

# Publication 515

## Withholding of Tax on Nonresident Aliens and Foreign Entities

For use in preparing

**2025** Returns

Volume 4 of 7



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**Scholarships, fellowships, and grants.**

Scholarships, fellowships, and grants are sourced according to the residence of the payer. Those made by entities created or domiciled in the United States are generally treated as income from sources within the United States. However, see *Activities outside the United States* next. Those made by entities created or domiciled in a foreign country are treated as income from foreign sources.

***Activities outside the United States.*** A scholarship, fellowship, grant, targeted grant, or an achievement award received by a nonresident alien for activities conducted outside the United States is treated as foreign source income.

**Pension payments.** The source of pension payments is determined by the part of the distribution that constitutes the compensation element (employer contributions)

and the part that constitutes the earnings element (the investment income).

The compensation element is sourced the same as compensation from the performance of personal services. The part attributable to services performed in the United States is U.S. source income, and the part attributable to services performed outside the United States is foreign source income.

Employer contributions to a defined benefit plan covering more than one individual are not made for the benefit of a specific participant, but are made based on the total liabilities to all participants. All funds held under the plan are available to provide benefits to any participant. If the payment is from such a plan, you can use the method in Revenue Procedure 2004-37, 2004-26 I.R.B. 1099, available at [IRS.gov/irb/2004-26\\_IRB#RP-2004-37](https://www.irs.gov/irb/2004-26_IRB#RP-2004-37), to allocate the payment to sources within and without the United States.

The earnings part of a pension payment is U.S. source income if the trust is a U.S. trust.

Chart B. **Summary of Source Rules for FDAP Income**

<b>IF you have...</b>	<b>THEN the source of that income is determined by...</b>
pay for personal services	where the services are performed.
dividends	the type of corporation (U.S. or foreign).
interest	the residence of the payer.
rents	where the property is located.
royalties—patents, copyrights, etc.	where the property is used.

royalties—natural resources	where the property is located.
pensions—distributions attributable to contributions	where the services were performed.
pensions—investment earnings on contributions	the location of pension trust.
scholarships and fellowship grants	in most cases, the residence of the payer.
guarantee of indebtedness	the residence of the debtor or whether the payment is effectively connected with a U.S. trade or business.

# Fixed or Determinable Annual or Periodical (FDAP) Income

FDAP income is all income except:

- Gains from the sale of property (not including original issue discount and certain gains that are referred to in *Amounts Subject to Chapter 3 Withholding*, earlier); and
- Items of income excluded from gross income without regard to U.S. or foreign status of the owner of the income, such as tax-exempt municipal bond interest and qualified scholarship income.

The following items are examples of FDAP income.

- Compensation for personal services paid to an individual or a sole proprietorship.
- Dividends and dividend equivalent payments.

- Interest.
- Original issue discount.
- Real estate mortgage investment conduit (REMIC) excess inclusion income.
- Pensions and annuities.
- Alimony (no longer income if the divorce or separation agreement is executed after December 31, 2018, or if executed before January 1, 2019, but modified after December 31, 2018, the modification must state that section 11051 of P.L. 115-97 (TCJA) applies to the modification).
- Real property income, such as rents, other than gains from the sale of real property.
- Royalties.
- Taxable scholarships and fellowship grants.
- Other taxable grants, prizes, and awards.



- A sales commission paid or credited monthly.
- A commission paid for a single transaction.
- The distributable net income of an estate or trust that is FDAP income and must be distributed currently, or has been paid or credited during the tax year.
- FDAP income distributed by a partnership that, or such an amount that, although not actually distributed, is includible in the gross income of a foreign partner.
- Taxes, mortgage interest, or insurance premiums paid to, or for the account of, a nonresident alien landlord by a tenant under the terms of a lease.
- Publication rights.
- Prizes awarded to nonresident alien artists for pictures exhibited in the United States.

- Purses paid to nonresident alien boxers for prize fights in the United States.
- Prizes awarded to nonresident alien professional golfers in golfing tournaments in the United States.

Payments for the following purposes are examples of payments that are not withholdable payments.

- Services (including wages and other forms of employee compensation (such as stock options)).
- The use of property.
- Office and equipment leases.
- Software licenses.
- Transportation.
- Freight.
- Gambling winnings.
- Awards, prizes, and scholarships.

- Interest on outstanding accounts payable arising from the acquisition of goods or services.

**Periodic or lump-sum payments.** Income can be FDAP income whether it is paid in a series of repeated payments or in a single lump sum. For example, \$5,000 in royalty income would be FDAP income whether paid in 10 payments of \$500 each or in one payment of \$5,000.

**Insurance proceeds.** Income derived by an insured nonresident alien from U.S. sources upon the surrender of, or at the maturity of, a life insurance policy, is FDAP income and is subject to chapter 3 withholding and is a withholdable payment. This includes income derived under a life insurance contract issued by a foreign branch of a U.S. life insurance company. The proceeds are income to the extent they exceed the cost of the policy.

However, certain payments received under a life insurance contract on the life of a terminally or chronically ill individual before death (accelerated death benefits) may not be subject to tax. This also applies to certain payments received for the sale or assignment of any part of the death benefit under contract to a viatical settlement provider. For more information, see [Pub. 525](#).

**Racing purses (for purposes of chapter 3 withholding).** Racing purses are FDAP income and racetrack operators must withhold 30% on any purse paid to a nonresident alien racehorse owner in the absence of definite information contained in a statement filed together with a Form W-8 that the owner has not raced, or does not intend to enter, a horse in another race in the United States during the tax year. If available information indicates that the racehorse owner has raced a horse in another race in the United States during the tax year,

then the statement and Form W-8 filed for that year are ineffective. The owner may be exempt from withholding of tax at 30% on the purses if the owner gives you Form W-8ECI, which provides that the income is effectively connected with the conduct of a U.S. trade or business and that the income is includible in the owner's gross income.

**Covenant not to compete.** Payment received for a promise not to compete is generally FDAP income. Its source is the place where the promisor forfeited their right to act. Amounts paid to a nonresident alien for their promise not to compete in the United States are subject to chapter 3 withholding and are withholdable payments.

## **Withholding on Specific Income**

Different kinds of income are subject to different withholding requirements.

# **Effectively Connected Income**

In most cases, when a foreign person engages in a trade or business in the United States, all income from sources in the United States connected with the conduct of that trade or business is considered effectively connected with a U.S. business. FDAP income may or may not be effectively connected with a U.S. business. For example, effectively connected income (ECI) includes rents from real property if the alien chooses to treat that income as effectively connected with a U.S. trade or business.

