

What Does Foreign (Non-U.S.) Versus U.S. Mean?

It All Depends on What You are Referring to!

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by: Marc J. Strohl, CPA
Protax Consulting Services Inc.
www.protaxconsulting.com

The goal of this article is to provide a comprehensive checklist of information to consider in determining what is 'foreign' for the purposes of differing relevant Internal Revenue Code (IRC) Section(s) (Sec). This article is not designed to teach you the required technical competence required to perform self compliance; however, it will certainly arm you with the technical knowledge to determine if your U.S. Certified Public Accountant (CPA) tax preparer knows all that they should know to provide you with technically competent professional services.

Foreign- the Form 2555- Foreign Earned Income, Exclusion (FEIE), Form 1116- Foreign Tax Credit (FTC), Substantial Presence Test (SPT), Form 8938- Statement of Specified Foreign Financial Asset and Form 114- Report of Foreign Bank and Financial Accounts (FBAR):

Under IRC Sec 911- Citizens or Residents of the United States Living Abroad- the FEIE, IRC Sec. 901- Foreign Tax Credit and IRC Sec. 7701(b) Definition of Resident Alien and Non Resident Alien and use of an international income tax treaty, IRC Sec. 6038D- Foreign Asset Reporting and under Department of Treasury Regulations Title 31 CFR 1010.350- Money and Finance Treasury Report of Foreign Bank and Financial Accounts (FBAR) - the concept of 'foreign' plays a critical role in determining whether income, income taxes, physical presence, Specified Foreign Financial Assets or foreign accounts qualify for respective exclusions, credits, residency or disclosure.

In all cases the concept of 'foreign' takes on a different meaning.

IRC Sec 911/ §1.911-2(g)-(h)- Citizens or Residents of the United States Living Abroad- the FEIE:

Under IRC Sec. 911, there is a provision to avoid "double taxation". The provision is reportable on IRS Form 2555- Foreign Earned Income, Exclusion (FEIE). The tests to use the FEIE are the: the Bonfide Resident Test (BFR), or Physical Presence Test (PPT) and Tax Home Test (THT) where you must live, reside, work or be physically present in a 'foreign country'.

For these above purposes, a 'foreign country' is defined as any territory under the sovereignty of a government other than the United States. 'Foreign country' does not include ships or aircraft traveling in or above international waters. Nor does it include offshore installations which are located outside the territorial waters of any individual nation.

Additionally, the term 'foreign country' includes the country's airspace and territorial waters, in addition to the seabed and subsoil of those submarine areas adjacent to the country's territorial waters over which it has exclusive rights under international law to explore and exploit the natural resources.

The term 'foreign country' does not include the Antarctica (a Continent not a foreign country) or U.S. possessions, such as Puerto Rico, Guam, the Commonwealth of the Northern Mariana Islands, the U.S. Virgin Islands and Johnston Island.

Sub-notes- there is a possession exclusion available to individuals who are BFR of American Samoa for the entire tax year. See Form 4563- Exclusion of Income for Bona Fide Residents of American Samoa. Puerto Rico and U.S. Virgin Islands- may not claim the FEIE however residents of Puerto Rico generally are not subject to U.S. tax on Puerto Rican source income.

IRC Sec. 901- Foreign Tax Credit/ §1.901-2(g)(2)/ Form 1116- Foreign Tax Credit:

Under U.S. domestic law IRC Sec. 901 and also included in most federally negotiated international income tax treaties, there is a provision to avoid “double taxation”. The provision is reportable on IRS Form-1116- as the “Foreign Tax Credit” (FTC).

The FTC is a dollar-for-dollar reduction of U.S. tax- for the General Limitation category- in respect of non-excluded foreign tax on non-excluded foreign income.

For this purpose, a ‘foreign’ tax and income are defined as belonging to a foreign country or a U.S. possession. A foreign country includes any foreign state and its political subdivisions. A foreign city or province qualify. A U.S. possession includes Puerto Rico, Guam, the Northern Mariana Islands and American Soma.

