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**Communications & Liaison Division**

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## Determining Tax Residency Status

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## Welcome to Today's IRS Webinar

### Determining Tax Residency Status



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Senior Revenue Agent

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## Determining Tax Residency Status



Bethany Krause and Tracy McFee

June 27, 2019

*The information contained in this presentation is current as of the date it was presented. It should not be considered official guidance.*

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### Objectives

- Explain the impact of residency status on U.S. taxation
- Differentiate residency status under U.S. immigration law versus U.S. tax law
- Determine an individual's residency status for U.S. tax purposes
- Describe the special tax rules that apply to dual-status aliens



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### Taxation Is Based on Tax Residency Status

- U.S. citizens and resident aliens
  - Generally taxed on worldwide income at rates specified in IRC § 1
  - May be subject to employment taxes
  - File Form 1040
- Nonresident aliens
  - Taxed on U.S. source investment income and income that is effectively connected with the conduct of a U.S. trade or business under IRC § 871
  - File Form 1040NR



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U.S. Citizen

- Born in the U.S. or in the U.S. territories of Puerto Rico, U.S. Virgin Islands, Guam, or The Commonwealth of the Northern Mariana Islands.
- Born abroad to U.S. citizen parent(s)
- Granted a Certificate of Naturalization by United States Citizenship and Immigration Services (USCIS)
- Includes a dual citizen of the United States and another country

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Categories of Aliens Under U.S. Immigration Law

**Immigrant Alien:** a person granted the right to reside permanently in the U.S. (also known as a lawful permanent resident or LPR).

**Non-immigrant Alien:** a person granted the right to temporarily reside in the U.S. Generally issued a class of visa (e.g., "A", "B", "F", "G").

**Undocumented Alien:** a person who entered the U.S. illegally or entered legally and overstayed permitted time limit.

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Categories of Aliens Under U.S. Tax Law

**Resident Alien**

- Lawful Permanent Resident (green card)
- Substantial Presence Test
- First Year Election under IRC § 7701(b)(4)

**Nonresident Alien**

- Not a Lawful Permanent Resident
- Did not meet Substantial Presence Test
- Did not make First Year Election

**Dual-Status Alien**

- Both nonresident alien and resident alien in the same tax year

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## Impact of Residency Status on Taxation – Resident Alien

### Resident Alien . . .

- Must report and pay applicable federal taxes on ALL income, regardless of source, unless specifically exempt under the Internal Revenue Code or a tax treaty provision.
- Generally must file Form 1040.



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## Impact of Residency Status on Taxation – Nonresident Alien

### Nonresident Alien

- Is taxed under IRC § 871 on U.S. source investment income and income that is effectively connected with the conduct of a U.S. trade or business, unless the applicable tax is reduced by a tax treaty provision
- Generally files Form 1040NR
- If married to U.S. citizen or resident, may elect to be taxed as U.S. resident and file joint return with spouse under IRC § 6013(g) or (h)



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### Polling Question

When deciding which form (1040 or 1040NR) to file, the determining factor is:

- a. The source of income – domestic or foreign
- b. Residency status for U.S. income tax purposes
- c. Mailing address – domestic or foreign
- d. None of the above



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### Impact of Residency Status on Taxation – Dual-Status Alien

#### Dual-Status Alien

- Is a nonresident alien and resident alien in the same tax year.
- Usually occurs in the year the individual arrives or departs from the United States.
- Generally files “dual-status” return consisting of both Forms 1040 and 1040NR.



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### Rules About Tax Residency

- First, apply IRC § 7701(b) and regulations.
- Then, consider residence articles in income tax treaties.
- If the individual would be treated as a tax resident of both the U.S. and treaty country under domestic law, apply the treaty's tie-breaker rule.



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### Rules About Tax Residency (cont'd)

- A U.S. resident alien who is claiming foreign residency under a treaty's tie-breaker rules must timely file Form 1040NR with an attached Form 8833, *Treaty-Based Return Position Disclosure*, or if not otherwise required to file a return, timely file the Form 8833 separately with the IRS.