The factors to be considered in establishing whether FDAP income and similar amounts are effectively connected with a U.S. trade or business include:

- Whether the income is from assets used in, or held for use in, the conduct of that trade or business; or

- Whether the activities of that trade or business were a material factor in the realization of the income.

**Income from securities.** There is a special rule determining whether income from securities is effectively connected with the active conduct of a U.S. banking, financing, or similar business.

If the foreign person's U.S. office actively and materially participates in soliciting, negotiating, or performing other activities required to arrange the acquisition of securities, the U.S. source interest or dividend income from the securities, gain or loss from their sale or exchange, income or gain economically equivalent to such amounts, or amounts received for providing a guarantee of indebtedness, is attributable to the U.S. office and is ECI.

**Withholding exemption.** In most cases, you do not need to withhold tax on income for purposes of chapter 3 or 4 if you receive a Form W-8ECI on which a foreign payee represents that:

- The foreign payee is the beneficial owner of the income;
- The income is effectively connected with the conduct of a trade or business in the United States; and
- For purposes of chapter 3 withholding, the income is includible in the payee's gross income.

This withholding exemption applies to income for services performed by a foreign partnership or foreign corporation (unless item (4) below applies to the corporation).

The exemption does not apply, however, to:

1. Pay for personal services performed by an individual for purposes of chapter 3



(see *Pay for Personal Services Performed*, later),

2. Effectively connected taxable income of a partnership that is allocable to its foreign partners (see *Partnership Withholding on ECTI*, later),
3. Income from the disposition of a USRPI (see *U.S. Real Property Interest*, later), or
4. Payments to a foreign corporation for personal services if all of the following apply.
  - a. The foreign corporation otherwise qualifies as a personal holding company for income tax purposes;
  - b. The foreign corporation receives amounts under a contract for personal services of an individual whom the corporation has no right to designate;

- c. 25% or more in value of the outstanding stock of the foreign corporation at some time during the tax year is owned, directly or indirectly, by or for an individual who has performed, is to perform, or may be designated as the one to perform, the services called for under the contract.

**Withholding exemption for purposes of chapter 4.** Income effectively connected with the conduct of a trade or business in the United States is not a withholdable payment under chapter 4 and thus is not subject to withholding for chapter 4 purposes. You do not need to withhold tax under chapter 4 if you receive a Form W-8ECI on which a foreign payee makes the representations described in Withholding exemptions, earlier.

## **Notional principal contract income.**

Certain payments attributable to a notional principal contract are not subject to withholding regardless of whether a Form W-8ECI is provided. However, payments of dividend equivalents that are not effectively connected with the conduct of a trade or business in the United States, pursuant to a specified notional principal contract (described later under *Dividend equivalent payments*) are subject to withholding.

Income from a notional principal contract is subject to reporting on Form 1042-S if it is effectively connected with the conduct of a trade or business in the United States. You must treat the income as effectively connected with a U.S. trade or business if you pay the income to, or to the account of, a qualified business unit (a branch) of a foreign person located in the United States or a qualified business unit located outside the United States and you know, or have reason

to know, the income is effectively connected with the conduct of a U.S. trade or business. You do not need to treat notional principal contract income as effectively connected if you receive a Form W-8BEN-E that represents that the income is not effectively connected with the conduct of a U.S. trade or business or if the payee provides a representation in a master agreement or in the confirmation on the particular notional principal contract transaction that the payee is a U.S. person or a non-U.S. branch of a foreign person.

**Income paid to U.S. branch of foreign bank or insurance company.** A payment to a U.S. branch of a foreign bank or a foreign insurance company that is subject to U.S. regulation by the Federal Reserve or state insurance authorities is presumed to be effectively connected with the conduct of a trade or business in the United States if you have an EIN for the branch, unless the branch provides a Form W-8BEN-E or Form W-8IMY

for the income. If a U.S. branch of a foreign bank or insurance company receives income that the payer did not withhold upon because of the presumption that the income was effectively connected with the U.S. branch's trade or business, the U.S. branch is required to withhold on the income if it is in fact not effectively connected with the conduct of its trade or business in the United States.

Withholding is required whether the payment was collected on behalf of other persons or on behalf of another branch of the same entity.

### **Income Not Effectively Connected**

This section discusses the specific types of income that are subject to chapter 3 withholding and where withholding under chapter 4 is required. The income codes contained in this section correspond to the income codes used in the current-year revision of Form 1042-S (discussed later).

For purposes of chapter 3, you must withhold tax at the statutory rates shown in Chart C unless a reduced rate or exemption under a tax treaty applies. For U.S. source gross income that is not effectively connected with a U.S. trade or business, the rate is usually 30%. In most cases, you must withhold the tax at the time you pay the income to the foreign person. See When to withhold, earlier.

## **Interest**

Interest from U.S. sources paid to foreign payees is subject to chapter 3 withholding and is a withholdable payment (except when the interest is paid with respect to a grandfathered obligation or another exemption under chapter 4 applies). When making a payment on an interest-bearing obligation, you must withhold on the gross amount of stated interest payable on the interest payment date, even if the payment or a part of the payment may be a return of capital rather than interest.

A substitute interest payment made to the transferor of a security in a securities lending transaction or a sale-repurchase transaction is treated the same as the interest on the transferred security. Use Income Code 33 to report these substitute payments.

**Interest paid by U.S. obligors—general (Income Code 1).** With specific exceptions, such as portfolio interest (for purposes of chapter 3), you must withhold on interest paid or credited on bonds, debentures, notes, open account indebtedness, governmental obligations, certain deferred payment arrangements (as provided in section 483), or other evidences of indebtedness of U.S. obligors. U.S. obligors include the U.S. Government or its agencies or instrumentalities, any U.S. citizen or resident, any U.S. corporation, and any U.S. partnership.

If, in a sale of a corporation's property, payment of the bonds or other obligations of the corporation is assumed by the buyer, that buyer, whether an individual, partnership, or corporation, must deduct and withhold the taxes that would be required to be withheld by the selling corporation as if there had been no sale or transfer. Also, if interest coupons are in default, the tax must be withheld on the gross amount of interest whether or not the payment is a return of capital or the payment of income.

A resident alien paying interest on a margin account maintained with a foreign brokerage firm must withhold from the interest whether the interest is paid directly or constructively.

Interest on bonds of a U.S. corporation paid to a foreign corporation not engaged in a trade or business in the United States is subject to withholding even if the interest is guaranteed by a foreign corporation.



Domestic corporations must withhold on interest credited to foreign subsidiaries or foreign parents.

