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Foreign Students and Scholars and the United States Tax System

DAVID WILLIAMS, II

I. Introduction

During the 1992-1993 school year, more than 425,000 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.

Fifty-eight foreign countries sent 1,000 or more of their citizens to the United States as students,[1] while fifty-nine United States academic institutions

1.

Country	Number of Students in United States	Country	Number of Students in United States
China	45,130	Jamaica	2,630
Japan	42,840	Italy	2,620
Taiwan	37,430	Peru	2,560
India	35,950	Lebanon	2,540
Republic of South Korea	28,520	Former U.S.S.R.	2,530
Canada	20,970	Nigeria	2,490
Hong Kong	14,020	Norway	2,420
Malaysia	12,660	Kenya	2,350
Indonesia	10,920	Sri Lanka	2,270
Thailand	8,630	Australia	2,190
Pakistan	8,020	Kuwait	2,160
Germany	7,880	Argentina	2,020
United Kingdom	7,630	Netherlands	1,970
Mexico	7,580	Trinidad & Tobago	1,970
France	5,660	Bahamas	1,890
Spain	5,160	South Africa	1,860
Turkey	4,980	Cyprus	1,760
Singapore	4,860	United Arab Emirates	1,710
Brazil	4,540	Panama	1,650
Greece	4,350	Yugoslavia	1,640
Iran	4,090	Egypt	1,560
		Ethiopia	1,490

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each enrolled over 1,800 foreign students.[2] With all this diversity and size, most of the foreign nationals that are in some way affiliated with a United States academic institution have the following in common:

Country	Number of Students in United States	Country	Number of Students in United States
Saudi Arabia	3,750	Switzerland	1,400
Philippines	3,700	Poland	1,380
Venezuela	3,440	Ecuador	1,160
Jordan	3,260	Ireland	1,110
Israel	3,010	Nepal	1,060
Bangladesh	2,930	Ghana	1,050
Colombia	2,850	Honduras	1,030
Sweden	2,810		

Paul Desruisseaux, *A Foreign-Student Record,* CHRON. HIGHER EDUC., Dec., 1, 1993, at A42, 43. The figures are from the 1992-93 school year.

2.

Institution	Number of Foreign Students
Univ. of Texas, Austin	4,152
Boston Univ.	4,084
Univ. of Southern California	4,038
Univ. of Wisconsin, Madison	4,014
New York Univ.	3,531
Ohio State Univ., Main Campus	3,440
Columbia Univ.	3,338
Univ. of Pennsylvania	3,248
Univ. of Illinois, Urbana-Champaign	3,089
Texas A&M Univ., Main Campus	2,956
Univ. of Minnesota, Twin Cities	2,781
Southern Illinois Univ., Carbondale	2,700
Harvard Univ.	2,600
Univ. of Houston	2,585
Univ. of Maryland, College Park	2,558
Univ. of Michigan, Ann Arbor	2,544
Cornell Univ.	2,478
Iowa State Univ.	2,448
Northeastern Univ.	2,448
George Washington Univ.	2,421
Arizona State Univ.	2,409
Purdue Univ., Main Campus	2,403
Stanford Univ.	2,373
Rutgers Univ., New Brunswick	2,372
Michigan State Univ.	2,322
Univ. of Florida	2,261
Indiana Univ., Bloomington	2,174
Massachusetts Institute of Technology	2,167
Univ. of Arizona	2,161
Temple Univ.	2,153
Univ. of Kansas	2,126
Univ. of California, Berkeley	2,099
Wayne State Univ.	2,086

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A. Most of them are nonresident aliens for tax purposes.[3]
B. They must annually file United States tax returns, even if they owe no money, unlike United States citizens or resident aliens.[4]
C. They have little or no understanding of the United States tax system and their rights and responsibilities under it.
D. They are uneasy, confused, and worried about the consequences of tax noncompliance.
E. They receive little or no assistance in this task.[5]

It is my hope that this article will demystify the process a bit and lighten the burden for foreign students and scholars and those trying to assist them.

Institution	Number of Foreign Students
Univ. of Hawaii, Manoa	2,052
State Univ. of New York, Buffalo	2,049
Pennsylvania State Univ., Main Campus	2,037
Santa Monica College	2,011
City Univ. of New York, City College	1,975
Univ. of Iowa	1,949
Univ. of Washington	1,926
Univ. of Illinois, Chicago	1,882
Louisiana State Univ., Baton Rouge	1,869
Univ. of Miami	1,866
Univ. of Massachusetts, Amherst	1,852
Univ. of Missouri, Columbia	1,846
Univ. of California, Los Angeles	1,764
Hawaii Pacific Univ.	1,734
Oklahoma State Univ., Main Campus	1,731
Florida International Univ.	1,688
Western Michigan Univ.	1,656
Miami-Dade Community College	1,654
State Univ. of New York, Stony Brook	1,615
Syracuse Univ.	1,610
American Univ.	1,601
Univ. of Utah	1,571
Virginia Potytechnic Institute and State U.	1,530
Univ. of Oregon, Main Campus	1,529
Univ. of Oklahoma, Main Campus	1,520
Univ. of Pittsburgh, Main Campus	1,517

Id. at A43.

