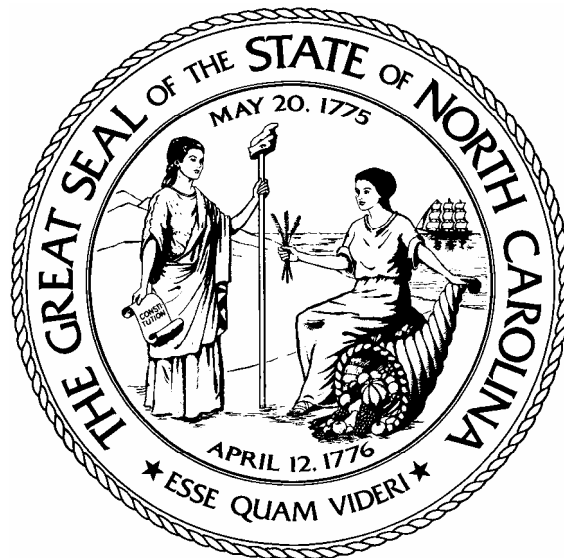


**POLICY AND PROCEDURES  
PERTAINING TO PAYMENTS AND  
COMPENSATION OF  
FOREIGN NATIONALS, GOVERNMENTS,  
AND CORPORATIONS**



**March 2006**

**Policy and Procedures Pertaining to Payments and Compensation of Foreign Nationals,  
Governments, and Corporations**

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## **Policy and Procedures Pertaining to Payments and Compensation of Foreign Nationals, Governments and Corporations**

### **POLICY:**

The reporting and withholding of taxes associated with payments made to non-U.S. citizens by universities, community colleges, and other agencies of the State of North Carolina are in accordance with the laws and regulations of the U.S. Citizenship and Immigration Services (USCIS) and the Internal Revenue Service (IRS). The U.S. Citizenship and Immigration Services define what payments may be made to aliens who perform services in the United States. The Internal Revenue Service defines which payments made to aliens are reported and subject to taxes, as well as establishes the tax rates for those payments. In depth discussion of the alien tax system is provided in Appendix I.

Note: Although the preferred term for identifying a person who is not a U.S. citizen is “Foreign National”, the Internal Revenue Service and the U.S. Citizenship and Immigration Services use the word “alien”. Therefore, all non-U.S. citizens will be referred to as “aliens” in this text to minimize confusion with the federal government publications.

### **Procedures for Paying or Compensating an Alien:**

The 6-step process detailed below must be followed to ensure that aliens are paid according to prevailing tax and immigration rules/regulations with appropriate taxes withheld and payments properly reported.

This procedure is intended to provide guidance in the majority of situations facing the state entities. The procedure is not inclusive. Tax and immigration laws are voluminous. Any situations not covered by this procedure should be handled on a case-by-case basis and receive additional guidance from the Office of the State Controller.

#### **Step 1 - The Payee - Payment Eligibility and Tax Residency Status**

A Foreign National Information System Data Gathering Form, Appendix IV should be completed and presented with copies of the specified immigration documentation. This information is used to:

- Determine eligibility for payments to be made based on the type of visa issued. Refer to the Visa Matrix (Appendix V). (An explanation of U.S. Immigration Law as it applies to employment can be found in Appendix II and descriptions of the more commonly used nonimmigrant visas are discussed in Appendix III.)
- Determine if the Payee's tax status is Nonresident Alien or Resident Alien. Refer to the Substantial Presence Test (Appendix VI)

#### **Step 2 - The Type of Payment**

The type of payment made to the alien falls into four primary categories:

- 1) Dependent personal services: Wages, service related scholarship/fellowship payments;
- 2) Independent personal services: Consulting fees, guest speaker, honoraria
- 3) Scholarships/Fellowships:
  - a) Qualified component (for degree candidates): Educational expenses, tuition, fees, books, etc.
  - b) Nonqualified component: Living expenses, stipend
- 4) Miscellaneous Income Types: Prizes and awards, royalties, etc.