For withholding under chapter 4 on the interest payments described in this section, see the definition of withholdable payments in Regulations section 1.1473-1(a).

**Original issue discount (Income Code 30).** Original issue discount paid on the redemption of an obligation is subject to chapter 3 withholding and is a withholdable payment (except when paid with respect to a grandfathered obligation). Original issue discount paid as part of the purchase price of an obligation sold or exchanged, other than in a redemption, is not subject to chapter 3 withholding unless the purchase is part of a plan the principal purpose of which is to avoid tax and the withholding agent has actual knowledge or reason to know of the plan.

However, such original issue discount is a withholdable payment (except when paid with respect to a grandfathered obligation).

Withholding is required by a person other than the issuer of an obligation (or the issuer's agent).

The original issue discount that is subject to chapter 3 withholding and is a withholdable payment (except when paid with respect to a grandfathered obligation) is the taxable amount of original issue discount. The taxable amount for both chapters 3 and 4 withholding purposes is the original issue discount that accrued while the obligation was held by the foreign beneficial owner up to the time the obligation was sold or exchanged or a payment was made, reduced by any original issue discount that was previously taxed. If a payment was made, the tax due on the original issue discount may not exceed the

payment reduced by the tax imposed on the part of the payment that is qualified stated interest.

If you cannot determine the taxable amount, you must withhold on the entire amount of original issue discount accrued from the date of issue until the date of redemption (or sale or exchange, if subject to chapter 3 withholding or a withholdable payment) determined on the basis of the most recently published [Pub. 1212](#).

For more information on original issue discount, see [Pub. 550](#).

### Chart C. **Withholding Tax Rates for Purposes of Chapter 3**

**Note.** You must withhold tax at the following rates on payments of income unless a reduced rate or exemption is authorized under a tax treaty.

The President may apply higher tax rates on income paid to residents or corporations of foreign countries that impose burdensome or discriminatory taxes on U.S. persons.

<b>IF you paid the following type of income...</b>	<b>THEN you must generally withhold at the following rate...</b>
Taxable part of U.S. scholarship or fellowship grant paid to holder of "F," "J," "M," or "Q" visa (see <u>Scholarships and Fellowship Grants</u> , later)	14%
Gross investment income from interest, dividends, rents, and royalties paid to a foreign private foundation	4%

Pensions—part paid for personal services (see <u><i>Pensions, Annuities, and Alimony</i></u> , later)	Graduated rates in Circular A or Circular E
Wages paid to a nonresident alien employee (see <u><i>Pay for Personal Services Performed</i></u> , later)	Graduated rates in Circular A or Circular E
Each foreign partner's allocable share of the partnership's ECTI (see <u><i>Partnership Withholding on ECTI</i></u> , later)	37% for noncorporate partners; 21% for corporate partners
Distributions of ECTI to foreign partners by publicly traded partnerships (see <u><i>Publicly</i></u>	37% for noncorporate partners; 21%

<u>Traded Partnerships</u> , later)	for corporate partners
Dispositions of USRPI (see <u>U.S. Real Property Interest</u> , later)	15%*
Dispositions of partnership interests under section 1446(f)	10%
Dividends paid to Puerto Rican corporation	10%
All other income subject to withholding	30%

\*21% in the case of certain distributions by corporations, partnerships, trusts, or estates.

## Reduced Rates of Withholding on Interest



*Notwithstanding the exception from withholding under chapter 3 on interest described under this heading, withholding may still apply under chapter 4 when the payment is a withholdable payment and an exception from withholding under chapter 4 does not apply.*

Certain interest is subject to a reduced rate of, or exemption from, withholding.

**Portfolio interest exempt from chapter 3 withholding.** Interest and original issue discount that qualifies as portfolio interest is exempt from chapter 3 withholding. However, these amounts are not exempt from withholding under chapter 4 when the interest is a withholdable payment, unless an exception from chapter 4 withholding applies.

To qualify as portfolio interest, the interest must be paid on obligations issued after July 18, 1984, and otherwise subject to chapter 3 withholding.

**Note.** The rules for determining whether interest is portfolio interest changed for obligations issued after March 18, 2012. Before March 19, 2012, portfolio interest included interest on certain registered and nonregistered (bearer) bonds if the obligations meet the requirements described below.

For obligations issued after March 18, 2012, portfolio interest does not include interest paid on debt that is not in registered form, except for interest paid on foreign-targeted registered obligations issued before January 1, 2016, as described in *Foreign-targeted registered obligations*, later.

***Obligations in registered form.*** Portfolio interest includes interest paid on an obligation



that is in registered form, and for which you have received documentation that the beneficial owner of the obligation is not a U.S. person.

Generally, an obligation is in registered form if (i) the obligation is registered as to both principal and any stated interest with the issuer (or its agent) and any transfer of the obligation may be effected only by surrender of the old obligation and reissuance to the new holder, (ii) the right to principal and stated interest with respect to the obligation may be transferred only through a book entry system maintained by the issuer or its agent, or (iii) the obligation is registered as to both principal and stated interest with the issuer or its agent and can be transferred both by surrender and reissuance and through a book entry system.

An obligation that would otherwise be considered to be in registered form is not considered to be in registered form as of a

particular time if it can be converted at any time in the future into an obligation that is not in registered form, except as otherwise provided in Notice 2012-20, 2012-13 I.R.B. 574, available at [IRS.gov/irb/ 2012-13 IRB#NOT-2012-20](https://www.irs.gov/irb/2012-13_IRB#NOT-2012-20), as described in the following section.

***Dematerialized book-entry systems and effectively immobilized obligations.*** An obligation will be considered to be in registered form if it is issued through either a dematerialized book entry system maintained by a clearing organization (or agent thereof) or a clearing system in which the obligation (including a global obligation in bearer form) is effectively immobilized. See [Notice 2012-20](https://www.irs.gov/irb/2012-20), amplified by Notice 2013-43, 2013-31 I.R.B. 113, available at [IRS.gov/irb/2013-31 IRB#NOT-2013-43](https://www.irs.gov/irb/2013-31_IRB#NOT-2013-43).

Under dematerialized book-entry systems, bonds are required to be represented only by book entries, and no physical certificates are issued or transferred. The bonds are transferred only by book entries.

An obligation will be considered to be effectively immobilized if (1) it is represented by one or more global securities in physical form that are issued to and held by a clearing organization (or by a custodian or depository acting as an agent of the clearing organization) for the benefit of purchasers and under arrangements that prohibit transfer except to a successor clearing organization subject to the same terms, and (2) beneficial interest in the underlying obligation is transferable only through a book-entry system maintained by the clearing organization or its agent.

