



IRS Nationwide Tax Forum | 2021

Determining an Individual's Tax Residency Status
July 29, 2021

Start Time: 11:00 AM Eastern / 10:00 AM Central
9:00 AM Mountain / 8:00 AM Pacific

Note: You should be hearing music while waiting for webinar to start.

Having Technical Issues?

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Objectives

- Determine an individual's tax residency status under U.S. tax law
- Identify the filing requirements for individuals who are tax residents of the United States under U.S. tax law, those who are not, and those who are both resident and nonresident in the same year (dual status)
- Specify the federal income tax filing requirements for individuals with income from a U.S. territory



Taxation Is Based On Tax Residency Status

- U.S. citizens and residents
 - Generally taxed on worldwide income at rates specified in Internal Revenue Code (IRC) § 1
 - May be subject to employment taxes
- Nonresidents
 - 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

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

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.



Categories of Noncitizens Under U.S. Tax Law

Resident

- Lawful Permanent Resident (green card / Form I-551)
- Substantial Presence – IRC § 7701(b)(3)
- First Year Election – IRC § 7701(b)(4)

Nonresident

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

Dual-Status

- Both nonresident and resident in the same tax year

Lawful Permanent Resident (LPR)

- Authorized to permanently live and work in U.S. (green card / Form I-155)
- Subject to U.S. taxation whether living in U.S. or abroad
- Residency start date is 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

Lawful Permanent Resident (LPR) (cont'd)

LPR status continues until:

- A final USCIS administrative or judicial order of exclusion, deportation or abandonment is issued, or
- The individual signs USCIS Form I-407, *Abandonment of Lawful Permanent Resident Status*, and returns the green card to USCIS or a consular office

Cutting up the green card or remaining outside the U.S. for an extended period does not change the individual's tax status from resident to nonresident.



Substantial Presence Test (SPT)

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

- Count days on which physically present in the United States at any time during the day
- “United States” does not include U.S. territories or U.S. airspace
- Certain days of presence do not count for purposes of this test [Treas. Reg. 301.7701(b)-3]

Counting Days for SPT

Physically present in the United States:

- At any time of the day on at least 31 days during the year in question, **and**
- At least 183 days during 3-year period counting:
 - All days present in U.S. during year in question, and
 - 1/3 of days present in U.S. during prior year, and
 - 1/6 of days present in U.S. in year before that



Residency Start and End Dates – SPT

- If not a U.S. resident in the prior year, **residency start date** is generally the first day of presence in the U.S. during the calendar year in which met the SPT
- If also an LPR for that year, residency start date is the earlier of the first day of presence in U.S. under either test
- **Residency end date** for an individual who met the SPT is generally the last day of the calendar year

Closer Connection Exception to SPT

Allows individual who met the SPT to be treated as nonresident if, during the year in question, they:

- Were present in U.S. less than 183 days, **and**
- Had tax home in foreign country during entire year, **and**
- Had closer connection to that country than to U.S., **and**
- Had not taken steps toward, and did not have an application pending for, LPR status (green card), **and**
- Submitted Form 8840, *Closer Connection Exception Statement for Aliens*

First Year Election – IRC § 7701(b)(4)

Must meet **all** the following:

- Not have been LPR or met SPT during current calendar year (“election year”)
- Present in U.S. 31 consecutive days during election year
- Present in U.S. on at least 75% of days beginning with first day of 31-day period and ending with last day of election year
- Not have been LPR or met SPT in year before election year
- Qualify as resident under SPT in year after election year



No-Lapse Rule – Reg. 301.7701(b)-4(e)

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

An individual who is a U.S. resident for any part of the current year **and** is also a U.S. resident for any part of the following year, regardless of whether the individual has a closer connection to a foreign country than to the U.S. during the current year, **will continue** to be taxed as a U.S. resident through the end of the current year.



Nonresident

A nonresident is an individual who . . .

- Is not a U.S. citizen,

- Is not an LPR (“green card holder”),

- Did not meet the SPT, and

- Did not make a first-year election under IRC § 7701(b)(4).



Impact of Residency Status On Taxation – U.S. Citizen or Resident

- 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



Impact of Residency Status On Taxation – Nonresident

- Taxed under IRC § 871 on U.S. source investment income and income 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)



Impact of Residency Status On Taxation – Dual Status

- Nonresident and resident in the same tax year
- Usually occurs in the year of arrival or departure from the United States
- Different rules for part of year spent as resident and part of year spent as nonresident
- Generally, files “dual-status” return consisting of both Forms 1040 and 1040NR
- Special rules apply – no standard deduction, cannot file as head-of-household, etc.



Dual-Resident

An individual who is a U.S. resident for U.S. tax purposes may also be treated as a resident of a foreign country with which the United States has an income tax treaty, under that country's domestic law. Treas. Reg. § 301.7701(b)-7(a).

