

HOW NON-U.S. RESIDENTS SAVE U.S. TAXES ON U.S. BROKERAGE ACCOUNTS



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Robert Green's content

- Mr. Green is a leading authority on trader tax.
- He is the author of [Green's 2018 Trader Tax Guide](#), which GreenTraderTax published as an annual tax guide every year since 1997. The 2018 edition discusses the Tax Cuts and Jobs Act's impact on investors, traders, and investment managers.
- Mr. Green has been a contributor to Forbes.com since 2010. Leading brokerage firms and other financial media feature Mr. Green's blog posts and Webinar content.

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Webinar description

- Many non-U.S. residents have U.S. brokerage accounts. The U.S. Treasury requires brokers to withhold U.S. taxes on non-U.S. residents on U.S. dividends and certain other types of U.S. passive or portfolio income. However, there is no withholding on capital gains, which are not taxable in the U.S. if the non-U.S. resident alien does not spend more than 183 days per year in the U.S.
- Join trader tax expert Robert A. Green, CPA, of GreenTraderTax as he explains how U.S. brokerage accounts work for non-U.S. residents, and ways to save U.S. income and estate taxes, using tax treaties, foreign tax credits, and other tax planning strategies including U.S. entities.

OVERVIEW

U.S. tax withholding on certain passive income

- In a U.S. or foreign brokerage account, non-U.S. resident individuals and foreign companies are subject to U.S. tax withholding on U.S. dividends and certain other U.S.-source passive or portfolio income.
- The default U.S. withholding tax rate on this passive/portfolio income is 30%.
- Income tax treaties between the U.S. and other countries provide for lower rates; on passive/portfolio income it's usually around 15% or less.
- Many non-U.S. residents are eligible for a foreign tax credit (FTC) for U.S. tax withholding on their home country tax return.

U.S. Form 1040-NR may not be required

- U.S. brokers handle tax withholding on passive/portfolio income and pay those taxes to the U.S Treasury (IRS).
- The U.S. broker reports this income and withholding to the IRS and non-U.S. residents on Form 1042-S.
- The non-U.S. resident does not have an obligation for filing a U.S. tax return (Form 1040-NR), if the tax liability of such person was fully satisfied by the withholding of U.S. tax at the source, and such person was not engaged in a trade or business in the U.S. at any time during the tax year.

File a Form 1040-NR if there is a tax refund

- A non-U.S. resident should consider filing a Form 1040-NR if they are due a tax refund.
- Such a condition could arise if the U.S. broker withheld the default 30% rate, but the taxpayer is entitled to a lower tax treaty rate.
- The non-U.S. resident might have overlooked claiming tax treaty benefits on the W-8BEN filed with the broker when opening the account.
- A broker is unable to request a refund of tax withholding already paid to the IRS, so the taxpayer should file a 1040-NR refund claim with the IRS.

Capital gains may be non-taxable

- The critical point is that capital gains are not taxable in the U.S. if the non-U.S. resident does not spend more than 183 days per year in the U.S.
- The 183-day rule applies to students, scholars, and employees of foreign governments if they intended to reside in the U.S. for longer than one year at the time of their arrival.
- U.S. brokers do not withhold taxes on capital gains transactions.

NON-U.S. RESIDENT U.S. WITHHOLDING TAXES ON U.S. BROKERAGE ACCOUNTS

U.S. tax withholding, tax forms W-8 and 1042-S, and FATCA.

Types of passive/portfolio income subject to withholding tax

- Non-U.S. residents are subject to U.S. tax withholding on dividends paid by U.S. companies, payments in lieu of dividends for U.S. companies, and other “fixed or determinable, annual, or periodic” (FDAP) income.
- Per [IRS Taxation of Nonresident Aliens](#): “FDAP income is passive income such as interest, dividends, rents or royalties.”
- Dividends paid by foreign companies are not subject to U.S. withholding.

Types of passive/portfolio income subject to withholding tax

- Mutual funds are generally subject to withholding on U.S. taxable dividend distributions, including short-term capital gain distributions, but not long-term capital gains distributions. (See “Income Subject To Withholding” in [IRS Publication 515](#) on page 23.)
- Interest income on bonds and commercial paper issued by U.S. companies, by the U.S. Treasury, and by U.S. government agencies is generally exempt from U.S. tax withholding, although it’s reportable on Form 1042-S.