These bonds are considered to be in registered form if the holder may only obtain a physical certificate in bearer form when (1)

the clearing organization that maintains the book-entry system goes out of business without a successor, (2) the issuer defaults, or (3) definitive securities are issued at the issuer's request upon a change in tax law adverse to the issuer. See [Notice 2012-20](#) and proposed regulations in [82 FR 43720](#), for more information on registered form requirements.

***Foreign-targeted registered obligations.***

A registered bond issued after March 18, 2012, and before January 1, 2016, will also be considered to be in registered form if it is targeted to foreign markets, and portfolio interest treatment may apply even when you do not receive documentation regarding the beneficial owner of the bond.

If the registered obligation is not targeted to foreign markets, you must receive documentation on which you may rely to treat the payee as a foreign person that is the beneficial owner of the interest.

A registered obligation is targeted to foreign markets if it is sold (or resold in connection with its original issuance) only to foreign persons or to foreign branches of U.S. financial institutions in accordance with procedures similar to those provided in Regulations section 1.163-5(c)(2)(i).

However, the procedure that requires the obligation to be offered for sale (or resale) only outside the United States does not apply if the registered obligation is offered for sale through a public auction. Also, the procedure that requires the obligation to be delivered outside the United States does not apply if the obligation is considered registered because it may be transferred only through a book-entry system and the obligation is offered for sale through a public auction. The documentation needed depends on whether the interest is paid to a financial institution, a member of a clearing organization, or to some other foreign person.

See Notice 2012-20 and Regulations section 1.871-14(e) for more information on foreign-targeted registered obligations.

***Obligations not in registered form and obligations issued before March 19, 2012.*** For obligations issued before March 19, 2012, interest on an obligation that is not in registered form (bearer obligation) is portfolio interest if the obligation is foreign targeted. A bearer obligation is foreign targeted if:

- There are arrangements to ensure that the obligation will be sold, or resold in connection with the original issue, only to a person who is not a U.S. person;
- Interest on the obligation is payable only outside the United States and its territories; and
- The face of the obligation contains a statement that any U.S. person who holds

the obligation will be subject to limits under the U.S. income tax laws.

Documentation is not required for interest on bearer obligations to qualify as portfolio interest. In some cases, however, you may need documentation for purposes of Form 1099 reporting and backup withholding.

Interest on such obligations is not a withholdable payment under chapter 4, except when the instrument is materially modified after March 18, 2012.

**Interest that does not qualify as portfolio interest.** Payments to certain persons and payments of contingent interest do not qualify as portfolio interest. You must withhold at the statutory rate on such payments unless some other exception, such as a treaty provision, applies and withholding under chapter 4 does not apply.

***Contingent interest.*** Portfolio interest generally does not include contingent interest. Contingent interest is interest that is determined by reference to any of the following.

- Any receipts, sales, or other cash flow of the debtor or a related person.
- Income or profits of the debtor or a related person.
- Any change in value of any property of the debtor or a related person.
- Any dividend, partnership distributions, or similar payments made by the debtor or a related person.
- Any amount that is a dividend equivalent.

The term “related person” is defined in section 871(h)(4)(B) .



The contingent interest rule does not apply to any interest paid or accrued on any indebtedness with a fixed term that was issued:

- On or before April 7, 1993; or
- After April 7, 1993, pursuant to a written binding contract in effect on that date and at all times thereafter before that indebtedness was issued.

**10% owners.** Interest paid to a foreign person that owns 10% or more of the total combined voting power of all classes of stock of a corporation, or 10% or more of the capital or profits interest in a partnership, that issued the obligation on which the interest is paid is not portfolio interest. To determine 10% ownership, see Regulations section 1.871-14(g).

**Banks.** Except in the case of interest paid on an obligation of the United States, interest paid to a bank on an extension of credit made

pursuant to a loan agreement entered into in the ordinary course of the bank's trade or business does not qualify as portfolio interest.

***Controlled foreign corporations.*** Interest paid to a controlled foreign corporation from a person related to the controlled foreign corporation is not portfolio interest.

**Reduced rate or exemption from chapter 3 withholding for interest on real property mortgages (Income Code 2).**

Certain treaties permit a reduced rate or exemption for interest paid or credited on real property mortgages. This is interest paid on any type of debt instrument that is secured by a mortgage or deed of trust on real property located in the United States, regardless of whether the mortgagor (or grantor) is a U.S. citizen or a U.S. business entity.

***REMIC excess inclusions.*** A domestic partnership must separately state a partner's allocable share of REMIC taxable income or

net loss and the excess inclusion amount on Schedule K-1 (Form 1065). If the partnership allocates all or some part of its allocable share of REMIC taxable income to a foreign partner, the partner must include the partner's allocated amount in income as if that amount was received on the earlier of the following dates.

1. The date of distribution by the partnership.
2. The date the foreign partner disposed of its indirect interest in the REMIC residual interest.
3. The last day of the partnership's tax year.

For purposes of item (2), the disposition may occur as a result of:

- A termination of the REMIC,
- A disposition of the partnership's residual interest in the REMIC,

- A disposition of the foreign partner's interest in the partnership, or
- Any other reduction in the foreign partner's allocable share of the partnership's part of the REMIC net income or deduction.

The partnership must withhold tax on the part of the REMIC amount that is an excess inclusion. Excess inclusion income is treated as income from sources in the United States and is not eligible for any reduction in withholding tax (by treaty or otherwise). It is also a withholdable payment for chapter 4 purposes.

An excess inclusion allocated to the following foreign persons must be included in that person's income at the same time as other income from the entity is included in income.

- Shareholder of a real estate investment trust (REIT).

- Shareholder of a regulated investment company (RIC).
- Participant in a common trust fund.

Patron of a subchapter T cooperative organization.

The entity must withhold on the excess inclusion.

For information on the taxation and reporting of excess inclusion income by REITs, RICs, and other pass-through entities, see Notice 2006-97, 2006-46 I.R.B. 904, available at [IRS.gov/irb/2006-46\\_IRB#NOT-2006-97](http://IRS.gov/irb/2006-46_IRB#NOT-2006-97).

**Reduced rate or exemption from chapter 3 withholding for interest paid to controlling foreign corporations (Income Code 3).** A treaty may permit a reduced rate or exemption for interest paid by a domestic corporation to a controlling foreign corporation.

The interest may be on any type of debt, including open or unsecured accounts payable, notes, certificates, bonds, or other evidences of indebtedness.