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

4. United States citizens or resident alients do not have to file tax returns if their income is less than their Personal Exemption plus their Standard Deduction. On the other hand, nonresident aliens must file annual tax returns if they have *any United States income source* during the tax year, whether they owe money or not.

5. This is not necessarily a mark against the academic institutions. In fact, many do try to offer some assistance. However, the tax laws in this area are extremely complex and do not yield easily to study by lay people.

II. DETERMINING TAX STATUS

Tax status for foreign nationals has little or nothing to do with their status for immigration purposes. In fact, tax status as a resident or nonresident alien is determined by § 7701(b) of the Internal Revenue Code of 1986 (hereinafter the Tax Code). Under § 7701(b), a resident alien is defined for tax purposes as any individual who

A. is lawfully admitted for permanent residence or
B. passes the substantial presence test, or
C. makes the first year election [6]

The Tax Code goes further and defines a nonresident alien as any individual who is neither a United States citizen nor a resident alien during any calendar year. Because the tax status is based on each calendar year, it is entirely possible for an individual to be a nonresident alien during 1991, a resident alien during 1992 and a nonresident alien during 1993. [7] Therefore, the tax status of each foreign student, scholar, researcher, lecturer, and professor must be assessed each year if each is to comply with United States tax laws.

A. Lawfully Admitted for Permanent Residence

The one area in which tax status and immigration status coincide is the test for being lawfully admitted for permanent residence. A foreign national is a resident alien for tax purposes if he or she has been issued a "green card" by the Immigration and Nationality Service (INS) [8] and that card has neither been revoked nor administratively or judicially considered abandoned. [9] An individual's "green card" is deemed revoked if a final administrative or judicial order of exclusion or deportation has issued against the alien. [10]

The moment of abandonment hinges on who initiated the action for abandonment. If the INS or a consular officer initiates the action, abandonment, if found, occurs upon the issuance of the final administrative order. [11] If the action is initiated by the alien, abandonment occurs upon filing by the alien of the application for abandonment with INS or a consular officer. [12]

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6. I.R.C. § 7701(b)(1)(A) (1986).
7. *See id.* § 7701(b)(1)(B).
8. *See id.* § 7701(b)(6)(A). While the card is referred to as a "Green Card," it is not actually green.
9. *See id.* § 7701(b)(6)(B).
10. Treas. Reg. § 1.7701(b)-1(b)(3) (1992).
11. *Id.*
12. *Id.*

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Under this test, resident alien tax status can extend beyond the alien's stay in the United States and, if proper action has not been taken, even after the alien has abandoned any desire to be a resident alien.

B. Substantial Presence

This is the category through which most foreign students, scholars, researchers, lecturers, and professors may be classified as resident aliens for tax purposes. Resident alien status for the tax year will exist if

A. the alien is present in the United States at least 31 days in the current year, and
B. the sum of the number of days present in the United States during the current year and the two preceding calendar years equals or exceeds 183 days. [13]

But under the Tax Code, things are not always what they seem. A "day" is a moving target under the Internal Revenue Service formula. During the taxable year in question, each day an alien is present is counted as one day. However, each day of presence in the first preceding year counts only as one third of a day; and in the second preceding year a whole day counts only as four hours, or one sixth of a day. [14] If the sum of these "days" reaches 183, the alien will be held to have had a substantial presence in the United States and to be a resident alien for tax purposes.

EXAMPLE I

X, an alien 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:

Year	Days present for SPT
1992	115
1991	40 (1/3 of 120)
1990	30 (1/6 of 180)
Total	185

Because X was present in the United States 31 or more days in 1992 and her total "days" 1992, 1991 and 1990 exceed 183, she would be treated as a resident alien for the tax year 1992.

13. I.R.C. § 7701(b)(3)(A) (1986).
14. *Id.*

While the reasons for this calculation may seem obscure, the test itself would appear to be fairly straightforward; but it is not. Even if an alien meets the substantial presence test, there are ways to avoid classification as a resident alien for tax purposes. If the alien is present in the United States for less than 183 days in the current tax year and can establish that he has a tax home in a foreign country for that year *and* he has a closer connection to that foreign country than the United States, his "substantial presence" will be ignored and he will not be considered a resident alien in that tax year.[15] This may appear to be a fairly easy exception under which to fit, but in fact it is quite difficult. First, the alien must be in a position to show, under United States tax law, that he has a tax home in another country.[16] Then, the individual must be able to establish that he has a closer connection to his tax home than he has to the United States.[17]

Another escape from the substantial presence test (and the one of most interest here) involves "exempt days." Under this concept, certain aliens can be physically present in the United States without having the days of presence count in the substantial presence calculations.[18] The aliens who can take advantage of the exempt day provision are:

aliens unable to leave the United States because of a medical condition;[19]
foreign government-related aliens;[20]
certain professional athletes;[21] and, most importantly for this article;
teachers, trainees and students.[22]

For purposes of the substantial presence test and the exempt days provision, a teacher or trainee is defined as any individual who

i) is temporarily present in the United States under a J-Visa[23] (except as a student), and

15. *See id.* § 7701(b)(3)(B).

