

THE SOCIAL SECURITY/MEDICARE AND SELF-EMPLOYMENT TAX LIABILITY OF FOREIGN STUDENTS, SCHOLARS, TEACHERS, RESEARCHERS, AND TRAINEES---

A FEW BASIC FACTS ABOUT U.S. IMMIGRATION LAW

The article below prepared by Lowell G. Hancock, IRS Office of Foreign Payments is provided for your general information. It was prepared in March 1999.

A very basic knowledge about U.S. immigration laws is essential to understanding the taxation of aliens in the United States because the treatment of aliens under the internal revenue and social security laws of the United States is based, in part, on the status of such aliens under the immigration laws of the United States.

An alien is any person who is not a citizen of the United States. The immigration laws of the United States are administered by the Immigration and Naturalization Service (INS); although the U.S. Department of State in its embassies and consulates abroad determines initially which aliens will be allowed to enter the United States. The immigration laws classify all aliens into three basic categories: (1) immigrants, (2) non-immigrants, and (3) illegal aliens. Immigrants have the right to reside permanently in the United States, and sooner or later will come into possession of that most coveted of documents known as the "green card" (INS form I-551). The green card is the tangible evidence of a person's immigrant status. It allows the alien who possesses it to reside permanently in the United States, to enter and leave the United States at will without having to resort to visas or reentry permits, and to earn self-employment and employment income in the United States under the same conditions as would apply to a U.S. citizen.

A "non-immigrant" is an alien who is allowed to reside temporarily in the United States. A non-immigrant has represented to the U.S. Department of State and to the INS that he is a permanent resident of a foreign country to which he fully intends to return after his temporary stay in the United States has come to an end. Most non-immigrants enter the United States with the permission of the U. S. Department of State, and they bear written evidence of this fact in their passports in the form of a "visa" which is usually stamped by a U. S. embassy or consulate abroad on one of the pages in the non-immigrant's passport. A non-immigrant visa allows a non-immigrant to enter the United States in one of several different categories, which correspond to the purpose for which the non-immigrant is being admitted to the United States. For example, a foreign student will usually enter the United States on an F-1 visa, a visitor for business on a B-1 visa, an exchange visitor (including students, teachers, researchers, trainees, alien physicians, au pairs, and others) on a J-1 visa, a diplomat on an A or G visa, etc. The categories of non-immigrant visas correspond exactly to the "non-immigrant status" assigned to each non-immigrant upon his arrival, based on the purpose for which the non-immigrant was admitted to the United States. For example, a foreign student who enters the United States on an F-1 visa is considered to be in F-1 student status after he enters the United States; and he will remain

in that status until he violates the conditions prescribed for that status, or until he changes to another non-immigrant or immigrant status with INS permission, or until he leaves the United States.

An "illegal alien" is an alien who entered the United States illegally without the proper authorization and documents, or is an alien who once entered the United States legally and has since violated the terms of the status in which he entered the United States.

RESIDENT ALIENS AND NONRESIDENT ALIENS

Although the immigration laws of the United States speak of immigrants, non-immigrants, and illegal aliens, the tax laws of the United States speak only of **RESIDENT ALIENS** and **NONRESIDENT ALIENS**. The general controlling principle is that **RESIDENT ALIENS** are taxed in the same manner as U.S. citizens, and **NONRESIDENT ALIENS** are taxed according to special rules contained in certain parts of the Internal Revenue Code (hereinafter referred to as the Code). The tax residency rules are found in section 7701(b) of the Code. Although the tax residency rules are based on the immigration laws about immigrants and non-immigrants, they define residency for tax purposes in a way very different from the immigration laws. Under the tax residency rules of the Code, any alien who is not a **RESIDENT ALIEN** must be a **NONRESIDENT ALIEN**. An alien will become a **RESIDENT ALIEN** in one of three ways: (1) by being lawfully admitted to the United States for permanent residence under the immigration laws (the Green Card test); (2) by passing the Substantial Presence Test (which is a numerical formula which measures days of presence in the United States); or (3) by making what is called the "First Year Election" (a numerical formula under which an alien may pass the substantial presence test one year earlier than under the normal rules). Under these rules, even an illegal alien under the immigration laws who passes the Substantial Presence Test of the tax Code will be treated for tax purposes as a **RESIDENT ALIEN**. With these basic residency concepts in mind, we may now proceed to analyze the very specific case of foreign students, scholars, teachers, researchers, and trainees and their liability for social security/Medicare taxes and the self-employment tax.