**Reduced rate or exemption from chapter 3 withholding for interest paid by foreign corporations (Income Code 4).** If a foreign corporation is engaged in a U.S. trade or business, any interest paid by the foreign corporation's trade or business in the United States (branch interest) is subject to chapter 3 withholding as if paid by a domestic corporation (without considering the "payer having income from abroad" exception) and is a withholdable payment. As a result, the interest paid to foreign payees is generally subject to chapter 3 withholding and withholding may apply under chapter 4 absent an applicable withholding exception. In addition, if "allocable interest" exceeds the branch interest paid, the excess interest is also subject to tax and reported on the

foreign corporation's income tax return, Form 1120-F. See the [Instructions for Form 1120-F](#) for more information.

If there is no treaty provision that reduces the rate of withholding on branch interest, you must withhold tax under chapter 3 at the statutory rate of 30% on the interest paid by a foreign corporation's U.S. trade or business and you must withhold under chapter 4 when otherwise applicable and without regard to a treaty provision.

In general, payees of interest from a U.S. trade or business of a foreign corporation are entitled to reduced rates of, or exemption from, tax under a treaty in the same manner and subject to the same conditions as if they had received the interest from a domestic corporation. However, a foreign corporation that receives interest paid by a U.S. trade or business of a foreign corporation must also be a qualified resident of its country of residence to be entitled to benefits under that country's

tax treaty. If the payee foreign corporation is a resident of a country that has entered into an income tax treaty since 1987 that contains a limitation on benefits article, the foreign corporation need only satisfy the limitation on benefits article in that treaty to qualify for a reduced rate of tax.

Alternatively, a payee may be entitled to treaty benefits under the payer's treaty if there is a provision in that treaty that applies specifically to interest paid by the payer foreign corporation. This provision may exempt all or a part of this interest. Some treaties provide for an exemption regardless of the payee's residence or citizenship, while others provide for an exemption according to the payee's status as a resident or citizen of the payer's country.

A foreign corporation that pays interest must be a qualified resident (under section 884) of its country of residence for the payer's treaty to exempt payments from tax by the foreign



corporation. However, if the foreign corporation is a resident of a country that has entered into an income tax treaty since 1987 that contains a limitation on benefits article, the foreign corporation need only satisfy the limitation on benefits article in that treaty to qualify for the exemption.

**Interest on deposits (Income Code 29).**

Foreign persons are not subject to chapter 3 withholding on interest that is not connected with a U.S. trade or business if it is from:

- Deposits with persons carrying on the banking business;
- Deposits or withdrawable accounts with savings institutions chartered and supervised under federal or state law as savings and loan or similar associations, such as credit unions, if the interest is or would be deductible by the institutions; or

- Amounts left with an insurance company under an agreement to pay interest on them.

Deposits include certificates of deposit, open account time deposits, Eurodollar certificates of deposit, and other deposit arrangements.

You may have to file Form 1042-S to report certain payments of interest on deposits. See *Deposit interest paid to certain nonresident alien individuals* under *Returns Required*, later. You may also have to file Form 1042-S when the deposit interest is a withholdable payment to which withholding applies (or was applied) to chapter 4.

**Obligations issued before August 10, 2010.** Interest received from a resident alien individual or a domestic corporation is not subject to chapter 3 withholding and is not a withholdable payment if the interest meets all of the following requirements.

- At least 80% of the payer's gross income from all sources has been from active foreign business for the 3 tax years of the payer before the year in which the interest is paid, or for the applicable part of those 3 years.
- The recipient is not a related person. Use rules similar to those in section 954(d)(3) to determine if the recipient is a related person.
- The interest is paid on an obligation issued before August 10, 2010.
- The obligation has not been significantly modified since August 10, 2010.

***Interest from foreign business***

***arrangements.*** In certain cases, interest received from a domestic payer, most of whose gross income is active foreign business income, is not subject to chapter 3 withholding and is not a withholdable payment.

Active foreign business income is gross income that is:

- Derived from sources outside the United States, and
- Attributable to the active conduct of a trade or business in a foreign country or territory of the United States by the domestic payer.

**Corporations existing on January 1, 2011.** Certain interest received from a domestic corporation that is an existing 80/20 company is not subject to withholding. An existing 80/20 company must meet all of the following requirements.

- It was in existence on January 1, 2011.
- For the 3 tax years beginning before January 1, 2011 (or for its years of existence if the corporation was in existence for less than 3 tax years), at least 80% of its gross income from all sources was active foreign business income.

- It continues to meet the 80% test for every tax year beginning after December 31, 2010.
- It has not added a substantial line of business after August 10, 2010.

**Transitional rule for active foreign business income.** In most cases, the domestic corporation determines its active foreign business income by combining its income and the income of any subsidiary in which it owns, directly or indirectly, 50% or more of the stock. However, if the testing period includes 1 or more tax years beginning before January 1, 2011, the corporation can use only its gross income for any tax year beginning before January 1, 2011, and will meet the 80% test if the weighted average percentage of active foreign business income is more than 80%.

A foreign beneficial owner does not need to provide a Form W-8 or documentary evidence for this exception.

However, documentation may be required for purposes of Form 1099 reporting and backup withholding.

**Sales of bonds between interest dates.**

Amounts paid as part of the purchase price of an obligation sold or exchanged between interest payment dates is not subject to chapter 3 withholding. In addition, such a payment is not a withholdable payment. This does not apply if the sale or exchange is part of a plan the principal purpose of which is to avoid tax and you have actual knowledge or reason to know of the plan. The exemption from chapter 3 withholding and from withholdable payments applies even if you do not have any documentation from the payee. However, documentation may be required for purposes of Form 1099 reporting and backup withholding.

**Short-term obligations.** Interest and original issue discount paid on an obligation that is payable 183 days or less from the date

of its original issue (without regard to the period held by the taxpayer) that satisfy other requirements intended to ensure that the debt is not held by a U.S. nonexempt person are not subject to chapter 3 withholding. In addition, such a payment is not a withholdable payment. These exemptions apply even if you do not have any documentation from the payee. However, documentation may be required for purposes of Form 1099 reporting and backup withholding.

**Income from U.S. Savings Bonds of residents of the Ryukyu Islands or the Trust Territory of the Pacific Islands.**

Interest from a Series E, Series EE, Series H, or Series HH U.S. Savings Bond is not subject to chapter 3 withholding if the nonresident alien individual acquired the bond while a resident of the Ryukyu Islands or the Trust Territory of the Pacific Islands.

# Dividends

The following types of dividends paid to foreign payees are generally subject to chapter 3 withholding and are generally withholdable payments such that withholding chapter 4 applies absent an exception available under chapter 4.

