

**A Guide to US Federal Income Tax
for F & J Visa Holders:
Part One**

Introduction

- The University of Michigan provides its F & J visa holders with free access to the user-friendly tax form completion software, CINTAX.
- While CINTAX simplifies the tax form completion process it does not explain how the US taxes F & J visa holders.
- This webinar was designed to provide a frame of reference for that process.
- It should NOT be mistaken for tax advice.

Topics of Presentation

Part One

1. US Income Tax Background
2. Tax Residency Classifications: Resident vs. Nonresident Alien
3. Income Subject to US Taxation
4. Rate of Taxation

1. US Income Tax Background

US Income Taxation

- US tax authority, *Internal Revenue Service (IRS)* classifies income as earned →

Earned - income for personal services

i.e. wages (*subject to withholding*)

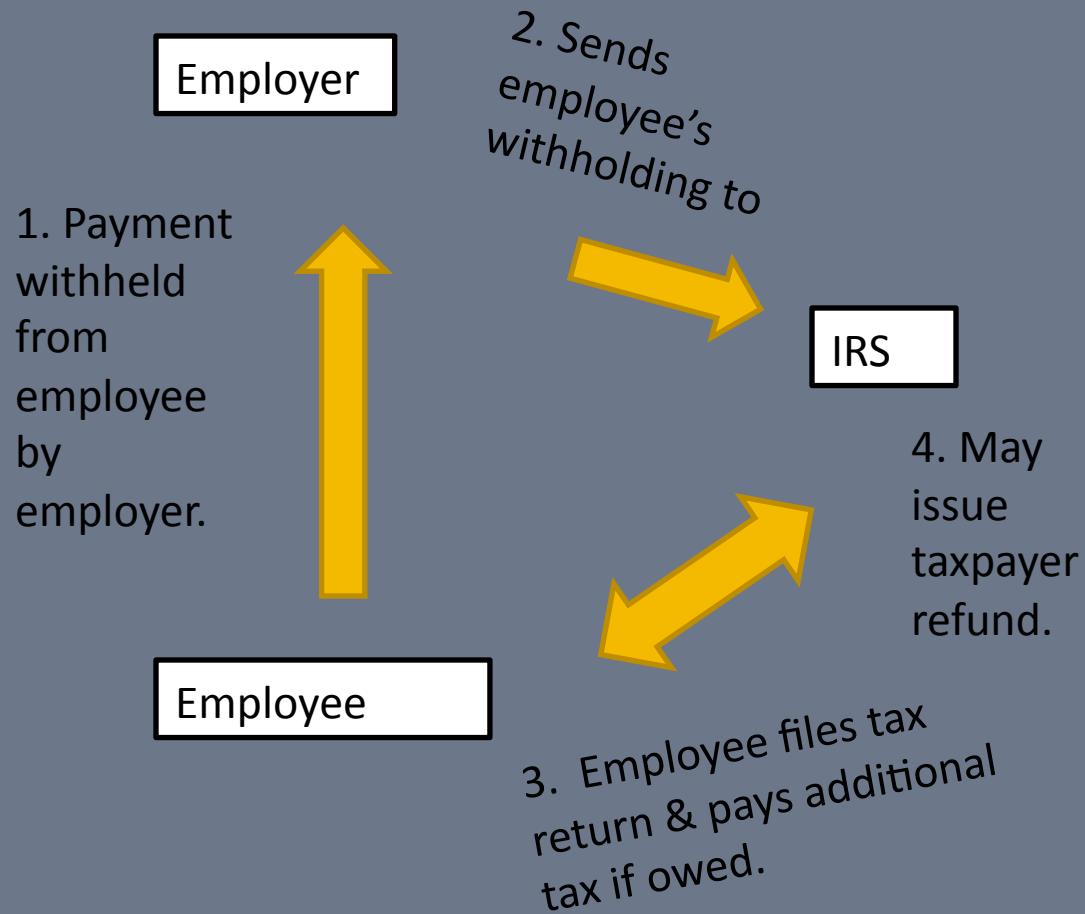
OR

Unearned - non service related income

i.e. dividends (*nonresident alien withholding only*)

- Tax based on gross income (earned + unearned).
- Withholding = estimate only so tax return needed

Illustration of Withholding Process



2. US Tax Residency Classifications: Resident vs. Nonresident Alien

Are You a Resident Alien?

