International Services
HR Services, Workforce Development & Resources Section
630.840.3688 (fax)

Visa Office
630.840.4203 / 3933
visaoffice@fnal.gov
visas.fnal.gov

User's Office
630.840.3811 / 3111 (phone)
usersoffice@fnal.gov
users.fnal.gov

US Taxes for Non-US Citizen Users at Fermilab

This memo is for informational purposes only. It is an overview of some, but not all, of the possible tax issues that you might face. You must access and review the linked information (from the IRS website) for full information. It is not intended to constitute tax advice. It cannot be used by the recipient or any other individual to avoid penalties under any federal, state, local or other tax statutes or regulations.

The Visa Office and Finance Section are not tax specialists. We therefore cannot give tax advice on these issues, nor tell you whether you are subject to these reporting requirements. If you have specific questions about your situation, please consult with a qualified tax advisor.

A detailed discussion of the issues facing non-citizens can be found in IRS Publication 519 (http://www.irs.gov/publications/p519/ch01.html#en_US_publink1000222151).

A. Background

In the United States, a tax is imposed on income by the Federal, most state, and many local governments. The income tax is determined by applying a tax rate, which may increase as income increases, to taxable income (as defined by U.S. law).

Non-US citizen users at Fermilab are *potentially* subject to U.S. tax rules, even if they do not receive income from a U.S. source, have no US-employer, or have no other ties to the U.S. other than visits to Fermilab.

This memo is intended to alert you to the possibility of these obligations, so that you can obtain appropriate guidance from a qualified tax advisor. Foreign nationals at Fermilab need to understand the U.S. tax rules that apply to them because

(a) serious consequences could arise if an individual is required, under U.S. tax law, to make a tax payment and does not. These consequences might affect the individual's long-term ability to reside in, or work in, the United States, and

(b) sometimes significant *refunds* of tax payments could be available to individuals, if the U.S. tax rules are understood and the appropriate filings submitted.

B. Basic Tax-Related Obligations

There are three separate tax-related requirements that apply to non-US citizens who visit or stay in the U.S. (including users):

1. The requirement to FILE a tax return that states what income and other money you received during the tax year in question (as well as other information);
2. The requirement to PAY money, usually because of tax due on income received. *Note: the requirement to file is different from the requirement to pay. However, if you are required to pay, you must file to be able to do so*; and
3. The requirement to INFORM the U.S. Internal Revenue Service ("IRS") about certain non- U.S. bank accounts that you own, or in which you share ownership.

C. Federal versus State Taxes

a. Federal Taxes

The federal government is the primary taxing authority in the United States. It operates through the Internal Revenue Service (IRS). See www.irs.gov.

b. State Taxes

Additionally, all of the States have taxing authority. Each state calls their taxing agency by a different name. If you have a residence, or employment, within a state, you might be subject to that state's taxing authority in addition to the federal government's taxing authority.

In Illinois, the taxing authority is called the Illinois Department of Revenue (IDR). See http://www.revenue.state.il.us/#t=tab1.

D. The U.S. Tax Year

a. The Calendar Year

The tax year in the United States runs from January 1 through December 31.

b. Common Tax Forms Issued at the End of a Tax Year

Each following January, U.S. companies or organizations that have paid out funds (including but not limited to wages, per diems, or honorariums) to any individual, issue certain forms to those individuals. The two most common U.S. forms are: (1) the W-2 Wage and Tax Statement, and (b) the Form 1099. The forms mentioned (W-2 and 1099) tell both the individual and the IRS about the details of the funds paid.

c. Tax Payments and Tax Deductions ("Withholdings")

Even though the tax year runs from January to December, U.S. law requires individuals who are subject to U.S. tax rules to pay the taxes owed to the appropriate taxing authorities throughout the year. For federal taxes, the payments must be made incrementally to the IRS. For state taxes (see below) the payments must be made incrementally to the relevant state taxing authority.

As a result, whenever a U.S. company or organization issues funds to a person, it usually deducts a portion of the funds owing to the individual and forwards those deductions to the IRS or to a relevant state taxing authority (see below for further details) on a quarterly basis. By the end of the tax year, the IRS or state taxing authority already has received most of (or more than) the taxes owed to it by the person.

The process by which an organization deducts a portion of the funds it owes to an individual and forwards those deductions to the IRS or state taxing authority is called ""Withholding". Withholding is different from Tax. "Tax" is the amount of money that an individual is obligated to <u>pay</u> to the IRS or taxing authority under the various rules that might apply. Thus, the "rate of withholding" (the amount of money deducted) by an organization is intended to ensure that the taxing authorities are more likely than not to get all the taxes owed to it by the individual. The rules are supposed to ensure that the amount withheld is either roughly the same as the amount of tax the individual is supposed to pay, or (in certain situations, described later in this memo) slightly more that whatever tax might apply.