16. *See id.* § 7701(b)(3)(B)(ii). The test used to determine tax home for this purpose is the same used to determine tax home under I.R.C. § 911(d)(3).

17. *Id.* For the definition of closer connection see Treas. Reg. § 1.7701(b)-2.

18. I.R.C. § 7701(b)(3)(D) (1986).

19. *See id.* § 7701(b)(3)(D)(ii).

20. *See id.* § 7701(b)(5)(A)(i).

21. *See id.* § 7701(b)(5)(A)(iv).

22. *See id.* § 7701(b)(5)(A)(ii),(iii).

23. The visa category is used by foreign students, scholars, experts, medical interns and residents, "international visitors," and industrial and business trainees to enter the United States as "exchange visitors" in U.S. government-approved Exchange-Visitor Programs, for the purpose of gaining experience, studying, or doing research in their respective fields. *See* AUSTIN T. FRAGOMEN et al., 1993 IMMIGRATION PROCEDURES HANDBOOK (1992).

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ii) substantially complies with the requirements of the visa for being present.[24]

An alien teacher or trainee cannot use this status to exempt days in the relevant tax year if he or she had exempt days as a teacher, trainee, or student in any two of the previous six years.[25] However, the two-year-period requirement will be softened to require exempt days to have been taken in four of the previous six years when the individual's total compensation for the current year comes from a foreign employer.[26]

EXAMPLE II

X, an alien, has been physically present in the United States for 200 days during 1992. Under the substantial presence test X would 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, he will be able to exempt all 200 days and will be treated as a nonresident alien for 1992.

On the other hand, if X was in the United States during 1991, 1990, 1989, and 1988 and exempted days as a teacher, trainee or student during any two of those years, she cannot exempt days as a teacher/trainee in 1992.

However, if her total compensation in 1992 is being paid by a foreign employer, she must have exempted days in all four years before she is prohibited from exempting days in 1992.

For purposes of the exemption provision, a student is defined as any individual who

i) is temporarily present in the United States under an F- or J- Visa[27] and

ii) substantially complies with the requirements of the visa for being present.[28]

Like the teacher/trainee rule, the student exemption rule has a limitation. After an individual has exempted days for five years as a student, teacher,

24. I.R.C. § 7701(b)(5)(C) (1986).

25. *See id.* § 7701(b)(5)(E)(i).

26. *Id.*

27. *See supra* note 23. Foreign Nationals may enter the United States as nonimmigrants in order to engage in academic studies, subject to certain restrictions. These students, who may range from elementary school students to doctoral candidates and persons engaged in postdoctoral studies, are classified in the F visa category.

28. I.R.C. § 7701(b)(5)(D) (1986).

trainee, or any combination of the three, he can no longer exempt days as a student.[29] However, the five-year limitation rule can be waived for any year that the foreign student can establish that he does not intend to permanently reside in the United States.[30]

Under the Treasury Department's "piggy-back" 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.[31] "Immediate family" is given its common American meaning; but to qualify for exempt days, the family member must be under twenty-one years of age, must reside regularly in the household of the exempting alien, and must not be a member of anyone else's household.[32]

Section 7701(b)(8) of the Tax Code requires an individual who will be exempting days under these provisions to provide the Internal Revenue Service with an Exempt Day Statement.[33] While the IRS does not provide a form for this statement, the regulations require that the statement (to be submitted with the alien's tax return) include the following:

(1) the individual's name, address, United States taxpayer identification number (if any), and United States visa number;
(2) the country that issued the individual her passport and the passport number;
(3) the relevant tax year;
(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 where present during the tax year;
(6) the name, address and telephone number of the director of the academic and 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.[34]

What is extremely interesting about this 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 an individual who fails to submit this statement will

29. *See id.* § 7701(b)(5)(E)(ii).
30. *Id.*
31. Treas. Reg. § 1.7701(b)-3(b)(3) (1992).
32. *See id.* § 1.7701(b)-3(8).
33. I.R.C. § 7701(b)(8) (1986).
34. Treas. Reg. § 1.7701(b)-8(a)(2),(b)(2) (1992).

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not be able to exempt *any* days even if she is in the United States as a student, teacher, or trainee.[35] If this is in fact the case, it appears that the exempting of days is another form of election to be a resident alien. Thus if a student, teacher, or trainee wishes to forgo her exempt days, and she may become a "fall-back" resident alien for tax purposes under the substantial presence test. Between 1986 and 1992, while the § 301.7701(b) regulations were only in proposed form, an excellent planning opportunity was thus provided for foreign students, teachers, trainees, and their advisors.[36]

Under the final § 301.7701(b) regulations,[37] the Internal Revenue Service has added two points to this provision. First, the aforementioned penalty will not apply if the alien can show by clear and convincing evidence that she took reasonable actions to become aware of the filing requirements and significant affirmative steps to comply with the requirements.[38] But more importantly, the Service in its *sole discretion, when it is in the best interest of the government* to do so, and based on all of the facts and circumstances, can *disregard* the alien's failure to timely file the exempt day statement.[39] In essence, this allows the government to pick and choose. If the alien student fails to file his exempt day statement and has substantial foreign source income, the Service can invoke the penalty section, count the exempt days, make the alien a resident alien, and tax him on his worldwide income. If, on the other hand, the alien student has only United States source income but is present in the United States with his wife and children, the Service can disregard his failure to file the exempt day statement, thereby ignoring the penalty of not counting the exempt days, and denying the alien student valuable exemptions and deductions. This last-minute addition appears to allow the government to have its cake and eat it to.