The “Residency” article of an income tax treaty typically has tiebreaker rules for determining a single country of residence for a dual-resident taxpayer for purposes of the treaty.



Taxation of Dual-Resident

For the taxable year (or portion thereof) during which an individual is a resident of a foreign country under the tiebreaker rules of an income tax treaty between that country and the U.S. may choose to:

- File as a U.S. resident (Form 1040), or
- Be treated as a resident of the other country and file as a nonresident (Forms 1040NR and 8833, *Treaty-Based Return Position Disclosure*)

Expatriation

A U.S. citizen or long-term resident* who expatriates on or after 06/17/2008 is a “covered expatriate” subject to IRC § 877A, if:

- Average annual net income tax liability for 5 years ending before expatriation exceeds a specified amount, or
- Net worth of \$2 M or more as of date of expatriation, or
- Failed to certify compliance with all U.S. federal tax obligations for the 5 taxable years preceding expatriation by filing Form 8854

* LPR in at least 8 of the last 15 years ending with the year of expatriation

U.S. Territory Taxation

The U.S. territories of American Samoa, the Commonwealth of Northern Mariana Islands (CNMI), Guam, Puerto Rico and the U.S. Virgin Islands (USVI) each have their own independent tax departments that administer their respective territorial income tax law.

Individuals with U.S. territory income may be required to file an income tax return with the territory, the IRS or both. Which return(s) an individual must file depends on:

- Bona fide residence in one of these five U.S. territories, and
- Sources of income

Bona Fide Residency In U.S. Territory

To be a bona fide resident (BFR) of a U.S. territory for a particular year, an individual must meet **all** the following:

- Be present in the relevant territory for at least 183 days during the year or satisfy one of the other four alternative tests set forth in Treas. Reg. 1.937-1(c)
- Not have a tax home outside the relevant territory
Treas. Reg. 1.937-1(d)
- Not have a closer connection to the U.S. or to a foreign country than to the relevant territory
Treas. Reg. 1.937-1(e)

U.S. Territory Income Taxation – BFR

All BFRs of U.S. territories must report their worldwide income to the relevant territory.

A BFR of American Samoa or Puerto Rico with income from sources outside the territory must also file a U.S. Form 1040 reporting worldwide income and excluding income from sources in that territory, other than amounts received for services as an employee of the US government.

- Other than reporting worldwide income, a nonresident of the United States will still be treated as a nonresident – no standard deduction, etc.



Taxation If U.S. Citizen or Resident and Not BFR of U.S. Territory

A U.S. citizen or resident who is not a BFR of a U.S. territory with income from Puerto Rico or American Samoa:

- Must report to Puerto Rico or American Samoa only the income from that respective territory
- Must file a U.S. Form 1040, reporting worldwide income
- May claim a credit for taxes paid to Puerto Rico or American Samoa



Taxation If U.S. Citizen or Resident and Not BFR of U.S. Territory (cont'd)

A U.S. citizen or resident who is not a BFR of a U.S. territory with income from:

- USVI must file a U.S. Form 1040 reporting worldwide income and file an identical copy with USVI (with Form 8689 to allocate USVI)
- CNMI must only file a U.S. Form 1040 reporting worldwide income (with Form 5074 to allocate tax to CNMI)
- Guam must only file a U.S. Form 1040 reporting worldwide income (with Form 5074 to allocate tax to Guam)



Taxation If Not U.S. Citizen or Resident and Not BFR of U.S. Territory

An individual who **is not** a U.S. citizen or resident and **is not** a BFR of a U.S. territory with income from a U.S. territory must:

- Report to the territory only income from that territory
- File a U.S. Form 1040-NR to report any U.S. source income

U.S. Territories – Self-Employment Tax

American Samoa, CNMI, Guam, Puerto Rico and USVI do not have separate systems for social security.

Self-employed individuals who live and work in these U.S. territories must report and pay self-employment tax to the IRS. Depending on the circumstances, report self-employment tax to the IRS using:

- Schedule SE with Form 1040 or 1040-NR, or
- Form 1040-SS or 1040-PR



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Resources – Publications

- IRS Publication 519, *U.S. Tax Guide for Aliens*
- IRS Publication 570, *Tax Guide for Individuals With Income From U.S. Possessions*
- IRS Publication 901, *U.S. Tax Treaties*



Resources – Practice Units

- Determining Tax Residency Status of Lawful Permanent Residents
- Substantial Presence Test
- First-Year Election Under IRC § 7701(b)(4)
- Election Under IRC § 6013(g)
- Election Under IRC § 6013(h)
- Determining an Individual's Residency for Treaty Purposes
- U.S. Territories – Determining Bona Fide Residency Status
- U.S. Territories – Self-Employment Tax