
MEMORANDUM

RE: U.S. INCOME TAX (NON-RESIDENT ALIENS)

Non-resident aliens are subject to U.S. Income Tax on U.S. source: (1) FDAP Income, (2) Effectively Connected Income.

(1) “FDAP” Income

U.S. Source “FDAP Income” i.e., Fixed or Determinable Annual or Periodical Income (e.g., salaries, wages, interest, rents, dividends and royalties).

A non-resident alien is subject to U.S. federal income tax on FDAP income at a flat 30% tax rate (without the benefit of any related deductions) IRC §871(a), 873(a). The flat 30% income tax is withheld at the income source (IRC §1441).

“FDAP Income” includes:

1. Gains from sale of intangible property (i.e., patents, copyrights or other intangibles) (IRC §871(a)(1)(D)).

“FDAP Income” does not include:

1. Gain from the sale of stock of a domestic corporation (Treas Reg §1.871-7(a)(1)).
2. Interest on bank deposits and “portfolio interest” (IRC §871(h) and (i)).

Income tax treaties may reduce or eliminate the 30% flat tax on the FDAP Income.

(2) Effectively Connected Income

Income that is “effectively connected” to a U.S. trade or business.

A non-resident alien, who is engaged in a U.S. trade or business, is subject to U.S. federal income tax on his “effectively connected income”, at same tax rates as U.S. citizens and resident aliens (IRC §871(b)).

For a non-resident alien, engaging in a U.S. trade or business is not the basis for U.S. income tax. U.S. income tax is imposed if a non-resident alien owns a business through a permanent establishment in the U.S., i.e., a fixed place of business, (e.g., place of management, a branch, an office, a factory).

If the non-resident alien is a resident of a country with which the U.S. has an income tax treaty, the treaty may reduce or eliminate U.S. federal income tax on effectively connected income.

A non-resident alien must file IRS Form 8833 to disclose reliance on a U.S. tax treaty for an exemption from U.S. tax on "effectively connected income."

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