considered to be a foreign employer. Second, income for the performance of personal services paid by a foreign company or foreign individual to a nonresident alien, who is present in the United States 90 days or less during the year, will qualify as foreign source income and be exempt from U.S. taxation.\textsuperscript{59} Once again the concept of exempt days used to determine tax status can not be applied here for purposes of meeting the 90 day or less requirement. Also, this provision only applies if the income received for the personal services does not exceed $3,000. Finally, earned income received by a non-resident alien for the performance of certain services in the United States may be exempt from U.S. taxation by virtue of a tax treaty between the United States and the alien taxpayer's country of residence.\textsuperscript{60}

If a foreign student is studying in the United States and receiving a graduate teaching or research assistantships that was

\textsuperscript{57} $871(b)$.

\textsuperscript{58} $872(b)(3)$.

\textsuperscript{59} $871(b)$.

\textsuperscript{60} See U.S. - China Income Tax Treaty.
awarded after August 16, 1986, the income from the assistantship is viewed as pay for work, thus earned income and sourced to the country where the services are performed (U.S.). Since it is U.S. source the non-resident alien student must pay tax to the United States on this income. If a tuition reduction award is part of the student's package, it may be exempt from taxation unless the reduction represents payment to the student for the research or teaching services.\textsuperscript{61} If the graduate assistantship was awarded prior to August 17, 1986, the income is exempt from U.S. taxation if the following four conditions are met:

a. the services were performed for the educational institution,

b. the services were not in excess of specifically stated, reasonably appropriate requirements for the degree sought,

c. the services were not conditioned on the performance of past, present or future services, and

d. similar services are required of all candidates for the degree.

Presently, scholarships and fellowships are sourced to the country of residence of the grantor of the scholarship or fellowship.\textsuperscript{62} Therefore, a non-resident alien who is attending an institution of higher education in the United States on a scholarship or fellowship must complete a two step process to determine her potential tax inclusion. Since the portion of the scholarship or fellowship that represent "qualified educational

\textsuperscript{61} §117(d).

\textsuperscript{62} Revenue Ruling 89-67 C.B. 1989-1.
expenses" is excluded from taxation, this amount should be computed. Next, the residence of the payor of the scholarship or fellowship should be determined. If the grantor's residence is the United States, then the non qualified educational expenses portion will be U.S. source and subject to U.S. tax. On the other hand, if the grantor's residence is other than the United States, then the non qualified educational expenses portion will be foreign source and not subject to U.S. tax for the nonresident alien. For purposes of taxation of scholarships and fellowship, "qualified educational expenses" are tuition, enrollment fees, and expenses for books, equipment, and supplies that are required. All other expenses such as room, board, and transportation are nonqualified and taxable. Since education is deemed to be a nonresident alien's trade or business, the taxable portion of the scholarship or fellowship is deemed to be income connected to the conduct of a U.S. trade or business and taxed under the graduated rates that apply to U.S. citizens and resident aliens.

63. §117(a).
64. §117(b).
65. §871(c).
66. Id.
EXAMPLE F

X, foreign student, who exempts days and is a non-resident alien, is studying at The Ohio State University. X receives a scholarship of $20,000 awarded by The Ohio State University. For the year, X has the following expenses:

- tuition = $5,850
- books = $1,900
- supplies = $780
- equipment = $1,230
- room = $4,800
- board = $2,900
- transportation = $2,100
- others = $440

While the total scholarship is U.S. source, the portion that is used for tuition ($5,850), books ($1,900), required supplies ($780), and required equipment ($1,230) will be considered "qualified educational expenses and exempt from taxation. However the remaining portion of the scholarship which equal $10,240, is non qualified expenses and must be reported as income by X on her 1040NR.

For scholarships and fellowships awarded prior to August 17, 1986, that are still in force, a special grandfather rule was established. Under this special rule the entire amount of the scholarship or fellowship can be excluded from taxation if the grant provides:

a. that the original notice of award establishes the grantor's commitment to provide a fixed or readily determinable amount to the grantee,
b. that the grant was made for more than one academic period for the duration of a degree program, and
c. that the grantee is not required to reapply to the grantor for support in subsequent academic periods.

