

**Division of Accounting
Payroll Compliance Group**

**Bulletin # 2014_002
Tax Treatment of Income Paid to Aliens**

INTRODUCTION

The Division of Accounting Payroll Compliance Group (PCG) reviews the tax status of alien workers including teachers and professors employed by the State of Delaware. Based upon the varied facts and circumstances for individual employees and the applicable code, the guidelines in this bulletin should be followed.

IRS regulations cover the full gamut of how income of aliens is taxed. This bulletin addresses only the scenarios that PCG has reviewed to-date for State employees. Contact the State Payroll Compliance Administrator for assistance with scenarios not covered in this bulletin.

A Tax Residency Decision Tree is available as a companion to this Bulletin on the DOA website.

FACTS

Local school districts and charter schools (Schools), and other State Organizations hire individuals who are residents of foreign countries. Many of these School employees are in the United States through the J-1 Visa Exchange Visitor Program that is administered by the U.S. Department of Education. Organizations may also employ residents of foreign countries, here in the U.S., on F-1 (students) or H-1B Visas. Each of these Visa programs has unique tax regulations that must be considered when on-boarding these employees.

U.S. Tax Treaties

The United States has income tax treaties with a number of foreign countries. Under these treaties, certain types of income paid to residents of foreign countries are taxed at a reduced rate, or are exempt from U.S. income taxes. These reduced rates and exemptions vary among countries.

Nonresident Alien vs. Resident Alien

For income tax purposes, employers must determine if an employee is a nonresident alien or a resident alien. An individual is a **resident alien** if they have been given an "Alien Registration Card" (Green Card) or they meet the Substantial Presence Test.

The Substantial Presence Test is a weighted formula to determine if a worker has been in the U.S. at least 183 days during the current and immediate preceding two calendar years as described below.

Substantial Presence Test

To meet this test, the employee must be physically present in the United States on at least:

1. 31 days during the current calendar year

2. 183 days during the 3-year period that includes the current calendar year and the two immediate preceding years, counting:
 - a. All the days present in the current year,
 - b. 1/3 of the days present in the immediate preceding year,
 - c. 1/6 of the days present in the second preceding year.

NOTE: If the worker has been present in the U.S. for at least 183 days of the current calendar year, he or she meets the SPT. There is no need to count the days present for the preceding years.

Form W-4 & Federal Income Taxes

Nonresident aliens must follow the special instructions below when completing Form W-4, Employee's Withholding Allowance Certificate.

1. Check only "Single" or "Married Filing Separately" marital status on line 3 (regardless of actual marital status).
2. Claim no more than one withholding allowance on line 5. (Exceptions: residents of Canada, Mexico, South Korea, a U.S. national, or a student or business apprentice from India.)
3. Do not claim "Exempt" withholding status on line 7.
4. Write "Nonresident Alien" or "NRA" above the dotted line on line 6 of Form W-4.

NOTE: The State cannot accept a Form W-4 that has not been completed in accordance with IRS regulations.

Nonresident aliens who are exempt from wage withholding on part or all of their compensation for dependent personal services under an income tax treaty should not complete Form W-4. These individuals complete Form 8233, Exemption from Withholding on Compensation for Independent (and Certain Dependent) Personal Services of a Nonresident Alien Individual.

FINDINGS

China, People's Republic of

J-1 Visa Program: China and the United States have an income tax treaty (Ref. IRS Pub. 901). An individual who is a resident of China and temporarily in the United States primarily to teach, lecture, or conduct research at a university or other accredited educational institution is exempt from U.S. income tax on income for the teaching, lecturing, or research for a total of **not more than three years**.

F-1 Visa Program: A student, business apprentice, or trainee who is a resident of the People's Republic of China on the date of arrival in the United States and who is present in the United States solely to obtain training, education, or special technical experience is exempt from U.S. income tax on income from personal services performed in the United States of up to \$5,000 for each tax year. An individual is entitled to this exemption only for the time reasonably necessary to complete the education or training.

H-1B Visa Program: If the individual does not have a Green Card, the individual's tax status is determined by applying the Substantial Presence Test (see above) to determine if the worker is a nonresident or resident alien, for tax purposes only.

Note: The U.S./China income tax treaty does not apply to Hong Kong.

France

J-1 Visa Program: France and the United States have an income tax treaty (Ref. IRS Pub. 901). An individual who is a resident of France on the date of arrival in the U.S. and who is temporarily in the U.S. at the invitation of a recognized educational institution primarily to teach or engage in research, is exempt from U.S. income tax on income from teaching or research for a maximum of **two years** from the date of arrival in the US.

F-1 Visa Program: An individual who is a resident of France on the date of arrival in the United States and who is temporarily in the United States primarily to study at a university or other recognized educational institution in the United States, obtain professional training, or study, or do research as a recipient of a grant, allowance, or award from a not-for-profit governmental, religious, charitable, scientific, artistic, cultural, or educational organization is exempt from U.S. income tax on income from personal services performed in the United States of up to \$5,000 each tax year. An individual is entitled to this benefit for a maximum of five tax years.

