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U.S. Tax Guide for Aliens

For use in preparing
2000 Returns



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Contents

Introduction	1
Important Changes	2
Important Reminders	3
1. Nonresident Alien or Resident Alien?	3
2. Source of Income	10
3. Exclusions From Gross Income ..	13
4. How Income of Aliens Is Taxed ..	15
5. Figuring Your Tax	20
6. Dual-Status Tax Year	26
7. What, When, and Where To File ..	33
8. Paying Tax Through Withholding or Estimated Tax	35
9. Tax Treaty Benefits	41
10. Employees of Foreign Governments and International Organizations	44
11. Departing Aliens and the Sailing or Departure Permit	44
12. How To Get Tax Help	46
Appendix A—Tax Treaty Exemption Procedure for Students	48
Appendix B—Tax Treaty Exemption Procedure for Teachers and Researchers	50
Index	53

Introduction

For tax purposes, an alien is an individual who is not a U.S. citizen. Aliens are classified as nonresident aliens and resident aliens. This publication will help you determine your status and give you information you will need to file your U.S. tax return. Resident aliens generally are taxed on their worldwide income, the same as U.S. citizens. Nonresident aliens are taxed only on their income from sources within the United States and on certain income connected with the conduct of a trade or business in the United States.

Table A, *What You Need To Know About U.S. Taxes*, provides a list of questions and the chapter or chapters in this publication where you will find the related discussion.

The information in this publication is not as comprehensive for resident aliens as it is for nonresident aliens. Resident aliens are generally treated the same as U.S. citizens and can find more information in other IRS publications.

Comments and suggestions. We welcome your comments about this publication and your suggestions for future editions.

You can e-mail us while visiting our web site at www.irs.gov/help/email2.html.

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Suspending the Choice

The choice to be treated as a resident alien does not apply to any tax year (after the tax year you made the choice) if neither spouse is a U.S. citizen or resident alien at any time during the tax year.

Example. Dick Brown was a resident alien on December 31, 1997, and married to Judy, a nonresident alien. They chose to treat Judy as a resident alien and filed joint 1997 and 1998 income tax returns. On January 10, 1999, Dick became a nonresident alien. Judy had remained a nonresident alien throughout the period. Dick and Judy could have filed joint or separate returns for 1999. However, since neither Dick nor Judy is a resident alien at any time during 2000, their choice is suspended for that year. If either has U.S. source income or foreign source income effectively connected with a U.S. trade or business in 2000, they must file separate returns as nonresident aliens. If Dick becomes a resident alien again in 2000, their choice is no longer suspended.

Ending the Choice

Once made, the choice to be treated as a resident applies to all later years unless suspended (as explained above) or ended in one of the following ways.

If the choice is ended in one of the following ways, neither spouse can make this choice in any later tax year.

- 1) **Revocation.** Either spouse can revoke the choice for any tax year, provided he or she makes the revocation by the due date for filing the tax return for that tax year. The spouse who revokes must attach a signed statement declaring that the choice is being revoked. The statement must include the name, address, and identification number of each spouse. (If one spouse dies, include the name and address of the person who is revoking the choice for the deceased spouse.) The statement also must include a list of any states, foreign countries, and possessions that have community property laws in which either spouse is domiciled or where real property is located from which either spouse receives income. File the statement as follows:
 - a) If the spouse revoking the choice must file a return, attach the statement to the return for the first year the revocation applies,
 - b) If the spouse revoking the choice does not have to file a return, but does file a return (for example, to obtain a refund), attach the statement to the return, or
 - c) If the spouse revoking the choice does not have to file a return and does not file a claim for refund, send the statement to the Internal Revenue Service Center where you filed the last joint return.
- 2) **Death.** The death of either spouse ends the choice, beginning with the first tax year following the year the spouse died. However, if the surviving spouse is a U.S. citizen or resident and is entitled to

the joint tax rates as a surviving spouse, the choice will not end until the close of the last year for which these joint rates may be used. If both spouses die in the same tax year, the choice ends on the first day after the close of the tax year in which the spouses died.

- 3) **Legal separation.** A legal separation under a decree of divorce or separate maintenance ends the choice as of the beginning of the tax year in which the legal separation occurs.
- 4) **Inadequate records.** The Internal Revenue Service can end the choice for any tax year that either spouse has failed to keep adequate books, records, and other information necessary to determine the correct income tax liability, or to provide adequate access to those records.

Special Situations

If you are a nonresident alien from **American Samoa** or **Puerto Rico**, you may be treated as a resident alien.

If you are a nonresident alien in the United States and a bona fide resident of American Samoa or Puerto Rico during the entire tax year, you are taxed, with certain exceptions, according to the rules for resident aliens of the United States. For more information, see chapter 5.

If you are a nonresident alien from American Samoa or Puerto Rico who does not qualify as a bona fide resident of American Samoa or Puerto Rico for the entire tax year, you are taxed as a nonresident alien.

Resident aliens who formerly were bona fide residents of American Samoa or Puerto Rico are taxed according to the rules for resident aliens.

2.

Source of Income

Introduction

After you have determined your alien status, you must determine the source of your income. This chapter will help you determine the source of different types of income you may receive during the tax year. This chapter also discusses special rules for married individuals who are domiciled in a country with community property laws.

Topics

This chapter discusses:

- Income source rules, and
- Community income.

Useful Items

You may want to see:

Publication

- 520** Scholarships and Fellowships
- 721** Tax Guide to U.S. Civil Service Retirement Benefits

See chapter 12 for information about getting these publications.

Resident Aliens

A resident alien's income is generally subject to tax in the same manner as a U.S. citizen. If you are a resident alien, you must report all interest, dividends, wages, or other compensation for services, income from rental property or royalties, and other types of income on your U.S. tax return. You must report these amounts whether from sources within or outside the United States.

Nonresident Aliens

A nonresident alien usually is subject to U.S. income tax only on U.S. source income. Under limited circumstances, certain foreign source income is subject to U.S. tax. See **Foreign Income** in chapter 4.

The general rules for determining U.S. source income that apply to most nonresident aliens are shown in **Table 2-1**. The following discussions cover the general rules as well as the exceptions to these rules.

TIP Not all items of U.S. source income are taxable. See chapter 3.

Interest

Generally, U.S. source interest income includes the following items.

- Interest on bonds, notes, or other interest-bearing obligations of U.S. residents or domestic corporations.
- Interest paid by a domestic or foreign partnership or foreign corporation engaged in a U.S. trade or business at any time during the tax year.
- Original issue discount.
- Interest from a state, the District of Columbia, or the U.S. Government.

The place or manner of payment is immaterial in determining the source of the income.

A substitute interest payment made to the transferor of a security in a securities lending transaction or a sale-repurchase transaction is sourced in the same manner as the interest on the transferred security.