Types of passive/portfolio income subject to withholding tax

- A commodity ETF, structured as a publicly traded partnership (PTP), might issue an annual Schedule K-1 tax statement to U.S. residents and non-U.S. residents.
- A partnership is a flow-through entity, and the Schedule K-1 might pass-through capital gains, which might be non-taxable for non-U.S. residents.
- The partnership is the withholding agent, not the U.S. broker.

Non-U.S. residents file a W-8 with a U.S. broker

- Non-U.S. resident individuals should fill out W-8BEN (Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding and Reporting – Individuals) and furnish it to their broker. Don't overlook Part II to claim tax treaty benefits.
- The broker then withholds taxes on U.S.-source dividends and other FDAP income at the appropriate tax treaty rates, or 30% if there is no tax treaty, and pays those taxes to the IRS directly.

Other W-8 forms

There are other types of [W-8 forms](#), including:

- W-8BEN-E (entities)
- W-8ECI (ECI from U.S. business)
- W-8EXP (foreign government or organization)
- W-8IMY (foreign intermediary or branch)

A U.S. broker issues a Form 1042-S to non-U.S. residents

- As a withholding agent, the U.S. broker is required to report all U.S.-source passive/portfolio income, and related taxes withheld, to the IRS and the client on [Form 1042-S](#) (Foreign Person's U.S. Source Income Subject to Withholding). (See Form 1042-S [instructions](#), [NRA Withholding](#), and [FDAP Income](#).)
- The U.S. broker issues a separate Form 1042-S for each category of passive/portfolio income.
- A U.S. resident receives a Form 1099-B instead of a Form 1042-S.

Form 1042-S		Foreign Person's U.S. Source Income Subject to Withholding		2018		OMB No. 1545-0096	
Department of the Treasury Internal Revenue Service		▶ Go to www.irs.gov/Form1042S for instructions and the latest information.		UNIQUE FORM IDENTIFIER		Copy A for Internal Revenue Service	
1 Income code		2 Gross income		3 Chapter indicator. Enter "3" or "4"		13e Recipient's U.S. TIN, if any	
		3a Exemption code		4a Exemption code		13f Ch. 3 status code	
		3b Tax rate		4b Tax rate		13g Ch. 4 status code	
5 Withholding allowance		13h Recipient's GIIN		13i Recipient's foreign tax identification number, if any		13j LOB code	
6 Net income		13k Recipient's account number		13l Recipient's date of birth (YYYYMMDD)			
7a Federal tax withheld		7b Check if federal tax withheld was not deposited with the IRS because escrow procedures were applied (see instructions)		14a Primary Withholding Agent's Name (if applicable)			
8 Tax withheld by other agents		9 Overwithheld tax repaid to recipient pursuant to adjustment procedures (see instructions)		14b Primary Withholding Agent's EIN		15 Check if pro-rata basis reporting	
10 Total withholding credit (combine boxes 7a, 8, and 9)		11 Tax paid by withholding agent (amounts not withheld) (see instructions)		15a Intermediary or flow-through entity's EIN, if any		15b Ch. 3 status code	
12a Withholding agent's EIN		12b Ch. 3 status code		12c Ch. 4 status code		15c Ch. 4 status code	
12d Withholding agent's name		12e Withholding agent's Global Intermediary Identification Number (GIIN)		15d Intermediary or flow-through entity's name		15e Intermediary or flow-through entity's GIIN	
12f Country code		12g Foreign taxpayer identification number, if any		15f Country code		15g Foreign tax identification number, if any	
12h Address (number and street)		12i City or town, state or province, country, ZIP or foreign postal code		15h Address (number and street)		15i City or town, state or province, country, ZIP or foreign postal code	
13a Recipient's name		13b Recipient's country code		16a Payer's name		16b Payer's TIN	
13c Address (number and street)		13d City or town, state or province, country, ZIP or foreign postal code		16c Payer's GIIN		16d Ch. 3 status code	
				16e Ch. 4 status code			
				17a State income tax withheld		17b Payer's state tax no.	
						17c Name of state	

For Privacy Act and Paperwork Reduction Act Notice, see instructions.

Cat. No. 11386R

Form 1042-S (2018)



FATCA reporting

- The IRS might report a non-U.S. resident's account activity to tax authorities in their home country under an information-sharing agreement under [FATCA](#) (Foreign Account Tax Compliance Act).