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### Residency Start Date Lawful Permanent Resident

- Residency start date:
  - Generally, first day of physical presence in U.S. as a lawful permanent resident
  - If also met the Substantial Presence Test for the year, the earlier of first day of physical presence in U.S. under either test



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### Lawful Permanent Resident Status

- Subject to U.S. taxation whether living in the U.S. or abroad
- Cutting up the green card or remaining outside the U.S. for an extended period of time does not change your tax status from resident alien to nonresident alien.



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### Polling Question

A lawful permanent resident who leaves the United States and shreds his or her green card is no longer subject to U.S. taxation.

- a. True
- b. False



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### Lawful Permanent Resident Status (cont'd)

- A green card holder's U.S. tax resident status continues until their lawful permanent resident (LPR) status is determined to have been rescinded or abandoned under U.S. immigration law.
- Rescission occurs when USCIS or a federal court issues a final removal order.



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### Lawful Permanent Resident Status (cont'd)

- Abandonment occurs when either:
  - The green card holder voluntarily gives up their LPR status by filing USCIS Form I-407, or
  - USCIS administratively, or a federal court judicially, determines the green card holder has voluntarily abandoned their LPR status.



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### Resident Alien Substantial Presence Test

If not a lawful permanent resident, then apply the Substantial Presence Test to determine U.S. tax status.

- Count days on which physically present in the U.S. at any time during the day.
- The term United States does not include U.S. possessions and territories or U.S. airspace.
- Days of presence in the U.S. for certain individuals do not count for purposes of this test.



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### Counting Days for the Substantial Presence Test

- Physically present in the United States:
  - At any time during the day on at least 31 days during the year in question and



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### Counting Days for the Substantial Presence Test (cont'd)

- 183 days during the 3-year period that includes the year in question and the 2 years immediately before that, counting:
  - All days present in U.S. in the year in question and
  - 1/3 of days present in U.S. in the 1<sup>st</sup> prior year and
  - 1/6 of days present in U.S. in the 2<sup>nd</sup> prior year.



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### Substantial Presence Test “Exempt Individual”

- Do not count days as an “exempt individual” (exempt from counting days, not exempt from U.S. income tax):
  - Foreign government-related individual temporarily present in the U.S. under an “A” or “G” visa, other than an “A-3” or “G-5” class visa
  - Teacher or trainee temporarily present in the U.S. under a “J” or “Q” visa and substantially compliant with the requirements of the visa



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### Substantial Presence Test “Exempt Individual” (cont'd)

- Do not count days as an “exempt individual” (exempt from counting days, not exempt from U.S. income tax):
  - Student temporarily present in the U.S. under an “F,” “J,” “M” or “Q” visa and substantially compliant with the requirements of the visa
  - Professional athlete temporarily present in the U.S. to compete in a charitable sports event



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### Substantial Presence Test “Exempt Individual” (cont’d)

- Do not count days in the U.S.:
  - Due to medical condition that arose while in the U.S.
  - Less than 24 hours while in transit between two places outside the U.S.
  - As a regular commuter from Canada or Mexico



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### Substantial Presence Test “Exempt Individual” (cont’d)

- Do not count days in the U.S.:
  - As a regular crew member of a foreign vessel engaged in transportation between the U.S. and a foreign country or U.S. territory, **UNLESS** you otherwise engaged in any trade or business in the U.S. on those days.
- Form 8843, *Statement for Exempt Individuals and Individuals with a Medical Condition*



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### Residency Starting Date and Termination Date – *De Minimis* Rule

- An individual may be in the U.S. for up to 10 days without triggering his or her residency starting date or extending his or her residency termination date if:
    - Able to establish that, during that period, his or her tax home was in a foreign country, and
    - He or she maintained a “closer connection”\* to that foreign country than to the U.S.
- \* Closer Connection = stronger tie / more significant contacts



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### De Minimis Rule (cont'd)

When disregarding days under this rule, an individual:

- Must be able to establish that, on those days, he or she had a closer connection to a foreign country and had a tax home in that foreign country.
- May disregard days from more than one period as long as the total days in all periods is not more than 10.