Exceptions. U.S. source interest income does not include the following items.

- 1) Interest paid by a resident alien or a domestic corporation if for the 3-year period ending with the close of the payer's tax year preceding the interest payment at least 80% of the payer's total gross income:
 - a) Is from sources outside the United States, and

- b) Is attributable to the active conduct of a trade or business by the individual or corporation in a foreign country or a U.S. possession.
- 2) Interest paid by a foreign branch of a domestic corporation or a domestic partnership on deposits or withdrawable accounts with mutual savings banks, cooperative banks, credit unions, domestic building and loan associations, and other savings institutions chartered and supervised as savings and loan or similar associations under federal or state law if the interest paid or credited can be deducted by the association.
- 3) Interest on deposits with a foreign branch of a domestic corporation or domestic partnership, but only if the branch is in the commercial banking business.

$$\frac{\text{Number of days you performed services in the United States}}{\text{Total number of days of service for which you receive payment}}$$

Example. Jean Blanc, a nonresident alien, is a professional hockey player with a U.S. hockey club. Under Jean's contract, he received \$98,500 for 242 days of play during the year. This includes days spent at pre-season training camp, days during the regular season, and playoff game days. Of the 242 days, Jean spent 194 days performing services in the United States and 48 days playing hockey in Canada. Jean's U.S. source income is \$78,963, figured as follows:

$$\frac{194}{242} \times \$98,500 = \$78,963$$

container used in connection with a vessel or aircraft.

All income from transportation that begins **and** ends in the United States is treated as derived from sources in the United States. If the transportation begins **or** ends in the United States, 50% of the transportation income is treated as derived from sources in the United States.

For transportation income from personal services, 50% of the income is U.S. source income if the transportation is between the United States and a U.S. possession. For nonresident aliens, this only applies to income derived from, or in connection with, an aircraft.

For information on how U.S. source transportation income is taxed, see chapter 4.

Dividends

In most cases, dividend income received from domestic corporations is U.S. source income. Dividend income from foreign corporations is usually foreign source income. Exceptions to both of these rules are discussed below.

A substitute dividend payment made to the transferor of a security in a securities lending transaction or a sale-repurchase transaction is sourced in the same manner as a distribution on the transferred security.

First exception. Dividends received from a domestic corporation are not U.S. source income if the corporation elects to take the Puerto Rico economic activity credit or the possession tax credit.

Second exception. Part of the dividends received from a foreign corporation is U.S. source income if 25% or more of its total gross income for the 3-year period ending with the close of its tax year preceding the declaration of dividends was effectively connected with a trade or business in the United States. If the corporation was formed less than 3 years before the declaration, use its total gross income from the time it was formed. Determine the part that is U.S. source income by multiplying the dividend by the following fraction.

$$\frac{\text{Foreign corporation's gross income connected with a U.S. trade or business for the 3-year period}}{\text{Foreign corporation's gross income from all sources for that period}}$$

Personal Services

All wages and any other compensation for services performed in the United States are considered to be from sources in the United States. The only exception to this rule is discussed in chapter 3, under *Employees of foreign persons, organizations, or offices*.

If your compensation is for personal services performed both inside and outside the United States, you must figure the amount of income that is for services performed in the United States. You usually do this on a time basis. That is, you must include in gross income as U.S. source income the amount that results from multiplying the total amount of compensation by the following fraction.

Reenlistment bonus. A reenlistment bonus received by a nonresident alien for reenlistment in the U.S. Navy while in a foreign country is not U.S. source income.

Crew members. Compensation for services performed by a nonresident alien in connection with the individual's temporary presence in the United States as a regular crew member of a foreign vessel engaged in transportation between the United States and a foreign country or U.S. possession is not U.S. source income.

Transportation Income

Transportation income is income from the use of a vessel or aircraft or for the performance of services directly related to the use of any vessel or aircraft. This is true whether the vessel or aircraft is owned, hired, or leased. The term "vessel or aircraft" includes any

Scholarships, Grants, Prizes, and Awards

Generally, the source of scholarships, fellowship grants, grants, prizes, and awards is the residence of the payer regardless of who actually disburses the funds. However, see *Activities to be performed outside the United States*, later.

For example, payments for research or study in the United States made by the United States, a noncorporate U.S. resident, or a domestic corporation, are from U.S. sources. Similar payments from a foreign government or foreign corporation are foreign source payments even though the funds may be disbursed through a U.S. agent.

Payments made by an entity designated as a public international organization under the International Organizations Immunities Act are from foreign sources.

Table 2-1. Summary of Source Rules for Income of Nonresident Aliens

Item of Income	Factor Determining Source
Salaries, wages, other compensation Business income: Personal services Sale of inventory — purchased Sale of inventory — produced	Where services performed Where services performed Where sold Allocation
Interest	Residence of payer
Dividends	Whether a U.S. or foreign corporation*
Rents Royalties: Natural resources Patents, copyrights, etc.	Location of property Location of property Where property is used
Sale of real property	Location of property
Sale of personal property	Seller's tax home (but see <i>Personal Property</i> , later, for exceptions)
Pensions	Where services were performed that earned the pension
Sale of natural resources	Allocation based on fair market value of product at export terminal. For more information, see section 1.863-1(b) of the regulations.

* Exceptions include:

- Dividends paid by a U.S. corporation are foreign source if the corporation elects the Puerto Rico economic activity credit or possessions tax credit.
- Part of a dividend paid by a foreign corporation is U.S. source if at least 25% of the corporation's gross income is effectively connected with a U.S. trade or business for the 3 tax years before the year in which the dividends are declared.

Activities to be performed outside the United States. Scholarships, fellowship grants, targeted grants, and achievement awards received by nonresident aliens for activities performed, or to be performed, outside the United States are not U.S. source income.



These rules do not apply to amounts paid as salary or other compensation for services. See Personal Services, earlier, for the source rules that apply.

Pensions and Annuities

When you receive a pension from a domestic trust for services performed both in and outside the United States, part of the pension payment is from U.S. sources. That part is the amount attributable to earnings of the trust and the employer contributions made for services performed in the United States. This applies whether the distribution is made under a qualified or nonqualified stock bonus, pension, profit-sharing, or annuity plan (whether or not funded).

If you performed services as an employee of the United States, you may receive a distribution from the U.S. Government under a plan, such as the Civil Service Retirement System, that is treated as a qualified pension plan. Your U.S. source income is the otherwise taxable amount of the distribution that is attributable to your total U.S. Government basic pay other than tax-exempt pay for services performed outside the United States.

Rents or Royalties

Your U.S. source income includes rent and royalty income received during the tax year from property located in the United States or from any interest in that property.

