

## Prefer An American Work Experience?

### Temporary Assignments in the U.S.- Tricks and Traps

#### Some U.S. Tax Matters You Should Know Before ‘Coming To America’!

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The goal of this article is to provide a comprehensive checklist of information for the foreign national person to consider prior to accepting an assignment inside the United States (U.S.). This article is not designed to teach you the technical competence required to perform self compliance; however it will certainly arm you with the knowledge to determine if your U.S. tax preparer knows all that they should know to provide you with technically competent professional services.

#### U.S. Tax Residency 101:

With one exception the U.S. (and Philippines) unlike all other countries worldwide, does not use a separate, distinct and/ or unique tax definition termed "tax residency" to define a U.S. resident alien, preferring instead to piggy-back U.S. immigration law concepts. Therefore U.S. persons- U.S. citizens and legal permanent residents (green card holders)- are always defined as U.S. resident aliens, the additional one exception also being any non-U.S. persons meeting the Substantial Presence Test (SPT), who are also defined as U.S. resident aliens.

#### Taxation in those other places:

"Tax residency" found in all other countries worldwide outside the U.S. is determined by a variety of facts-and-circumstance tests or features unique to each country's tax system. For example, permanence and purpose of stay, personal property and social ties, spouse, dependents and dwelling, etc...In some cases establishing tax ties in another country becomes part of those tests or features. Some countries permit taxpayers who move to become tax non-residents upon departure. Such tax non-residents of those former countries are taxed only on income earned or sourced from those former countries. Tax residence is re-established if and when the taxpayer returns to that country.

#### Consequences of Filing as a U.S. Nonresident Alien/ Becoming a U.S. Resident Alien:

All U.S. resident aliens are subject to U.S. tax on their worldwide income, regardless of where the income is earned, the type of currency, or the location where the income is deposited to.

All U.S. nonresident aliens are taxed in the U.S., only on their U.S. source income. The source of the income depends on the type of income. A basic taxation premise is that the country of income source maintains the first right of taxation related to that income. However income tax treaties usually seek to have such income taxed in the country of residence (and not the source country) to avoid a double filing compliance obligation.

#### The SPT- To Be or Not To Be a U.S. Resident Alien:

Under Internal Revenue Code (IRC) Section (Sec.) 7701(b)(3) individuals meet the SPT if they have at least 31 days of U.S. presence in the current year *and* when the following sums to 183 days or greater: 100 percent of the physical days of U.S. presence in the current year + 1/3 of the days of U.S. presence in the preceding year + 1/6 of the days of U.S. presence in the second preceding year. To summarize SPT determination, one looks at the presence in the U.S. consisting of all days in the current year and fractions of days in the two-year look-back period.

For the purposes of the SPT, partial days count as full days and, while fractional days add, any remaining fractional days are neither rounded up or down, but dropped. The SPT must continue to be met on an annual U.S. calendar tax period basis for an individual to continue to be considered a continuing U.S. resident alien year after year.

As below- Starting Date- under IRC Sec 7701(b)(2)(C)(ii), up to 10 de minimus days may be excluded from U.S. presence for the determination of the SPT.

#### Ways Out of U.S. Tax Residency- Beating the System:

Under IRC Sec. 7701(b)(3)(B), the fractional two-year look back period is effectively negated when an individual meets the SPT to become a U.S. resident alien having less than 183 days in the current year but is in excess of the requirements using the fractional two-year look back rule in the preceding and second preceding tax years. In such cases, these individuals will be able to file IRS Form 8840, Closer Connection Exception Statement for Aliens, claiming a “tax home” and “closer connection” to a foreign country and remain U.S. non resident aliens.

Such U.S. domestic relief, the Closer Exception Connection, is not available in cases where the SPT test is met based upon days of U.S. presence in the current year alone. In such cases, the U.S. resident alien needs to seek relief under an income tax treaty between the U.S. and the alien's other country of residence (typically under OECD Model Article IV- Residence), generally referred to as the “treaty tiebreaker” article (see below).