C. First Year Election

An alien can elect to be treated as a resident alien for tax purposes under this test if the following three requirements are met: First, the alien cannot

35. *See id.* § 1.7701(b)-8(d)(1).

36. If this is the case, an alien individual with enough United States source income to cause a problem and enough possible exempt days to be a nonresident alien could by failing to file the statement, become a resident alien and thus increase his possible personal and itemized deductions and allow the taking of the standard deduction.

37. The § 301.7701(b) regulations were adopted as final regulations on April 27, 1992.

38. Treas. Reg. § 1.7701(b)-8(d)(2) (1992).

39. *See id.* § 1.7701(b)-8(e).

already be a resident alien of the United States by way of the lawfully admitted test or the substantial presence test in the year affected by the election (hereinafter the election year).[40] Second, the alien cannot have been a resident alien of the United States the year immediately preceding the election year.[41] Moreover, the alien must be a resident alien of the United States, by way of the substantial presence test, the year immediately following the election year.[42] Finally the alien must be both present in the United States for a period of at least thirty-one consecutive days in the election year and present in the United States for at least 75% of the days in what is referred to as the "test period."[43] This "test period" begins on the first day of the thirty-one consecutive period and ends on the last day of the tax year.[44]

EXAMPLE III

> 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.

D. Tax Status by Marriage and Dual Status

A nonresident alien who is married to a United States citizen, a United States permanent resident, or a resident alien may elect to be taxed as a resident alien.[45] If this election is made, the couple must file a joint return. The election will be suspended for any year when neither spouse is a United States citizen or resident alien.[46] 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 endpoints for her sojourn in the United States must be made.[47] An alien taxpayer may actually be classified as a nonresident for part of a tax year and a resident alien for the remainder of it.[48] In that particular year, she would be known as a dual status taxpayer.[49]

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40. I.R.C. § 7701(b)(4)(A)(i) (1986).
41. *See id.* § 7701(b)(4)(A)(ii).
42. *See id.* § 7701(b)(4)(A)(iii).
43. *See id.* § 7701(b)(4)(A)(iv).
44. *See id.* § 7701(b)(4)(A)(iv)(II).
45. *See* I.R.S. Publication 519 and I.R.C. § 6013(g), (h).
46. *Id.*
47. I.R.C. § 7701(b)(2) (1986).
48. *Id.*
49. *Id.*

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III. TAX COMPLIANCE FOR ALIENS

A. Resident Aliens

An individual who is a resident alien for any given year has tax duties identical to those of a United States citizen. The resident alien may file a 1040EZ, 1040A, or 1040 tax form. The return is ordinarily due on April 15; however, the resident alien is eligible for extension of the time to August 15 and October 15.[50] The completed tax return must be sent to the applicable Internal Revenue Service Center for the city in which the resident alien is residing.

B. Nonresident Aliens

If the individual is a nonresident alien for any tax year, the compliance requirements are very different. First, the proper tax form to file 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.[51] If the nonresident alien has any earned wages subject to withholding, then the 1040NR is due on April 15. All other 1040NRs are not due until June 15. All 1040NRs are to be sent to:

Internal Revenue Service Center
Philadelphia, Pennsylvania 19255

One problem confronting aliens is what to do about correcting mistakes. There is no "1040NRX" form to complement the 1040X for amending returns. The proper procedure in such an event is to file a corrected 1040NR with "amending" written across the face of the return and with a copy of the erroneous return attached. The same procedure should be followed when an alien has mistakenly filled a 1040EZ, 1040A, or 1040 for a prior tax year and now realizes that she should have filed a 1040NR.

If an alien is a dual status taxpayer for a taxable year, his obligations are mixed. The proper form to be used is the one which reflects his status on the last day of the year. If he was a nonresident alien on December 31, he must file a 1040NR. If he was a resident alien on December 31, he must file a 1040EZ, a 1040A, or a 1040. Regardless of which of these forms is filed, the individual must also file a statement covering the portion of the year when

50. I.R.C. §§ 6072(a), 6081(a) (1986).
51. *See supra* note 33.

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his status was different from the one reflected by the form he files. As a practical matter, this can be accomplished by attaching the form he is *not* required to file with "statement" written across the front.