U.S. source income also includes rents or royalties for the use of, or for the privilege of using, in the United States, intangible property such as patents, copyrights, secret processes and formulas, goodwill, trademarks, franchises, and similar property.

Real Property

Real property is land and buildings and generally anything built on, growing on, or attached to land.

Gross income from sources in the United States includes gains, profits, and income from the sale or other disposition of real property located in the United States.

Natural resources. The income from the sale of products of any farm, mine, oil or gas well, other natural deposit, or timber located in the United States and sold in a foreign country, or located in a foreign country and sold in the United States, is partly from sources in the United States. For information on determining that part, see section 1.863-1(b) of the regulations.

Personal Property

Personal property is property, such as machinery, equipment, or furniture, that is not real property.

Gain or loss from the sale or exchange of personal property generally has its source in the United States if you have a **tax home** in the United States. If you do not have a tax home in the United States, the gain or loss

generally is considered to be from sources outside the United States.

Tax home. Your tax home is the general area of your main place of business, employment, or post of duty, regardless of where you maintain your family home. Your tax home is the place where you permanently or indefinitely work as an employee or a self-employed individual. If you do not have a regular or main place of business because of the nature of your work, then your tax home is the place where you regularly live. If you do not fit either of these categories, you are considered an itinerant and your tax home is wherever you work.

Inventory property. Inventory property is personal property that is stock in trade or that is held primarily for sale to customers in the ordinary course of your trade or business. Income from the sale of inventory that you purchased is sourced where the property is sold. Generally, this is where title to the property passes to the buyer. For example, income from the sale of inventory in the United States is U.S. source income, whether you purchased it in the United States or in a foreign country.

Income from the sale of inventory property that you produced in the United States and sold outside the United States (or vice versa) is partly from sources in the United States and partly from sources outside the United States. For information on making this allocation, see section 1.863-3 of the regulations.

These rules apply even if your tax home is not in the United States.

Depreciable property. To determine the source of any gain from the sale of depreciable personal property, you must first figure the part of the gain that is not more than the total depreciation adjustments on the property. You allocate this part of the gain to sources in the United States based on the ratio of U.S. depreciation adjustments to total depreciation adjustments. The rest of this part of the gain is considered to be from sources outside the United States.

For this purpose, "U.S. depreciation adjustments" are the depreciation adjustments to the basis of the property that are allowable in figuring taxable income from U.S. sources. However, if the property is used predominantly in the United States during a tax year, all depreciation deductions allowable for that year are treated as U.S. depreciation adjustments. But there are some exceptions for certain transportation, communications, and other property used internationally.

Gain from the sale of depreciable property that is more than the total depreciation adjustments on the property is sourced as if the property were inventory property, as discussed above.

A loss recognized after January 10, 1999, is sourced in the same way as the depreciation deductions were sourced. However, if the property was used predominantly in the United States, the entire loss reduces U.S. source income. You can choose to apply this rule to losses recognized in tax years beginning after 1986. For details about making this choice, see section 1.865-1T(f)(2) of the regulations.

The **basis of property** usually means the cost (money plus the fair market value of other property or services) of property you acquire. **Depreciation** is an amount deducted to recover the cost or other basis of a trade

or business asset. The amount you can deduct depends on the property's cost, when you began using the property, how long it will take to recover your cost, and which depreciation method you use. A depreciation deduction is any deduction for depreciation or amortization or any other allowable deduction that treats a capital expenditure as a deductible expense.

Intangible property. Intangible property includes patents, copyrights, secret processes or formulas, goodwill, trademarks, trade names, or other like property. Income from the sale of intangible property that is contingent on the productivity, use, or disposition of the property is sourced in the country where the property is used. If the income is not contingent on the productivity, use, or disposition of the property, the income is sourced according to the seller's tax home as discussed earlier. If payments for goodwill do not depend on its productivity, use, or disposition, their source is the country in which the goodwill was generated.

To the extent gain from the sale of an intangible does not exceed its depreciation adjustments, treat the gain as if the intangible were depreciable personal property, discussed earlier.

Sales through offices or fixed places of business. Despite any of the above rules, if you do not have a tax home in the United States, but you maintain an office or other fixed place of business in the United States, treat the income from any sale of personal property (including inventory property) that is attributable to that office or place of business as U.S. source income. However, this rule does not apply to sales of inventory property for use, disposition, or consumption outside the United States if your office or other fixed place of business outside the United States materially participated in the sale.

If you have a tax home in the United States but maintain an office or other fixed place of business outside the United States, income from sales of personal property, other than inventory, depreciable property, or intangibles, that is attributable to that foreign office or place of business may be treated as U.S. source income. The income is treated as U.S. source income if an income tax of less than 10% of the income from the sale is paid to a foreign country. This rule also applies to losses recognized after January 10, 1999, if the foreign country would have imposed an income tax of less than 10% had the sale resulted in a gain. You can choose to apply this rule to losses recognized in tax years beginning after 1986. For details about making this choice, see section 1.865-1T(f)(2) of the regulations. For stock losses, see section 1.865-2(e) of the regulations.

Community Income

If you are married and you or your spouse are subject to the community property laws of a foreign country, a U.S. state, or a U.S. possession, you generally must follow those laws to determine the income of yourself and your spouse for U.S. tax purposes. But you must disregard certain community property laws if:

- 1) Both you and your spouse are nonresident aliens, or

- 2) One of you is a nonresident alien and the other is a U.S. citizen or resident and you do not both choose to be treated as U.S. residents as explained in chapter 1.

In these cases, you and your spouse must report community income as explained below.

Earned income. Earned income of a spouse, other than trade or business income and a partner's distributive share of partnership income, is treated as the income of the spouse whose services produced the income. That spouse must report all of it on his or her separate return.

Trade or business income. Trade or business income, other than a partner's distributive share of partnership income, is treated as the income of the spouse carrying on the trade or business. That spouse must report all of it on his or her separate return.

Partnership income (or loss). A partner's distributive share of partnership income (or loss) is treated as the income (or loss) of the partner. The partner must report all of it on his or her separate return.

Separate property income. Income derived from the separate property of one spouse (and which is not earned income, trade or business income, or partnership distributive share income) is treated as the income of that spouse. That spouse must report all of it on his or her separate return. Use the appropriate community property law to determine what is separate property.

Other community income. All other community income is treated as provided by the applicable community property laws.

3. Exclusions From Gross Income

Introduction

Resident and nonresident aliens are allowed exclusions from gross income if they meet certain conditions. An exclusion from gross income is generally income you receive that is not included in your U.S. income and is not subject to U.S. tax. This chapter covers some of the more common exclusions allowed to resident and nonresident aliens.