While scholarships and fellowship are presently sourced by the residence of the grantor, it should be noted that the Treasury Department has a proposal to change this and source scholarships and fellowship based on where the services
(studying) are rendered or takes place. If this proposal is accepted, students who receive scholarship from foreign grantor to study in the United States will have U.S. source income instead of foreign source income. Presently this proposal is being hotly debated in Washington with excellent arguments being made on both sides.67

B. Deductions, Exemptions and Restrictions

While resident alien taxpayers are afforded the same array of deductions, credits and exemptions granted U.S. citizens, non-resident aliens faced a restricted menu in this regard. Non-resident aliens are unable to take the standard deductions68, are not entitled to any credit for child care69, cannot file a joint return with their spouse70, and with the exception of nationals from Mexico, Canada, Japan, and the Republic of Korea (South Korea), can take no more than one personal exemption.71

In addition to the above limitations, the non-resident alien's ability to itemize his deductions are also limited. The only itemized deductions the non-resident alien may take are state and local taxes which have been withheld, contributions to

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67. While Treasury has proposed this, many United States Foundations have spoken out against it. They believe it will force foreign students to seek study opportunities outside of the United States.

68. See the Form 1040NR and its instructions and §873(b).

69. Id.

70. Id.

71. Id.
U.S. charities, casualty and theft losses in the United States, and miscellaneous business deductions. The area of miscellaneous business deductions may prove to be of great benefit to some non-resident aliens. If the non-resident alien student is nondegree seeking, she may be able to deduct educational costs such as tuition, fees and books as job-related expense if:

a. she is in the U.S. to obtain short-term training which is required by her employer, or by law, or regulations to keep her job, salary or status, or
b. it maintains or improves skills that are required in her present work from which a temporary leave of absence has been taken.72

Under certain situations a non-resident alien student or teacher/trainee may be able to take business-related deductions for reasonable travel and living expenses while away from home.73 First, the individual must be able to prove that their tax home is located in their home country. While this might sound easy enough the concept of tax home is very complex.74 Each case must be considered on its own facts and circumstances to make this determination. Some of the things that are determinative are:

a. that the individual worked in the area of their claimed tax home immediately before beginning training, studying, or teaching in the United States,
b. that the individual continues to have work contacts in the tax home area during their absence,
c. that the individual has living expenses at the tax home that are duplicated in the U.S. due to required training,
d. that members of the individual's immediate family must live in the claimed tax home,

72. Treasury Regulations §1.162-5.
73. Id.
74. Supra see Footnote.
e. that the individual will return to the same tax home and work upon completion of their time in the U.S.  

These deductions should be entered on a form 2106 and attached to the individual's 1040NR. If eligible, the non-resident alien will be able to take a reasonable deduction for rent, food, certain transportation and utilities. However, the deductions can only be for his expenses not for his spouse or children. For visiting professor, scholars and lecturers, this deduction is a must, while for students it presents a greater review of the facts.

C. Withholding

While resident aliens, like U.S. citizens, will have taxes withheld on their wages, non-resident aliens are subject to much greater withholding requirement. Payors of investment income or income that has no employer-employee relationship are generally required to withhold 30% of the income even if the true tax will be less than 30%. A good example of this would be the consulting fees or honorarium paid to a non-resident alien that is not entered on the university's payroll. In this case the non-resident alien's actually tax rate may come from the graduated rates, but the university would be required to withhold 30%.

Non-resident aliens who have earned income, such as wages from teaching or from a graduate assistant, will have withholding

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76. §1441(a).
based on the graduated rates like U.S. citizens and resident aliens. Generally, foreign recipients of U.S. source scholarships or fellowships will have 14% of the amount withheld by the grantor. However, Revenue Procedure 88-24\(^7\) provides a method by which the individual can request the grantor to withhold an amount less than 14% if that amount is a better estimate of the actual tax that will be owed.