IRC Sec. 7701(b)(1)(A)(2) Definition of Resident Alien and Non-Resident Alien:

Under IRC Sec 7701(b) All individuals meeting the Substantial Presence Test (SPT)- comprising the addition of the actual days of U.S. presence in the current year with a fractional two year look back rule- are U.S. resident aliens.

You meet the SPT if you have at least 31 days of U.S. presence in the current year *and* where the following sums to 183 days or greater: 100 % 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.

Under IRC Sec §301.7701(b)-1(c)(2)(ii) The term U.S. includes all 50 states and the District of Columbia (DC), the territorial waters of the U.S. and the seabed and subsoil of those submarine areas that are adjacent to U.S. territorial waters and over which the U.S. has exclusive rights under international law to explore and exploit natural resources. The term U.S. does not include U.S. possessions and territories or U.S. airspace.

Additionally, to add a twist, in limited circumstances an individual’s physical days of U.S. presence may be excluded (be considered ‘foreign’) for purposes of determining the SPT, in cases where they were:

a) exempt individuals IRC Sec 7701(b)(5): (i)/ §301.7701(b)-3. a student in the U.S. on a F, J, M or Q visa, a trainee or a teacher in the U.S. on a J or Q visa, (ii) a professional athlete, or (iii) IRC Sec. 7701(b)(3)(D) an individual with a medical condition, or

b) others IRC Sec 7701(b)(7)/ §301.7701(b)-3.: (i) regular commuters to work in the U.S. from Canada or Mexico, (ii) when in transit in the U.S. between other points for less than 24 hours, (iii) days in the U.S. as a crew member of a foreign vessel and (iv) all employees of international organizations or foreign governments.

c) IRC Sec 7701(b)(3)(B)/ §301.7701(b)-2- In cases where 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, 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.

d) Relief under a U.S. income tax treaty article covering residency, generally referred to as the “treaty tiebreaker” Article, usually Article IV.

Department of Treasury Regulations Title 31 CFR 1010.350- Money and Finance Treasury- Form 114- Report of Foreign Bank and Financial Accounts:

For FBAR reporting and disclosure purposes, the United States includes the 50 States, District of Columbia, all United States territories and possessions (e.g., American Samoa, the Commonwealth of the Northern Mariana Islands, the Commonwealth of Puerto Rico, Guam, and the United States Virgin Islands), and the Indian lands as defined in the Indian Gaming Regulatory Act.

IRC Sec. 6038D- Foreign Asset Reporting

Under IRC Sec 6038D- Information with Respect to Foreign Financial Assets- “Foreign” in A Specified ‘Foreign’ Financial Asset is defined as:

(i) any Financial Account maintained by a Foreign Financial Institution, defined under IRC Sec 1471(d)(4) as a financial institution that is not a U.S. entity, such term shall not include a financial institution which is organized under the laws of any possession of the United States.

(II) A Stock or Security issued by a person other than a U.S. person, (which includes under the laws of a U.S. possession),

(iii) A Financial Instrument or Contract with an Issuer or Counterparty, which is other than a U.S. person (which includes under the laws of a U.S. possession), and

(iv) an interest in a Foreign Entity, defined as any entity that is not a U.S. person.

Where a U.S. possession is defined under IRC Reg 1.6038D-1(5) as the American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, or the U.S. Virgin Islands.

A U.S. Person is defined under IRC Sec 7701(a)(30) as a 7701(a)(30)(A) a citizen or resident of the United States, 7701(a)(30)(B) a domestic partnership, 7701(a)(30)(C) a domestic corporation, 7701(a)(30)(D) any estate (other than a foreign estate, within the meaning of paragraph (31)), and 7701(a)(30)(E) any trust if— 7701(a)(30)(E)(i) a court within the United States is able to exercise primary supervision over the administration of the trust, and 7701(a)(30)(E)(ii) one or more United States persons have the authority to control all substantial decisions of the trust.

Marc J. Strohl, CPA is a Principal at Protax Consulting Services Inc.

He may be reached at: Tel: (212) 714-1805, Fax: (212) 714-6654

Email: mstrohl@protaxconsulting.com

Web site: www.protaxconsulting.com