Topics

This chapter discusses:

- Nontaxable interest,
- Certain compensation paid by a foreign employer,
- Gain from sale of home, and
- Scholarships and fellowship grants.

Useful Items

You may want to see:

Publication

- **54** Tax Guide for U.S. Citizens and Resident Aliens Abroad
- **523** Selling Your Home

See chapter 12 for information about getting these publications.

Resident Aliens

Resident aliens may be able to exclude the following items from their gross income.

Foreign Earned Income and Housing Amount

If you are physically present in a foreign country or countries for at least 330 full days during any period of 12 consecutive months, you may qualify for the foreign earned income exclusion. For tax years beginning in 2000, the exclusion is \$76,000. In addition, you may be able to exclude or deduct certain foreign housing amounts. You may also qualify if you are a bona fide resident of a foreign country and you are a citizen or national of a country with which the United States has an income tax treaty. For more information, see Publication 54.

Foreign country. The term "foreign country" means any territory under the sovereignty of a government other than that of the United States. The term also includes territorial waters of the foreign country, the airspace over the foreign country, and the seabed and subsoil of submarine areas adjacent to the territorial waters of the foreign country.

Nonresident Aliens

Nonresident aliens can exclude the following items from their gross income.

Interest

U.S. source interest income that is not connected with a U.S. trade or business is excluded from income if it is from:

- 1) Deposits (including certificates of deposit) with persons in the banking business,
- 2) Deposits or withdrawable accounts with mutual savings banks, cooperative banks, credit unions, domestic building and loan associations, and other savings institutions chartered and supervised as savings and loan or similar associations under federal or state law (if the interest paid or credited can be deducted by the association), and
- 3) Amounts held by an insurance company under an agreement to pay interest on them.

Government obligations. Interest on obligations of a state or political subdivision, the District of Columbia, or a U.S. possession,

generally is not included in income. However, interest on certain private activity bonds, arbitrage bonds, and certain bonds not in registered form is included in income.

Portfolio interest. U.S. source interest income that is not connected with a U.S. trade or business and that is portfolio interest on obligations issued after July 18, 1984, is excluded from income. Portfolio interest is interest (including original issue discount) that is paid on obligations:

- 1) Not in registered form (bearer obligations) that are sold only to foreign investors, and the interest on which is payable only outside the United States and its possessions, and that has on its face a statement that any U.S. person holding the obligation will be subject to limitations under the U.S. income tax laws,
- 2) In registered form that are targeted to foreign markets and the interest on which is paid through financial institutions outside the United States, or
- 3) In registered form that are *not* targeted to foreign markets, if you furnished the payer of the interest (or the withholding agent) a statement that you are not a U.S. person. You should have made this statement on a Form W-8 or on a substitute form similar to Form W-8. In either case, the statement should have been signed under penalties of perjury, should have been certified that you are not a U.S. citizen or resident, and should have included your name and address.



Form W-8 is not valid after 2000. After 2000, you must make the statement in (3) above on Form W-8BEN or on a substitute form provided by the withholding agent.

Portfolio interest does not include the following types of interest.

- 1) Interest you receive on an obligation issued by a corporation of which you own, directly or indirectly, 10% or more of the total voting power of all classes of voting stock.
- 2) Interest you receive on an obligation issued by a partnership of which you own, directly or indirectly, 10% or more of the capital or profits interests.
- 3) Contingent interest.

Contingent interest. Portfolio interest does not include contingent interest. Contingent interest is either of the following:

- 1) Interest that is determined by reference to:
 - a) Any receipts, sales, or other cash flow of the debtor or related person,
 - b) Income or profits of the debtor or related person,
 - c) Any change in value of any property of the debtor or a related person, or
 - d) Any dividend, partnership distributions, or similar payments made by the debtor or a related person.

- 2) Any other type of contingent interest that is identified by the Secretary of the Treasury in regulations.

For the definition of “related person” in connection with any contingent interest, and for the exceptions that apply to interest described in item (1), see subparagraphs (B) and (C) of Internal Revenue Code section 871(h)(4).

Exception for existing debt. Portfolio interest includes any contingent interest paid or accrued on any debt with a fixed term that was issued:

- 1) On or before April 7, 1993, or
- 2) After April 7, 1993, pursuant to a written binding contract in effect on that date and at all times thereafter before that debt was issued.

Services Performed for Foreign Employer

If you were paid by a foreign employer, your U.S. source income may be exempt from U.S. tax, but only if you meet one of the situations discussed next.

Employees of foreign persons, organizations, or offices. If three conditions exist, income for personal services performed in the United States as a nonresident alien is not considered to be from U.S. sources and is tax exempt. If you do not meet **all three** conditions, your income from personal services performed in the United States is U.S. source income and is taxed according to the rules in chapter 4.

The three conditions are:

- 1) You perform personal services as an employee of or under a contract with a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in a trade or business in the United States; or you work for an office or place of business maintained in a foreign country or possession of the United States by a U.S. corporation, a U.S. partnership, or a U.S. citizen or resident,
- 2) You perform these services while you are a nonresident alien temporarily present in the United States for a period or periods of not more than a total of 90 days during the tax year, and
- 3) Your pay for these services is not more than \$3,000.

If your pay for these services is more than \$3,000, the entire amount is income from a trade or business within the United States. To find if your pay is more than \$3,000, do not include any amounts you get from your employer for advances or reimbursements of business travel expenses, if you were required to and did account to your employer for those expenses. If the advances or reimbursements are more than your expenses, include the excess in your pay for these services.

A day means a calendar day during any part of which you are physically present in the United States.

Example 1. During 2000, Henry Smythe, a nonresident alien from a nontreaty country, worked for an overseas office of a domestic partnership. Henry, who uses the calendar year as his tax year, was temporarily present

in the United States for 60 days during 2000 performing personal services for the overseas office of the partnership. That office paid him a total gross salary of \$2,800 for those services. During 2000, he was not engaged in a trade or business in the United States. The salary is not considered U.S. source income and is exempt from U.S. tax.

Example 2. The facts are the same as in Example 1, except that Henry's total gross salary for the services performed in the United States during 2000 was \$4,500. He received \$2,875 in 2000, and \$1,625 in 2001. During 2000, he was engaged in a trade or business in the United States because the compensation for his personal services in the United States was more than \$3,000. Henry's salary is U.S. source income and is taxed under the rules in chapter 4.

Crew members. Compensation for services performed by a nonresident alien in connection with the individual's temporary presence in the United States as a regular crew member of a foreign vessel engaged in transportation between the United States and a foreign country or U.S. possession is not U.S. source income and is exempt from U.S. tax.

Students and exchange visitors. Nonresident alien students and exchange visitors present in the United States under “F,” “J,” or “Q” visas can exclude from gross income pay received from a foreign employer.

