

Prefer An American Work Experience?

Some US 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 US person to consider prior to accepting an assignment inside the US. 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 US tax preparer knows all that they should know to provide you with technically competent professional services.

Taxation in Your Former Country of Residence/ Nationality:

While most countries tax their individuals based on their "tax residency," a legal tax status, the U.S. taxes its individuals based on their legal immigration status-citizenship (and legal residence or "green card").

"Tax residency" 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 on departure. Such tax non-residents are taxed only on income earned in the prior tax residence country. Tax residence is reestablished if and when the taxpayer returns to the country.

An overriding tax resident principle is that tax residents of a particular country are taxed in that country on their worldwide income and tax non-residents of a particular country are taxed in that country only on income from that country and not on their worldwide income.

Therefore if a taxpayer were to continue to maintain a source of income from your former country of tax residence or nationality, that income would continue to be taxed. A basic taxation premise is that the country of income source maintains 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.

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

All United States (U.S.) citizens, green card holders and foreign national individuals in the US 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 US resident aliens.

Individuals meet the SPT if they have at least 31 days of U.S. presence in the current year *and* where 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. 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.

Ways Out of U.S. Tax Residency:

Under U.S. domestic law, the fractional two-year look back rule 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 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 a US-XX income tax treaty article covering residency, generally referred to as the “treaty tiebreaker” article (see below).

Therefore, individuals may be classified as a U.S. resident aliens if they meet the above SPT. If they fail the SPT they are automatically classified as a US non resident aliens. 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: a student in the US on a F, J, M or Q visa, a trainee or a teacher in the U.S. on a J or Q visa, a professional athlete, or an individual with a medical condition, or b) others: regular commuters to 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.

There are EXCEPTIONS to the Exempt individual rules above, where:

(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) 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 than to the U.S.; 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.

Consequences of Filing as a US Nonresident alien/ Becoming a US Resident Alien:

All U.S. resident aliens are subject to U.S. tax on their worldwide income, regardless of where the income is earned, then type of currency, or the location where the income is deposited. All U.S. nonresident aliens are taxable in the U.S., only on US source income. Income effectively connected with a US trade or business, includes compensation income but excludes passive income.

Effectively connected income is reported on Form 1040NR page 1 at U.S. regular graduated tax rates and non effectively connected income is reported on Form 1040NR page 4 on Schedule NEC at the flat rate tax

of 30% or as reduced by treaty.

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 rigorous.

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 here 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 US 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 that 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 and may NOT file jointly. They cannot use the Head of Household filing status or the Standard deduction.

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

Individual taxpayers entering 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 to US 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.

Likewise 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:

In addition to a facts and circumstances “domicile” rule, many states have enacted a “statutory residence rule”. The main purpose of the statutory residence rule is to catch those individuals claiming a foreign state as their state of domicile, where the statutory residence rule sets down rules as to physical days of respective presence, and in some circumstances subjective terminology such as a “Permanent Place of Abode”, which has generally come to represent: a temporary stay, for a fixed and limited period of time and for a particular business purpose. For more information on state residency issues, please consult us separately.

Starting Date:

For persons who were not U.S. resident aliens at all during the prior tax year and meet either the above SPT or green card test their first day of presence (making them US resident aliens) will be counted starting: 1) (for the SPT)- the first day that they enter the U.S. in the year in which they meet the SPT, excluding up to 10 de minimus days of prior presence, and 2) (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 they meet the SPT, their first day of US residence is considered to be the actual date that the new non-exempt visa takes effect per US Citizenship and Immigration Services (USCIS) notification of approval.

Ending Date- Expatriation Rules IRC Sec. 877 and Closer Connection:

For persons obtaining U.S. resident alien status as a result of U.S. citizenship or as green card holders, residency continues until renouncement or abandonment. In either case if certain income, asset and filing tests are met there is a presumption of US tax avoidance requiring the renouncer or abandoner to have (effective June 17, 2008) a onetime mark-to-market tax imposed on the property's net unrealized gains exceeding \$651,000- for 2012 (\$636,000- for 2011, \$627,000- for 2010 and 2009- \$626,000) from the original 2008- \$600,000 when the law was first implemented.. (Old Rules required- the continuance to file U.S. nonresident alien Form 1040NR tax returns on all U.S. source investment income for a period of ten subsequent years.). For more detailed information please see Article- **Choosing to Renounce U.S. Citizenship or Legal Permanent Residence (Green Card) Departures Effective June 17, 2008 Forward-**

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 US resident alien up to December 31 of that tax year, unless 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 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.

