CLASSIFYING & SOURCING PAYMENTS TO FOREIGN INDIVIDUALS

Presented By:
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Payroll Services
TODAY’S AGENDA

- **What** does Classifying & Sourcing mean?
- **Why** are Classifying & Sourcing important?
- **How** does Classifying & Sourcing relate to income for NRA?
- **Review** of various payment categories
  - Define and describe each payment
  - Source the income
  - Appropriate payment Venue
  - Documentation for each payment
What does Classifying & Sourcing Mean?

Merriam-Webster DEFINITIONS:

**Classify:**
- to assign to a category

**Source:**
- a point of origin or procurement
Why are Classifying & Sourcing Important?

Classify
- It is the basis in which income is taxed

Source
- A NRA for tax purposes is subject to U.S. tax on **U.S. sourced income**
We **Classify** payments because:

**ALL payments are considered taxable** unless excluded by law:

1. Foreign Sourced  
2. Internal Revenue Code  
3. Income Tax Treaty

3 ways to exclude income from taxes
## Various Payments UC Pays to NRA

<table>
<thead>
<tr>
<th>SERVICE</th>
<th>NON SERVICE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Compensation</td>
<td>Travel</td>
</tr>
<tr>
<td>– Wages, Salaries</td>
<td>– Pensions</td>
</tr>
<tr>
<td>– Benefits (Fringe/Health)</td>
<td>– Prizes</td>
</tr>
<tr>
<td>Awards</td>
<td>– Awards</td>
</tr>
<tr>
<td>– Prize</td>
<td>– Reimbursements</td>
</tr>
<tr>
<td>Fellowship/Scholarship</td>
<td>– Royalties</td>
</tr>
<tr>
<td>– Service portion of F/S</td>
<td>– F/S</td>
</tr>
<tr>
<td>Stipend</td>
<td>– Visa Fees</td>
</tr>
<tr>
<td>Lecture Fee</td>
<td>– Rents</td>
</tr>
<tr>
<td></td>
<td>– Honorarium</td>
</tr>
</tbody>
</table>
## Summary of Sourcing Rules for Income

<table>
<thead>
<tr>
<th>TYPE of INCOME</th>
<th>SOURCE DETERMINED by</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pay for personal services</td>
<td>Where services are performed</td>
</tr>
<tr>
<td>Business Income:</td>
<td></td>
</tr>
<tr>
<td>Sale of inventory - purchased</td>
<td>Where Sold</td>
</tr>
<tr>
<td>Sale of inventory - produced</td>
<td>Allocation</td>
</tr>
<tr>
<td>Dividends</td>
<td>Type of corporation (U.S. or foreign)</td>
</tr>
<tr>
<td>Interest</td>
<td>Residence of payer</td>
</tr>
<tr>
<td>Rents</td>
<td>Where property is located</td>
</tr>
<tr>
<td>Royalties - Patents, Copyrights, Etc.</td>
<td>Where property is used</td>
</tr>
<tr>
<td>Royalties - Natural resources</td>
<td>Where property is located</td>
</tr>
<tr>
<td>Pension due to personal services performed</td>
<td>Where services were performed while a nonresident alien</td>
</tr>
<tr>
<td>Scholarships and fellowship grants</td>
<td>Generally, residence of payer</td>
</tr>
</tbody>
</table>

For more information and exceptions to the above rules, refer to IRS Publication 515
REVIEW OF VARIOUS PAYMENTS

- Employment
- Independent Personal Services
- Scholarship/Fellowship
- Prize and Awards
- Royalties
- Reimbursements
- Pensions
FOR EMPLOYMENT
EMPLOYMENT DEFINITIONS

- **Employee** - A person who is hired by another person or business for a wage, fixed payment, or consideration in kind in exchange for personal services and who does not provide the services as part of an independent business.

- **Employer** – someone who can control what will be done and how it will be done.

- **Remuneration** - payment for services that an individual performs or carries out
  - Postdoc benefits
  - Cars/Lease
CLASSIFYING EMPLOYMENT AS INCOME

- Wages, Salaries
- Commissions
- Fees
- Tips
- Insurance - Benefits
- Allowances and Reimbursements
- Fringe Benefits
- Back pay Awards
- Bonuses and Awards
- Death Benefits
- Settlements
• **Sec. 872(b)(3)** - Compensation paid by a foreign employer to a nonresident alien individual

• **Sec. 893** - Compensation of employees of foreign governments or international organizations (Diplomats)

• **Sec. 125** - Cafeteria Plans

• **Sec. 162** – Ordinary Business Expenses

* applies to wage payments
IRS SEC. 125

CAFETERIA PLAN

• No amount shall be included in the gross income of a participant in a cafeteria plan.