This group includes bona fide students, scholars, trainees, teachers, professors, research assistants, specialists, or leaders in a field of specialized knowledge or skill, or persons of similar description. It also includes the alien's spouse and minor children if they come with the alien or come later to join the alien.

A nonresident alien temporarily present in the United States under a “J” visa includes an alien individual entering the United States as an **exchange visitor** under the Mutual Educational and Cultural Exchange Act of 1961.

Foreign employer. A foreign employer is:

- 1) A nonresident alien individual, foreign partnership, or foreign corporation, or
- 2) An office or place of business maintained in a foreign country or in a U.S. possession by a domestic corporation, a domestic partnership, or an individual who is a citizen or resident of the United States.

The term “foreign employer” does not include a foreign government. Pay from a foreign government that is exempt from U.S. income tax is discussed in chapter 10.

Income from certain annuities. Do not include in income any annuity received under a **qualified annuity plan** or from a **qualified trust** exempt from U.S. income tax if you meet both of the following conditions.

- 1) You receive the annuity only because:
 - a) You performed personal services outside the United States while you were a nonresident alien, or
 - b) You performed personal services inside the United States while you were a nonresident alien and you

met the three conditions described earlier under *Employees of foreign persons, organizations, or offices.*

- 2) At the time the first amount is paid as an annuity under the plan (or by the trust), 90% or more of the employees for whom contributions or benefits are provided under the annuity plan (or under the plan of which the trust is a part) are citizens or residents of the United States.

If the annuity qualifies under condition (1) but not condition (2) above, you do not have to include the amount in income if:

- 1) You are a resident of a country that gives a substantially equal exclusion to U.S. citizens and residents, or
- 2) You are a resident of a beneficiary developing country under the Trade Act of 1974.

If you are not sure whether the annuity is from a qualified annuity plan or qualified trust, ask the person who made the payment.

Income affected by treaties. Income of any kind that is exempt from U.S. tax under a treaty to which the United States is a party is excluded from your gross income. Income on which the tax is only limited by treaty, however, is included in gross income. See chapter 9.

Gain From the Sale of Your Main Home

If you sold your main home, you may be able to exclude up to \$250,000 of the gain on the sale of your home. If you are married and file a joint return, you may be able to exclude up to \$500,000. For information on the requirements for this exclusion, see Publication 523.



This exclusion does not apply to nonresident aliens who are subject to the expatriation tax rules discussed in chapter 4.

Scholarships and Fellowship Grants

If you are a candidate for a degree, you may be able to exclude from your income part or all of the amounts you receive as a qualified scholarship. The rules discussed here apply to both resident and nonresident aliens.



If a nonresident alien receives a grant that is not from U.S. sources, it is not subject to U.S. tax. See Scholarships, Grants, Prizes, and Awards in chapter 2 to determine whether your grant is from U.S. sources.

Qualified scholarship. A qualified scholarship is any amount you receive as a scholarship or fellowship grant that you use according to the conditions of the grant for:

- 1) Tuition and fees required to enroll in, or to attend, an educational institution, or
- 2) Fees, books, supplies, and equipment that the educational institution requires for the courses of instruction.

Amounts you receive from a scholarship or fellowship that you use for other expenses, such as room and board or travel, are not excludable from income.

Terms of grant. Your scholarship or fellowship can still qualify as tax free even if the terms do not provide that it only be used for tuition and course-related expenses. It will qualify if you use the grant proceeds for tuition and course-related expenses. However, if the terms of the grant require its use for other purposes, such as room and board, or specify that the grant cannot be used for tuition or course-related expenses, the amounts received under the grant cannot be excluded from income.

Candidate for a degree. The term candidate for a degree means a student (whether full- or part-time) who:

- 1) Attends a primary or secondary school or is pursuing a degree at a college or university, or
- 2) Attends an educational institution that is authorized and accredited to provide:
 - a) A program that is acceptable for full credit toward a bachelor's or higher degree, or
 - b) A program of training to prepare students for gainful employment in a recognized occupation.

Payment for services. You cannot exclude from income the portion of any scholarship, fellowship, or tuition reduction that represents payment for teaching, research, or other services. This is true even if all candidates for a degree are required to perform the services as a condition for receiving the degree.

Example. On January 7, Maria Gomez is notified of a scholarship of \$2,500 for the spring semester. As a condition for receiving the scholarship, Maria must serve as a part-time teaching assistant. Of the \$2,500 scholarship, \$1,000 represents payment for her services. Assuming that Maria meets all other conditions, she can exclude no more than \$1,500 from income as a qualified scholarship.

4.

How Income of Aliens Is Taxed

Introduction

Resident and nonresident aliens are taxed in different ways. Resident aliens are generally taxed in the same way as U.S. citizens. Nonresident aliens are taxed based on the source of their income and whether or not their income is effectively connected with a U.S. trade or business. The following dis-

ussions will help you determine if income you receive during the tax year is effectively connected with a U.S. trade or business and how it is taxed.

Topics

This chapter discusses:

- Income that is effectively connected with a U.S. trade or business, and
- Income that is not effectively connected with a U.S. trade or business.

Useful Items

You may want to see:

Publication

- 544** Sales and Other Dispositions of Assets
- 1212** List of Original Issue Discount Instruments

Form (and Instructions)

- 6251** Alternative Minimum Tax—Individuals
- Schedule D (Form 1040)** Capital Gains and Losses

See chapter 12 for information about getting these publications and forms.

Resident Aliens

Resident aliens are generally taxed in the same way as U.S. citizens. This means that their worldwide income is subject to U.S. tax and must be reported on their U.S. tax return. Income of resident aliens is subject to the graduated tax rates that apply to U.S. citizens. Resident aliens use the Tax Table and Tax Rate Schedules located in the Form 1040 instructions, which apply to U.S. citizens.

Nonresident Aliens

A nonresident alien's income that is subject to U.S. income tax must be divided into two categories:

- 1) Income that **is** effectively connected with a trade or business in the United States, and
- 2) Income that **is not** effectively connected with a trade or business in the United States (discussed under *The 30% Tax*, later).

The difference between these two categories is that effectively connected income, after allowable deductions, is taxed at **graduated rates**. These are the same rates that apply to U.S. citizens and residents. Income that is not effectively connected is taxed at a **flat 30% (or lower treaty) rate**.



If you were formerly a U.S. citizen or resident alien, these rules may not apply. See *Expatriation Tax*, later, in this chapter.

Trade or Business in the United States

Generally, you must be engaged in a trade or business during the tax year to be able to treat income received in that year as effectively connected with that trade or business. Whether you are engaged in a trade or business in the United States depends on the nature of your activities. The discussions that follow will help you determine whether you are engaged in a trade or business in the United States.