CAPITAL GAINS AND LOSSES

183-day rule

Capital gains 183-day rule

- If a non-U.S. resident spends more than 183 days in the U.S. in a given tax year, they owe taxes on net U.S. source capital gains, even though they may not trigger U.S. residency under the [substantial presence test](#).
- U.S. residency is triggered with lawfully permanent resident status or by meeting the substantial presence test. Lawfully permanent resident status includes U.S. citizenship, dual U.S. citizenship, or having a U.S. Permanent Resident Card (green card).
- If fewer than 183 days then capital gains are foreign source.

Students, scholars and employees of foreign governments

- “Nonresident alien students and scholars and alien employees of foreign governments and international organizations who, at the time of their arrival in the United States, intend to reside in the United States for longer than one year are subject to the 30 percent taxation on their capital gains during any tax year (usually calendar year) in which they are present in the United States for 183 days or more, unless a tax treaty provides for a lesser rate of taxation.”
- See [IRS The Taxation of Capital Gains of Nonresident Alien Students, Scholars and Employees of Foreign Governments](#)

A trading business is not ECI

Per TCJA [Joint Explanatory Statement](#) page 448:

- "Detailed rules govern whether trading in stocks or securities or commodities constitutes the conduct of a U.S. trade or business. [Sec. 864(b)(2)]
- A foreign person who trades in stock or securities or commodities in the United States through an independent agent generally is not treated as engaged in a U.S. trade or business if the foreign person does not have an office or other fixed place of business in the United States through which trades are carried out.

A trading business is not ECI

- A foreign person who trades stock or securities or commodities for the person's own account also generally is not considered to be engaged in a U.S. business so long as the foreign person is not a dealer in stock or securities or commodities."

INCOME TAX TREATIES

Treaties can often reduce or eliminate U.S. withholding tax.

Income tax treaties may provide tax relief

- The U.S. has income tax treaties with many foreign countries. For non-U.S. residents, these treaties can often reduce or eliminate U.S. tax on various types of personal services and other income, such as pensions, interest, dividends, royalties, and capital gains.
- Each income tax treaty must be reviewed to determine whether specific types of income are exempt from U.S. tax or taxed at a reduced rate. (Find more details in [IRS Publication 901, U.S. Tax Treaties](#).)
- Form 8833 (Treaty-Based Return Position Disclosure) does not apply to a reduced rate of withholding tax on non-effectively connected income, such as dividends, interest, rents or royalties.

Ask your broker for help

- Ask your U.S. broker what tax treaty rate applies to your U.S.-source income.
- Have them identify the types of income you expect to receive that are subject to withholding tax, the withholding rate that applies to each category, and income that is exempt from withholding.
- As a withholding agent, your broker should have these tax resources readily available to inform you.

FOREIGN TAX CREDITS

Non-U.S. residents might get credit for U.S. taxes withheld on their home country tax return.

Foreign tax credits

- Several countries, including the U.S., tax residents on worldwide income and allow residents a foreign tax credit (FTC) to avoid double taxation; paying tax on the same income to two countries.
- The taxpayer's effective tax rate is the higher of the tax rate in their home jurisdiction or the U.S. withholding tax rate.
- For example, if the home country tax rate is 35% and the U.S. rate is 30%, then the taxpayer gets an FTC on their home country tax return for the entire amount of U.S. tax withheld.

U.S. ESTATE TAX FOR A NON-U.S. RESIDENT DOMICILIARY

U.S. estate tax for a non-U.S. resident domiciliary

- For a non-U.S. resident domiciliary, if the fair market value (FMV) at death of the decedent's U.S.-situated assets exceeds \$60,000, there is a U.S. estate tax.
- The U.S. estate tax rate starts at 18% and rises to 40%.
- “A non-U.S. resident domiciliary is entitled to deductions for funeral and administrative expenses, debts allocated to the U.S. gross estate, donations to U.S. charities, and a marital deduction for property passing to a surviving spouse who is a U.S. citizen.” ([*The Tax Adviser*](#))

Non-U.S. resident domiciliary vs. U.S. resident domiciliary

- The 2017 Tax Cuts and Jobs Act (TCJA) raised the 2018 estate & gift exemption (limit) for a U.S. resident domiciliary to \$11,180,000 per person, and it's indexed for inflation each year.
- A U.S. resident domiciliary estate includes worldwide assets.
- TCJA and prior tax legislation did not increase the \$60,000 exemption for a non-U.S. resident domiciliary, and that limit is not indexed for inflation.