Finally, a resident of a country that has a tax treaty with the United States may receive relief from the withholding requirement due to an article in that treaty. If a non-resident alien qualifies and wants to take advantage of this, she must provide a completed Form 8233 to her employer, or payor, and include a reference to the applicable treaty article. The employer/payor must file this Form 8233 before they may stop or reduce the amount of withholding under a treaty provision.

F. Social Security Tax

Generally, individuals in the United States under F-1, M-1, and J-1 visas are not subject to social security tax, while individual with J-2, H visas and those under the special November 30, 1989 Presidential Directive\(^7\) are subject to social security tax. However, regardless of immigration status, income that

\(^7\) C.B. 1988-2.

\(^7\) This was the directive by President Bush that allows students from the People's Republic of China to remain in the U.S. after the events involving the Chinese Government and their university students who were protesting the government's actions.
meets the following criteria will be exempt from social security
tax. It must be income that is:

a. for services performed by an enrolled student for the
   school regularly attended,
b. for services performed for a state or local government,
   unless an agreement with the federal government is
   involved,
c. for services performed for a foreign government, or

d. for services performed for an international
   organization.

Unfortunately, social security tax is sometimes mistakenly
withheld from an individual's pay. If this is the case, the
individual must first contact the employer for correction and
assistance. If this fails, then the individual can file a
request for repayment with the IRS center in which the payor
files their return. To have the IRS consider this request, the
individual must include the following:

a. Form 843
b. Form W-2
c. Form I-94
d. proof of permission to work, and
e. a statement that refund was requested from the payor.

It usually will take about one year to get the refund from the
United States government.

G. Tax Treaties

One of the most important things that have to be considered
in dealing with the tax situation of any foreign individual,
where student, teacher, trainee or other, is tax treaties. The
United States presently has tax treaties in force with over 30
countries and is presently negotiates with other countries.
While the major components of many of these treaties is the
elimination of double taxation and the exchange of information,
tax treaties can be a wealth of relief for many foreign students, teachers and researchers. A tax treaty can change any of the rules covered above from determination of tax status to rate of withholding to type of income taxed or exempted. In fact, many tax treaties go a long way to benefit foreign individuals who are present in the United States for educational purposes.

Generally professor, teachers and researchers from certain countries that have tax treaties with the United States, will have their income exempt from U.S. tax for two of three years, even though that income is U.S. source.79

Many of our tax treaties also have favorable provisions for students. While most exempt income that is received from abroad, others go much farther. In many cases the non-resident alien student, or educator, might take advantage of tax treaties provision that exempt certain types of personal service income from taxation, as well as investment income. In addition, many treaties provide for increased deductions, exemption or reduced levels of withholding.80 It is clear that attention to any tax

79. As of February 1992 some of these countries were: Austria, Belgium, Canada, People's Republic of China, Denmark, Egypt, France, Germany, Hungary, Iceland, India, Indonesia, Ireland, Italy, Jamaica, Japan, Republic of Korea, Luxembourg, Netherlands, Norway, Pakistan, Philippines, Poland, Romania, Sweden, Switzerland, Trinidad and Tobago, United of Soviet Socialist Republics, United Kingdom.

80. As of February 1992 some of these countries were: Austria, Belgium, Canada, People's Republic of China, Cyprus, Egypt, France, Germany, Iceland, Indonesia, Japan, Republic of Korea, Morocco, Netherlands, Norway, Pakistan, Philippines, Poland, Romania, Trinidad and Tobago, Tunisia, United of Soviet Socialist Republics.
treaty that the United States has with the home country of a foreign student, teacher, scholar, lecturer, or researcher is mandatory.

H. CONCLUSION

As can be seen, the tax landscape for our friends from foreign countries who come here to study, teach, lecture or do research can be very complex and confusing. To them, it can be a pure nightmare. While the IRS and the government do not appear to be rendering any help or relief in the near future, we must continue the struggle to help our friends comply with their responsibilities and at the same time afford themselves of the best possible tax position. It is my hope that this monograph will help in both of these endeavors.

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81. For example see Article 19 & 20 of the U.S. - China Income Tax Treaty.