



# Internal Revenue Service

DEPARTMENT OF THE TREASURY

## LB&I International Practice Service Concept Unit

Shelf		Individual Inbound		
Volume	15	Withholding on Payments to Non-Resident Aliens	UIL Code	9422
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<b>Unit Name</b>	Overview of FDAP
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## General Overview

### Overview of FDAP

The United States (U.S.) generally taxes its citizens and resident aliens on their worldwide income without any regard to where the income is earned. By contrast, nonresident aliens (NRA) are taxed ordinarily only on their income earned or sourced in the U.S. For a NRA, U.S. source income falls into two main categories: 1) Fixed or Determinable, Annual or Periodical (FDAP) income, and 2) Effectively Connected Income (ECI). The U.S. taxes these two categories of income received by a NRA in two vastly different manners. FDAP income is income which is not effectively connected with a trade or business and it is taxed at a flat 30% rate (unless a lesser rate is available via income tax treaty or other allowable reductions). The 30% tax on FDAP income is on the gross amount and is not reduced by deductions and/or credits. Alternatively, ECI or trade or business income is taxed at the normal graduated tax rates and allowable deductions and/or credits are permitted. Therefore, it is imperative to identify the FDAP income received by a NRA to ensure it is taxed correctly. This International Practice Service (IPS) unit will identify the general types of FDAP income earned by NRAs.

Although not the focus of this IPS unit, it is important to note that the payment of the 30% tax on FDAP income is collected by withholding at the source, meaning the payor of the FDAP income is required to withhold and remit this tax to the Internal Revenue Service (IRS). Without such withholding, the IRS would usually have no practical recourse for collection of tax from the NRA if they have no trade or business in the U.S. when the income is paid. Additionally, in most instances, if a NRA has no ECI and realizes FDAP income which the tax was fully and properly withheld at the source, then the NRA is not required to file a U.S. tax return. If the withholding was not sufficient to cover the tax due, then the NRA would have to file a tax return and pay the remaining tax due on such income.

**Note:** See the Index of Related Issues/Topics for a list of IPS Practice Units that provide a closer look at different types of FDAP income, NRAs, sourcing of income, ECI, legal status, etc. on Slide 11.

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## Relevant Key Factors

### Overview of FDAP

#### Key Factors

There are several key considerations to evaluate as it applies to FDAP income, such as:

- The Tax Status of the Income Recipient
  - Individual must be a NRA.
- U.S. Sourced Income
  - U.S. asserts jurisdiction to tax NRA on his/her U.S. sourced income, therefore FDAP income received must be from sources within the U.S. to be taxed by the U.S.
- Income earned or received is FDAP and is Not Effectively Connected with a U.S. Trade or Business
  - Income received must be U.S.-source income which falls into certain categories which are classified as FDAP income.

**T Treaty Implications:** Treaty benefits exempt some forms of FDAP income and usually reduces the withholding tax rate from 30% to rates ranging from zero to 15% depending on the type of income and the terms of the specific treaty.

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## Detailed Explanation of the Concept

Overview of FDAP		
Analysis	Resources	6103 Protected Resources
<p>FDAP income normally includes income that is:</p> <ul style="list-style-type: none"> <li>▪ fixed or for which the amounts to be paid are known ahead of time;</li> <li>▪ is determinable or there is a basis for figuring the amount to be paid;</li> <li>▪ is annual or paid yearly;</li> <li>▪ or is periodic or paid from time to time not specifically in regular intervals, IRC § 871(a) .</li> </ul> <p>FDAP income is defined very broadly and generally includes all U.S. sourced income except gains derived from the sale of real or personal property and income specifically excluded from gross income such as tax-exempt interest and qualified scholarship income, see <a href="#">FDAP Income (IRS.gov)</a>; Internal Revenue Manual (IRM) 4.10.21.2(11); <i>Commissioner. v. Wodehouse</i>, 337 U.S. 369 for further information.</p> <p>Examples of types of income generally considered FDAP income include dividends, certain interest, original issue discount, pensions and annuities, alimony, rents, royalties, scholarships and fellowship grants, prizes, awards, purses for boxing, compensation for personal services, sales commissions paid monthly, commissions paid for a single transaction, distributable estate or trust non-ECI income, and distributed partnership non-ECI income as provided in Slide 6.</p>		

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## Detailed Explanation of the Concept (cont'd)

Overview of FDAP		
Analysis	Resources	6103 Protected Resources
<p>FDAP income generally includes all <b>non</b>-ECI U.S. sourced income (unless specifically noted) including:</p> <ul style="list-style-type: none"> <li>▪ Interest, dividends, rents, salaries, wages, premiums, annuities, compensations, gambling (other than excepted games), remunerations, emoluments, and other FDAP gains, profits, and income</li> <li>▪ Alimony</li>   <li>▪ Lottery winnings/Slot machine winnings</li>   <li>▪ Gains realized on the disposition of timber, coal or domestic iron ore, with a retained interest covered by IRC § 631(b)</li>   <li>▪ Realized income in the form of original issue discount, as defined in IRC § 871(g)</li> </ul>	<ul style="list-style-type: none"> <li>▪ IRC § 871(a)(1)(A),</li> <li>▪ Treas. Reg. §1.871-7(b),</li> <li>▪ Treas. Reg. §1.1441-2(b))</li>   <li>▪ Rev. Rul. 54-53, 1954-1 C.B. 156,</li> <li>▪ Rev. Rul. 65-283, 1965-2 C.B. 25,</li> <li>▪ <i>Lamm v. Commissioner</i>, T.C. Memo 1975-95</li>   <li>▪ <i>Barba v. U.S.</i>, 52 A.F.T.R. 2d 83-5272 (1983),</li> <li>▪ <i>Park v. Commissioner</i>, 136 T.C. 569 (2011)</li>   <li>▪ IRC § 871(a)(1)(B)</li> <li>▪ IRC § 631(b)</li>   <li>▪ IRC § 871(a)(1)(C)</li> <li>▪ IRC § 871(g)</li> </ul>	