U.S.-situated assets for a non-U.S. resident domiciliary

- See IRS [Some Nonresidents with U.S. Assets Must File Estate Tax Returns](#):
- “Deceased nonresidents who were not American citizens are subject to U.S. estate taxation with respect to their U.S.-situated assets.
- U.S.-situated assets include American real estate, tangible personal property, and securities of U.S. companies.
- A nonresident’s stock holdings in American companies are subject to estate taxation even though the nonresident held the certificates abroad or registered the certificates in the name of a nominee.

U.S.-situated assets for a non-U.S. resident domiciliary

- Exceptions: Assets that are exempt from U.S. estate tax include securities that generate portfolio interest, bank accounts not used in connection with a trade or business in the U.S., and insurance proceeds.
- Estate tax treaties between the U.S. and other countries often provide more favorable tax treatment to nonresidents by limiting the type of asset considered situated in the U.S. and subject to U.S. estate taxation.”

U.S. estate & gift tax treaties

- See an IRS list of 15* [Estate & Gift Tax Treaties \(International\)](#).
- *The U.S.–Canada Income Tax Treaty includes estate tax provisions. Canadians have a \$2,000,000 U.S. estate exemption instead of the default \$60,000 threshold.
- U.S. estate tax treaties deal with domicile, the inclusion of the property in the estate, deductions, tax credits, exchange of information, and other definitions and administrative matters.

Residency rules vary for purposes of income tax vs. estate tax

- Residency rules vary for purposes of income tax vs. estate tax. The estate tax treaties consider residences, businesses, family connections, voting history, and more.
- “It is possible for a person to be domiciled (for U.S. estate tax) in the United States and not be considered a resident (for income tax). Also, it is possible for a person to be a resident in one place (United States) and have a domicile in another. For estate (transfer) tax purposes, a person is considered a nonresident alien domiciliary of the United States if that person has no intention of residing here.”
([The Tax Adviser](#))

U.S. estate proceedings

- U.S. brokers are not responsible for U.S. estate tax compliance.
- However, they require “estate tax clearance” before allowing withdrawals from a brokerage account belonging to a non-U.S. resident domiciliary.
-
- Consider a “will” to help with probate of the estate.
- Certain types of U.S. or foreign trusts or entity structures might be helpful, too.

U.S. estate proceedings

- See Charles Schwab's [U.S. Tax, and Estate Disclosure to Non-U.S. Persons](#): U.S. Estate Proceedings:
- “If title to the account is held in joint tenancy with another person, title will pass automatically to the surviving joint tenant (although tax clearance will still be required).
- If title to your account is in the name of a trust, disposition of the assets should be under the terms of the trust instrument.”

U.S. GIFT TAX FOR NON-U.S. RESIDENTS

Gift tax annual exclusions

- The 2018 gift tax annual exclusion is \$15,000 per gift recipient.
- The 2018 gift tax annual exclusion for gifts to a non-U.S. resident spouse is \$152,000.
- There is no marital deduction for gift tax purpose for property transferred to a non-U.S. resident spouse.
- Include gifts of property within three years of death in the estate at current FMV.

U.S.-situated assets

- For purposes of U.S. gift and estate tax, the IRS treats U.S.-situated assets differently for a non-U.S. resident.
- Gifts include transfers of cash on deposit in a U.S. bank, whereas, estates exclude it. (Non-bank deposits, such as cash accounts in U.S. brokerage firms, are likely to be subject to U.S. estate tax.)
- Estates include stock in a U.S. corporation, whereas, gifts exclude it.

U.S. ENTITY ACCOUNTS

Some non-U.S. residents open a U.S. entity account.

U.S. entity accounts for non-U.S. residents

- Some U.S. brokers might recommend forming a U.S. LLC entity to open a U.S. entity account instead of a non-U.S. resident or foreign entity account.
- The broker might treat this U.S. entity account like other U.S. entities, not subject to tax withholding on U.S. dividends and other passive and portfolio income.
- However, the non-U.S. resident owners of this U.S. entity do not avoid U.S. tax withholding on passive and portfolio income. The owners might get U.S. estate tax relief.

Forms W-9 and 1099-B

- To open a U.S. entity account, the broker requires a Form W-9 (Request for Taxpayer Identification Number and Certification).
- The U.S. broker should issue an annual Form 1099-B (Proceeds From Broker and Barter Exchange Transactions) to the U.S. LLC.
- The 1099-B reports dividends, interest, sale proceeds, and cost basis, and other items of income or loss to the IRS and the taxpayer.

