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Tax Treaties and Special Considerations for Unemployment Income, Foreign Students, and Academic Employees

Inna Ostrovsky
San Jose State University

Tax Enlightenment: Tax Treaties and Special Considerations for Unemployment Income, Foreign Students, and Academic Employees

-Inna Ostrovsky, *MST Student*

Overview of Tax Treaties

When two countries impose taxes on the same earnings, capital, investments or other forms of wealth, double taxation occurs. It is usually the country of a taxpayer's residence and the country of the income source that claim the rights to tax the same income. To make the international tax system harmonized, many countries have adopted bilateral tax treaties – the agreements between two countries that define the rights and rules on taxation in such situations. Treaties can potentially supersede domestic law, and the US Constitution calls them "the supreme law of the land".[1] Section §7852(d) equalizes treaties and the Code while Section §894(a) states that application of the Code should always consider treaty obligations. Based on non-statutory law, with some exceptions, if there is a conflict between the regular U.S. domestic applicable law and the tax treaty, the one that was enacted on the same issue most recently is the applicable law in play for the transaction.[2]

Tax treaties play an important role for international trade and commerce and generally benefit both sides: taxpayers and countries.[3] First, they often allow companies to avoid double taxation and minimize their tax expense. Treaties are a powerful tool for countries trying to increase the inflow of investments by promoting a more favorable tax structure. Knowing that a country's withholding tax or the double-taxation effect will be eliminated by applying a treaty, companies are more interested in expanding their businesses in the countries with favorable tax treaties. Tax treaties are also applicable to individuals. They may provide significant benefits by implementing a lower tax rate or eliminating taxes or fees completely to residents of other countries. Also, in the absence of treaties, traveling could become very problematic and disadvantageous for individuals and devastating for tourism-oriented countries. For example, anticipating complexity and double-taxation effect in one country, travelers would choose the destinations with tax treaties, and this would impact the economy of the countries that heavily rely on tourism but have no tax treaties.

Although the general benefits and purpose of tax treaties are clear, there might be some nuances under which treaties are not helpful for tax reduction or elimination of the double-taxation problem. An example of this is unemployment income of a nonresident alien under the United States-Canada tax treaty. Under this treaty there is no section that specifically mentions this type of income. In a recent case of *Guo v. Commissioner*, which is discussed in more detail

[1] US Constitution, Article VI, § 2.

[2] Reid v Covert, 354 US 1 (1954), 77 S Ct 1222.

[3] Herzfeld, Mindy, Doernberg, Richard L., International Taxation in a Nutshell (West Academic Publishing 11th, 2018), 128.

later, the court held that unemployment benefits were taxable in the United States by a Canadian citizen.[4] On the other hand, students' income, awards, and benefits are generally, non-taxable in the United States. The purpose of this article is to explore the treatment of the unemployment income and the income received by students or professors under the U.S. treaties with Canada, China, France, India, Russia and U.K.

Unemployment Income Under U.S. – Canada Treaty

In *Guo*, Pei Fang Guo, a Canadian citizen, came to the United States in 2010 to work at the University of Cincinnati, Ohio, as a post-doctoral fellow. Her employment with the university ended in November 2011, and not being able to find another job, she returned to Canada. In 2012, she applied for and received unemployment compensation from the state of Ohio. For 2012, she filed tax returns in both Canada and the United States but paid no taxes on the unemployment income that she received (while reported on her Canadian tax return, after applicable deductions and credits and no tax was ultimately due). Guo claimed that she owed no taxes to the United States on this income because Article XV[5] of the U.S. – Canada tax treaty applied, but the IRS disagreed by stating that in her situation Article XXII[6] of the treaty should apply instead.

Article XV covers wages, salaries, and other remuneration related to an employment earned by a resident. According to this article, only Canada can tax the Guo's income if she, a resident of Canada, earned income in Canada. However, if Guo earned income in the United States, the article grants the United States the right to tax it as well. Under the paragraph 2, only Canada can tax the income if it was less than $10,000 or if Guo was not physically present in the United States for more than 183 days or her employer was not a U.S. resident. Article XXII covers the types of income not covered by other articles of that convention. It states that income earned by a resident of one country in another country may be taxed by both jurisdictions.

The court determined that Article XV did not apply to Guo since her income was not wages or any type of remuneration associated with employment. However, even if it was such remuneration, Article XV directly gives the right to the United States to tax it because the employment occurred in the United States, the amount was greater than $10,000 and her employer was a U.S. resident. The court further agreed with the Commissioner that Article XXII should be used rather than XV.