**Dividends paid by U.S. corporations—general (Income Code 6).** This category includes all distributions of domestic corporations (other than dividends qualifying for direct dividend rate—Income Code 7).

A corporation making a distribution with respect to its stock, or any intermediary making a payment of such a distribution, is required to withhold on the entire amount of the distribution at the rate applicable under chapter 3 when withholding under chapter 4 does not apply. However, a distributing corporation or intermediary may elect to not withhold on the part of the distribution that:



1. Represents a nontaxable distribution payable in stock or stock rights;
2. Represents a distribution in part or full payment in exchange for stock;
3. Is not paid out of current or accumulated earnings and profits, based on a reasonable estimate of the anticipated amount of earnings and profits for the tax year of the distribution made at a time reasonably close to the date of the distribution;
4. Represents a capital gain dividend (use Income Code 36) or an exempt interest dividend by a RIC; or
5. Is subject to withholding under section 1445 (withholding of tax on dispositions of USRPIs) and the distributing corporation is a U.S. real property holding corporation or a qualified investment entity (QIE).

The election is made by actually reducing the amount of withholding at the time the distribution is paid.

***Dividends paid by a QIE (Income Code 24).*** A QIE is:

Any REIT, or

Any RIC that is a U.S. real property holding corporation.

A distribution by a QIE to a nonresident alien or a foreign corporation is treated as a dividend and is not subject to withholding under section 1445 as a gain from the sale or exchange of a USRPI if:

- The distribution is on stock regularly traded on a securities market in the United States, and
- The individual or corporation did not own more than 10% of such stock in the case of a REIT or 5% of such stock in the case

of a RIC at any time during the 1-year period ending on the date of distribution.

Certain distributions by a REIT may be treated as a dividend and are not subject to withholding under section 1445 as a gain from the sale or exchange of a USRPI. See Qualified investment entities (QIEs) under *U.S. Real Property Interest*, later.

***Dividends paid by a domestic corporation (an existing "80/20" company).*** The active foreign business percentage of any dividend paid by a domestic corporation that is an existing 80/20 company is not subject to withholding. A domestic corporation is an existing 80/20 company if it satisfies all of the following.

1. It was in existence on January 1, 2011.
2. For the 3 tax years beginning before January 1, 2011 (or for all years of existence if it was in existence for less

than 3 tax years), at least 80% of its gross income from all sources was active foreign business income. Active foreign business income is gross income that is:

- a. Derived from sources outside the United States, and
  - b. Attributable to the active conduct of a trade or business in a foreign country or territory of the United States by the corporation.
- 3. It continues to meet the 80% test for every tax year beginning after December 31, 2010.
  - 4. It has not added a substantial line of business after August 10, 2010.

***Transitional rule for item (2).*** In most cases, the domestic corporation determines its active foreign business income by combining its income and the income of any subsidiary in which it owns, directly or

indirectly, 50% or more of the stock.

However, if the testing period includes 1 or more tax years beginning before January 1, 2011, the corporation can use only its gross income for any tax year beginning before January 1, 2011, and will meet the 80% test if the weighted average percentage of active foreign business income is more than 80%.

The active foreign business percentage is found by dividing the corporation's active foreign business income for the testing period by the corporation's total gross income for that period. The testing period is the 3 tax years before the year in which the dividends are declared (or shorter period if the corporation was not in existence for 3 years). If the corporation has no gross income for that 3-year period, the testing period is the tax year in which the dividend is paid.

***Consent dividends.*** If you receive a Form 972, Consent of Shareholder To Include Specific Amount in Gross Income, from a

nonresident alien individual or other foreign shareholder who agrees to treat the amount as a taxable dividend, you must pay and report on Form 1042 and Form 1042-S any withholding tax you would have withheld if the dividend actually had been paid.

**Interest-related dividends and short-term capital gain dividends received from mutual funds.** Certain interest-related dividends and short-term capital gain dividends paid by a mutual fund or other RIC are exempt from chapter 3 withholding.

**Dividends qualifying for direct dividend rate (Income Code 7).** A treaty may reduce the rate of withholding on dividends from that which generally applies under the treaty if the shareholder owns a certain percentage of the voting stock of the corporation when withholding under chapter 4 does not apply. In most cases, this preferential rate applies only if the shareholder directly owns the required percentage,

although some treaties permit the percentage to be met by direct or indirect ownership. The preferential rate may apply to the payment of a deemed dividend under section 304(a)(1). Under some treaties, the preferential rate for dividends qualifying for the direct dividend rate applies only if no more than a certain percentage of the paying corporation's gross income for a certain period consists of dividends and interest other than dividends and interest from subsidiaries or from the active conduct of a banking, financing, or insurance business. A foreign person should claim the direct dividend rate by filing the appropriate Form W-8.

***Consent dividends.*** If you receive a Form 972 from a foreign shareholder qualifying for the direct dividend rate, you must pay and report on Form 1042 and Form 1042-S any withholding tax you would have withheld if the dividend actually had been paid.

## **Dividends paid by foreign corporations**

**(Income Code 8).** Dividends paid by a foreign corporation are generally not subject to chapter 3 withholding and are not withholdable payments. This exception does not require a Form W-8. However, a Form W-8 may be required for purposes of Form 1099 reporting and backup withholding.

The payment to a foreign corporation by a foreign corporation of a deemed dividend under section 304(a)(1) is subject to chapter 3 withholding and may be a withholdable payment except to the extent it can be clearly determined to be from foreign sources.

### ***Corporation subject to branch profits tax.***

If a foreign corporation is subject to branch profits tax for any tax year, withholding is not required on any dividends paid by the corporation out of its earnings and profits for that tax year.



Dividends may be subject to withholding if they are attributable to any earnings and profits when the branch profits tax is prohibited by a tax treaty.

A foreign person may claim a treaty benefit on dividends paid by a foreign corporation to the extent the dividends are paid out of earnings and profits in a year in which the foreign corporation was not subject to the branch profits tax. However, you may apply a reduced rate of withholding under an income tax treaty only under rules similar to the rules that apply to treaty benefits claimed on branch interest paid by a foreign corporation. You should check the specific treaty provision.

**Dividends paid to Puerto Rican corporation.** For chapter 3 purposes, the tax rate on dividends paid to a corporation created or organized in, or under the law of, the Commonwealth of Puerto Rico is 10%, rather than 30%, if:

- At all times during the tax year less than 25% in value of the Puerto Rican corporation's stock is owned, directly or indirectly, by foreign persons;
- At least 65% of the Puerto Rican corporation's gross income is effectively connected with the conduct of a trade or business in Puerto Rico or the United States for the 3-year period ending with the close of the tax year of that corporation (or the period the corporation or any predecessor has been in existence, if less); and
- No substantial part of the income of the Puerto Rican corporation is used, directly or indirectly, to satisfy obligations to a person who is not a bona fide resident of Puerto Rico or the United States.