H-1B Visa Program: If the individual does not have a Green Card, the individual's tax status is determined by applying the Substantial Presence Test (see above) to determine if the worker is a nonresident or resident alien, for tax purposes only.

Greece

J-1 Visa Program: Greece and the United States have an income tax treaty (Ref. IRS Pub. 901). An individual who is a resident of Greece and temporarily in the United States primarily to teach, lecture, or conduct research at a university or other accredited educational institution is exempt from U.S. income tax on income for the teaching, lecturing, or research for a total of **not more than three years**.

F-1 Visa Program: There is no exemption on income tax on income from personal services performed in the United States by a student who is a resident of Greece and temporarily in the United States to study or acquire business experience.

H-1B Visa Program: If the individual does not have a Green Card, the individual's tax status is determined by applying the Substantial Presence Test (see above) to determine if the worker is a nonresident or resident alien, for tax purposes only.

Spain

J-1 Visa Program: Spain is not listed as a treaty country with a special provision for teachers. Therefore, citizens of Spain must pay income tax.

F-1 Visa Program: An individual who is a resident of Spain at the beginning of the visit to the United States and who is temporarily in the United States primarily to study at a U.S. university or other accredited educational institution, to obtain training to become qualified to practice a profession or professional specialty, or to study or do research as a recipient of a grant, allowance, or award from a governmental, religious, charitable, scientific, literary, or educational organization is exempt from U.S. income tax on income from personal services performed in the United States of up to \$5,000 for each tax year. An individual is entitled to the benefit of this exemption for a **maximum of five years**.

H-1B Visa Program: If the individual does not have a Green Card, the individual's tax status is determined by applying the Substantial Presence Test (see above) to determine if the worker is a nonresident or resident alien, for tax purposes only.

Nonresident Alien Teachers

General Rules

Federal Income Tax

Exemptions are based on country-specific treaties and special provisions for professors, teachers, and researchers.

State Income Tax

If a foreign national has specific earned income that is exempt from Federal taxation it is also exempt from Delaware taxation.

Wilmington City Wage Tax

A nonresident alien temporarily in the United States on a Visa is subject to Wilmington City Wage Tax if working or living within the taxable limits of the City.

Social Security/Medicare

J-1 Visa Program: A nonresident alien temporarily in the United States on a J-1 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 for the **first two years** in the U.S. If the individual was in the U.S. for even one day of a calendar year, that counts as one year of presence in the U.S.

F-1 Visa Program: Generally, an individual who is a resident of a foreign country and is temporarily in the United States primarily to study at a U.S. university or other accredited educational institution, is exempt from Social Security and Medicare taxes for a **maximum of five years**. If the individual was in the U.S. for even one day of a calendar year, that counts as one year of presence in the U.S.

H-1B Visa Program: Nonresident aliens are liable for Social Security and Medicare taxes on wages paid to them for services performed in the United States.

Pension

As long as the Position is pension-creditable, the incumbent is subject to Pension contributions.

Unemployment Tax

Wages paid to nonresident aliens on J-1 Visas are subject to Unemployment Tax.

Workers Compensation Deduction

Wages paid to nonresident aliens on J-1 Visas are subject to Workers Compensation.

Organizations must retain all supporting documentation for tax withholding status.

Resident Alien Teachers

General Rules

Federal Income Tax

Exemptions are based on country-specific treaties and special provisions for professors, teachers, and researchers.

State Income Tax

If a foreign national has specific earned income that is exempt from Federal taxation it is also exempt for Delaware taxation.

Wilmington City Wage Tax

A resident alien temporarily in the United States on a J-1 Visa is subject to Wilmington City Wage Tax if working or living within the taxable limits of the City.

Social Security/Medicare

J-1 Visa Program: A resident alien temporarily in the United States on a J-1 Visa is 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 beginning with the third year in the U.S. If the individual was in the U.S. for even one day of a calendar year, that counts as one year of presence in the U.S.

F-1 Visa Program: Generally, an individual who is a resident of a foreign country temporarily in the United States primarily to study at a U.S. university or other accredited educational institution, is exempt from Social Security and Medicare taxes for a **maximum of five years**. If the individual was in the U.S. for even one day of a calendar year, that counts as one year of presence in the U.S.

H-1B Visa Program: Resident aliens, in general, have the same liability for Social Security and Medicare taxes as U.S. Citizens.

Pension

As long as the Position is pension-creditable, the incumbent is subject to Pension contributions.

Unemployment Tax

Wages paid to resident aliens on J-1 Visas are subject to Unemployment Tax.

Workers Compensation Deduction

Wages paid to resident aliens on J-1 Visas are subject to Workers Compensation.

Organizations must retain all supporting documentation for tax withholding status.

REGULATORY REFERENCES

The guidance in this Bulletin is supported by the applicable Code, Regulations, and laws cited below.