Example IV

An alien scholar is a dual status taxpayer for 1992 and a resident alien on 12/31/92. She must file form 1040EZ, 1040A, or 1040. For the portion of 1992 that she was a nonresident alien a separate tax statement must be filed. A 1040NR for that portion of 1992 with the word "statement" written across its face will suffice.

IV. TAXATION OF THE FOREIGN TEACHER, SCHOLAR OR STUDENT

If the teacher, scholar, student, or lecturer is a resident alien during a tax year, she will be taxed just like a United States citizen, with the same rights to deductions, exemptions, and credits. However, she will be required to pay taxes to the United States on *all* her income for the year, regardless of the fact that it was earned in or outside of the United States. On the other hand, if she was a nonresident during the tax year, the rules differ. Although the nonresident alien has restrictions on her deductions, exemptions, and credits, as well as a potentially higher tax rate on certain types of income, she has to pay United States tax only on income earned in the United States—United States source income.

A. Sourcing of Income

There is a complex system of United States tax rules concerning the source of different types of income.[52] These rules are very important for nonresident aliens because any foreign source income of the nonresident alien is not reportable to or taxable by the United States. Unearned income, such as dividends and interest, is generally considered to flow from the residence of the entity making the payments. Therefore, interest paid to a nonresident alien by a bank in his home country would be foreign source income and thus not subject to United States tax. On the other hand, interest paid to a nonresident alien by a bank in the United States would be generally subject to United States tax. However, a special Tax Code section exempts any interest a nonresident alien receives from a United States bank, a United States

52. *See* I.R.C. §§ 861-865 and the regulations under these sections.

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savings and loan institution, or most United States insurance companies.[53] By contrast, dividends paid to a nonresident alien by a "domestic" corporation[54] are held to be from a United States source and thus subject to tax. Dividends paid to a nonresident alien by a foreign corporation[55] are generally considered to be from a foreign source and thus outside the United States taxing regime.[56]

EXAMPLE V

X, a visiting scholar from Mexico has been in the United States for the entire year of 1991. However, having been able to exempt days as a teacher/trainee, she is a nonresident 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 domestic corporation
d. dividends from a Canada corporation.

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

The tax rate for nonresident aliens on most unearned income from United States sources (such as interest, dividends, and capital gains) is a flat thirty percent.[57] However, there are special rules for capital gains. First, capital gains from the sale of real property located in the United States, or of a United States Real Property Interest,[58] while from a United States source, will be actually taxed, as if the gain was earned income from the conduct of a trade or business in the United States and not at the flat thirty percent

53. I.R.C. § 871(i) (1986).

54. I.R.C. § 7701(a)(4) (1986) (defining 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).

55. I.R.C. § 7701(a)(5) (1986) (defining any corporation which is not a domestic corporation as a foreign corporation).

56. I.R.C. § 872(a) (1986).

57. I.R.C. § 871(a) (1986).

58. A United States Real Property Interest is defined as an interest in real property located in the United States or the Virgin Islands and an interest in certain domestic corporations. I.R.C. § 897(c) (1986).

capital gain rate.[59] Next, capital gains from property other than real estate realized by a nonresident alien who has been actually physically present in the United States less than 183 days in the tax year are totally free from United States tax, even though this income is from a United States source.[60] Actual physical presence is the key to determining the number of days present in the United States. The alien cannot use exempt days to slip under the 183-day ceiling.

EXAMPLE VI

> Two alien sibling students, M and F, have capital gains from the sale of jointly owned stock of a domestic corporation. Both M and F qualify as nonresident aliens for the tax year 1992. Though M has lived in the United States throughout 1992, he has exempted those days to qualify as a nonresident for tax purposes. F has just arrived in the United States for the first time on an F-Visa in the fall semester and qualifies as a nonresident alien because she fails the substantial presence test and has not exercised her first-year election option. F's capital gains will be tax-free since she has not been in the United States for 183 days. But because M cannot use exempt days to reduce his actual presence in the country for capital gains tax purposes, his capital gains will be subject to the thirty percent tax.
>
> If the property they sold were real estate, however, both M's and F's gain would be taxed as earned income from a United States source.

Earned income, such as wages, salaries, professional fees, and honoraria from performing services, is considered to come from the source where the services are actually performed.[61] Therefore, the income earned at a United States educational institution by a nonresident alien visiting professor, being from a United States will be taxed by the United States. Because this income is connected to the professor's trade or business (teaching) and that trade or business is being conducted in the United States, the income will be taxed at the same graduated rates which apply to United States citizens and resident aliens.[62] While this income is from a United States source and thus generally subject to United States taxation, there are three major exceptions to this treatment.

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59. I.R.C. § 884 (1986).
60. I.R.C. § 871(a)(2) (1986) and accompanying regulations.
61. I.R.C. § 861(a)(3) (1986).
62. I.R.C. § 871(b) (1986).