No special rules apply to Puerto Rican corporations for chapter 4 purposes, but special withholding rules do apply for withholdable payments made to territory

financial institutions and nonfinancial entities. See the chapter 4 regulations for information on these special requirements.

## **Dividend Equivalents**

**Dividend equivalent payments.** Dividend equivalent payments are treated as U.S. source dividends such that withholding under chapter 3 may apply. Use Income Code 34 or 40 to report dividend equivalent payments. Dividend equivalent payments are withholdable payments except when an exception applies for chapter 4 purposes.

A dividend equivalent is a payment (as defined in Regulations section 1.871-15(c)) that, directly or indirectly, is contingent on, or determined by reference to, the payment of a dividend from U.S. sources. Dividend equivalent payments include the following payments.

1. A substitute dividend made under a securities lending or sale-repurchase transaction involving a U.S. stock.
2. A payment that references the payment of a dividend from an underlying security made under a specified notional principal contract.
3. A payment that references the payment of a dividend from an underlying security made to a specified equity-linked instrument.

***Substitute dividend (Income Code 34).*** A substitute dividend is any payment made under a securities lending or sale-repurchase transaction that (directly or indirectly) is contingent upon, or determined by reference to, the payment of a dividend from sources in the United States.

***Specified notional principal contracts (SNPCs) and specified equity-linked instruments (SELIs) (Income Code 40). Transactions entered into on or after January 1, 2017.***

For transactions entered into on or after January 1, 2017 (including as a result of a deemed exchange pursuant to section 1001), an SNPC or SELI is a notional principal contract (NPC), or equity-linked instrument, respectively, with a delta of 0.8 or greater if it is a simple contract under Regulations section 1.871-15(a)(14)(i), or it meets the substantial equivalence test if it is a complex contract under Regulations section 1.871-15(a)(14)(ii). See Regulations section 1.871-15(g) for the delta test and Regulations section 1.871-15(h) for the substantial equivalence test.

Notwithstanding the preceding paragraph, for transactions entered into prior to January 1, 2025, transition relief provides that,

subject to an anti-abuse rule, only delta-one transactions will be treated as SNPCs and SELIs. See Notice 2022-37, 2022-37 I.R.B. 234, available at [IRS.gov/irb/ 2022-37 IRB#NOT-2022-37](https://www.irs.gov/irb/2022-37_IRB#NOT-2022-37).

***NPCs entered into before January 1, 2017.***

For transactions entered into before January 1, 2017, an SNPC is any NPC if:

- In connection with entering into the contract, any long party to the contract transfers the underlying security to any short party to the contract;
- In connection with the termination of the contract, any short party to the contract transfers the underlying security to any long party to the contract;
- The underlying security is not readily tradeable on an established securities market; or

- In connection with entering into the contract, the underlying security is posted as collateral by any short party to the contract with any long party to the contract.

For more information regarding dividend equivalents, see Regulations section 1.871-15 and Notice 2022-37.

***Amounts paid to qualified securities lenders (QSLs).*** A withholding agent that makes substitute dividend payments to a QSL may apply the transition rules described in Notice 2010-46, Part III, for payments made before January 1, 2025. See Notice 2022-37.

***Amounts paid to QDDs.*** Only an eligible entity that has entered into a QI agreement can be a QDD. An eligible entity is a home office or branch that is a QI and that is:

1. A dealer in equity derivatives that is subject to regulatory supervision as a dealer by a governmental authority in

the jurisdiction in which it was organized or operates;

2. A bank or bank holding company that is subject to regulatory supervision as a bank or bank holding company (as applicable) by a governmental authority in the jurisdiction in which it was organized or operates;
3. An entity that is wholly owned (directly or indirectly) by a bank or bank holding company subject to regulatory supervision as a bank or bank holding company (as applicable) by a governmental authority in the jurisdiction in which the bank or bank holding company (as applicable) was organized or operates and that entity, in its capacity as a dealer in equity derivatives:
  - a. Issues potential section 871(m) transactions to customers; and



- b. Receives dividends with respect to stock or dividend equivalent payments pursuant to potential section 871(m) transactions that hedge potential section 871(m) transactions that it issued;
- 4. A foreign branch of a U.S. financial institution if the foreign branch would be described in (1), (2), or (3) had it been a separate entity; or
- 5. Any person otherwise acceptable to the IRS.

A QDD is liable for tax under section 881 on its section 871(m) amount for each dividend on each underlying security. The section 871(m) amount is described in Regulations section 1.871-15(q)(3).

For more information on amounts paid to QDDs, see the chapter 3 regulations issued with the section 871(m) regulations.

You can view the regulations at [IRS.gov/irb/2017-09\\_IRB#TD-9815](https://www.irs.gov/irb/2017-09_IRB#TD-9815).

## **Gains**

You generally do not need to withhold under chapter 3 or 4 on any gain from the sale of real or personal property because it is not FDAP income. However, see *U.S. Real Property Interest*, later.

**Capital gains (Income Code 9).** You must withhold at 30%, or if applicable, a reduced treaty rate, on the gross amount of the following items.

- Gains on the disposal of timber, coal, or domestic iron ore with a retained economic interest, unless an election is made to treat those gains as income effectively connected with a U.S. trade or business.
- Gains on contingent payments received from the sale or exchange after October 4, 1966, of patents, copyrights,

secret processes and formulas, goodwill, trademarks, trade brands, franchises, and other like property.

- Gains on certain transfers of all substantial rights to, or an undivided interest in, patents if the transfers were made before October 5, 1966.
- Certain gains from the sale or exchange of original issue discount obligations issued after March 31, 1972. For more on withholding on original issue discount obligations, see *Interest*, earlier.

If you do not know the amount of the gain, you must withhold an amount necessary to ensure that the tax withheld will not be less than 30% of the recognized gain. The amount to be withheld, however, must not be more than 30% of the amount payable because of the transaction.

Unless you have reason to believe otherwise, you may rely upon the written statement of the person entitled to the income as to the amount of gain. The Form W-8 or documentary evidence must show the beneficial owner's basis in the property giving rise to the gain.

**Tax treaties.** Many tax treaties exempt certain types of gains from U.S. income tax. Be sure to carefully check the provision of the treaty that applies before allowing an exemption from withholding.

## **Royalties**

In general, you must withhold tax under chapter 3 on the payment of royalties from sources in the United States. However, certain types of royalties are given reduced rates or exemptions under some tax treaties. Accordingly, these different types of royalties are treated as separate categories for withholding purposes.