Therefore, individuals may be classified as U.S. resident aliens if they meet the above SPT. If they fail the SPT they are automatically classified as U.S. non resident aliens.

However in limited circumstances an individual’s physical days of U.S. presence may be excluded for purposes of determining the SPT, in cases where they were:

- a. *exempt individuals*: under IRC Sec 7701(b)(3)(D) a student in the U.S. on an F visa, a trainee or a teacher in the U.S. on a J visa or others on an M or Q visa, a professional athlete, or an individual with a medical condition;
- b. *others*: under IRC Sec 7701(b)(7) regular commuters who work in the U.S. from Canada or Mexico when in transit in the U.S. between other points for less than 24 hours, days in the U.S. as a crew member of a foreign vessel and all employees of international organizations or foreign governments.

Some exempt individuals need to complete IRS Form 8843, Statement for Exempt Individuals and Individuals with a Medical Condition, and attach it for filing with their annual U.S. tax return, either IRS Form 1040NR or 1040. In this effort the United States Citizenship and Immigration Services form(s) F-20 for F visa holders and DS2019 for J visa holders will be critical to complete Form 8843.

There are EXCEPTIONS to the Exempt individual rules above for J and F visa holders, where:

(i) under IRC Sec 7701(b)(5)(E)(i) **A teacher or trainee on a J visa was exempt as a teacher, trainee or student for any part of two of the last six prior calendar years.** In that case in the current year you **cannot exclude days of presence unless all four of the following apply** as a teacher or trainee in the current year:

1) You were exempt as a teacher, trainee or student for any part of three or fewer of the prior six calendar years and 2) A foreign employer paid all current year compensation and 3) You were present in the U.S. as a teacher or trainee in any of the six prior years and 4) A foreign employer paid all compensation during each of those prior six years you were present in the U.S. as a teacher or trainee **or**

(ii) under IRC Sec 7701(b)(5)(E)(ii) **A student on an F visa was exempt as a teacher, trainee or student for any part of more than five calendar years cannot exclude days of presence unless they establish that they did not intend to reside permanently in the U.S.**

The facts and circumstances to be considered in determining if you have demonstrated an intent to reside permanently in the U.S. include, but are not limited to: 1) Whether you have maintained a closer connection to a foreign country other than to the U.S.; and 2) Whether you have taken affirmative steps to change your status from nonimmigrant to lawful permanent resident (green card holder).

Income from personal services performed as a U.S. nonresident alien temporarily in the U.S. for a period or periods of not more than 90 days, where the compensation for such services are performed for a foreign employer and is not more than \$3,000, is exempt from U.S. taxation.

#### Residency Starting Date:

For persons who were not U.S. resident aliens at all during the prior tax year and who meet either the above SPT or green card test their first day of presence (making them U.S. resident aliens) will be counted starting:

- a. (for the SPT)- the first day that they enter the U.S. in the year in which they meet the SPT, excluding under 7701(b)(C)(ii) up to 10 de minimus days of prior presence; and
- b. (for the green card test)- the first time that they land on U.S. soil with a valid green card.

In cases where an individual's visa status changes from exempt to a non-exempt, assuming that the individual meets the SPT, the individuals' first day of U.S. residence is considered to be the actual date that the new non-exempt visa takes effect per U.S. Citizenship and Immigration Services (U.S.C.I.S.) notification of approval.

#### Residency Ending Date:

For persons obtaining U.S. resident alien status as a result of compliance with the SPT, U.S. residency continues until the tax year that compliance with the SPT stops. In the year of actual physical departure an individual continuing to meet the SPT is presumed to continue to be a U.S. resident alien up to December 31 of that tax year, unless under IRC Sec 7701(b)(2)(B)(i), (ii) & (iii) he or she files a "closer connection" white paper statement claiming a "tax home" and "closer connection" to a foreign country as at his or her actual physical date of departure. The filing is required to avoid continued U.S. residence and taxation on worldwide income. However there is controversy whether such a white paper filing is required, or is a "closer connection" more a question of fact. Additionally where joint taxpayers departing earlier choose to remain U.S. tax residents up to December 31 for tax minimization reasons, the IRS has the right to step in and terminate residency on that earlier departing date citing closer connection status.