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First, income paid by a foreign employer to a nonresident alien who is present in the United States under an F- or J-Visa is exempt from United States taxation.[63] 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 ninety days or less during the year will qualify as foreign source income and thus be exempt from United States taxation.[64] Once again, the alien cannot use exempt days for purposes of meeting the ninety-day-or-less requirement. This provision, furthermore, only applies if the income received for the personal services does not exceed $3,000. Finally, earned income received by a nonresident alien for the performance of certain services in the United States may be exempt from United States taxation by virtue of various provisions of tax treaties between the United States and the alien taxpayer's country of residence.[65]

If a foreign student is studying in the United States and receiving a graduate teaching or research assistantship that was awarded after August 16, 1986, the income from the assistantship is viewed as pay for work and thus as earned income from a United States source. The nonresident alien student must pay tax to the United States on this income; but a tuition reduction may be free from taxation unless the reduction represents payment to the student for research or teaching services.[66] If the graduate assistantship was awarded prior to August 17, 1986, the income is free from United States 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, a scholarship or fellowship is considered to be from the country of residence of its grantor.[67] Therefore, a nonresident 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

63. I.R.C. § 872(b)(3) (1986).
64. I.R.C. § 871(b) (1986).
65. *See, e.g.*, Article 19 of the United States—China Income Tax Treaty.
66. I.R.C. § 117(d) (1986).
67. Rev. Rul. 89-67, 1989-1 C.B. 233.

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liability on the scholarship or fellowship. Because the portion of the scholarship or fellowship that represents "qualified educational expenses" is excluded from taxation,[68] the amount thereof 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 nonqualified educational expenses portion will be considered income from a United States source and thus subject to United States tax. On the other hand, if the grantor's residence is not the United States, then the nonqualified educational expenses portion will be considered income from a foreign source and thus not subject to United States tax. For purposes of taxation of scholarships and fellowship, "qualified educational expenses" are tuition, enrollment fees, and expenses for books, equipment, and required supplies.[69] All other expenses such as room, board, and transportation are nonqualified and taxable. Because education is deemed to be a nonresident alien's trade or business,[70] the taxable portion of the scholarship or fellowship is deemed to be income connected to the conduct of a United States trade or business and thus taxed under the graduated rates that apply to United States citizens and resident aliens.[71]

EXAMPLE VII

X, a foreign student, is a nonresident alien studying at a United States university. X receives a scholarship of $20,000 from the 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
other	$ 440

While the total scholarship is from a United States 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 thus be exempt from taxation. However, the remaining expenses are nonqualified and must be reported by X as income on her 1040NR.

68. I.R.C. § 117(a) (1986).
69. I.R.C. § 117(b) (1986).
70. I.R.C. § 871(b) (1986).
71. *Id.* "Education" is classified as a foreign student's "Trade or Business."

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For scholarships and fellowships awarded prior to August 17, 1986, there is a special grandfather rule. Under this rule the entire amount of the scholarship or fellowship can be excluded from taxation if the grant provides all of the following:

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

Though scholarships and fellowships are presently considered, for tax purposes, to flow from the residence of the grantor, the Treasury Department at one point proposed to change this and treat scholarships and fellowships as flowing from the country where the services (studying) are rendered or take place. Under this rule, students receiving scholarships from foreign grantors to study in the United States would have that income traced to a United States source instead of a foreign source, and alien students receiving scholarships from United States grantors (such as United States-based foundations) but doing their study or research abroad would have that income traced to a foreign source.

This proposed change generated a hot debate in Washington. Excellent arguments were made on both sides of the question. Finally, the Service issued a proposed regulation providing guidance for determining the source of scholarships and fellowship grants.[72] Under this proposed regulation, the general rule of Revenue Ruling 89-67 would apply: scholarships and fellowship grants would be sourced by reference to the residence of the grantor.[73] However, a special rule would exist for nonresident aliens receiving scholarships or fellowship grants from United States grantors for study or research activities performed outside the United States. Under this rule, the income from the scholarship or grant would be treated as derived from sources outside the United States and therefore foreign.[74]

B. Deductions, Exemptions, and Restrictions

While resident alien taxpayers are afforded the same array of deductions, credits, and exemptions enjoyed by United States citizens, nonresident aliens

72. Prop. Treas. Reg. § 1.863-1(d)(2), 58 Fed. Reg. 33,060 (1993).
73. *See supra* note 67 and accompanying text.
74. *See supra* note 72.

face a restricted menu of choices. Nonresident aliens are unable to take the standard deduction,[75] are not entitled to any credit for child care,[76] cannot file joint returns with their spouses,[77] and, except for nationals from Mexico, Canada, Japan, and the Republic of South Korea, can take no more than one personal exemption.[78]

In addition to these limitations, the nonresident alien is limited in her ability to itemize deductions. She may deduct only withheld state and local taxes, contributions to United States 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 nonresident alien students. If the nonresident alien student is not seeking a degree, she may be able to deduct educational costs such as tuition, fees, and books as job-related expenses if

a. she is in the United States 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 while she is on a temporary leave of absence.[79]

Under certain situations a nonresident alien student or teacher/trainee may be able to take business-related deductions for reasonable travel and living expenses while away from home.[80] First, he must be able to prove that his tax home is located in his home country. This is a more complex matter than it may seem. Some determinative features are

a. that he worked in the area of his claimed tax home immediately before beginning training, studying, or teaching in the United States,
b. that he continues to have work contacts in the tax home area during his absence,
c. that he has living expenses at the tax home that are duplicated in the United States because of required training,
d. that members of his immediate family must live in the claimed tax home,
e. that the individual will return to the same tax home to work, upon completion of his sojourn in the U.S.[81]

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75. *See* Form 1040NR and its instructions and I.R.C. § 873(b).
76. *Id.*
77. *Id.*
78. *Id.*
79. Treas. Reg. § 1.162-5 (1967).
80. *Id.*
81. Rev. Rul. 83-82, 1983-1 C.B. 45. These deductions should be entered on a Form 2106 and attached to the individual's 1040NR.