Personal Services

If you perform personal services in the United States at any time during the tax year, you usually are considered engaged in a trade or business in the United States.



Certain compensation paid to a nonresident alien by a foreign employer is not included in gross income. For more information, see Services Performed for Foreign Employer in chapter 3.

Other Trade or Business Activities

Other examples of being engaged in a trade or business in the United States follow.

Students and trainees. You are considered engaged in a trade or business in the United States if you are temporarily present in the United States as a nonimmigrant under a "F," "J," "M," or "Q" visa. A nonresident alien temporarily present in the United States under a "J" visa includes a nonresident alien individual admitted to the United States as an **exchange visitor** under the Mutual Educational and Cultural Exchange Act of 1961. The taxable part of any scholarship or fellowship grant that is U.S. source income is treated as effectively connected with a trade or business in the United States.

Business operations. If you own and operate a business in the United States selling services, products, or merchandise, you are, with certain exceptions, engaged in a trade or business in the United States.

Partnerships. If you are a member of a partnership that at any time during the tax year is engaged in a trade or business in the United States, you are considered to be engaged in a trade or business in the United States.

Beneficiary of an estate or trust. If you are the beneficiary of an estate or trust that is engaged in a trade or business in the United States, you are treated as being engaged in the same trade or business.

Trading in stocks, securities, and commodities. If your only U.S. business activity is trading in stocks, securities, or commodities (including hedging transactions) through a U.S. resident broker or other agent, you are not engaged in a trade or business in the United States.

For transactions in stocks or securities, this applies to any nonresident alien, including a dealer or broker in stocks and securities.

For transactions in commodities, this applies to commodities that are usually traded on an organized commodity exchange and to transactions that are usually carried out at such an exchange.

This discussion does not apply if you have a U.S. office or other fixed place of business at any time during the tax year through which, or by the direction of which, you carry out your transactions in stocks, securities, or commodities.

Trading for a nonresident alien's own account. You are not engaged in a trade or business in the United States if trading for your own account in stocks, securities, or commodities is your only U.S. business activity. This applies even if the trading takes place while you are present in the United States or is done by your employee or your broker or other agent.

This does not apply to trading for your own account if you are a dealer in stocks, securities, or commodities. This does not necessarily mean, however, that as a dealer you are considered to be engaged in a trade or business in the United States. Determine that based on the facts and circumstances in each case or under the rules given above in *Trading in stocks, securities, and commodities*.

Effectively Connected Income

If you are engaged in a U.S. trade or business, all income, gain, or loss for the tax year that you get from **sources within the United States** (other than certain investment income) is treated as effectively connected income. This applies whether or not there is any connection between the income and the trade or business being carried on in the United States during the tax year.

Two tests, described under *Investment Income*, determine whether certain items of investment income (such as interest, dividends, and royalties) are treated as effectively connected with that business.

In limited circumstances, some kinds of foreign source income may be treated as effectively connected with a trade or business in the United States. For a discussion of these rules, see *Foreign Income*, later.

Investment Income

Investment income from U.S. sources that may or may not be treated as effectively connected with a U.S. trade or business generally falls into the following three categories.

- 1) Fixed or determinable income (interest, dividends, rents, royalties, premiums, annuities, etc.).
- 2) Gains (some of which are considered capital gains) from the sale or exchange of the following types of property.
 - a) Timber, coal, or domestic iron ore with a retained economic interest.
 - b) Patents, copyrights, and similar property on which you receive contingent payments after October 4, 1966.
 - c) Patents transferred before October 5, 1966.
 - d) Original issue discount obligations.
- 3) Capital gains (and losses).

Use the two tests, described next, to determine whether an item of U.S. source income falling in one of the three categories above and received during the tax year is effectively connected with your U.S. trade or

business. If the tests indicate that the item of income is effectively connected, you must include it with your other effectively connected income. If the item of income is not effectively connected, include it with all other income discussed under *The 30% Tax*, later, in this chapter.

Asset-use test. This test usually applies to income that is not directly produced by trade or business activities. Under this test, if an item of income is from assets (property) used in, or held for use in, the trade or business in the United States, it is considered effectively connected.

An asset is used in, or held for use in, the trade or business in the United States if the asset is:

- 1) Held for the principal purpose of promoting the conduct of a trade or business in the United States,
- 2) Acquired and held in the ordinary course of the trade or business conducted in the United States (for example, an account receivable or note receivable arising from that trade or business), or
- 3) Otherwise held to meet the present needs of the trade or business in the United States and not its anticipated future needs.

Generally, stock of a corporation is not treated as an asset used in, or held for use in, a trade or business in the United States.

Business-activities test. This test usually applies when income, gain, or loss comes directly from the active conduct of the trade or business. The business-activities test is most important when:

- 1) Dividends or interest are received by a dealer in stocks or securities,
- 2) Royalties are received in the trade or business of licensing patents or similar property, or
- 3) Service fees are earned by a servicing business.

Under this test, if the conduct of the U.S. trade or business was a material factor in producing the income, the income is considered effectively connected.

Personal Service Income

You usually are engaged in a U.S. trade or business when you perform personal services in the United States. Personal service income you receive in a tax year in which you are engaged in a U.S. trade or business is effectively connected with a U.S. trade or business. Income received in a year other than the year you performed the services is also effectively connected if it would have been effectively connected if received in the year you performed the services. Personal service income includes wages, salaries, commissions, fees, per diem allowances, and employee allowances and bonuses. The income may be paid to you in the form of cash, services, or property.

If you are engaged in a U.S. trade or business only because you perform personal services in the United States during the tax year, income and gains from assets, and gains and losses from the sale or exchange of capital assets are generally not effectively connected with your trade or business. How-

ever, if there is a **direct economic relationship** between your holding of the asset and your trade or business of performing personal services, the income, gain, or loss is effectively connected.

Pensions. If you were engaged in a U.S. trade or business in a tax year because you performed personal services in the United States, and you later receive a pension or retirement pay as a result of these services, the retirement pay is effectively connected income in each year you receive it. This is true whether or not you are engaged in a U.S. trade or business in the year you receive the retirement pay.

Transportation Income

Transportation income is effectively connected if you meet the following two conditions.

- 1) You had a fixed place of business in the United States involved in earning the income.
- 2) At least 90% of your U.S. source transportation income is attributable to regularly scheduled transportation.

"Fixed place of business" generally means a place, site, structure, or other similar facility through which you engage in a trade or business. "Regularly scheduled transportation" means that a ship or aircraft follows a published schedule with repeated sailings or flights at regular intervals between the same points for voyages or flights that begin or end in the United States. This definition applies to both scheduled and chartered air transportation.

If you do not meet the two conditions above, the income is not effectively connected and different rules apply. See *Transportation Tax*, later, in this chapter.

