Ways in and Out of U.S. Tax Residency

To Be or Not To Be a U.S. Resident Alien!

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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 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 required 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.

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. income tax on their worldwide income, regardless of where the income is earned, the type of currency, or the geographical location of where the income is deposited.

All U.S. nonresident aliens are income 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 premise of taxation 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:

Individuals may be classified as U.S. resident aliens if they meet the SPT. If they fail the SPT they are automatically classified as U.S. nonresident aliens.

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 first 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 immediately preceding 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 simply 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 minimis days may be excluded from U.S. presence for the determination of the SPT start date.

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

First-year election- Under IRC Sec 7701(b)(4)- applies to individual taxpayers who do not meet the SPT test in the year of entry, they may elect to be treated as a U.S. resident alien from the date of entry forward when and if:- i) they are a U.S. nonresident alien in the prior tax year, ii) they are a U.S. resident alien under SPT in the following tax year, iii) they may elect to be treated as U.S. resident aliens *from the date of entry forward* if during the arrival year they are present in the U.S. for 31 consecutive days and iv) from the first day of that 31 consecutive day period to December 31 the alien is present in the U.S., for at

least 75% of the time, where up to 5 days of absence from the U.S. can be disregarded and treated as days present in the U.S.

This above election is not available to individuals, as above, whose days were either excludable under the SPT as above as either *Exempt* or *Other* individuals, under IRC Sec 7701(b)(3)(D) as defined by 7701(b)(5)(A-D) or IRC Sec 7701(b)(7).

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 making the election may facilitate the breaking of tax 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) IRC Sec 6013(g) a December 31 U.S. resident alien married to a December 31 U.S. nonresident alien, which applies to the tax year made and all subsequent tax years or b) IRC Sec 6013(h) to two dual status December 31 U.S. resident aliens, which applies to the first elected tax year only. This IRC Sec 6013(h) election may only be made once in a lifetime.

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, to credit out dollar for dollar or exclude this foreign income taken into taxation under this election.

If neither spouse is a December 31 U.S. resident alien, the *First-year election* under IRC Sec 7701(b)(4) may be used first if applicable, then the *married election* under IRC Sec 6013 may be elected subsequently in series.

To suspend the IRC Sec 6013(g) election- it may be i) Revoked- provided it is made by the extended due date of the tax year wished to be revoked, by white paper signed statement, or ii) Death- of either spouse beginning with the first tax year following the year the spouse died, or iii) Legal separation- under decree of divorce beginning with the tax year in which the legal separation occurs or iv) Inadequate records- as ended by the IRS.

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

Under IRC Sec. 7701(b)(3)(B), the fractional two-year look back period can effectively be 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 first 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. nonresident aliens.

Such U.S. domestic relief, the Closer Connection Exception, is not available in cases where the SPT 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).

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 the individual is:

a. *exempt individuals*: under IRC Sec 7701(b)(3)(D) as defined by 7701(b)(5)(A-D) a student in the U.S. on an F, M, J or Q visa, a trainee or a teacher in the U.S. on a J or Q visa or others on an M or Q visa, a professional athlete to compete in a charitable sports event (with other pre-qualifying conditions), 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.

Exempt individuals need to complete IRS Form 8843, Statement for Exempt Individuals and Individuals with a Medical Condition (and Professional Athletes), and send it to the IRS or when they have a U.S. tax return filing obligation 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 (USCIS) Form(s) I-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 specified J and F visa holders, where:

(i) under IRC Sec 7701(b)(5)(E)(i) **A teacher or trainee- on a J or Q 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 or J or M or Q 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 not 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).

Additionally, 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, are exempt from U.S. taxation.

Marc J. Strohl, CPA is a Principal at Protax Consulting Services Inc.
Seven Penn Plaza, Suite 816, New York, New York 10001
He may be reached at: Tel: (212) 714-1805, Fax: (212) 714-6654
Email: mstrohl@protaxconsulting.com
Web site: www.protaxconsulting.com