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### De Minimis Rule (cont'd)

- May not disregard any days in a period of consecutive days of presence unless all days in that period can be disregarded.

NOTE: Disregarded days still count as days of presence for purposes of determining whether the Substantial Presence Test is satisfied.  
Treas. Reg. § 301.7701(b)-4(c)



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### Residency Ending Date

- Generally, the last day of the calendar year.
- However, if after leaving the U.S., for the remainder of the calendar year the individual:
  - Had a tax home in a foreign country
  - and
  - Maintained a closer connection to that country than to the U.S., then it is the last day of physical presence in the U.S. during the year.



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### Residency Ending Date (cont'd)

- If an individual satisfied the Substantial Presence Test and was also a lawful permanent resident for the same year, residency ending date is the later of:

- Residency ending date under the Substantial Presence Test

or

- First day on which the individual was no longer a lawful permanent resident.



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### Closer Connection Exception to the Substantial Presence Test

An individual who meets the Substantial Presence Test can be treated as a nonresident alien under the closer connection exception if, during the year, he or she:

- Was present in the U.S. less than 183 days, and

- Had a tax home in a foreign country during the entire year, and



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### Closer Connection Exception to the Substantial Presence Test (cont'd)

- Had a closer connection to that foreign country than to the U.S., and

- Had not taken steps toward, and did not have an application pending for, lawful permanent resident status (green card).



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### Closer Connection Exception Factors to Consider

- Location of:
  - Permanent home
  - Family
  - Vehicles and personal belongings
  - Social, political, cultural or religious organizations with which affiliated or involved



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### Closer Connection Exception Factors to Consider (cont'd)

- Location of:
  - Routine banking activities
  - Driver's license / voter registration
  - Business activities, other than those conducted in tax home

Must timely file Form 8840, *Closer Connection Exception Statement for Aliens*, even if not required to file a return.



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### Polling Question

You must file Form 8840, *Closer Connection Exception Statement for Aliens*, as a stand-alone form if you are claiming the "closer connection exception" and are not required to file a U.S. federal income tax return.

- a. True
- b. False



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### **Resident Alien – IRC § 7701(b)(4) First Year Election**

In order to make the first year election to be treated as a dual-status alien for the year of arrival, an individual must satisfy all five of the following requirements:

- (1) Not be a U.S. resident under either the green card test or the substantial presence test during the current calendar year (the "election year"), and
- (2) Not have been a U.S. resident under either test in the calendar year immediately preceding the election year, and



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### **Resident Alien – IRC § 7701(b)(4) First Year Election (cont'd)**

- (3) Satisfy the substantial presence test for the calendar year immediately following the election year, and
- (4) Have been present in the U.S. for at least 31 consecutive days during the election year, and
- (5) Have been present in the U.S. for at least 75% of the days beginning with the first day of the 31-day period and ending with the last day of the election year.



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### **Resident Alien – IRC § 7701(b)(4) First Year Election (cont'd)**

Because individuals do not qualify to make this election until the Substantial Presence Test is met in the following year, they:

- May request an extension and, once the Substantial Presence Test is met, file a Form 1040 including a statement that they are making the election under IRC § 7701(b)(4).
- Must still pay any tax owed by the due date of the return, computed as if they were a nonresident alien for the entire election year.



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### No-Lapse Rule Residency in Preceding Year

- An individual who
  - Was a U.S. resident during any part of the preceding calendar year and
  - Was a U.S. resident for any part of the current year, will continue to be taxed as a resident at the beginning of the current year.

*This applies whether a resident under the substantial presence test or green card test.*

See Treas. Reg. § 301.7701(b)-4(e).



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### No-Lapse Rule Residency in Following Year

- An individual who . . .
  - Was a U.S. resident for any part of the current year, and
  - Was also a U.S. resident for any part of the following year, will be taxed as a resident through the end of the current year, even if he or she had a closer connection to a foreign country than to the U.S. during the current year.