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If eligible for these miscellaneous deductions, the nonresident alien will be able to take a reasonable deduction for rent, food, certain transportation, and utilities. However, the deductions can be only for his expenses, not those of his spouse or children. For visiting professors, scholars and lecturers, this deduction is routine; for students, however, the expenses are more closely scrutinized.

C. Withholding

Taxes of resident aliens are withheld from their wages. Standard withholding from wages from teaching, research or assistantships also applies to nonresident alien scholars; but they are subject to more withholding requirements than are resident aliens or United States citizens. For nonresident aliens, investment income or income from "nonemployers" are subject to a thirty percent withholding requirement regardless of the ultimate tax liability. [82]

For example, thirty percent of a consulting fee or honorarium of a nonresident scholar not on the university's payroll would be withheld. Generally, alien recipients of scholarships or fellowships from United States sources will be subject to fourteen percent withholding; however, Revenue Procedure 88-24 [83] provides that an alien student can request the grantor to withhold less than that if the resulting 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 find relief from the withholding requirement in the terms of the treaty. [84]

D. 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 individuals with J-2 and H- visas and those covered by the special November 30, 1989 Presidential

82. I.R.C. § 1441(a) (1986).

83. 1988-2 I.R.B. 800.

84. If a nonresident alien qualifies and wants to take adantage 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 it may stop or reduce the amount of withholding under a treaty provision. *See* Rev. Proc. 93-22, 1993-18 I.R.B. 15.

Directive[85] and the Chinese Student Protection Act of 1992[86] are subject to Social Security tax. Regardless of immigration status, however, income that meets the following criteria will be exempt from social security tax:

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 in international organization.

Unfortunately, Social Security tax is routinely withheld from an individual's pay. If this happens, the individual must try to get her employer to correct the error. If this fails, she can file a request for repayment with the IRS Center in which the employer files its return.[87] It usually will take about one year to get the refund from the United States.

E. Tax Treaties

The United States presently has tax treaties in force with over thirty countries and is negotiating with other countries. While many of these treaties consist largely of the elimination of double taxation and the exchange of tax and fiscal information, tax treaties can be a source of tax relief for many foreign students, teachers, and researchers. A tax treaty can change any of the rules we have discussed — determination of tax status, rate of withholding, type of income taxed or exempted, etc. In fact, many tax treaties specifically benefit foreign individuals who are present in the United States for educational purposes.

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85. *See supra* note 23. This was the directive by President Bush that allowed students from the People's Republic of China to remain in the U.S. after the events involving the Chinese government and the Chinese university students who were protesting the government's actions at Tiananmen Square. In general, H-Visas are of the nonimmigrant visa category and are used by companies and other organizations to temporarily employ foreign nationals who qualify as persons in "specialty occupations."

86. Pub. L. No. 102-404, 106 Stat. 1969 (1992).

87. 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.

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Professors, teachers, and researchers from certain countries may have their income exempt from United States tax for two or three years, even though that income is from a United States source.[88]

Many of our tax treaties also have favorable provisions for students. While most of these treaties exempt from taxation income that is received from abroad, others go much further. In many cases the nonresident alien student or educator may take advantage of provisions that free certain types of personal service or investment income from taxation. In addition, many treaties provide for increased deductions, exemptions, or reduced levels of withholding.[89]

One interesting aspect of how tax treaties affect nonresident alien students involves the United States—India Income Tax Treaty.[90] Under Article 21(2) of this treaty, Indian students, or apprentices, are entitled to the same benefits available to United States residents.[91] Since the enactment of the United States—India Treaty, Indian students and the Internal Revenue Service have been at odds. The Indian students claimed Article 21(2) allowed them to take the standard deduction and exemptions for spouse and dependents, file joint or head of household returns, and to claim child care credits, as any United States resident would be entitled to do. The Internal Revenue Service, citing Rev. Proc. 88-24,[92] denied all such suggestions and treated the Indian students as they did all other nonresident aliens.[93] Finally, the Internal Revenue Service compromised, issuing Rev. Proc. 93-20,[94] which confirms the unique status of the Indian students. Under Rev. Proc. 93-20, the Indian students may

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88. As of February 1993 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, Union of Soviet Socialist Republics, United Kingdom.

89. As of February 1993 some of tehse 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, Union of Soviet Socialist Republics.