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## Detailed Explanation of the Concept (cont'd)

Overview of FDAP		
Analysis	Resources	6103 Protected Resources
<p>FDAP income generally includes all <b>non</b>-ECI U.S. sourced income (unless specifically noted) including:</p> <ul style="list-style-type: none"> <li>▪ Gains from the sale of copyrights, patents and similar types of intellectual property where the payments are contingent on productivity, use, or disposition of the property</li> <li>▪ Capital gains from the sale of personal property by NRAs in the U.S. for 183 days or more during the taxable year <ul style="list-style-type: none"> <li>– The 183-day rule above is unrelated to the substantial presence test under IRC § 7701(b) and is applicable to certain “exempt individuals” whose presence in the U.S. in excess of 183 days will not classify them as a resident alien</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▪ IRC § 871(a)(1)(D)</li> <li>▪ IRC § 871(a)(2)</li> <li>▪ IRC 7701(b)(5)(B), (C) and (D)</li> </ul>	

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## Detailed Explanation of the Concept (cont'd)

Overview of FDAP		
Analysis	Resources	6103 Protected Resources
<p>There are several types of U.S. sourced income that are received by a NRA that are specifically identified as <b>NOT</b> FDAP, these include:</p> <ul style="list-style-type: none"> <li>▪ Effectively connected income (ECI) from a U.S. trade or business</li> <li>▪ Rental income treated as ECI via the election IRC § 871(d)</li> <li>▪ Most gains derived from the sale of personal property including market discount and option premiums</li> <li>▪ Gains derived from the sale of real property</li> <li>▪ Certain types of interest income: <ul style="list-style-type: none"> <li>– Portfolio Interest</li> <li>– Interest on deposits in U.S. financial institutions including insurance companies</li> <li>– Interest from an existing 80/20 company</li> </ul> </li> <li>▪ Certain types of dividend income: <ul style="list-style-type: none"> <li>– Dividends from an existing 80/20 company</li> <li>– Dividends from a foreign corporation if 75% or more of gross income is foreign sourced</li> </ul> </li> <li>▪ Certain Gambling winnings including blackjack, baccarat, craps, roulette and big-6 wheel</li> <li>▪ Annuities from a qualified annuity plan</li> </ul>	<ul style="list-style-type: none"> <li>▪ IRC §§ 871(a) &amp; (b), IRS.gov – ECI</li> <li>▪ IRC § 871(d)</li> <li>▪ Treas. Reg. § 1.871-10</li>   <li>▪ Treas. Reg. §1.1441-2(b))</li> <li>▪ IRC § 897</li>   <li>▪ IRC § 871(h)</li> <li>▪ IRC § 871(i)(2)(A)</li> <li>▪ IRC § 871(i)(2)(B)(ii)</li> <li>▪ IRC § 871(l)(1)(A)</li> <li>▪ IRC § 871(i)(2)(B)(i)</li> <li>▪ IRC § 871(i)(2)(D)</li> <li>▪ IRC § 871(j)</li> <li>▪ IRC § 871(f)(1)</li> </ul>	



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## Training and Additional Resources

Overview of FDAP		
Type of Resource	Description(s) and/or Instructions for Accessing	References
CENTRA sessions	<ul style="list-style-type: none"> <li>▪ FYE 12 IIC CPE – Withholding: A shallow dive on the three withholding regimes including IRC 1441, 1445 and 1446.</li> <li>▪</li> <li>▪ FYE 12 IIC CPE – Treaties &amp; Jurisdiction to Tax: A shallow dive into issues including but not limited to determining residency of individuals.</li> <li>▪ IIC Withholding</li> </ul>	<ul style="list-style-type: none"> <li>▪ IIC Withholding (DVP015868) 07/19/2012</li> <li>▪</li> <li>▪</li> <li>▪ IIC Treaties &amp; Jurisdiction to Tax (KSK446527) 07/17/2012</li> <li>▪ IIC Withholding (DVP015868)</li> </ul>
Other Training Materials	<ul style="list-style-type: none"> <li>▪ International Training OJT Workshops - Source of Income</li> </ul>	<ul style="list-style-type: none"> <li>▪ LMSB/IRS.gov</li> </ul>
White Papers / Guidance	<ul style="list-style-type: none"> <li>▪ Refer to IRM listed at right</li> </ul>	<ul style="list-style-type: none"> <li>▪ IRM 4.10.21, Examination of Returns, U.S. Withholding Agent Examinations – Forms 1042</li> </ul>

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## Glossary of Terms and Acronyms

Acronym	Definition
ECI	Effectively Connected Income
FDAP	Fixed or Determinable, Annual or Periodical
IPS	International Practice Service
IRM	Internal Revenue Manual
NRA	Nonresident Alien

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## Index of Related Issues

Issue	Associated UIL(s)	References
FDAP Overview	9424.01	TBD
FDAP income	9424.01	TBD
FDAP Payments - Portfolio Debt Exemption - Requirements and Exceptions	9424.01-01	IPS Unit – DCN: RPW/9424.01_01(2013)
Non-Services FDAP Income	9424.01-01	IPS Unit – DCN: RPW/9424.01_02(2013)
Determining Tax Residency Status of Lawful Permanent Residents	9431.01-02	IPS Unit – DCN: JTO/9431.01_02(2013)