The US tax system presumes that the individual will file a return with appropriate documentation to receive whatever refund (if any) is owed back to him or her. Many foreign nationals might be able to get refunds of these deductions that are sent to the IRS. However, studies have shown that because many foreign nationals do not file U.S. tax returns, or do not file correctly, the end result is a massive *over*payment of U.S. taxes by these foreign nationals.

E. The 2 Different Ways to be Taxed in the US

The three tax obligations listed above (in Part B) depend on determining whether the individual is "resident for tax purposes" or a "non-resident for tax purposes". These are ***tax*** terms and do not have the same meaning as in an immigration context.

A ***resident for tax purposes*** is subject to the same U.S. tax rules that apply to U.S. citizens, on worldwide income (not just US-sourced income).

A ***nonresident for tax purposes*** is taxed only on that income that is US-sourced, or "effectively connected" with the U.S.

A person also can go back and forth between "resident" and "nonresident" multiple times over the years, or even change "residency" for tax purposes within a given year.

F. Residency for Tax Purposes

As mentioned, whether non- U.S. citizens are subject to taxation in the U.S. depends on whether they satisfy certain rules regarding "residency for tax purposes".

Many foreign users at Fermilab are "resident for tax purposes" because of the visa status they hold. These include people who hold H, O, TN, or E-3 visas from other U.S. institutions. Greencard holders (permanent residents) also are resident for tax purposes.

Users who hold F or J visa status *might* be "resident for tax purposes" depending on their circumstances, including how long they have been in the U.S.

<u>J Visa Holders</u> The days that a J visa holder spends in the U.S. normally do not count toward residency for tax purposes. While this exemption is in place, they are "nonresident" for tax purposes. However, this "exemption" exists only for a limited time. The usual length of this "exemption" is two out of any six years. The exemption might apply for four out of six years if the J visa holder was paid solely by a non-US employer for each year of that six-year period.

<u>F Visa Holders</u> The days that an F student spends in the U.S. do not count toward residency for tax purposes, but again, this exemption exists only for a limited time. The usual length of the exemption is five years.

Once a person loses the J or F exemption, then the person usually must "count days" to see whether a "substantial presence" in the U.S. has occurred (which would result in being "resident for tax purposes"). This is called the Substantial Presence Test. U.S. law sets out a mathematical formula for this. For purposes of the mathematical formula, we shall call the calendar year for which you are trying to determine "residency for tax purposes" as "Year X".

The threshold is whether, during Year X, you have at least 31 days of presence in the U.S. *for any reason*. If that threshold is reached, then the following "Look Back Test" must be done:

Add:

- All days of presence during Year X, plus
- 1/3 of days in Year X-1, plus
- 1/6 of days in Year X-2.

If this adds up to 183, then you have Substantial Presence for Year X and are "resident for tax purposes" for that year.

However, U.S. law has an important exception to the Substantial Presence Test. It is called the Closer Connection Test. Under this rule, you will **not** be a "resident for tax purposes" even if you can add up to 183 over a three-year period, if:

- You are physically present for fewer than 183 days in Year X, *and*
- You have a "tax home" in a single foreign country (a "tax home" is a main place of business, employment or post of duty) for the entire Year X, *and*
- You have a "closer connection" to the country where your tax home is located, than to the U.S. U.S. law sets out many examples of how a "closer connection" might be established. Multiple criteria are required to show that the balance of all circumstances weighs in favor the closer connection to the non-US country. See IRS Publication 519, online at http://www.irs.gov/publications/p519/ch01.html#en_US_publink1000222151.

The J and F exemptions, *then* the Substantial Presence test, and *then* the Closer Connection test, are the most common ways of determining residency for tax purposes for most people. However, there are other, less common exceptions to the Substantial Presence Test. See Publication 519 for an overview of these, too. It is important that you understand all the rules that might apply to you.

As mentioned, it is possible to change from resident for tax purposes to non-resident, or the other way, during a single calendar year. This is called "dual status". See Publication 519.

It sometimes is advisable or necessary to "elect" to be treated as a resident for tax purposes, even if you can document that you are eligible to be "nonresident". Examples of such situations include when you marry a lawful permanent resident or U.S. citizen, when you first arrive in the U.S. for a long-term stay, or when you leave the U.S. There also might be other situations. See Publication 519 for more information, or see a qualified tax advisor.

You should go through this analysis for each year in which you spend time in the U.S.