90. The United States-India Income Tax Treaty was enacted on September 12, 1989.

91. Convention for the Avoidance of Double Taxation, Sept. 12, 1989, United States-India, art. 21(2), Tax Treaties (CCH) (par. 4203). It reads as follows: "In respect of grants, scholarships and remuneration from employment not covered by paragraph 1, a student or business apprentice described in paragraph 1 shall, in addition, be entitled during such education or training to the same exemptions, reliefs or reductions in respect of taxes available to residents of the State which he is visiting."

92. 1988-1 CB 800.

93. *See supra* notes 75–78 and accompanying text.

94. 1993-13 I.R.B. 10.

indeed take the standard deduction.[95] In addition, Indian nonresident alien students may claim spousal exemptions[96] and dependency exemptions[97] under certain conditions.[98]

A recent development involving treaties and alien students involves the United States, the former Soviet Union and the new Republic of Russia. Until the break-up of the Soviet Union, the United States had a tax treaty with the Union of Soviet Socialist Republics which provided that nonresident students from the Soviet Union would be exempt from United States taxation on up to $10,000 in grants, regardless of the source of the money.[99] Therefore, an alien from the Soviet Union attending college in the United States on a $10,000 grant from a United States foundation while earning United States source income would be exempt from United States taxation. After the breakup of the Soviet Union, students from the many newly established republics were still allowed to use provisions of the United States-Union of Soviet Socialist Republics tax treaty.

As of January 1, 1994, the new United States-Russia tax treaty went into effect.[100] Under this treaty, each country agrees that it will not tax students from the other country on funds they receive from abroad.[101] Thus, Russian students studying in the United States who receive financial support from American institutions or foundations will be subject to United States tax on these funds. However, if the Russian students would have fared better under

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95. *See* I.R.C. § 63(c) (1986). Under § 63(c) the exclusion from gross income of the amount of standard deduction is explained. The standard deduction is a fixed amount (by statute) for those taxpayers not taking itemized deductions.

96. *See* I.R.C. § 151(b) (1986). Under § 151(b) the taxpayer is allowed a deduction of the exemption amount for his spouse if a joint return is not made by the taxpayer and his spouse and if the spouse, for the calendar year in which the taxable year of the taxpayer begins, has no gross income and is not the dependent of another taxpayer.

97. *See* I.R.C. § 151(c) (1986). Under § 151(c) the taxpayer is allowed a deduction of the exemption amount ($2,000) for each dependent whose gross income for the calendar year in which the taxable year of the taxpayer begins is less than the exemption amount or who is a child of the taxpayer and has not attained the age of nineteen at the close of the calendar year in which the taxable year of the taxpayer begins.

98. *See supra* note 93. Dependents must be United States citizens or nationals, or residents of the United States, Canada or Mexico.

99. Convention for the Avoidance of Double Taxation, June 20, 1973. United States-Union of Soviet Socialist Republics, art. VI(d), Tax Treaties (CCH) (par. 10,603).

100. U.S. Senate Foreign Relations Committee Report on the 1992 United States-Russia Income Tax Treaty and Protocol (Exec. Rept. 93-17) Nov. 18, 1993. *See also* Scott Jaschik, *New Treaty Means Russia Students in the U.S. Will Pay More Taxes,* CHRON. HIGHER EDUC., Jan. 5, 1994, at A52.

101. U.S.-Russia Tax Treaty, *supra* note 100.

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the old United States-Union of Soviet Socialist Republics treaty than under the new United States-Russia treaty, then the Russian student may claim benefits under the old treaty for one additional year.[102]

Under § 6114 of the Tax Code, an alien could be classified as a "dual resident taxpayer." A "dual resident taxpayer" is an alien who is considered a resident of both the United States under § 7701(b) and a United States tax treaty partner under that treaty partner's internal laws.[103] In order to determine residency for purposes of United States tax law, a "tie-breaker" provision exists in each of the United States tax treaties.[104] The alien will be considered a resident of either the United States or the foreign country (treaty partner) based on this "tie-breaker" provision. This may allow the "dual resident taxpayer" to claim resident status in the treaty partner country for treaty purpose and claim treaty benefit as a nonresident of the United States.[105]

Attention to any tax treaty that the United States has with the home country of a foreign student, teacher, scholar, lecturer, or researcher is mandatory for that individual's tax advisor.

F. CONCLUSION

For our colleagues and students from foreign countries, the tax landscape can be very complex and confusing. Indeed, it can be a nightmare.[106] The IRS and the government do not appear interested in remedying the problem soon. It is my hope that this article may help our visiting friends to comply with their responsibilities while affording them the least possible tax liability under the law.

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102. *See id.*, at art. 27.

103. Treas. Reg. § 1.7701(b)-7(a)(1) (1992).

104. *See, e.g.*, Article 4 of the United States-Canada Income Tax Treaty.

105. The IRS, in Announcement 93-63, 1993-16 I.R.B. 11, has stated that a dual resident taxpayer who claims a treaty benefit must now file new Form 8833 attached to Form 1040NR.

106. *See, e.g.*, Articles 19 and 20 of the United States-China Income Tax Treaty.

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