#### Consequences of Filing as a U.S. Nonresident alien- Forms, Forms, Forms:

Nonresident aliens file U.S. income tax returns using Form 1040NR, U.S. Nonresident Alien Income Tax Return, which comprises five pages. Effectively connected income is reported on Form 1040NR page 1 and 2 at U.S. regular graduated tax rates and non effectively connected income is reported on Form 1040NR page 4- Schedule NEC at the flat rate tax of 30% or as reduced by treaty. Form 1040NR also contains an information page 5. Income effectively connected with a U.S. trade or business includes compensation income, but excludes passive income.

U.S. nonresident alien filers cannot use the standard deduction nor all the itemized deductions afforded to U.S. resident aliens, nor can they file jointly if married. Additionally, the claiming of exemptions for dependents is much more difficult. Furthermore, if foreign income is reported on a fiscal basis it must first be converted to a calendar year (January 1 to December 31) reporting period to be useful for U.S. reporting purposes (in the U.S. the calendar year is used as the tax reporting period).

### Dual-Status- When You Are Both a Resident Alien and Non Resident Alien in a Single Tax year:

In cases where a foreign national in the U.S. has two statuses in a single tax year, for example, when they go from a nonresident to resident status (or vice-versa) in the same U.S. tax calendar year, the foreign national is called a dual-status filer in recognition of these two statuses. The tax return that dual status individuals file is based on their status on December 31 of the tax year. The tax return must be clearly indicated on the top of the form as “Dual-Status Return”. However dual-status filers must also file a statement with their tax return covering the other portion of the tax year for which they have the other status. Form(s) 1040 or 1040NR, may be used for the statement reporting period indicating on the top of the form “Dual-Status Statement”. A white paper statement will also suffice for these purposes. The statement is purely presentational with the amounts covering only the statement period.

If Dual Status filers are married they must file separately. They cannot use the Head of Household filing status or the Standard deduction.

### Elections to be Treated as a U.S. Resident Alien:

*First-year election-* Under IRC Sec 7701(b)(4) individual taxpayers who do not meet the SPT test in the year of entry, may elect to be treated as U.S. resident aliens *from the date of entry forward* if they meet certain criteria. This election is not available to individuals, as above, whose days were either exempted or excludable under the SPT. The election to be treated as a U.S. resident alien from the date of entry forward may benefit taxpayers with mortgage interest or other itemized deductions not allowed as deductions to U.S. nonresident aliens, or if they have foreign losses, e.g.: foreign rental losses. Also in some cases it may facilitate breaking residence in their former country. Spouse and dependents must also qualify, therefore the election must be made individually for the entire family. There is an option to do one election, with all non minor family members signing the election.

*Married election-* Likewise under IRC Sec 6013(g) and (h) there exists an election for married persons to make them both full year U.S. resident aliens. This election applies to either: a) a full year U.S. resident alien married to a December 31 U.S. nonresident alien or b) to two dual status December 31 U.S. resident aliens. This election to be treated as U.S. resident aliens for the full U.S. tax year may benefit taxpayers that can take advantage of the married filing joint tax rates, certain itemized deductions not allowed to married filing separate U.S. nonresident aliens, or if they have foreign losses, e.g.: net rental losses. Additionally, there is opportunity in cases where this election would draw in to U.S. taxation foreign income the possibility to use either the: 1) foreign tax credit or 2) a reverse IRC Sec. 911 Foreign Earned Income Exclusion, to credit out dollar for dollar or exclude this foreign income taken into taxation under this election.