• This allows the employer contributions for health, dental, and vision benefits to be excluded from gross income.

*Exception includes Post-Doctoral Scholars (3253 and 3254)
IRS Federal Income

Tax Treaty Exclusion

An agreement between the U.S. and another country that allows either a reduced rate of withholdings or exemption from federal tax withholding.

Tax treaties for wages recognized at UCLA are
- Employment - Income Code 18
- Student Employment – Income Code 19
WAGE PAYMENTS AT UCLA

Personnel Payroll System (PPS) -
Wage payments are recorded and paid through PPS at UCLA, UC Merced, and UCOP.

Employee/Employer Relationship -
Departments *may only enter* individuals on the PPS whose relationship with the University has been determined to be employee/employer* in nature.

*This includes without salary appointments
Only the following categories should be entered on PPS as Without Salary (Functioning like an employee but WOS)

- **Emeritus Status** – approved by the Chancellor’s Office
- **Clinicians** - offers services in exchange for the UCLA’s labs, etc.
- **Visiting Titles** - approved by Academic Personnel
- **Post Doc Titles** – DOS code = PDW
  - 3253 – Post Doc Fellow Recipient
  - 3254 – Post Doc Paid Direct
- **Affiliates**: Orthopedic Hospital, Ceres, Inc., Martin L. King, Jr CRD Medical Center, Harbor UCLA Research and Education Martin L. King Drew Hospital (MLK), Cedars Sinai Medical Center, Los Angeles Biomedical Institute, Oliveview Hospital.

Volunteers Should not be entered In PPS
Employment vs. Non-Employment

IRS assumes that all payments made for services are to employees.

Departments are responsible for defining the work individuals will be paid for and properly classifying them as employees or independent contractors.

Departments are required to apply guidelines from Business and Finance Bulletin 77 in order to make a correct determination.
California Senate Bill 1467

- Applies state agency conflict of interest guidelines and penalties to UC
- Prohibits Current UC Employees to be paid as an Independent Contractor
- Restricts Former UC Employees being hired as an Independent Contractor
SOURCING WAGES - EMPLOYEES

Payments for personal services are sourced by the *location of the activity*

- **US Sourced Income** - Wages and other compensation for services *performed* in the *United States* are considered to be from sources in the United States.
- **CA Sourced Income** – Wages paid to an NRA while in California is considered CA sourced.
- **Foreign Sourced Income** - Wages and other compensation for services performed OUTSIDE the *United States* are considered to be *foreign sourced*.
Independent Personal Services
Business & Finance Bulletin 77
Independent Contractor Guidelines

- Guidelines to assist departments in classifying an individual’s status as it relates to employment. Includes an independent pre-hire worksheet.

- It is assumed that a department is applying the principals of Bus. 77 every time a non-employment payment is made. Payments over $5,000.00 must complete an independent pre-hire worksheet.

Web site: www.ucop.edu/ucophome/policies/bfb
Types of Non-Employee Payments to NRA’s
Tax Definitions

- **Honorarium** - an award granted in recognition of a special service or distinguished achievement. It is not pre-determined. It is a gift. (object code 7900)

- **Lecture fee** - a payment for a one time lecture or a series of lectures that occur in a span of two weeks or less. (Object code 3345)

- **Performance fee** - is made to an individual or group for professional services not directly related to an academic function. (object code 3307)

- **Royalty** - a payment made for the use of property, especially a patent or copyrighted work. (object code 3480 – UC Press only)

- **Consulting Fee** - a fee to one who gives professional advice or services generally considered an expert in their field (object code 3455)

**Other non employee payments include:**
Awards, Prizes, Fellowship/Scholarship, Death Payments, Travel Reimbursements and Visa Fees.
Sourcing Payment - Payments for personal service are sourced by location of activity

**Foreign Sourced**

- **California**: Amounts paid to a nonresident of CA for services performed outside of CA are not “California sourced”
- **Federal**: Amounts paid to a nonresident for services performed outside of U.S. are “foreign sourced”. They are not subject to taxation or reporting

**U.S. Sourced**

- **Federal**: Amounts paid to a nonresident for services performed in the U.S. are U.S. sourced and subject to taxation
- **California**: Amounts paid to a nonresident of CA for services performed in CA are “California sourced”

Please note that an independent contractor is paid for **TOTAL work** (which includes preparation).
An agreement between the U.S. and another country that allows for a reduced rate or an exemption of federal tax withholding.