For chapter 4 purposes, royalties are nonfinancial payments and are therefore excluded as withholdable payments.



*Most treaties have more than one withholding rate on royalties, which varies by the classification of the payment in that treaty. Be sure to check your particular treaty for the specific rate that applies to you.*

### **Industrial royalties (Income Code 10).**

This category of income includes royalties for the use of, or the right to use, patents, trademarks, secret processes and formulas, goodwill, franchises, “know-how,” and similar rights. It may also include payments for the use of, or right to use, industrial, commercial, and scientific equipment, when this is included in the treaty definition of royalties.

**Motion picture or television copyright royalties (Income Code 11).** This category refers to royalties paid for the use of motion picture and television copyrights.

**Other royalties (for example, copyright, software, broadcasting, endorsement payments) (Income Code 12).** This category refers to the royalties paid for the use of copyrights on books, periodicals, articles, etc., except motion picture and television copyrights.

### **Real Property Income and Natural Resources Royalties (Income Code 14)**

You must withhold tax under chapter 3 on income (such as rents and royalties) from real property located in the United States and held for the production of income, unless the foreign payee elects to treat this income as effectively connected with a U.S. trade or business. If the foreign payee chooses to treat this income as effectively connected, the payee must give you Form W-8ECI (discussed earlier). This real property income includes royalties from mines, wells, or other natural deposits, as well as ordinary rents for the use of real property.

For chapter 4 purposes, income from real property is either a nonfinancial payment (and therefore not a withholdable payment) or is excluded as a withholdable payment because it is ECI. For withholding that applies to the disposition of USRPI, see U.S. Real Property Interest, later.

## **Pensions, Annuities, and Alimony (Income Code 15)**

The following rules apply to withholding on pensions, annuities, and alimony of foreign payees.

**Pensions and annuities.** In most cases, you must withhold tax on the gross amount of pensions and annuities that you pay that are from sources within the United States. This includes amounts paid under an annuity contract issued by a foreign branch of a U.S. life insurance company.

Most tax treaties provide an exemption from tax on non-government pensions and annuities. See the specific treaty rules for government pensions. The exemption may not apply to lump-sum payments. See, for example, Article 17(2) of the United States–United Kingdom income tax treaty. In addition, it does not apply to payments treated as deferred compensation, which is often treated as income from employment.

For purposes of chapter 3 withholding, in the absence of a treaty exemption, you must withhold at the statutory rate of 30% on the entire distribution that is from sources within the United States. You may, however, apply withholding at graduated rates to the part of a distribution that arises from the performance of services in the United States after December 31, 1986.

Employer contributions to a defined benefit plan covering more than one individual are not made for the benefit of a specific



participant, but are made based on the total liabilities to all participants. All funds held under the plan are available to provide benefits to any participant. If the distribution is from such a plan, you can use the method in Revenue Procedure 2004-37 to allocate the distribution to sources in the United States.

The withholding rules that apply to payments to foreign persons generally take precedence over any other withholding rules that would apply to distributions from qualified plans and other qualified retirement arrangements.

Foreign pension plans are exempt from applying withholding under chapter 4 when they are exempt beneficial owners under Regulations section 1.1471-6(f). A payment from a U.S. pension plan to a foreign individual beneficiary in the plan is not subject to withholding under chapter 4.

**No withholding.** Do not withhold tax on an annuity payment to a nonresident alien if at the time of the first payment from the plan,

90% or more of the employees eligible for benefits under the plan are citizens or residents of the United States and the payment is:

1. For the nonresident's personal services performed outside the United States; or
2. For personal services by a nonresident individual present in the United States for 90 days or less during each tax year, whose pay for those services did not exceed \$3,000, and the personal services were performed for:
  - a. A nonresident alien individual, foreign partnership, or foreign corporation not engaged in a trade or business in the United States; or

- b. An office or place of business of a U.S. resident or citizen that was maintained outside the United States.

If the payment otherwise qualifies under these rules, but less than 90% of the employees eligible for benefits are citizens or residents of the United States, you still need not withhold tax on the payment if:

- The recipient is a resident of a country that gives a substantially equal exclusion to U.S. citizens and residents, or
- The recipient is a resident of a beneficiary developing country under the Trade Act of 1974.

The foreign person entitled to the payments must provide you with a Form W-8BEN that contains the TIN of the foreign person.

**Alimony payments.** In most cases, alimony payments made by U.S. resident aliens to nonresident aliens are taxable and subject to

chapter 3 withholding whether the recipients are residing abroad or are temporarily present in the United States.

Many tax treaties, however, provide for an exemption from withholding for alimony payments. See *Tax Treaties*, later, for information about treaty benefits.

Alimony payments made to a nonresident alien by a U.S. ancillary administrator of a nonresident alien estate are from foreign sources and are not subject to withholding. Alimony payments are not subject to chapter 4 withholding.

**Note.** Under section 11051 of P.L. 115-97 (TCJA), alimony is no longer considered income if the divorce or separation agreement is executed after December 31, 2018, or if executed before January 1, 2019, but modified after December 31, 2018, the modification must state that section 11051 of P.L. 115-97 applies to the modification.

## **Scholarships and Fellowship Grants Subject to Chapter 3 Withholding (Income Code 16)**

A scholarship or fellowship grant is an amount given to an individual for study, training, or research, and which does not constitute compensation for personal services. For information about withholding on scholarship and fellowship grants that is treated as compensation for services, see *Pay for services rendered*, later. Whether a fellowship grant from U.S. sources is subject to chapter 3 withholding depends on the nature of the payments and whether the recipient is a candidate for a degree. These amounts are not subject to chapter 4 withholding. See *Scholarships, fellowships, and grants* under *Source of Income*, earlier.

**Candidate for a degree.** Do not withhold on a qualified scholarship from U.S. sources granted and paid to a candidate for a degree.

A qualified scholarship means any amount paid to an individual as a scholarship or fellowship grant to the extent that, in accordance with the conditions of the grant, the amount is to be used for the following expenses.

- Tuition and fees required for enrollment or attendance at an educational organization.
- Fees, books, supplies, and equipment required for courses of instruction at the educational organization.

The payment of a qualified scholarship to a nonresident alien is not reportable and is not subject to withholding. However, the part of a scholarship or fellowship paid to a nonresident alien that does not constitute a qualified scholarship is reportable on Form 1042-S and is subject to withholding. For example, those parts of a scholarship devoted to travel, room, and board are subject to withholding and are reported on Form 1042-S.