SELF-EMPLOYMENT TAX LIABILITY

The Internal Revenue Code imposes the self-employment tax on the self-employment income of any person in the United States who has such self-employment income. However, the Code also provides an exemption from self-employment tax on the self-employment income of **NONRESIDENT ALIENS**. A **NONRESIDENT ALIEN** is simply not liable for the self-employment tax. However, once an alien individual becomes a **RESIDENT ALIEN** under the residency rules of the Code, he then becomes liable for self-employment taxes under the same conditions as a U.S. citizen.

Under the rules pertaining to the Substantial Presence Test, foreign scholars, teachers, researchers, and trainees (including medical interns) who arrive in the United States on J-1 and Q-1 visas are considered to be "exempt individuals" (i.e., exempt from counting days of presence in the United States under the Substantial Presence Test) during the first

two calendar years of their physical presence in the United States; and foreign students who arrive in the United States on F-1, J-1, M-1, or Q-1 visas are considered to be exempt individuals during the first five calendar years of their physical presence in the United States. This means that foreign scholars, teachers, researchers, trainees, and other non-students who enter the United States on J-1 or Q-1 visas are considered to be NONRESIDENT ALIENS during their first two calendar years in the United States; and foreign students who enter the United States on F-1, J-1, M-1, or Q-1 visas are considered to be NONRESIDENT ALIENS during their first five calendar years in the United States. Foreign scholars, teachers, researchers, trainees and other non-students who enter the United States on J-1 or Q-1 visas usually become RESIDENT ALIENS on January 1st of their third calendar year in the United States; and foreign students who enter the United States on F-1, J-1, M-1, or Q-1 visas usually become resident aliens on January 1st of their sixth calendar year in the United States.

After an alien student, scholar, teacher, researcher or trainee has become a RESIDENT ALIEN under the residency rules of the Code, he loses the NONRESIDENT ALIEN exemption from self-employment tax provided by the Code, and becomes fully liable for the self-employment tax. As an aside, however, it would be good to remember that, as a general rule, the immigration laws of the United States do not permit non-immigrants to earn self-employment income; and thus, the question of a foreign student's or scholar's liability for self-employment tax does not arise very often. Nevertheless, if a non-immigrant violates his non-immigrant status and earns self-employment income in the United States, the Internal Revenue Service (IRS) will not hesitate to impose income taxes on such self-employment income, and will not hesitate to impose the self-employment tax on such income if the alien has become a RESIDENT ALIEN.

THE SOCIAL SECURITY/MEDICARE TAX LIABILITY

The Code imposes the liability for social security and Medicare taxes on both the employer of, and the employee, who earns income from wages in the United States. The Code grants an exemption from social security and Medicare taxes to non-immigrant students, scholars, teachers, researchers, and trainees (including medical interns) temporarily present in the United States in F-1, J-1, M-1, or Q-1 status. The Social Security Act contains the same provision. Both code sections exempt the above-named non-immigrants from social security/Medicare taxes for as long as these non-immigrants are "NONRESIDENT ALIENS" in F-1, J-1, M-1, or Q-1 status. The IRS has published regulations which stipulate that aliens who arrive in the United States on F, J, M, or Q visas will be assumed to be "NONRESIDENT ALIENS" but only to the extent that the assumption is consistent with the residency rules of section 7701(b) of the Code. Since the social security/Medicare tax exemption for foreign students, scholars, teachers, researchers, and trainees under the Code requires that the payee be a "NONRESIDENT ALIEN", then the social security/Medicare tax exemption ceases to exist at the point the payee becomes a "RESIDENT ALIEN" under the residency rules of section 7701(b) of the Code.

