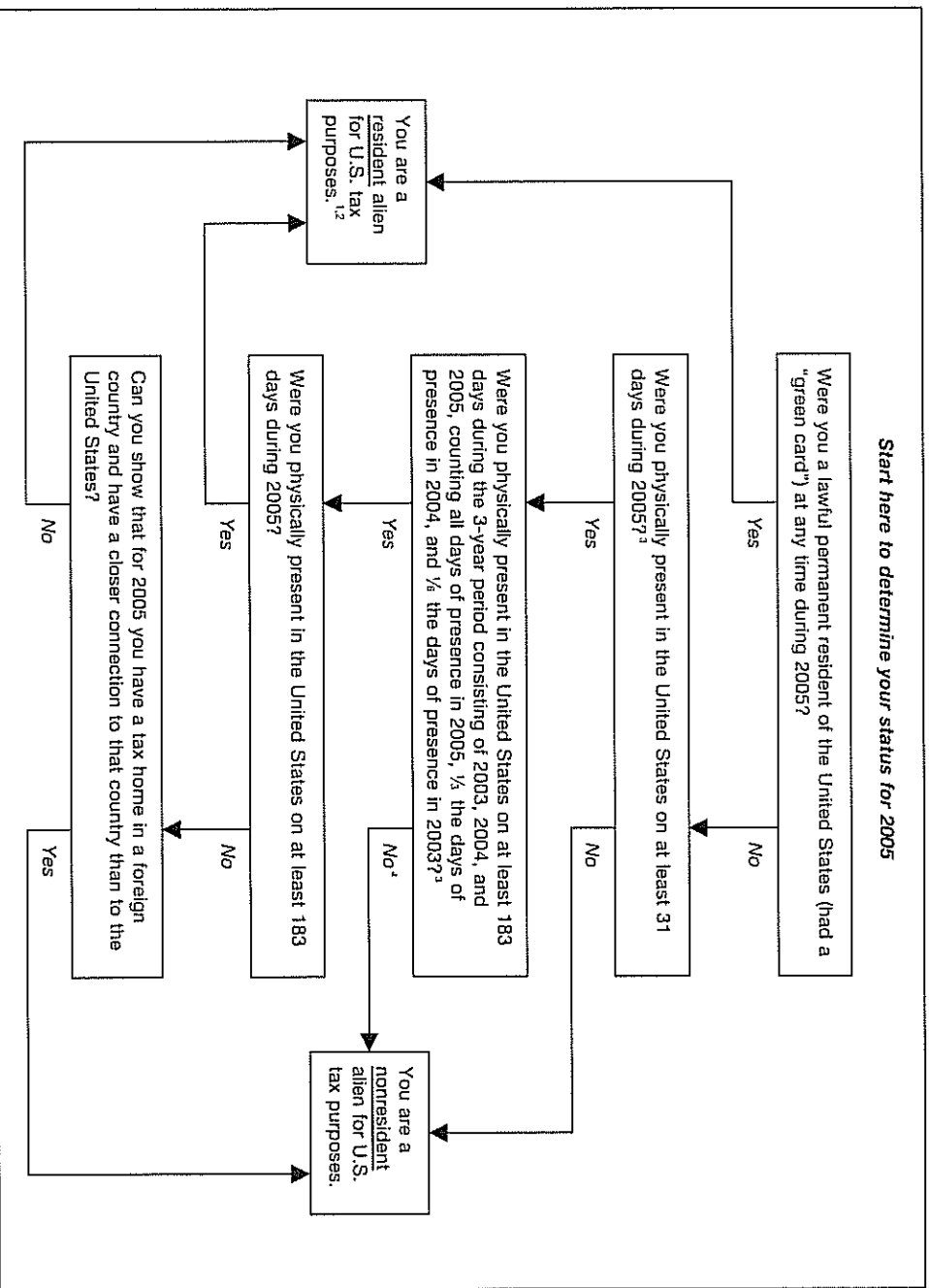


Figure 1-A. Nonresident Alien or Resident Alien?



<sup>1</sup> If this is your first or last year of residency, you may have a dual status for the year. See *Dual-Status Aliens* in chapter 1.

<sup>2</sup> In some circumstances you may still be considered a nonresident alien under an income tax treaty between the U.S. and your country. Check the provisions of the treaty carefully.

<sup>3</sup> See *Days of Presence in the United States* in this chapter for days that do not count as days of presence in the United States.