### Step 3 - The “Source” of the Income

As important as the recipient’s tax status, the payor of the income and their residence also has bearing for determining U.S. federal reporting and taxation.

A **resident alien’s** income is generally subject to tax in the same manner as a U.S. citizen. Therefore, worldwide income is reported.

A **nonresident alien** is usually subject to U.S. income tax only on U.S. source income. The U.S. source payor is responsible for reporting income paid to the nonresident alien. Refer to the **Summary of Source Rules for Income of Nonresident Aliens** (Appendix VII).

A determination is made as to the source of income in the following manner:

- For compensation paid to employees and independent contractors, income is sourced to the country where services are performed.
- For non-compensation payments such as scholarships/fellowships, grants, prizes, and awards, the source of the income is the residence of the payor regardless of who actually disburses the funds. If the activity is performed outside the United States, it is not considered U.S. sourced income.

### Step 4 - Is the Payment subject to Income Tax Withholding?

Income paid to a **resident alien** follows the same withholding tax rules as U.S. citizens. The federal withholding rates for resident aliens are the same as rates for U.S. citizens.

All U.S. sourced income paid to a **nonresident alien** is taxable with the exception of interest income and qualified scholarships/fellowships. The federal withholding rates for nonresident aliens are:

Type of Income	Federal Tax Rate
• Compensation (employees)	Standard graduated rates*
• Nonqualified Scholarships / Fellowships (F, J, M, Q visa holders)	14%
• Nonqualified Scholarships / Fellowships (all other visa holders)	30%
• Independent personal services (e.g. consulting fees, guest speaker fees, honoraria, awards, travel reimbursement and prizes)	30%
• Royalties	30%
• Prizes and awards	30%
• All other payments	30%

- \* Nonresident alien employees must complete the federal withholding form, W-4, in a specified manner.

Tax forms and other documents the alien must complete for withholding purposes are referenced in Appendix VIII.

**Tax Treaties** - If an alien is a resident of a country that has an income tax treaty with the United States AND the treaty contains an article covering the primary activity the alien is being compensated for, then the alien may exempt part or all of his income from U.S. federal withholding taxes as specified in the article. In depth information is referenced in Appendix IX. Countries with tax treaties containing applicable articles are referenced in Appendix X.

The alien must file a Form 8233, *Exemption from Withholding on Compensation for Independent (and Certain Dependent) Personal Services of a Nonresident Alien Individual* and statement -if required- with the designated reporting agency.

**Step 5 - Is the Payment subject to Social Security and Medicare Taxes (FICA)?**

Yes, all aliens, regardless of resident or nonresident tax status are subject to the same social security and Medicare taxes for wages as U.S. citizens. Wages earned in the employment groups as defined by the Federal Insurance Contribution Act is the income subject to these taxes.

As a general rule, the only aliens exempt from social security and Medicare taxes are F-1, J-1, M-1, and Q-1 visa holders while they are in nonresident tax status. Note: If one of these designated visa holder changes to resident tax status during a year, he is subject to social security and Medicare taxes for the entire year on his subject wages. More information concerning Federal Insurance Contribution Act taxes is referenced in Appendix XI.

**Step 6 - Determining if a Payment is Reportable and How to Report It**

**Resident alien** payments are reported to the federal government in the same manner as U.S. citizens. Forms issued to the resident alien regarding reportable income are the Form W-2, *Wage and Tax Statement* for wages and the various Forms 1099 for non-wage compensation. Note: If the resident alien uses a tax treaty, he will receive a Form 1042-S for tax reporting purposes.

**Nonresident alien** payments subject to taxes are reported to the federal government. Forms issued to the nonresident alien are Form W-2, *Wage and Tax Statement* for wages subject to income taxes and/or FICA taxes and the Form 1042-S, *Foreign Person's United States Source Income Subject to Withholding* for non-wage compensation. Form 1099 cannot be issued to nonresident aliens.

Appendix XII lists the reporting requirements for the withholding agent at year-end.



















































