After Ending:

The "No Lapse" Rule- 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 and thus 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 just above)- a U.S. resident alien who after having been a U.S. resident during three consecutive calendar years and then having ceased this status, becomes a US resident alien again before the close of that 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 thrown into the regime for taxation of U.S. citizens and residents, 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 -2063- U.S. Department Alien Income Tax Statement- are used to obtain a certificate or permit. The purpose of both forms is to obtain Certificates of Compliance or Sailing or Departure Permits for SPT non-excepted 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 a Certificate of Compliance. This Certificate of Compliance 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 filed later after departure (on the regular due date). Theoretically, any alien that tries to leave the U.S. without a sailing or departure permit may be subject to an income tax examination by an IRS employee at the point of departure. They then would then be made to complete the required income tax returns and statements and usually pay any taxes owed. Certificate of Compliance or Sailing or Departure 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 USCIS, or U.S. Customs would know that an alien is departing the U.S. permanently. Based upon years of practical experience regarding the preparation of Forms(s) 1040-C or 2063, it is not recommended that you obtain a Certificate of Compliance or Sailing or Departure Permit.

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:

- 1 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”.
- 2 Article VI- Income from Real Property: typically real property is real-estate, so 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.
- 3 Article X- Dividends: seeks to reduce the U.S. 30 percent flat tax lower as per specific treaty country.
- 4 Article XI- Interest: seeks to reduce the U.S. 30 percent flat tax lower as per specific treaty country.
- 5 Article XIII- Gains: covering capital gains from the disposition of assets this article seeks to reduce the U.S. 30 percent flat tax 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.
- 6 Article XIV- Independent Personal Services: seeks to address the taxation of income from self-employed persons.
- 7 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 US.
- 8 Article XVI- Artistes and Athletes: seeks to address the taxation of income from such persons.

- 9 Article XXII- Other Income: seeks to address the taxation of all other income not addressed elsewhere.
- 10 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.
- 11 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:

- 1 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.
- 2 Typically in the case of U.S .persons- citizens and green card holders- the U.S. has conveniently slipped in to most income treaties (generally under "Miscellaneous Rules") , a provision to enable the U.S. to tax as if the income tax treaty did not exist. This is typically referred to as a "Savings Clause" or "Limitation on Benefits Clause".
- 1 F, J or Q visa holders remaining as U.S. nonresident aliens, shall not include in their gross income for US tax purposes compensation paid to them by a foreign employer.
- 2 Under the IRS IRC, the compensation of non US 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 shall be exempt from US taxation.
- 3 Under the IRS IRC, while a U.S. nonresident alien, interest income derived from U.S. bank deposits is exempt from U.S. taxation.
- 4 Foreign national individuals who are not eligible to obtain a U.S social security number (SSN) (since they are not U.S. citizens, not U.S. green card holders or do not have valid U.S. work authorization) are able to obtain a U.S. Individual Tax Identification Number ("ITIN") valid for 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. As either original or notarized copies of originals are required to accompany the Form W-7 application, it is recommended that you either: 1) apply in an IRS office directly or 2) (outside the U.S.)- approach a U.S. embassy or consulate or "Acceptance Agent" to certify your documents, as the transfer of original documents is an unwarranted risk. A U.S. notary may notarize copies of such documents. But it must be a U.S. notary public, not a consulate or embassy notary. Generally a U.S. notary public is not authorized to transact outside their jurisdictional commission.
- 1 Sale of Principal residence: In the five year window prior to sale of your principal residence you must have: 1) owned *and* 2) used or lived in the home for at least two years (24 months or 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.

If you do not have the two years for both tests you will not qualify for the exclusion unless you have a change in location of employment, health reasons or for unforeseen circumstances.

Obviously the handicap for expatriates 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%.

Other Matters:

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

- 1 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.
- 1 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.
- 2 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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