Business Profits and Losses and Sales Transactions

All profits or losses from U.S. sources that are from the operation of a business in the United States are effectively connected with a trade or business in the United States. For example, profit from the sale in the United States of inventory property purchased either in this country or in a foreign country is effectively connected trade or business income. A share of U.S. source profits or losses of a partnership that is engaged in a trade or business in the United States is also effectively connected with a trade or business in the United States.

Real Property Gain or Loss

Gains and losses from the sale or exchange of U.S. real property interests (whether or not they are capital assets) are taxed as if you are engaged in a trade or business in the United States. You must treat the gain or loss as effectively connected with that trade or business.

U.S. real property interest. This is any interest in real property located in the United States or the Virgin Islands or any interest in a domestic corporation that is a U.S. real property holding corporation. Real property includes:

- 1) Land and unsevered natural products of the land, such as growing crops and

timber, and mines, wells, and other natural deposits,

- 2) Improvements on land, including buildings, other permanent structures, and their structural components, and
- 3) Personal property associated with the use of real property, such as equipment used in farming, mining, forestry, or construction or property used in lodging facilities or rented office space, unless the personal property is:
 - a) Disposed of more than one year before or after the disposition of the real property, or
 - b) Separately sold to persons unrelated either to the seller or to the buyer of the real property.

U.S. real property holding corporation.

A corporation is a U.S. real property holding corporation if the fair market value of the corporation's U.S. real property interests are at least 50% of the total fair market value of:

- 1) The corporation's U.S. real property interests, plus
- 2) The corporation's interests in real property located outside the United States, plus
- 3) The corporation's other assets that are used in, or held for use in, a trade or business.

You generally are subject to tax on the sale of the stock in any domestic corporation unless you establish that the corporation is **not** a U.S. real property holding corporation.

A U.S. real property interest does not include a class of stock of a corporation that is regularly traded on an established securities market, unless you hold more than 5% of the fair market value of that class of stock. An interest in a foreign corporation owning U.S. real property generally is not a U.S. real property interest unless the corporation chooses to be treated as a domestic corporation.

Alternative minimum tax. There may be a minimum tax on your net gain from the disposition of U.S. real property interests. Figure the amount of this tax, if any, on Form 6251.

Withholding of tax. If you dispose of a U.S. real property interest, the buyer may have to withhold tax. See the discussion of *Tax Withheld on Real Property Sales*, in chapter 8.

Foreign Income

Under limited circumstances, you must treat three kinds of foreign source income as effectively connected with a trade or business in the United States. These circumstances are:

- 1) You have an office or other fixed place of business in the United States to which the income can be attributed,
- 2) That office or place of business is a material factor in producing the income, and
- 3) The income is produced in the ordinary course of the trade or business carried on through that office or other fixed place of business.

An office or other fixed place of business is a **material factor** if it significantly contributes to, and is an essential economic element in, the earning of the income.

The three kinds of foreign source income are listed below.

- 1) Rents and royalties for the use of, or for the privilege of using, intangible personal property located outside the United States or from any interest in such property. Included are rents or royalties for the use, or for the privilege of using, outside the United States, patents, copyrights, secret processes and formulas, goodwill, trademarks, trade brands, franchises, and similar properties if the rents or royalties are from the active conduct of a trade or business in the United States.
- 2) Dividends or interest from the active conduct of a banking, financing, or similar business in the United States. A substitute dividend or interest payment received under a securities lending transaction or a sale-repurchase transaction is treated the same as the amounts received on the transferred security.
- 3) Income, gain, or loss from the sale outside the United States, through the U.S. office or other fixed place of business, of stock in trade, property that would be included in inventory if on hand at the end of the tax year, or property held primarily for sale to customers in the ordinary course of business. This will not apply if you sold the property for use, consumption, or disposition outside the United States and an office or other fixed place of business in a foreign country was a material factor in the sale.

Tax on Effectively Connected Income

Income you receive during the tax year that is effectively connected with your trade or business in the United States is, after allowable deductions, taxed at the rates that apply to U.S. citizens and residents.

Generally, you can receive effectively connected income only if you are a nonresident alien engaged in trade or business in the United States during the tax year. However, income you receive from the sale or exchange of property, the performance of services, or any other transaction in another tax year is treated as effectively connected in that year if it would have been effectively connected in the year the transaction took place or you performed the services.

Example. Ted Richards, a nonresident alien, entered the United States in August 1999, to perform personal services in the U.S. office of his overseas employer. He worked in the U.S. office until December 25, 1999, but did not leave this country until January 11, 2000. On January 7, 2000, he received his final paycheck for services performed in the United States during 1999. All of Ted's income during his stay here is U.S. source income.

During 1999, Ted was engaged in the trade or business of performing personal services in the United States. Therefore, all amounts paid to him in 1999 for services performed in the United States during 1999 are effectively connected with that trade or business during 1999.

The salary payment Ted received in January 2000 is U.S. source income to him in 2000. It is effectively connected with a trade or business in the United States because he was engaged in a trade or business in the United States during 1999 when he performed the services that earned the income.

Real property income. You may be able to choose to treat all income from real property as effectively connected. See *Income From Real Property*, later, in this chapter.

The 30% Tax

Tax at a 30% (or lower treaty) rate applies to certain items of income or gains from U.S. sources but only if the items are **not** effectively connected with your U.S. trade or business.

Fixed or Determinable Income

The 30% (or lower treaty) rate applies to the gross amount of U.S. source fixed or determinable annual or periodic gains, profits, or income.

Income is **fixed** when it is paid in amounts known ahead of time. Income is **determinable** whenever there is a basis for figuring the amount to be paid. Income can be **periodic** if it is paid from time to time. It does not have to be paid annually or at regular intervals. Income can be determinable or periodic even if the length of time during which the payments are made is increased or decreased.

Items specifically included as fixed or determinable income are interest (other than original issue discount), dividends, rents, premiums, annuities, salaries, wages, and other compensation. A substitute dividend or interest payment received under a securities lending transaction or a sale-repurchase transaction is treated the same as the amounts received on the transferred security. Other items of income, such as royalties, also may be subject to the 30% tax.

TIP Some fixed or determinable income may be exempt from U.S. tax. See chapter 3 if you are not sure whether the income is taxable.

Original issue discount. If you sold, exchanged, or received a payment on a bond or other debt instrument that was issued at a discount **after** March 31, 1972, all or part of the original issue discount (OID) (other than portfolio interest) may be subject to the 30% tax. The amount of OID is the difference between the stated redemption price at maturity and the issue price of the debt instrument. The 30% tax applies in the following circumstances.