### State Tax Issues:

For U.S. state tax purposes the requirements can be quite different and vary from state to state. Typically there are state-specific facts and circumstances domicile tests in addition to statutory resident tests the main purpose of which is to catch individuals claiming a foreign state as their state of domicile. These statutory resident tests are typically conjoined with a 183 days of presence rule and a permanent place of abode pretext, the latter of which is state specific, subjective and/ or vague. Additionally some states could deem taxpayers to be continuing tax residents even while away on foreign assignments, if the ultimate intention is to return to the state after the termination of the foreign assignment (basic domicile definition). For more information on state residency issues, please consult us separately.

### After Residency Ends....:

*The “No Lapse” Rule-* Under IRC Sec 7701(b)(2)(B)(iii) if after departing and terminating U.S. tax residency in one calendar tax year, a nonresident alien returns to the U.S. and resumes U.S. tax residency at any time during the subsequent calendar tax year, the intervening period between nonresidency and residency is deemed to be a resident period. There are worldwide U.S. income taxation implications during this corresponding period.

*Resumption of Residency within three years (not to be confused with the no lapse rule)-* IRC Sec 7701(b)(10)(A) provides a special rule for a U.S. resident alien who, after having been a U.S. resident alien during three consecutive calendar years and then having ceased to be a resident alien again becomes a U.S. resident alien before the close of the third calendar year beginning after the close of the first three calendar years. During this interim period, such individuals are still regarded as U.S. nonresident aliens, but they are subject to the regime of U.S. resident aliens; that is, graduated rates of taxation on all income except that generally only U.S. source income is taxed.

IRS Form(s) 1040C, U.S. Departing Alien Tax Return- and/or the shorter form 2063, U.S. Department Alien Income Tax Statement, used under certain conditions are used to obtain Certificates of Compliance (also called Departure or 'Sailing' Permits) for SPT non-exempted U.S. resident aliens who depart the U.S. permanently, in order to ensure that all of their U.S. tax is paid in full prior to or on departure from the U.S.

Theoretically, either of these forms should be brought to the IRS personally about 15 days, but no more than 30 days, prior to departure with copies of passports, visas, two years of past filed tax returns and the most current pay stub. These items are then presented to the IRS Field Assistant Area Director. Upon approval, the IRS Field Assistant Area Director will issue the Certificate of Compliance (Departure or Sailing Permit). This Certificate of Compliance (Departure or Sailing Permit) is supposed to be furnished by the departing alien upon exiting the U.S., in addition to the payment all U.S. taxes paid to the extent owed.

The completion and presentation of the Form(s) 1040C or 2063, does not, however, relieve the taxpayer from filing the final tax return. Any taxes paid at departure would be treated as a withholding tax or extension payment on the final Form 1040NR tax return to be filed after departure (on the regular due date). Theoretically, any alien that tries to leave the U.S. without a Certificate of Compliance (Departure or Sailing Permit) may be subject to an income tax examination by an IRS employee at the point of departure. They then would then be required to complete income tax returns and statements and usually pay any taxes owed.

Certificates of Compliance (Departure or Sailing Permits) however, are rarely if ever obtained. Most persons leaving the U.S. are fully withheld at source and have refunds owed to them. Furthermore, IRS agents are no longer posted at border crossings (they may have been decades ago, but not currently) and there is only a slight chance that U.S.C.I.S. or U.S. Customs would know that an alien is departing the U.S. permanently/ for the last time. Based upon years of practical experience regarding the preparation of Forms(s) 1040-C or 2063, Certificates of Compliance (Departure or Sailing) Permit) are rarely if ever prepared, practically used or presented at border pints of crossing.

#### Income Tax Treaties:

The U.S. and various other countries have negotiated income tax treaties based upon preset international models, one being the OECD Model Tax Convention. One purpose of the tax treaties is to avoid double taxation when the tax laws of two or more countries create a double tax situation. For the purposes of U.S. nonresident and U.S. resident aliens alike the following income tax treaty articles have been highlighted as relevant to possibly providing you relief:

- Article IV- Residence: will seek to determine where persons are tax resident if they are found to be tax resident of two or more countries under the domestic tax laws of the respective countries, commonly referred to as the “treaty tie-breaker rules”.
- Article VI- Income from Real Property: typically real property is real-estate, this article would cover in part rental income or losses. As below since the country of source maintains the first right of taxation, the possibility of double taxation here is probable. Most income tax treaties under Article VI will not avoid this matter, so the application of the catch-all article XXIV is required.
- Article X- Dividends: seeks to reduce the U.S. 30 percent flat tax or lower as per specific treaty country.

