

# U.S. TAXATION OF FOREIGN STUDENTS

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The application of U.S. federal income tax rules and the availability of income exemptions under the tax law may depend on policy reasons on an individual's immigration category. This is the case for foreign students in F (academic), J (exchange visitor), and M (vocational) student categories. Depending upon the number of calendar years that foreign students have been in the United States in F, M, J, or Q status since 1985, students may be either a nonresident alien or resident alien for U.S. income tax purposes. The difference is important because different tax withholding rules apply to nonresident aliens.

## **Substantial U.S. Presence**

Under the general rule for U.S. tax residency, foreign nationals are "substantially present," in the United States if they are present for at least 31 days in the current calendar year, and their U.S. days over 3 calendar years equal or exceed 183 days based on a formula. The 183-day formula considers all of the U.S. days in the current calendar year, plus 1/3 of the U.S. days in the prior year, plus 1/6 of the days in the year before the prior year. Foreign nationals whose presence in the United States satisfies the substantial presence formula are resident aliens and taxed like U.S. citizens.

## **The 5-Calendar Year Student Exception**

For policy reasons, foreign students are nonresident aliens for U.S. income tax purposes for 5 calendar years. Therefore, they are subject to U.S. income tax only on their U.S. income (unless an exception applies), but not on their foreign income. This results from the fact that the U.S. days of foreign students do not count for purposes of determining substantial presence in the United States for 5 calendar years.

The 5 calendar years include all years of presence as an "exempt individual" in F, J, M, or Q status since 1985. Special transitional rules apply to students who were already in the United States in 1985. Calendar years include years in which foreign students spent in the United States in high school, or even as young children accompanying a student parent.

## **Closer Connection Extension**

Foreign students who can support with facts that they are not intending to reside permanently in the United States can extend the 5-calendar year period by attaching a statement to Form 8843. This form is required to be submitted with a students' income tax return, or separately if no return is required. Although the tax law provides for procedures for requesting a letter from the IRS to support this claim, which would be needed for withholding purposes, effective procedures for requesting such a letter have yet to be implemented by the IRS.

Whether taxes are lower for foreign students who are resident aliens or nonresident aliens depends upon their type and source of income. Foreign students engaged in optional practical training in their 6th calendar year of U.S. presence frequently wish to remain nonresident aliens to avail themselves of the social security and Medicare tax exemption that applies to nonresident aliens in F-1 and J-1 status. However, foreign students who are intending to change status to H-1B Specialty Worker are not eligible for the closer connection extension of their nonresidency status.