Recognized Tax treaties for non-employee payments at UCLA include:

- Independent and Personnel Services Income Code 16
Prizes and Awards
Prizes and Awards ~

Two Categories

1. Prizes which are in the nature of a Scholarship/Fellowship (S/F). Funds are to be used to defray the expenses of study, training or research.

2. Prizes not in the nature of a S/F. Funds are given as recognition for a special achievement, special skill/knowledge or an award won in a contest. These can be either Employee, or Non-Employee based awards.
Prizes and Awards ~

WHICH SYSTEM PROCESSES THE PRIZE OR AWARD?

1. Scholarship/Fellowship Awards:

An award that is intended to help defray the cost of education, and does not require services is classified as a Scholarship or Fellowship award, and is processed through the student Billing and Accounts Receivable System (BAR).
Prizes and Awards ~

WHICH SYSTEM PROCESSES THE PRIZE OR AWARD?

2a. Employee Prize/Award Payments

Awards based upon achievement as an employee are considered to be employment based income, and are processed through the Personnel Payroll System (PPS). This includes student awards which are based upon achievement while functioning as an employee.
Prizes and Awards ~

WHICH SYSTEM PROCESSES THE PRIZE OR AWARD?

2b. Non-Employee Cash Prize/Award
Prizes and Awards which are based upon a past achievement unrelated to employment and not intended to defray the cost of education. Non-Employee Cash Prize/Award payments are processed through the BruinBuy system.
SOURCING INCOME

Prizes and Awards

The sourcing rules for prize/award payments depend on the type of award being issued:

- **Fellowship/Scholarship** awards are sourced based upon both the location of the payor and the activity (see Fellowship/Scholarship sourcing rules).
- **Employee** based awards are sourced based upon the location of the activity that had merited the award.
- **Non-Employee** Cash Prize/Awards are sourced based upon where the location of the payor.
Prizes and Awards ~

**TAX TREATY EXCLUSION**

Dependent upon the country that the recipient is from and the article from the country’s treaty, as well as the income classification based upon the type of award.
Scholarship/Fellowship
DEFINITION

For tax purposes, a scholarship or fellowship may be defined as any amount paid to an individual "for the purpose of aiding his study, training, or research", and which does not represent compensation for personal services.
MOST SCHOLARSHIP/FELLOWSHIP PAYMENTS AT UCLA

1) Are paid through the Billing Account Receivable System
2) Some are paid through Bruin Buy because the recipient is not a student or PostDoc of UCLA
Scholarship/Fellowship ~

THE AWARD CAN BE MADE UP OF:

- Compensation (Payroll)
  - Requires a service to receive
- Qualified Award (BAR)
  - Books, tuition, and required fees
- Non-Qualified Award
  - Living expenses, travel grant

F/S can have more than one of the listed components
Joe Bruin receives an award of $30,000.

<table>
<thead>
<tr>
<th>Description of Award</th>
<th>Payment classification</th>
<th>Breakdown of income</th>
</tr>
</thead>
<tbody>
<tr>
<td>The award requires Joe to work in the lab 10 hours per week for 2 years. The value is $10,000</td>
<td>Compensation-Employment</td>
<td>$10,000 on a W-2 (reported on W-2)</td>
</tr>
<tr>
<td>$15,000 for tuition, books, and required fees</td>
<td>Qualified Award Scholarship/Fellowship</td>
<td>0 excluded</td>
</tr>
<tr>
<td>$5,000 for living expenses or stipend</td>
<td>Unqualified Award Scholarship/Fellowship</td>
<td>$5000 on a 1042s</td>
</tr>
</tbody>
</table>
Scholarships/Fellowships～

Income in the form of a scholarship or fellowship is treated in one of three ways:

1. **EXCLUDABLE** under the Internal Revenue Code (this is called the Section 117 exclusion)

2. **EXEMPT** by treaty (must file Form W-8BEN with the educational institution)

3. **TAXABLE** (14%-30% depending on visa status)
Scholarships/Fellowships~

**IRC Sec. 117: Scholarships**

Gross income does not include any amount received as a qualified scholarship by an individual who is a candidate for a degree at an educational organization
Scholarships/Fellowships~

SOURCING

• Scholarships, fellowship grants, grants, prizes, and awards are sourced by the residence of the source of the payment.
• Scholarships, fellowship grants, and awards paid to a nonresident alien for activities performed outside the U. S. is foreign sourced.