G. Income Subject to Taxation

a. Residents for Tax Purposes

Residents for tax purposes are taxed on their worldwide income. This means that any income from any source, anywhere in the world, must be disclosed. It does not necessarily mean you will pay taxes on all different kinds of income you receive. Consult a qualified tax advisor for further details.

There are some exceptions to the "taxation on worldwide income" rule. Residents (for tax purposes) who are physically present in another country for at least 330 days during Year X might be able to exempt their foreign-earned income. See Publication 54 at http://www.irs.gov/pub/irs-pdf/p54.pdf.

b. Nonresidents for Tax Purposes

i. What is Taxed

Nonresidents (for tax purposes) are taxed solely on US-sourced income. Foreign-sourced income that is received by nonresidents for tax purposes is not subject to U.S. taxation.

Income earned by a foreign national for services performed ***IN*** the United States, even if paid by a non- U.S. organization, is generally considered US-sourced for tax purposes. Thus, as an example, if you are an Italian citizen who is employed by a UK university, but assigned to Fermilab and physically present at Fermilab for that reason, your university salary from the United Kingdom is considered "US-sourced" for the purposes of U.S. taxation.

Payments to a person by a U.S. organization (such as Fermilab) that are *reimbursements* of living expenses in the U.S. also usually are considered "US-sourced" income.

There is a limited exception to this rule. If you are employed by an organization outside the U.S. , are physically present in the U.S. for not more than 90 days during Year X, and earn less than $3,000, the income will not be considered US-sourced for tax purposes. See Publication 519, Chapter 3.

ii. How is it Taxed

1. Effectively Connected Income

The U.S. tax system divides the "US-sourced" income received by nonresidents for tax purposes into two categories:

1. Income that is "effectively connected" with trade or business in the United States, and
2. Income that is not "effectively connected" with trade or business in the United States.

The difference is that income that is "effectively connected" is taxed graduated rates, similar to the income tax rates applied to residents for tax purposes. Income that is ***not*** effectively connected has a flat 30% "Withholding Rate" applied to it. Quite often, this *withholding* rate will be higher than the graduated rate of *tax* available to "effectively connected" income.[1]

[1] See, again, the difference between "Withholding" and "Tax" as described on pages 2 - 3 of this memo.

If you provide services in the U.S. (even if for a foreign employer), the wages you receive for those services generally are considered to be US-sourced income that is "effectively connected" to the United States. Similarly, if you hold an F or J visa, the income you receive in connection with your authorized F or J activities likely will be considered US-sourced income that is "effectively connected" to the U.S. for tax purposes. See Publication 519 for more information.

Some tax treaties (see below) authorize a lower "Withholding rate" than 30% to be used for income that is not effectively connected with the U.S. See Publication 519 and the tax treaty applicable to your situation for more details.

iii. Tax Treaties

Certain individuals who are nonresident for tax purposes may rely on the provisions of the applicable tax treaty between the U.S. and their home country to reduce or adjust their tax obligation on their US-sourced income (as defined earlier).[2]

The United States has tax treaties with many (but not all) foreign countries. An A-Z list of all tax treaties between the United States and other countries is online at http://www.irs.gov/businesses/international/article/0,,id=96739,00.html.

Under these treaties, nonresidents for tax purposes are taxed at a reduced rate, or are exempt from U.S. taxes, on certain kinds of US-sourced income. These reduced rates and exemptions vary among countries and specific items of income. See http://www.irs.gov/businesses/international/article/0,,id=96739,00.html and http://www.irs.gov/businesses/small/international/article/0,,id=96454,00.html.

It is not necessary to be a citizen of the country whose tax treaty is being claimed. Instead, the critical issue is whether the individual is a resident for tax purposes in that country. Thus, a British citizen employed permanently by an Italian university likely would be able to use the provisions of the US-Italy tax treaty.

If the treaty does not cover a particular kind of income, or if there is no treaty between the individual's country and the United States, the individual usually must pay tax on the income in the same way and at the same rates shown in the instructions for the applicable U.S. tax return. In other words, that specific US-sourced income received by the nonresident (for tax purposes) is treated the same as if it was earned by a resident for tax purposes.

As explained earlier, many of the U.S. States also tax income. Usually they tax the income that is sourced to the State in question, and thus the state taxing authorities have their own rules about whether specific kinds of income are state-sourced income or not. Some States do not honor the provisions of tax treaties.

To gain the advantage of a tax treaty, the individual must include IRS Form 8833 in the tax return and list on it the country for which the tax treaty is claimed. If an individual is required to file Form 8833, but fails to do so, there might be a $1000 penalty.