YES, if →

- you are a legal permanent resident according to the *Immigration and Nationality Act*,

OR

- you were physically in the US for the timeframe required by the Substantial Presence Test (SPT).

Automatic Nonresidency for F & J Visa Holders

You are automatically a nonresident alien (SPT exempt) for the 2010 tax year if you were in the US as a . . .

(1) F- or J- student and you have not been an exempt scholar or student in F or J status for more than any part of 5 calendar years in your lifetime,

OR

(2) J-1 scholar and you have not been an exempt scholar or student in F or J status for more than any part of 2 of the 6 preceding years.

Once the applicable timeframe has passed, the substantial presence test is then applied to determine tax residency status.

Automatic Nonresidency for F & J Dependents.

- The same automatic non residency rules that apply to F-1s and J-1s also apply to their F and J dependents.
- F and J dependents should count exempt time spent in the US in F-1 or J-1 status while F-1s and J-1s must count time spent as a F or J dependent.

What Must I File to Claim Automatic Nonresidency Status?

- F & J visa holders & their dependents must file FORM 8843 to show that they are within the automatic nonresidency timeframe.
- This form must be filed even if you are NOT required to file a tax return.

Substantial Presence Test

You were substantially present for the 2010 tax year, if physically present in the US for --

- 31 days in the current tax year (2010), *and*
- 183 days in the previous 3-year period of (2010, 2009, 2008), counting:
 - (a) each day in 2010,
 - (b) 1/3 of days present in 2009, *and*
 - (c) 1/6 of days present in 2008.

Dual Status

You are in dual status if you are a resident & nonresident alien for a portion of the same tax year.

**See IRS Publication 519, pages 8-10 available at www.irs.gov.*

Marriage Based Residency Election

A nonresident alien married to a resident alien or US citizen may choose to be treated as a resident filer for the entire tax year if he or she files jointly with his or her spouse.

The spouse must be a resident or US citizen before the end of the tax year in question.

3. Income Subject to US Taxation

What Income Must I Report to IRS?

Resident Alien

- General Rule:
World-wide income

Nonresident Alien

- General Rule:
US source income
- What qualifies as US source income varies by income type, i.e. interest, wages

Income is US Source Income if →

- **Interest**- owed by US corporation or resident
- **Dividend**- paid by a US corporation
- **Wages/Compensation**- work performed in US
- **Scholarship/Fellowship**- US resident payer & activities performed in US
- **Real Property**- if property is located in US
- **Personal Property**- if seller's tax home in US

*Exceptions do apply. See IRS publication 519, p. 11-15 for details.

Tax Exempt US Source Income

- Interest-
 - (1) if portfolio interest, or
 - (2) interest from a bank deposit account

*No reporting obligation for bank deposit interest.
- Compensation-paid by foreign employer to nonresident alien on a F or J visa
- Scholarship/Fellowship- for qualified education expenses paid to a degree candidate attending an eligible institution

Excludable Scholarship/Fellowship Funds

Degree candidates are individuals who are –

(1) pursuing a degree at a college or university, or
(2) attending an accredited educational institution that is authorized to provide a . . .

- program acceptable for full credit toward a bachelor's or higher degree, or
- program of training to prepare students for gainful employment in a recognized occupation.

* J-1 scholars are NOT degree candidates.

Excludable Scholarship/Fellowship Funds continued...

Qualified Education Expenses-

- **Tuition & fees**-required for enrollment
- **Course-related expenses**-required of all students enrolled in the course
- If your funding requires you to provide a service in exchange, it is NOT “qualified,” i.e. salaries provided to GSIs, GSRAs, GSSAs at UM

4. Rate of Taxation

How is the Tax Rate Determined?

RESIDENT ALIENS

- Like US Citizens at graduated rates.

NONRESIDENT ALIENS

- Rate depends on whether income is **effectively connected to US trade or business in US**:
 - (1) Effectively connected → graduated rates.
 - (2) NOT effectively connected → flat 30% or (lower treaty rate).

What Does Effectively Connected to Trade or Business in the US Mean?

- Effectively connected income requires engagement in US trade or business.
- Whether you are engaged in a US trade or business varies with activity type.
- All US source income received in connection with such engagement is effectively connected.

Relevant Activities that Qualify As Engagement in US Business.

- Students/Scholars in F- or J- status are considered to be engaged in a US business
- Therefore related income is effectively connected.