*This applies whether a resident under the substantial presence test or green card test.*

See Treas. Reg. § 301.7701(b)-4(e).



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### Dual-Resident Taxpayer

- An individual who is a tax resident of both the United States and a foreign country with which the U.S. has an income tax treaty, under each country's domestic laws, is referred to as a "dual-resident" taxpayer.  
Treas. Reg. § 301.7701(b)-7(a)
- The "Resident" or "Residence" article of income tax treaties typically has tiebreaker rules for determining a single country of residence of a dual-resident taxpayer for purposes of the treaty.



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### Income Tax Treaty Tiebreaker Rules

- The residence tiebreaker rules in the United States' income tax treaties generally consider these factors in the following order to determine residence:
  - Permanent home
  - Center of vital interest
  - Habitual abode
  - Nationality



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### Income Tax Treaty Tiebreaker Rules (cont'd)

- If these factors do not resolve the issue, the residence articles of most income tax treaties provide that the competent authorities will try to reach an agreement on a single country of residence.
- Each tax treaty is different and must be read carefully.



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### Income Tax Treaty Tiebreaker Rules (cont'd)

- Some treaties require that U.S. citizens or lawful permanent residents satisfy additional requirements to be residents of the United States for purposes of the treaty.



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### Income Tax Treaty Tiebreaker Rules (cont'd)

For example, a treaty might provide that U.S. citizens or lawful permanent residents will *not* be treated as U.S. residents for treaty purposes unless they—

- Have a substantial presence, permanent home, or habitual abode in the United States, and
- Are not treated as residents of a third country under a treaty between the other Contracting State and that third country.



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### Taxation of Dual-Resident Taxpayer

- For any tax year (or portion thereof) for which an individual determines that he or she is a resident of a foreign country for treaty purposes pursuant to the “tiebreaker” rules of an income tax treaty between that country and the U.S., the individual may choose...



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### Taxation of Dual-Resident Taxpayer (cont'd)

- To be treated as a resident of the other country and file as a nonresident alien (Forms 1040NR and 8833, *Treaty-Based Return Position Disclosure*)
- or
- Not to be treated as a nonresident alien and instead file as a resident alien (Form 1040).



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### Joint Return Elections – Nonresident Alien Married to U.S. Citizen or Resident Alien

#### IRC § 6013(g) Election \*

- Allows an NRA who was not a U.S. resident alien during the tax year to be treated as a U.S. resident alien for purposes of most income tax and filing requirements for the entire tax year. Applies to all future years unless suspended or terminated.

#### IRC § 6013(h) Election \*

- Allows an NRA who becomes a U.S. resident alien by the end of the taxable year to be treated as a U.S. resident alien for purposes of most income tax and filing requirements for the entire tax year.

\* Making these elections generally prohibit individuals from claiming benefits under a U.S. income tax treaty as resident of a treaty country.



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### Polling Question

Mary, a U.S. citizen, is married to John, a nonresident alien. John was not a U.S. resident alien at any time during 2018. Can Mary and John make an election to treat John as a resident alien and file a joint U.S. income tax return for 2018?

- a. Yes
- b. No



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### Dual-Status Alien How Income Is Taxed

- Different rules for part of year spent as resident alien and part of year spent as nonresident alien.
- All worldwide income for period of residence and all income effectively connected with a U.S. trade or business for the period of nonresidence, after allowable deductions, is combined and taxed at the graduated tax rates that apply to U.S. citizens and residents.



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### **Dual-Status Alien How Income Is Taxed (cont'd)**

- U.S. source income for period of nonresidence, that is not connected with a U.S. trade or business, is subject to a flat 30% rate or lower treaty rate. No deductions are allowed against this income.



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### **Dual-Status Alien Special Rules**

- Cannot claim the standard deduction but may itemize certain allowable deductions
- May not use "Head of Household" tax rate
- May not file a joint return unless married to U.S. citizen or resident alien and elected with spouse to file jointly



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### **Dual-Status Alien Special Rules (cont'd)**

- If nonresident alien and married to U.S. citizen or resident alien for all or part of the tax year and did not file jointly with spouse:
  - Must use "Married Filing Separately" tax rate
  - May not take Earned Income Credit, Credit for Elderly or Disabled, or Education Credit



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## Dual-Status Alien Filing Requirements

Return consisting of both Forms 1040 and 1040NR, if the individual . . .