Further explanation:
1. Payments for research or study in the U S made a U. S. organization are U.S. sourced.
2. Payments from a foreign government or foreign corporation are foreign sourced payments even though the funds may be disbursed through a U.S. agent.
### SOURCING cont.

<table>
<thead>
<tr>
<th>Type of Income</th>
<th>Location of Activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Compensation</td>
<td>U.S. Sourced</td>
</tr>
<tr>
<td>Scholarship Fellowship</td>
<td>U.S. Sourced*</td>
</tr>
<tr>
<td></td>
<td>Foreign Sourced</td>
</tr>
</tbody>
</table>

Exclusion #1
Royalties
Royalties ~

**DEFINITION**

A payment for the right to use or the privilege of using, in the United States, an intangible property such as patents, copyrights, secret processes/formulas, goodwill, trademarks, franchises, and similar property.
Royalties

A royalty payment is sourced by it’s type:
1. For use of natural resource it is where the property is located.
2. For use of copyright, etc. it is where the property is used.

Royalties are payments for the use of, or for the privilege of using, in the United States, intangible property such as patents, copyrights, secret processes and formulas, goodwill, trademarks, franchises, and similar property.
TAX TREATY EXCLUSION

Industrial royalties (Income Code 10)
Copyright Royalties (Income Code 12)

Under certain tax treaties, different rates may apply to royalties for information concerning industrial, commercial, and scientific expertise.
Royalty payments are always paid through Accounts Payable - Bruin Buy System.
Reimbursements ~

**DEFINITION**

To pay back or compensate (another party) for money spent or losses incurred.
Reimbursements are created in Express and then processed by the Bruin Buy system.
SOURCING OF INCOME

Generally not required if payment meets the conditions under the accountable plan rule.
Types of Reimbursable Expense per UC Policy

- Travel Expense
  - Business and Finance G28
  - Express

- Relocation Expense
  - Business and Finance G13
  - Payroll
  - Bruin Buy

- Visa Fees
Reimbursements of Travel Expense

Exclusion From Income

Payments made to the purpose of defraying or reimbursing the deductible travel and lodging expenses of such nonresident alien individuals are excludible from the gross income of such nonresident alien individuals and are not reportable to the IRS by the payers of such payments, on the condition that the requirements of the accountable plan rules are met.

The requirements of the accountable plan rules are found in Treasury Regulation 1.62-2.
ACCOUNTABLE PLAN RULE

Requirement of Payee

1. Establish:
   • the business purpose and
   • connection of the expenses;

2. Substantiate the expenses claimed to the payer within a reasonable period of time; and

3. Return any amounts to the payer which are over and above the substantiated business expenses within a reasonable period of time.
Reimbursement of Relocation Expenses

- **Recruitment** - Not Taxable. Paid through Express
- **House hunting** – All taxable. Paid through EDB
- **Moving of household goods** - Travel
- **Travel to New Job** –
  - Transportation cost - Not Taxable. Paid through Express
  - Lodging - Not Taxable. Paid through Express
  - Meals – All taxable. Paid through EDB
- **Temporary Living Expense**
  - All Taxable. Goes Through P/R as MOV
Reimbursement of Visa Fees

If the foreign nationals employment is vital to further the University’s mission; then visa fees may be reimbursable.

- Alpha type visas - not taxable income and the fee is paid through Accounts Payable.
- Permanent Resident – may be taxable. Depends on what the employee does for UCLA
Pensions
Regular payments made to retired people and to some widows and disabled people, either by the state or from an investment fund.
Pensions ~

SOURCING

A pension earned for services performed in the United States is U.S. sourced income.

A pension earned for services performed outside the United States is Foreign Sourced.
Pensions Payments are administered and paid by UCOP and Fidelity.
Congratulations!

You made it to the end of class!

You are now an expert on the different types of payments made to nonresident alien and the particular rules for each of those payments.