

6 Important Facts About the U.S. Taxation of Foreign Persons



Are you considered a non-resident alien? Unsure of how the U.S. taxes certain foreign persons? If you answered yes to either of these questions, you are not alone. To help shed light on these and many other questions relating to non-resident aliens, Cohen & Company has created the following list of important facts about the U.S. taxation of foreign persons.

1. Why is residency status so important?

Residency status determines how the foreign person will be taxed in the U.S.

2. How are foreign persons classified for U.S. tax purposes?

Resident Alien – Individual has a green card or meets the substantial presence test. The substantial presence test is met if the individual is present in the U.S. for 183 days. In calculating this limit, days in the current year count as full days, days in the 1st prior year count as 1/3 and days in the 2nd prior year count as 1/6.

Non-Resident Alien – Individual is not a U.S. citizen and does not meet either of the tests for U.S. resident alien status.

3. What are the U.S. tax consequences for resident aliens and non-resident aliens?

Resident Aliens – File Form 1040 and generally, are taxed on their worldwide income, regardless of the source

of this income. Relief from double taxation is available via the foreign tax credit.

Non-Resident Aliens – File Form 1040NR and are taxed only on specific types of U.S. source income.

4. What specific types of income are non-resident aliens taxed on?

Effectively Connected Income – Income effectively connected with a U.S. trade or business, which encompasses rental real estate income. This income is subject to tax at the applicable graduated rate of U.S. tax.

Fixed, Determinable, Annual or Periodic Income – Includes interest, dividends, royalties and rents. Generally, it is subject to a flat 30% withholding tax. Certain treaties can reduce or eliminate this withholding.

Disposition of U.S. Real Property – Gain on the disposition of the U.S. real property (including vacation

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homes) is subject to tax at the applicable graduated rate of U.S. tax.

5. How can treaties offer relief?

Treaties can often offer relief to situations where double taxation is possible. Most treaties contain “tie-breaker” provisions for determining proper residency status.

6. What are the estate tax consequences of residency status?

Estate taxation of non-resident aliens differs from that of U.S. citizens. In general, non-resident aliens are only subject to U.S. estate tax on U.S. situated assets (including rental real estate, vacation homes). Therefore, non-resident aliens should seek specialized estate tax planning advice prior to purchasing U.S. assets.

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