This case shows what has to be considered when a resident of another country claims unemployment benefits earned from the United States. A person can become qualified for such income in the United States but then leaves the country and receives that income outside of the country. It is important to remember that not being physically present in the United States does not eliminate the obligation to pay taxes on the income generated in the United States. In addition, the type of income should be taken into consideration as treaties do not apply universally on all types of income. In *Guo*, the court determined that unemployment income

[4] Guo v. Commissioner, 149 T.C. No. 14 (2017).
[5] United States – Canada Income Tax Convention, Article XV Dependent Personal Services (August 16, 1984).
[6] United States – Canada Income Tax Convention, Article XXII Other Income (August 16, 1984).

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should be treated under the "Other Income" article rather than as salary or wages. Finally, in some cases the residency status of employer may play a determining role. Generally, employers who are U.S residents generate U.S source income that is taxable in the United States.

Unemployment Income Under Other U.S. Treaties

As is the case in the U.S. - Canada convention, unemployment income is also not specifically mentioned in the U.S. treaties with China[7], France[8], India[9], Russia[10], and the United Kingdom.[11] The U.S. Model Income Tax Convention that was developed in 2006 also does not cover it. However, the court in *Guo* determined that unemployment income was covered under the "Other Income" article (Article XXII) of the treaty. Thus, determining the correct treatment of this type of income under other treaties means to examine the article describing the "Other Income" category.

Although the wording of "Other Income" articles is very similar in the treaties mentioned above, they differ in one point. Some of the treaties only allow one country to tax income this income, and other treaties also give the right to tax it in a second country. In particular, as in the U.S. – Canada treaty, Article 23 of the U.S. – India treaty states that any income not covered in other articles "shall be taxable only in that Contracting State" but when "arising in the other Contracting State may also be taxed in that other State".[12] Thus, if a resident of India earns unemployment income in the United States, then the treaty directly allows not only India but also the United States to tax this income. On the other hand, according to the treaties between the U.S. and China, France, Russia or the United Kingdom, only taxpayer's country of residency may tax unemployment income generated in the United States.

To summarize, unemployment income can be either taxable by two countries or only by the country of residence. For instance, if taxpayer is a resident of China, France, Russia or U.K., only these countries have the right to tax unemployment income earned from the United States. On the other hand, residents of India and Canada should remember that both the country of residence and the United States have the right to tax their unemployment income that arose in the United States.

Treaty for Students and Professors

[7] United States – The People's Republic of China Income Tax Convention (January 1, 1987).
[8] Convention Between the Government of the United States of America and the Government of the French Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital (January 1, 1996).
[9] Tax Convention with the Republic of India (January 1, 1991).
[10] Income Tax Convention with the Russian Federation (January 1, 1994).
[11] Convention between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital Gains (July 24, 2001).
[12] Tax Convention with the Republic of India, Article 23 (January 1, 1991).

In *Guo*, the taxpayer was a post-doctoral fellow who received an unemployment income from the state of Ohio. However, if she had received income for being a student, teacher, researcher, or professor that would have turned her case in a different direction. The reason for that is that students, professors and teachers who receive a specific type of income generally have special favorable treatment in treaties. As mentioned earlier, the rules in the U.S. treaties with Canada, China, France, India, Russia, and U.K are comparable with minor variations.

The treaty between the United States and Canada, for example, does not mention teachers and professors directly.[13] In fact, a teacher is treated as any other person, and his income would be considered as either an independent (under Article XIV) or a dependent personal service (under Article XV).[14] According to these rules, the income from providing services and employment income can be taxed by both countries. Visiting students have a special status under Article XX. The income they receive from outside the country of their education is tax-exempt with no limit on number of years or the amount of income.

In contrast, the U.S. treaty with China contains a special provision for teachers, researchers and professors (Article 19). In it, a resident of either country who is temporarily present in another country for the purpose of "teaching, giving lectures or conducting research at a university, college, school" has tax-exempt status for three years. In other words, if a resident of China comes to the United States to work as a university professor, the income from teaching would not be taxable in the United States for a period of no more than three years. Moreover, under Article 20 of this treaty, students also receive a favorable status. According to the Article, a person who is in another country "for the purpose of his education, training or obtaining special technical experience" and who receives grants or awards from the government or any payments supporting his education or research is exempt from tax in the country of education. Additionally, students may claim up to $5,000 (or its equivalent amount in the Chinese yuan) of tax-exempt employment income. For instance, if a resident of China studies in the United States and receives a stipend from China, this income is non-taxable in the United States. Additionally, if that student works in the United States, then he may claim up to $5,000 of tax-exempt income under the treaty.