<sup>4</sup> If you meet the substantial presence test for 2006, you may be able to choose treatment as a U.S. resident alien for part of 2005. For details, see *Substantial Presence Test* under *Resident Aliens* and *First-Year Choice* under *Dual-Status Aliens* in chapter 1.

year preceding the interest payment, at least 80% of the payer's total gross income:

- a. Is from sources outside the United States, and
  - b. Is attributable to the active conduct of a trade or business by the individual or corporation in a foreign country or a U.S. possession.
2. Interest paid by a foreign branch of a domestic corporation or a domestic partnership on deposits or withdrawable accounts with mutual savings banks, cooperative banks, credit unions, domestic building and loan associations, and other savings institutions chartered and supervised as savings and loan or similar associations under federal or state law if the interest paid or credited can be deducted by the association.
  3. Interest on deposits with a foreign branch of a domestic corporation or domestic partnership, but only if the branch is in the commercial banking business.

## Dividends

In most cases, dividend income received from domestic corporations is U.S. source income. Dividend income from foreign corporations is usually foreign source income. Exceptions to both of these rules are discussed below.

A substitute dividend payment made to the transferee of a security in a securities lending transaction or a sale-repurchase transaction is sourced in the same manner as a distribution on the transferred security.

**First exception.** Dividends received from a domestic corporation are not U.S. source income if the corporation elects to take the Puerto Rico economic activity credit or the possession tax credit.

**Second exception.** Part of the dividends received from a foreign corporation is U.S. source income if 25% or more of its total gross income for the 3-year period ending with the close of its tax year preceding the declaration of dividends was effectively connected with a trade or business in the United States. If the corporation was formed less than 3 years before the declaration, use its total gross income from the time it was formed. Determine the part that is U.S. source income by multiplying the dividend by the following fraction.

$$\frac{\text{Foreign corporation's gross income connected with a U.S. trade or business for the 3-year period}}{\text{Foreign corporation's gross income from all sources for that period}}$$

## Personal Services

All wages and any other compensation for services performed in the United States are consid-

ered to be from sources in the United States. The only exception to this rule is discussed in chapter 3 under *Employees of foreign persons, organizations, or offices*.

If your compensation is for personal services performed both inside and outside the United States, you must figure the amount of income that is for services performed in the United States. You usually do this on a time basis. That is, you must include in gross income as U.S. source income the amount that results from multiplying the total amount of compensation by the following fraction.

$$\frac{\text{Number of days you performed services in the United States}}{\text{Total number of days of service for which you receive payment}}$$

**Example.** Jean Blanc, a nonresident alien, is a professional hockey player with a U.S. hockey club. Under Jean's contract, he received \$98,500 for 242 days of play during the year. This includes days spent at pre-season training camp, days during the regular season, and play-off game days. Of the 242 days, Jean spent 194 days performing services in the United States and 48 days playing hockey in Canada. Jean's U.S. source income is \$78,963, figured as follows:

$$\frac{194}{242} \times \$98,500 = \$78,963$$

**Crew members.** Compensation for services performed by a nonresident alien in connection with the individual's temporary presence in the United States as a regular crew member of a foreign vessel engaged in transportation between the United States and a foreign country or U.S. possession is not U.S. source income.

## Transportation Income

Transportation income is income from the use of a vessel or aircraft or for the performance of services directly related to the use of any vessel or aircraft. This is true whether the vessel or aircraft is owned, hired, or leased. The term "vessel or aircraft" includes any container used in connection with a vessel or aircraft.

All income from transportation that begins and ends in the United States is treated as derived from sources in the United States. If the transportation begins or ends in the United States, 50% of the transportation income is treated as derived from sources in the United States.

For transportation income from personal services, 50% of the income is U.S. source income if the transportation is between the United States and a U.S. possession. For nonresident aliens, this only applies to income derived from, or in connection with, an aircraft.

For information on how U.S. source transportation income is taxed, see chapter 4.

## Scholarships, Grants, Prizes, and Awards

Generally, the source of scholarships, fellowship grants, grants, prizes, and awards is the residence of the payer regardless of who actu-

Table 2-1. Summary of Source Rules for Income of Nonresident Aliens

Item of Income	Factor Determining Source
Salaries, wages, other compensation	Where services performed
Business income:	
Personal services	Where services performed
Sale of inventory—purchased	Where sold
Sale of inventory—produced	Allocation
Interest	Residence of payer
Dividends	Whether a U.S. or foreign corporation*
Rents	Location of property
Royalties:	
Natural resources	Location of property
Patents, copyrights, etc.	Where property is used
Sale of real property	Location of property
Sale of personal property	Seller's tax home (but see <i>Personal Property</i> , later, for exceptions)
Pensions	Where services were performed that earned the pension
Sale of natural resources	Allocation based on fair market value of product at export terminal. For more information, see section 1.863-1(b) of the regulations.

\*Exceptions include:

- a) Dividends paid by a U.S. corporation are foreign source if the corporation elects the Puerto Rico economic activity credit or possessions tax credit.
- b) Part of a dividend paid by a foreign corporation is U.S. source if at least 25% of the corporation's gross income is effectively connected with a U.S. trade or business for the 3 tax years before the year in which the dividends are declared.