- Was a resident alien on 12/31 and began the year as a nonresident alien – must file Form 1040 ("Dual Status Return") with Form 1040NR ("Dual Status Statement") attached.
- Was a nonresident alien on 12/31 and began the year as a resident alien – must file Form 1040NR ("Dual Status Return") with Form 1040 ("Dual Status Statement") attached.



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## Taxation is Based on Tax Residency Status

- U.S. citizen
- Resident alien
  - Lawful permanent resident (green card)
  - Substantial presence test
  - First year election
- Nonresident alien (if married to U.S. citizen or resident alien, may choose to file jointly and be treated as resident alien)
- Dual-status alien (year of arrival, departure and/or expatriation)



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## Resources

- Publication 519, *Tax Guide for Aliens*
- <https://www.irs.gov/Individuals/International-Taxpayers>
- <https://www.irs.gov/Businesses/International-Businesses/United-States-Income-Tax-Treaties---A-to-Z>
- Taxpayer Assistance: 1-800-829-1040
- Taxpayer Assistance Outside the United States: 00-1-267-941-1000



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## Practice Units

Available at:  
<https://www.irs.gov/businesses/corporations/practice-units>

- Determining Tax Residency Status of Lawful Permanent Residents
- Substantial Presence Test
- First Year Election Under IRC 7701(b)(4)
- Election Under 6013(g)
- Election Under 6013(h)



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## Key Points

- Your residency status for U.S. tax purposes is very important and affects how you are taxed—it determines your filing status, the amount of your income that is subject to U.S. income tax, which deductions, credits, and exemptions you may claim, and the applicable tax rates.
- The U.S. generally taxes its citizens and residents on worldwide income. They may also be subject to employment taxes.



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## Key Points

- Residency concepts under U.S. tax law and U.S. immigration law are not synonymous. A nonimmigrant or an undocumented alien under U.S. immigration law, could, depending on the circumstances, be a resident alien, dual-status alien, or nonresident alien under U.S. tax law.



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### Key Points

- A resident alien is an individual who is a lawful permanent resident of the United States, meets the substantial presence test, or makes a first-year election under IRC § 7701(b)(4).
- Cutting up the green card or remaining outside the U.S. for an extended period does not change an individual's status from resident to nonresident alien for tax purposes.



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### Upcoming Webinars

- For information on future webinars, visit [IRS.gov](https://www.irs.gov) and use keyword search "webinars."
- Visit the IRS Video Portal for a variety of video and audio topics.
- [www.irsvideos.gov](https://www.irsvideos.gov)



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### Certificates & Continuing Education

- Certificates of Completion will be emailed within the next few weeks.
- If you are eligible for Continuing Education from the IRS, the credit will be posted in your PTIN account.
- If you have not received your certificate and/or credit by July 25<sup>th</sup>, please email us:

CL.SL.Web.Conference.Team@IRS.gov



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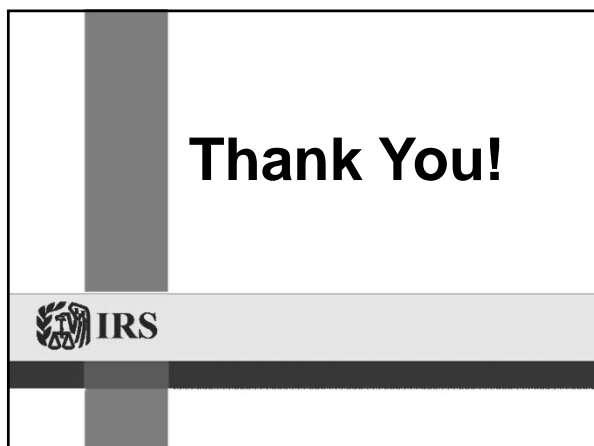
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