The U.S. treaty with France is very similar to the treaty with China. Here, the rules for teachers and researchers are also described in a separate article (Article 20). Under this Article, a resident of one country who is present in another country for the purpose of "teaching and engaging in research, or both" may claim an exemption from taxable income for teaching or research at a qualified institution in the non-resident country for the period of no more than two years. Important to note that under the French treaty, each person may claim this benefit only once. Under Article 21 "Students and Trainees," students' income that is intended to support their studies is tax-exempt for a "reasonable period" of time required to complete the education or

[13]Treasury Department Technical Explanation of the Convention between the United States of America and Canada with Respect to Taxes on Income and on Capital Signed at Washington, D.C. on September 26, 1980, as Amended by the Protocol Singed at Ottawa on June 14, 1983 and the Protocol Singed at Washington on March 28, 1984, Article XX Students, §2 (January 1, 1985).
[14]Independent Personal Services include the work performed as an independent specialist and not as an employee (for example, a doctor, a CPA, or a contractor). Dependent personal services include services performed as an employee.

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training, but not more than five years. As in the treaty with China, $5,000 of income from personal services is tax-exempt.

In the U.S. – India Treaty, Article 22 "Payments Received by Professors, Teachers and Research Scholars" grants teachers and professors a tax-exempt status for two years. Article 21 says that students or business apprentice who study in another country are exempt from tax for a period of time reasonable to complete their study. However, the second paragraph also entitles the students to all existing tax benefits and deductions as available to its residents.

In the U.S.-Russia treaty, provisions related to teachers, professors, and students is very similar to the law of the U.S. - Canada treaty. Specifically, the treaty does not contain a provision of a tax-exempt status for visiting teachers and professors (although a previous version from 1973 contained it[15]). Visiting students, trainees and researchers, on the other hand, obtain a favorable status in Article 17 for a reasonable period of time to complete the course of study, but not exceeding five years.

Finally, the latest version of the U.S. treaty with the United Kingdom from 2001 and its provision for students is stricter than its previous version.[16] For instance, Article 20 "Students", says that full-time students' income that arose outside the country of education is tax-exempt for a period not exceeding one year. The new treaty also eliminates the provision for visiting teachers and professors completely, thus, treating them as any other person under Article 14 "Income from Employment."

The comparison of these six treaties shows that the rules for visitors of the United States may be different depending on the country of residency of these visitors. The completed assessment of the rules for teachers, students, and professors shows that the most generous treaties, such as with China, France and India, provide the exemption status to both - students and professors. The treaties with Canada, Russia and U.K. are less generous as they do not grant a favorable status to professors and teachers but concede for students with specific limitations. Thus, for these categories of visitors in the U.S., the original place of residence matters.

CONCLUSION

The purpose of this article is to familiarize a reader with the general concepts of tax treaty. In regard to U.S. tax treaties, there are many beneficial provisions for students and professors who come to the United States from Canada, China, France, India, Russia or U.K. The article considers the *Guo* court case in analyzing a treaty. There are also many provisions applicable to students and professors in the U.S. in its bilateral treaties with Canada, China, France, India, Russia, and the United Kingdom. Although treaties are comparable in many aspects and approaches to

[15]Income Tax Convention with the Russian Federation, pg. 3 (January 1, 1994).

[16]Department of the Treasury Technical Explanation of the Convestion Between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital Gains, pg. 120 (2001).

eliminate double taxation for taxpayers, it is not rare to have differences among treaties with different countries.

Applying the found similarities and differences to the *Guo* case, it might be concluded that if Guo, a post-doctoral fellow, was a resident of China, France, Russia or the United Kingdom, her unemployment income would have been taxed only in the country of her residence. On the other hand, if she was from India, the unemployment income would have been taxable in the United States as well. If she worked as a professor from China, France or India, her employment income would have been tax-exempt for two to three years, but she wouldn't have been able to claim an exemption if she was a professor from Canada, Russia or U.K. And, finally, if she was a student from any of the examined countries, Guo's income for studying would have been tax-exempt for a period from one to five years. As demonstrated above, tax treaties are complex in application and require special considerations in regard to taxpayer's country of residence, income source, duration of temporary residence, and type of income. With all these variables, the effect of tax treaty may be different, so taxpayers considering applying a specific treaty should check on all the factors that may affect the result of applying the treaty.

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