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

1. Payment withheld from employee by employer.
2. Sends employee’s withholding to IRS.
3. Employee files tax return & pays additional tax if owed.
4. May issue taxpayer refund.
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](http://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?

<table>
<thead>
<tr>
<th>Resident Alien</th>
<th>Nonresident Alien</th>
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| • **General Rule:**  
  World-wide income | • **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.