US DEPARTMENT OF STATE

EXCHANGE PROGRAM (J1) OVERVIEW

This program is carried out under the provisions of the Mutual Educational and Cultural Exchange Act of 1961. The purpose of the Act is to increase mutual understanding between the people of the United States and the people of other countries by means of educational and cultural exchanges. At present, there are 15 categories of exchange that include teachers and professors. Foreign nationals participating in exchange visitor programs may only engage in activities authorized for their program.

Foreign teachers have the opportunity to teach in accredited primary and secondary schools in the United States. A teacher must:

- Meet the qualifications for teaching in primary or secondary schools in their country of nationality or last legal residence;
- Have three years of teaching or related professional experience;
- Satisfy the standards of the U.S. state in which they teach;
- Be entering the U.S. for the purpose of teaching full time at a primary or secondary accredited educational institution; and
- Possess sufficient proficiency in English language to participate in the program.

IRS

Pub. 901 – U.S. Tax Treaties (Rev. April 2011)

Publication 901 lists and explains tax treaties that exist between the U.S. and foreign countries.

Earnings paid to professors and teachers who are residents of treaty countries are generally exempt from U.S. income tax for 2 or 3 years if the employee temporarily visits the U.S. to teach or do research. The exempt period begins on the date of arrival in the U.S. for the purpose of teaching or engaging in research. For many countries, the exemption applies even if the stay in the U.S. extends beyond the applicable period. The exemption generally applies to pay received during a second teaching assignment if both are completed within the specified time, even if the second assignment was not arranged until after arrival in the U.S. on the first assignment. Employees who do not meet the requirements for exemption as a teacher, or are a resident of a treaty country that does not have a special provision for teachers, may qualify under an independent personal services (independent contractor) income provision.

Pub. 515 – Withholding of Tax on Nonresident Aliens and Foreign Entities (For Use in 2012)

A nonresident alien temporarily in the United States on an “F-1,” “J-1,” “M-1,” or “Q-1” 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 U.S. for the first two or five years depending on the type of Visa.

Form 8233 – Exemption From Withholding on Compensation for Independent (and Certain Dependent) Personal Services of a Nonresident Alien Individual

This form is used if the employee's scenario is not covered under Pub. 901 as explained above. The IRS expects the employee to know if a tax treaty exists between the country of residence and the United States. Form 8233 is **completed by the employee** based on the tax treaty terms. Tax treaty terms vary from country to country. The employee must file a statement with Form 8233 providing the specifics from the treaty on which they are basing their claim for exemption from withholding.

Once the employee completes and submits Form 8233, the IRS expects the employer to do due diligence to determine if the exemption from withholding is warranted; and, if so, forward it to the IRS (address provided on the form). The employer is allowed to begin withholding based on the exemptions the employee claims retroactive to the date of the Form; but, there is a 10-day waiting period to see if the IRS has any objections to the Form 8233.

Employers should not begin withholding based on the exemptions claimed, if they have knowledge that statements on the form are false or they have knowledge of circumstances that indicate the employee is not exempt (i.e., has a fixed base or permanent establishment in the United States).

The IRS will review the form and the tax treaty to determine if the tax exemptions are warranted. If they find that the form was filled out incorrectly or that the employee was mistaken to claim the exemptions, the IRS will notify the employer to immediately begin withholding.

Pub. 519 – U.S. Tax Guide for Aliens (For Use in 2011)

Appendix B – Tax Treaty Exemption Procedure for Teachers and Researchers

This appendix contains statements nonresident alien teachers and researchers must file with Form 8233 to claim a tax treaty exemption from withholding of tax on compensation for dependent personal services.

STATE OF DELAWARE-SPECIFIC GUIDELINES

Delaware Code - Title 30, Chapter 11, § 1105 defines taxable income as the entire taxable income of a resident of this State shall be the federal adjusted gross income as defined in the laws of the United States as the same are or shall become effective for any taxable year with the modifications and less the deductions and personal exemptions provided in this subchapter. A non-resident's taxable income is their federal adjusted gross income, as defined in the laws of the United States, less modifications laid out in § 1105, which consist of passive income.

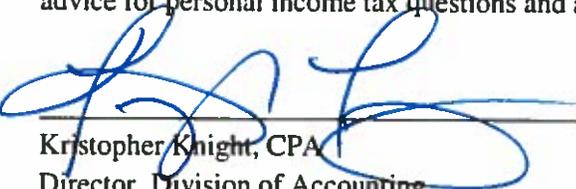
Pension Contributions

Federal rules that exempt employees from specific tax withholdings are not applicable to pension benefits from the Delaware Public Employees Retirement System. As long as the Position is pension-creditable, the incumbent is subject to Pension contributions.

TAX ADVICE DISCLAIMER

Although the opinion provided here is presented in good faith and believed to be correct, it is general in nature and is not intended as tax advice. Furthermore, the facts and regulatory references applicable to this scenario may not be applicable to or suitable for other similar scenarios that may require consideration of other factors.

Additionally, personnel of the Department of Finance do not advise on personal income tax requirements or issues. Use of any information provided by PCG is for general information only and does not represent personal tax advice either expressed or implied. State employees are encouraged to seek professional tax advice for personal income tax questions and assistance.



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