- Article XI- Interest: seeks to reduce the U.S. 30 percent flat tax or lower as per specific treaty country.
- Article XIII- Gains: covering capital gains from the disposition of assets this article seeks to reduce the U.S. 30 percent flat tax or lower as per specific treaty country. In many cases there is a catch-all provision that capital gains remain taxable *only* in the alienator's state of residence.
- Article XIV- Independent Personal Services: seeks to address the taxation of income from self-employed persons.
- Article XV- Dependent Personal Services: seeks to address the taxation of income of employees. In many treaties if the compensation is paid and borne by a foreign employer and the employee is not physically present in the U.S. for more than 183 days, the compensation shall only be taxable in the employees state of residence. In the case of foreign nationals here in the U.S., taxation would not be in the U.S.
- Article XVI- Artistes and Athletes: seeks to address the taxation of income from such persons.
- Article XXII- Other Income: seeks to address the taxation of all other income not addressed elsewhere.
- Article XXIV- Elimination of Double Taxation: seeks to invoke what is sometimes already incorporated in to pre-existing domestic tax law, the foreign tax credit. This article is a catch-all that prevents double taxation with respect to income not addressed above.
- Article XXVII- Exchange of Information: is an agreement in principle to allow the respective taxation authorities of all treaty countries to share information to help avoid tax evasion and to allow for the smooth application of domestic tax laws.

#### Other Income Tax Matters:

- A general tax presumption is that the country of income source retains the first right of taxation. However treaties usually seek to have that income taxed in the country of residence and not the country of source to avoid a double filing compliance obligation.
- The U.S. has conveniently slipped in to most income treaties (generally under "Miscellaneous Rules" ), a provision to enable the U.S. citizens and Green card holders as if the income tax treaty did not exist. This is typically referred to as a "Savings Clause" or "Limitation on Benefits Clause".
- F, J or Q visa holders remaining as U.S. nonresident aliens, shall not include in their gross income for U.S. tax purposes compensation paid to them by a foreign employer.
- Under the IRS IRC 893, the compensation of non U.S. citizen employees received from a foreign government or international organization for work performed in the U.S. shall not be included in gross income and will be exempt from U.S. taxation.
- Under the IRS IRC 871(i)(2)(A), while a U.S. nonresident alien, interest income derived from U.S. bank deposits is exempt from U.S. taxation.
- Under IRC Sec 871(d) election exists to treat income from real property as effectively connected with a U.S. trade or business, therefore taxing the net rental income at graduated U.S. income tax rates versus subjecting the gross rental income to a 30% flat tax or lower as per specific treaty. Stays in effect until revoked, make in first year only.

- Foreign national individuals who are not eligible to obtain a U.S. social security number (since they are not U.S. citizens, nor U.S. green card holders, nor do not have valid U.S. work authorization) are able to obtain a U.S. Individual Tax Identification Number (ITIN) valid for U.S. tax purposes only. The procedure is to complete and submit a Form W-7, Application for IRS Individual Taxpayer Identification Number, with the tax return remitted to the special ITIN unit in Austin, Texas for processing. Special exception rules permitted no tax return filing with Form W-7. On 11/29/12 effective starting 1/1/13 IRS IR-2012-98 made permanent interim changes released on 6/22/12 with IRS IR-2012-62, regarding ITIN application rules that were modified temporarily to protect and strengthen the integrity of the ITIN process,.