See generally IRS Publication 901, "US Tax Treaties," at http://www.irs.gov/pub/irs-pdf/p901.pdf.

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[2] As a reminder, when a nonresident for tax purposes receives income that the IRS considers to be foreign-sourced, that foreign-sourced income is not subject to US tax.

H. Filing a Federal Tax Return

a. What you need

To file a U.S. tax return, you generally need the tax form issued by the U.S. organization or company that paid you funds during the tax year – a Form W-2 or Form 1099. You also will need documentation of any reason you claim to reduce your taxes – including documentation of any *exemption* from taxation, *deduction* in the rate of taxation, or *credit* against the tax you owe. See Publication 519 generally.

If you receive funds from non- U.S. sources, you might need to obtain official statements from those organizations to determine the total amount paid to you, for purposes of detailing those payments on your U.S. tax return.

b. Non-Residents for Tax Purposes with only Foreign-Sourced Income

Individuals who are (a) non-residents for tax purposes, (b) *only* have income that, under IRS rules, would be considered foreign-sourced income (for which no payment to the IRS would be required) but (c) still must file U.S. tax returns, must file these with the IRS within 6 months of the date on which their U.S. tax year ends.

See http://www.irs.gov/businesses/small/international/article/0,,id=96477,00.html for more information.

For most people, this would be June 30 of the year following the tax year in question.[3] The only exception to this deadline is if you file a request for an extension of the deadline by which to file your tax return. See http://www.irs.gov/formspubs/article/0,,id=98155,00.html for more information about filing a request for an extension.

c. Individuals who must Pay U.S. Taxes or who have US-Sourced Income to Report

If you are required to pay income tax for a given year or have US-sourced income to report, then you normally must do so by April 15 of the following year. Late payment of taxes might result in interest and/or penalties being levied against you.

Filing to request an extension of the time in which to file your return does not change the date by which you must pay any tax owing. If you owe taxes and request an extension, then interest on the taxes owed could begin accruing as of the day after the deadline. Please see http://www.irs.gov/businesses/small/article/0,,id=108326,00.html for more information.

One option in such a situation is to pay an estimate of the owed taxes by April 15 while simultaneously submitting the extension request. This helps to avoid or minimize possible penalties or interest. On or before the expiration of the extension, the final tax return would have to be filed, along with either the payment of the remainder of taxes, or a request for a refund of any overpayment made.

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[3] See below for a general discussion of state tax rules. You must check the applicable state rules to confirm whether a tax filing with the state taxing authority would be required and, if so, the date by which it would be required.

See http://www.irs.gov/file/content/0,,id=105693,00.html for information about where to file.

Information about electronically filing a tax return is at http://www.irs.gov/efile/index.html.

d. **Federal Tax Return Forms**

The IRS Form 1040, U.S. Individual Income Tax Return, is the starting form for personal (individual) Federal income tax returns filed with the Internal Revenue Service (IRS) in the United States. It has multiple "versions" for different categories of filer.

The Form 1040NR is the standard individual tax return form used by individuals who are nonresident for tax purposes and have U.S. sourced income to report. There also is a Form 1040NR-EZ which is an "easy" version of the same form, and which may be used by those individuals with uncomplicated tax situations. Joint NR returns are not permitted, so that husband and wife must each file a separate return.

Individuals who are resident for tax purposes must use a version of the IRS Form 1040. Those with uncomplicated tax situations may use the Form 1040A (the "short form") or the even simpler Form 1040EZ (the "easy form") instead of Form 1040.

Form 1040 has several attachments, called "schedules" that itemize income, deductions, credits or other tax- or income-related situations.

In addition, the individual might need to include other IRS Forms with the Form 1040, such as if a tax treaty is claimed. (See above).

See, generally, information about the Form 1040 at http://www.irs.gov/individuals/article/0,,id=118506,00.html.

e. **Filing a Tax Return Electronically**

There are several vendors that provide software applications that review typical tax situations to facilitate the process by which you complete the necessary tax forms, showing the appropriate income and claiming the relevant deductions, credits or other exceptions under U.S. tax law. Many of these software programs do not comprehensively accommodate the unique tax situations of non-US-citizens who are non-resident for tax purposes, intermittently resident for tax purposes, or holding dual status for tax purposes. You should evaluate these programs for yourself to ascertain whether they are adequate for your situation.

Fermilab is contracting with CINTAX, a software program dedicated to federal tax filings for nonresidents eligible to complete the Form 1040NR.

I. Paying U.S. Taxes or Receiving your Refund

If you owe federal income tax (payable to the IRS) or state income tax (payable to the states to which you have a connection), then you pay these at the same time as you file your tax return.