Thus, to summarize, both the Internal Revenue Code and the Social Security Act allow an exemption from social security/Medicare taxes to alien students, scholars, teachers, researchers, and trainees who have entered the United States on F-1, J-1, M-1, or Q-1 visas and who are still classified as NONRESIDENTALIENS under the residency rules of the Internal Revenue Code. As discussed above, this means that foreign students in F-1, J-1, M-1, or Q-1 non-immigrant status who have been in the United States less than 5 calendar years are still NONRESIDENT ALIENS and are still exempt from social security/Medicare taxes. This exemption also applies to any period in which the foreign student is in "practical training" allowed by the INS, as long as the foreign student is still a NONRESIDENT ALIEN under the Code. Foreign students in F-1, J-1, M-1, or Q-1 non-immigrant status who have been in the United States more than 5 calendar years are RESIDENT ALIENS and are liable for social security/Medicare taxes. In a similar fashion, foreign scholars, teachers, researchers, trainees, and other non-students in J-1 or Q-1 non-immigrant status who have been in the United States less than two calendar years are still NONRESIDENT ALIENS and are still exempt from social security/Medicare taxes. However, foreign scholars, teachers, researchers, trainees, and other non-students in J-1 or Q-1 non-immigrant status who have been in the United States more than two calendar years are RESIDENT ALIENS and are liable for social security/Medicare taxes. When measuring an alien's date of entry for the purposes of determining the five calendar years or the two calendar years mentioned above, the actual date of entry is not important. It is the calendar year of entry, which is counted toward the two or five calendar years respectively. Thus, for example, a foreign student who enters the United States on December 31, 1998 counts 1998 as the first of his five years as an "exempt individual".

One must bear in mind also that the Code provides one exemption from social security/Medicare taxes for foreign students and it provides another exemption from social security/Medicare taxes for all students, American and foreign, who meet the conditions described in IRS Revenue Procedure 98-16. This is the so-called "student FICA exemption", and it may operate to exempt a foreign student from social security/Medicare taxes even though he has already become a RESIDENT ALIEN.

The IRS has issued regulations which clearly stipulate that the spouses and dependents of alien students, scholars, trainees, teachers, or researchers temporarily present in the United States in F-2, J-2, M-2, or Q-2 status are NOT exempt from social security and Medicare taxes, and are fully liable for social security/Medicare taxes on any wages they earn in the United States because such aliens have not entered the United States for the primary purpose of engaging in study, training, teaching, or research. Once more, as an aside, the immigration laws do not allow spouses and dependents in F-2 and M-2 status to be employed in the United States; but if such aliens are employed in violation of their non-immigrant status, the IRS will not hesitate to impose both income and social security and Medicare taxes on their income.

Alien students, scholars, trainees, teachers, or researchers in F-1, J-1, M-1, or Q-1 status who change to a non-immigrant status other than F-1, J-1, M-1, or Q-1 will become liable for social security/Medicare taxes in most cases on the very day of the change of status. Teachers, trainees, and researchers in H-1B status, and alien nurses in H-1A status, are liable for social security/Medicare taxes from the first day of U.S. employment, regardless of whether they are nonresident or resident aliens, and regardless of whether

their wages may or may not be exempt from federal income taxes under an income tax treaty. Foreign scholars, teachers, researchers, or trainees who arrive in the United States in O-1 status or TN status (from Canada or Mexico under the NAFTA treaty) are fully liable for U.S. social security/Medicare taxes if they are employed on the payroll of the university, regardless of whether or not they are resident or nonresident aliens.