- 1) You received a payment on an obligation. In this case, the amount of OID subject to tax is the OID that accrued while you held the obligation minus the OID previously taken into account. But the tax on the OID cannot be more than the payment minus the tax on the interest payment on the obligation.
- 2) You sold or exchanged the obligation. The amount of OID subject to tax is the OID that accrued while you held the obligation minus the amount already taxed in (1) above.

Report on your return the amount of OID shown on Form 1042-S, *Foreign Person's U.S. Source Income Subject to Withholding*,

if you bought the debt instrument at original issue. However, you must recompute your proper share of OID shown on Form 1042-S if any of the following apply.

- 1) You bought the obligation at a premium or paid an acquisition premium.
- 2) The obligation is a stripped bond or a stripped coupon (including zero coupon instruments backed by U.S. Treasury securities).
- 3) You receive a Form 1042-S as a nominee recipient.

For the definition of **premium** and **acquisition premium** and instructions on how to recompute OID, get Publication 1212.

If you held a bond or other debt instrument that was issued at a discount **before** April 1, 1972, contact the IRS for further information. See chapter 12.

Social Security Benefits

A nonresident alien must include 85% of any U.S. social security benefit (and the social security equivalent part of a tier 1 railroad retirement benefit) in U.S. source fixed or determinable annual or periodic income. This income is exempt under some tax treaties. See *Table 1* in Publication 901, *U.S. Tax Treaties*, for a list of tax treaties that exempt U.S. social security benefits from U.S. tax.

Sales or Exchanges of Capital Assets

These rules apply only to those capital gains and losses from sources in the United States that are **not** effectively connected with a trade or business in the United States. They apply even if you are engaged in a trade or business in the United States. These rules do not apply to the sale or exchange of a U.S. real property interest or to the sale of any property that is effectively connected with a trade or business in the United States. See *Real Property Gain or Loss*, earlier, under *Effectively Connected Income*.

A **capital asset** is everything you own except:

- Inventory.
- Business accounts or notes receivable.
- Depreciable property used in a trade or business.
- Real property used in a trade or business.
- Supplies regularly used in a trade or business.
- Certain copyrights, literary or musical or artistic compositions, letters or memoranda, or similar property.
- Certain U.S. government publications.
- Certain commodities derivative financial instruments held by a commodities derivatives dealer.
- Hedging transactions.

A **capital gain** is a gain on the sale or exchange of a capital asset. A **capital loss** is a loss on the sale or exchange of a capital asset.

You may want to read Publication 544. However, use Publication 544 only to determine what is a sale or exchange of a capital asset, or what is treated as such. Specific tax

treatment that applies to U.S. citizens or residents generally does not apply to you.

The following gains are subject to the 30% (or lower treaty) rate without regard to the 183-day rule, discussed later.

- 1) Gains on the disposal of timber, coal, or domestic iron ore with a retained economic interest.
- 2) Gains on contingent payments received from the sale or exchange of patents, copyrights, and similar property after October 4, 1966.
- 3) Gains on certain transfers of all substantial rights to, or an undivided interest in, patents if the transfers were made before October 5, 1966.
- 4) Gains on the sale or exchange of original issue discount obligations.

Gains in (1) are not subject to the 30% (or lower treaty) rate if you choose to treat the gains as effectively connected with a U.S. trade or business. See *Income From Real Property*, later.

183-day rule. If you were in the United States for 183 days or more during the tax year, your net gain from sales or exchanges of capital assets is taxed at a 30% (or lower treaty) rate. For purposes of the 30% (or lower treaty) rate, net gain is the excess of your capital gains from U.S. sources over your capital losses from U.S. sources. This rule applies even if any of the transactions occurred while you were not in the United States.

To determine your net gain, consider the amount of your gains and losses that would be recognized and taken into account only if, and to the extent that, they would be recognized and taken into account if you were in a U.S. trade or business during the year and the gains and losses were effectively connected with that trade or business during the tax year. Also take into account, in arriving at your net gain, all gains and losses treated under U.S. tax laws as gains or losses from the sales or exchanges of capital assets.

In arriving at your net gain, do **not** take the following into consideration.

- The four types of gains listed earlier.
- The deduction for a capital loss carry-over.
- Capital losses in excess of capital gains.
- Exclusion for gain from the sale or exchange of qualified small business stock (section 1202 exclusion).
- Losses from the sale or exchange of property held for personal use. However, losses resulting from casualties or thefts may be deductible on Schedule A (Form 1040NR). See *Itemized Deductions* in chapter 5.

If you are not engaged in a trade or business in the United States and have not established a tax year for a prior period, your tax year will be the calendar year for purposes of the 183-day rule. Also, you must file your tax return on a calendar-year basis.

If you were in the United States for **less than 183 days** during the tax year, capital gains (other than gains listed earlier) are tax exempt unless they are effectively connected

with a trade or business in the United States during your tax year.

Reporting. Report your gains and losses from the sales or exchanges of capital assets that are not connected with a trade or business in the United States on page 4 of Form 1040NR. Report gains and losses from sales or exchanges of capital assets (including real property) that are connected with a trade or business in the United States on a separate Schedule D (Form 1040) and attach it to Form 1040NR.

Income From Real Property

If you have income from real property located in the United States that you own or have an interest in and hold for the production of income, you can choose to treat all income from that property as income effectively connected with a trade or business in the United States. The choice applies to all income from real property located in the United States and held for the production of income and to all income from any interest in such property. This includes income from rents, royalties from mines, oil or gas wells, or other natural resources. It also includes gains from the sale or exchange of real property and from the sale or exchange of timber, coal, or domestic iron ore with a retained economic interest.

You can make this choice only for real property income that is not otherwise connected with your U.S. trade or business.

If you make the choice, you can claim deductions attributable to the real property income and only your net income from real property is taxed.

This choice does not treat a nonresident alien, who is not otherwise engaged in a U.S. trade or business, as being engaged in a trade or business in the United States during the year.

Making the choice. Make the initial choice by attaching a statement to your return, or amended return, for the year of the choice. Include in your statement:

- 1) A complete list of all your real property, or any interest in real property, located in the United States,
- 2) The extent of your ownership in the property,
- 3) The location of the property,
- 4) A description of any major improvements to the property, and
- 5) Details of any previous choices and revocations of the real property income choice.

This choice stays in effect for all later tax years unless you revoke it.

Revoking the choice. You can revoke the choice without IRS approval by filing Form 1040X, *Amended U.S. Individual Income Tax Return*, for the year you made the choice and for later tax years. You must file Form 1040X within 3 years from the date your return was filed or 2 years from the time the tax was paid, whichever is later. If this time period has expired for the year of choice, you cannot revoke the choice for that year. However, you may revoke the choice for later tax years only if you have IRS approval. For information on how to get IRS approval, see Regulation section 1.871-10(d)(2).

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