If you file a paper return, then you may pay by enclosing a check or other payment with the paper return. See http://www.irs.gov/taxtopics/tc202.html for an explanation of the different ways the IRS accepts payments. You will need to check with the states to which you owe taxes to determine appropriate payment mechanisms.

If you file your tax return electronically, then you also can pay electronically. As part of the electronic process, there will be an authorization for funds to be withdrawn from the bank account of your choice.
You also can pay electronically separately from your filing. See http://www.irs.gov/efile/article/0,,id=97400,00.html for more information.

In some cases, Fermilab (or some other institution or employer) might have withheld funds from payments it made to you (as reported on your Form 1099), and you might be eligible to reclaim those funds from the IRS. In that case, you must file your tax return to receive your refund. As with the payment of taxes, you can request your refund as part of your paper filing, or as part of your electronic filing.

J. State Taxes

a. Being a Resident of More than One State

If you have such connections to more than one state, for example, by being employed by a university in another state while residing in Illinois, then you might be subject to the taxation of *more than* one state. Be sure to discuss this with a qualified tax advisor.

Generally, the state where you physically reside (other than on a purely temporary basis, such as while on vacation) on December 31 of the tax year is the state where you will be considered "resident" for state tax purposes.

As stated above, taxing authorities in the U.S. require U.S. organizations (including but not limited to employers) to remit (pay) various tax payments that the organization thinks the individual will need to pay by the end of the tax year. The U.S. organization does this by *withholding* the tax payments from the money paid to the individual.[4] This is the case both for federal taxes (paid to the IRS) and state taxes (paid to the state where you are resident).

Generally, if an individual is employed by an institution in one State in the U.S. (other than Illinois), and working at Fermilab (in Illinois), the U.S. home institution should be told that the individual is not subject to taxation in the home institution's state. The U.S. home institution then likely will not make state tax deductions.

Take, for example, a person who is employed by the Well-Funded State University (WFSU) as a postdoc, but assigned for the entire employment term to Fermilab. WFSU is in Hawaii. This person should advise WFSU that the person is "non-resident" in Hawaii for tax purposes. (Note that even though WFSU is assigning the person to Fermilab, this will not mean, necessarily, that the WFSU's payroll office will know that the person is resident in Illinois for tax purposes.) Once WFSU's Payroll Office receives this information from the postdoc, it corrects its payroll records so that state taxes are no longer deducted from the postdoc's wages.[5]

b. Estimated Quarterly Payments

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[4] See pages 2 – 3 above.
[5] Whether *your* home institution is as responsive as WFSU is unknown. Talking to your payroll office and following their directions will help them to respond appropriately to your assignment out of state.

When a person is resident in a state other than where the employer or home institution is located, that person usually must remit their own tax payments to the appropriate state taxing authority. In many cases, it might be to the Illinois taxing authority. Please confirm with a qualified tax advisor or your local state taxing authority to confirm the state where you are resident for tax purposes.

To remit your quarterly tax payments, you must complete a form that estimates what your tax payments will be, and then pay those taxes by *roughly* the middle of each of April, June, September and January.

For Illinois, see http://tax.illinois.gov/Individuals/FilingRequirements/EstimatedPayments.htm and http://tax.illinois.gov/taxforms/IncmCurrentYear/Individual/IL-1040-ES.pdf for more information about estimated Illinois tax payments.

K. Foreign Bank Account Reporting (FBAR)

U.S. law requires people to report certain foreign financial accounts using Form TD F 90-22 1 (http://www.irs.gov/pub/irs-pdf/f90221.pdf). This rule applies to everyone who normally must file a tax return, but additionally, it applies to individuals who are present in the U.S. with J-1, H-1B, O-1 or B-1 visas, even if you are employed only outside the U.S. and/or receive all funding from non-U.S. sources.

Depending on their circumstances, visa holders who have spent 183 days over any three-year period might be subject to this financial reporting rule. Failure to report your bank accounts, if you are required to do so, might result in substantial monetary penalties.

All such visa holders should immediately confirm whether they are subject to the Federal Bank Account Reporting (FBAR) rule. A person who is "resident for tax purposes" will likely also be subject to this FBAR rule. We recommend you consult a qualified tax advisor to evaluate your situation.

Although this rule has existed for several years, reporting by certain non- U.S. citizens has been suspended for calendar years 2009 and earlier, making 2010 the first year the requirement is unavoidably in place. The deadline for filing is June 30, 2011.

Further information about FBAR is at http://www.irs.gov/businesses/small/article/0,,id=148849,00.html, and FAQs on the topic are at http://www.irs.gov/businesses/small/article/0,,id=148845,00.html.