Complications with a single-member LLC

- A single-member LLC (SMLLC) is a “disregarded entity,” which means the owner reports the activity on its tax return (i.e., an individual tax return).
- An SMLLC may consider a timely election to be taxed as an S-Corp or a C-Corp. The IRS does not permit non-U.S. residents to be an owner of an S-Corp. C-Corps are generally not attractive to traders, and it’s beyond the scope of this content. For an LLC to file a partnership return, it requires two or more members.

Complications with a single-member LLC

- If an SMLLC, owned by a non-U.S. resident, remains a disregarded entity, it should file a W-8BEN-E for foreign status.
- However, a U.S. broker might request a W-9 to treat the LLC as a U.S. entity. The U.S. broker won't do tax withholding, and it will issue an annual Form 1099-B.
- That leads to requiring a Form 1040-NR because the individual owner of the SMLLC owes taxes on U.S. dividends and other U.S. source passive and portfolio income since there was no withholding by the broker.

U.S. partnership tax return

- Consider a spousal-member LLC, which can file a U.S. partnership tax return (Form 1065). The LLC/partnership correctly submits a W-9, and the broker issues a 1099-B.
- The U.S. LLC/partnership takes over the role as tax withholding agent from the broker, and the U.S. partnership must issue the Form 1042-S to the non-U.S. resident owners of the LLC.
- Using a U.S. LLC/partnership does not avoid withholding taxes on U.S.-source passive/portfolio income for non-U.S. resident owners. It does prevent the need for a complicated Form 1040-NR.

Tax tips for preparing U.S. Form 1065

- The Form 1065 U.S. partnership tax return can be straightforward if all owners are non-U.S. residents.
- In that case, the partnership can report zero capital gains and losses but reconcile to the 1099-B for IRS matching purposes.
- In the tax return footnotes, the partnership should explain that the nonresident owners do not owe capital gains taxes if they are in the U.S. under 183 days per year.

LLC accounting and banking issues

- Usually, the partnership can allocate dividends and portfolio income to partners on the last day of the year, so tax deposits for withholding can wait until early January of the subsequent year.
- It's one accounting period, which reduces the stress of making tax payments on a timely basis to avoid penalties.
- There might be challenges to establishing an LLC bank account, and repatriating funds to a foreign country.

U.S. partnership is the agent for tax withholding

- “The Chapter 3 withholding regulations on U.S. source payments to foreign persons (by brokers) make clear that there is no U.S. withholding on payments to U.S. persons, which includes a partnership formed under U.S. law,” says tax attorney Roger D. Lorence.
- “The partnership is the withholding agent, and it is required to withhold on U.S. source dividends allocable to non-U.S. partners (nonresident aliens).”
- See IRS [Publication 515, Withholding of Tax on Nonresident Aliens and Foreign Entities](#).

U.S. estate tax considerations

- “The U.S. partnership is not engaged in a trade or business in the U.S. with effectively connected income (ECI). It’s an investor partnership with FDAP and a Section 864 exemption,” says NYC tax attorney Roger Lorence.

“Although not free from doubt, the better view is that it is not included in a U.S. estate of a nonresident alien owner.

- Intangible assets like partnership interests are situated where the owner resides and dies. Legal situs is where the owner is located on death.”

OTHER RESOURCES

Other resources

- Interactive Brokers: [Tax Information and Reporting for Non-US Persons & Entities](#), [Tax Reporting of Non-US Persons and Entities: Form 1042-S](#), and [U.S. Taxes and Reporting for Non-U.S. Clients](#) (YouTube video)
- Deloitte: [US estate and gift tax rules for resident and nonresident aliens](#)
- *The Tax Adviser*: [Advising Nonresidents and Recent U.S. Residents on Estate Tax Issues](#)
- Stroock: [U.S. Estate And Gift Taxation Of Nonresident Aliens](#)
- [Tax Cuts and Jobs Act](#) Joint Explanatory Statement (see pages 443-454)

CLOSING REMARKS, QUESTIONS & ANSWERS

Closing Remarks

- Thank you for attending this Webinar or watching the recording.
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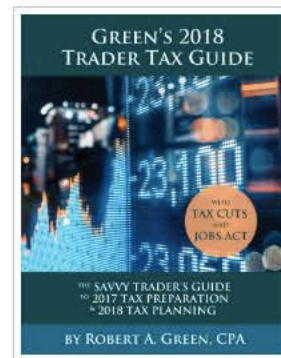
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