As such the IRS ITIN unit is now only accepting original documentation (U.S. notarized copies are no longer acceptable) or copies certified by the issuing agency. Further ITINs now expire after five years, however are renewable thereafter. New IRS IR-2012-98 also reintroduced the option of Certifying Acceptance Agents (CAAs) (rules strengthened effective 7/1/10) and in later January 2013 IRS Taxpayer Assistant Centers (TACs) based in London, Paris Beijing and Frankfurt, as able to verify and certify documentation obviating the need to send original documentation.

Also grandfathered in under IR-2012-98 were the IR-2012-62 provisions allowing spouses and dependents of U.S. military personnel and nonresident aliens applying for ITINs for the purposes of only claiming treaty benefits- using Form W-7 box a and h (not when accompanied by a U.S. tax returns), to remain under the pre 6/22/12 rule regime.

- Under IRC Sec. 121- Sale of Principal residence: In the five year window prior to sale of a principal residence the taxpayer must have: 1) owned *and* 2) used or lived in the home for at least two years = 24 months = 730 days for both spouses to qualify for the \$250,000 per spouse exclusion of gain. The two years for the owned and use test do not have to be the same two years within the five years prior to sale. Temporary absences even if rented out are counted as periods of use. Lastly this exclusion may only be used once every two years.

If the taxpayer does not have the two years for both tests they will not qualify for the exclusion unless: they have one of three ‘primary reasons’ that includes: change in location of employment, health reasons or unforeseen circumstances.

For each of the three ‘primary reasons’ the taxpayer would look at i) specific primary reason “safe harbors” and/ or ii) individual facts and circumstances for each of the primary reason, including such factors as: close in time, owned & used at time of specific primary reason, primary reason not reasonably foreseeable, material change in impairment of financial ability to maintain, use during ownership.

Safe harbors for change in location of employment (focal point of this article) (where employment includes new or continuing employment or self-employment) include where change occurred during period of ownership and use of main home and the new place of employment is at least 50 miles farther from the home sold than was the former place of employment.

As such a U.S. nonresident alien who moves to the U.S. and continues to maintain their foreign main home subsequently renting it out and selling it years after expatriating to the U.S., will still qualify under the change in location of employment primary reason.

Obviously the handicap for U.S. nonresidents is that although they usually meet the two year test of ownership they *do not* meet the test on use. If the home is *not* your "main home" or principal residence or you do not meet the above tests and you have held it for more than one year, then the gain would be taxed at the long term capital gain rate, which is currently 15% and maybe 20% starting January 1, 2013 for taxpayers in the new 39.6% bracket.

*Non-qualified use*-In the calculation of the gain from the sale or exchange of the principal residence the pro-rata portion of the gain attributable to non-qualified use in tax years 2009 or later, where neither you nor your spouse used the property as a main home, within certain exceptions will not be excludable under the above rules

An exception, however to the above is any portion of the 5-year period ending on the date of the sale or exchange after the last date you or your spouse used the property as your main home. In practicality what this means is that if there is any rental use during the 5 year window prior to sale, this rental period use it is NOT considered non-qualified use and the gain would not have to be pro-rata apportioned between qualified and non-qualified use.

The sale of principal residence exclusion under IRC Sec. 121 and other above information are also applicable to U.S. nonresident aliens and non- U.S. principal residences and 'main homes'.

Other Matters:

Social Security and Medicare Taxes or FICA (Federal Insurance Contributions Act):

- Nonresident aliens filing Form 1040NR with a Schedule C, Profit or Loss from Business, are exempt from U.S. self-employment FICA tax on their net income from that business.
- F, J or Q visa holders remaining as U.S. nonresident aliens, are exempt from FICA payroll taxes. All other foreign nationals present in the U.S. on any other work visa type are subject to U.S. FICA taxes.
- If your country of nationality or former residence has a negotiated Totalization or Social Security treaty with the U.S. (where you are currently either employed or self-employed), there may be an opportunity to obtain a retroactive Certificate of Coverage to ensure that you continue to pay in to your home country's social security system for a specified maximum number of years to ensure that you receive full benefit for your social security contributions on earnings in the U.S. Please visit <http://www.ssa.gov/international/> to determine if such an agreement exists in your circumstances.

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