TOTALIZATION AGREEMENTS

The United States has entered into what are known as "Totalization Agreements" with 17 foreign countries in order to prevent double taxation for social security tax purposes of the same wages by two different nations. A foreign student, scholar, teacher, researcher, or trainee may theoretically use the terms of a totalization agreement to prevent the imposition of U.S. social security and Medicare taxes if he is also paying foreign social security taxes on his U.S. wages. The totalization agreements operate to prevent double taxation of the same wages for social security tax purposes by two different governments. If the alien's home government is not taxing his U.S. wages for social security tax purposes, then the totalization agreement will not prevent the imposition of U.S. social security/Medicare taxes on the U.S. wages of such foreign student or scholar. Any alien who wishes to claim an exemption from U.S. social security/Medicare taxes under the terms of a totalization agreement must present a letter or certificate of coverage from the foreign social security agency, which verifies that the alien is paying the foreign social security taxes on his U.S. wages. If the foreign government will not issue such a letter or certificate, then the individual should secure such a letter from the U.S. Social Security Administration, Office of Research, Statistics, and International Policy in Baltimore to verify the foreign coverage. The specific procedures for doing all of this are contained in Revenue Procedures 80-56 and 84-54, and Revenue Ruling 92-9.

As of this time, the following nations have entered into Totalization Agreements with the United States:

Austria	Luxembourg
Belgium	Netherlands
Canada	Norway
Finland	Portugal
France	Spain
Germany	Sweden
Greece	Switzerland
Ireland	United Kingdom
Italy	

TAX INFORMATION FOR FOREIGN NATIONALS

Who should read this?	Foreign nationals should read this, as U.S. tax laws are complicated and it is the individual's responsibility to comply with these laws. Texas Christian University cannot act as a tax adviser but it will provide the following general information, which might be helpful.
Key Terms (tax terms--not immigration terms):	A Resident Alien is a foreign national who either has a green card <u>or</u> meets the "substantial presence test."
	All other foreign nationals are Nonresident Aliens . The "substantial presence test" is described in IRS Pub. 519. Information is also available from the TCU Payroll Dept.
Why do I care if I'm a nonresident alien or a resident alien?	A nonresident alien is taxed on U.S. source income only--not worldwide income. Generally, a nonresident alien is eligible for only one personal exemption and cannot take the standard deduction on his/her tax return. A resident alien is taxed in the same manner as a U.S. citizen.
Do I need a U.S. Tax Identification Number?	YES. Life in the U.S. is very complicated without a tax ID number. If you are on an F-1, H-1, J-1 or M-1 visa, you are eligible for a <i>social security number</i> and should obtain one immediately. Apply at 2785 Alta Mesa St. between 9 and 4 and present your passport and Exit Paper (I-94). In addition, bring your F-1 Sponsor Letter and I-20 Certificate of Eligibility (white), or your J-1 DS-2019 Certificate of Eligibility (pink), or your M-1 or H-1 I688B Work Authorization (plastic). All other foreign nationals (including spouses and children) should obtain an <i>individual taxpayer identification number</i> by filing IRS Form W-7 with original documentation described in the instructions. You can get a W-7 by calling IRS or printing it from IRS' Web Page.
Will I be subject to U.S. social security taxes?	<u>Nonresident aliens</u> on F-1, J-1 or M-1 visas are exempt from U.S. social security taxes.
	For <u>other individuals</u> , the exemption depends upon the type of payment and/or student status. Contact the Payroll Office if you need additional information.
Will TCU withhold federal income taxes on my payments?	There are no simple answers. TCU must withhold taxes on all payments to <i>nonresident aliens</i> unless the payment is exempt under the Internal Revenue Code, a tax treaty, or as foreign source income.

Copies of the Totalization Agreements may be obtained from the Social Security Administration at the following address:

Social Security Administration
Office of International Policy
P.O. Box 17741
Baltimore, Maryland 21235

The Social Security Administration also publishes small brochures, which concisely describe the terms of each totalization agreement. These brochures are available from many local Social Security Offices, or may be ordered from the following toll-free number: 1-800-772-1213. The complete text of these brochures and of the totalization agreements themselves are available on the internet at:

http://www.ssa.gov/international/inter_intro.html.

Author: Lowell G. Hancock
Issue Specialist
IRS Foreign Payments Branch
Washington, DC