

## 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:

Most countries, except the US which taxes its individuals based upon their legal immigration status-citizenship (and legal residence or "green card"), taxes its individuals based upon their "tax residency" a legal tax status. "Tax residency" is determined by a variety of facts and circumstance tests or features unique to each countries tax system. E.g.: permanence and purpose of stay, personal property and social ties, spouse, dependents and dwelling, etc...In some cases establishing tax ties in another country become part of those tests or features. Tax residency allows an individual to leave their former country of residence or nationality and become tax non-residents upon departure, recognizing our changing world, its emerging trading blocks and trade agreements. They therefore, become tax nonresidents meaning they only remain taxable in their former country on income from that country. Until such time as they move back resuming their residency and becoming a tax resident once again.

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 you 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 to you in that country as a nonresident of that country. A basic taxation premise is that the country of income source maintains the first right of taxation over that particular income. 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 US Resident Alien:

All United States (US) 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 US presence in the current year with a fractional two year look back rule- are US resident aliens.

You meet the SPT if you have at least 31 days of US presence in the current year and where the following sums to 183 days or greater: 100 % of the physical days of US presence in the current year + 1/3 of the days of US presence in the preceding year + 1/6 of the days of US presence in the second preceding year. For the purposes of the SPT part 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 US calendar tax period basis for an individual to continue to be considered a continuing US resident alien year after year.

### Ways Out of US Tax Residency:

Under US domestic law the fractional two year look back rule is effectively negated when an individual meets the SPT to become a US 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 US non resident aliens.

Such US domestic relief- the Closer Exception Connection- is not available in cases where the SPT test is met based upon days of US presence in the current year alone. In such cases, the US resident alien would need to seek relief under a US-XX income tax treaty article covering residency, generally referred to as the “treaty tiebreaker” article. Please see below.

Therefore, an individual may be classified as a US resident alien if they meet the above SPT, failing which they are automatically classified as a US non resident alien. In limited circumstances an individual’s physical days of US 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 US 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 US from Canada or Mexico when in transit in the US between other points for less than 24 hours, days in the US 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 US tax return, either IRS Form 1040NR or 1040.

Income from personal services performed as a US nonresident alien temporarily in the US 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 US taxation.

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

All US resident aliens are subject to US tax on their worldwide income, regardless of where the income is earned, what currency it is in, or where the income is deposited to. All US nonresident aliens are taxable in the US, 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 US regular graduated tax rates and non effectively connected income is reported on Form 1040NR page 4 at the flat rate tax of 30% or a reduced treaty rate.

US nonresident alien filers cannot: use the standard deduction, use all the itemized deductions afforded to US resident aliens, and they cannot 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 US reporting purposes, as in the US 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 US has two statuses in a single tax year, example when they go from a nonresident to resident status or vice-versa in the same US tax calendar year, they are called dual-status filers in recognition of these two statuses. The tax return that a dual status individual files is according to their status on December 31 of that tax year. Additionally 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. An actual US tax return, 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 from the return covering only the statement period.

Dual Status filers if married must file separately and NOT jointly. They cannot use the Head of Household filing status or the Standard deduction.

#### Elections to be Treated as a US Resident Alien:

Individual taxpayers entering the US at some point in the tax year and whom do not meet the SPT test in that US tax year, may elect to be treated as US resident aliens from the date of entry forward only if they meet certain criteria. This election is not available to individuals, as above, whose days were either exempted or excludable under the SPT. This election to be treated as a US 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 US resident aliens. This election applies to either: a) a full year US resident alien married to a December 31 US nonresident alien or b) to two dual status December 31 US resident aliens. This election to be treated as US resident aliens for the full US 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 US 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 US 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:

Many states have enacted in addition to a facts and circumstances "domicile" rule, 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". Permanent Place of Abode has generally come to represent: a temporary stay, for a fixed and limited period of time and for a particular business purpose. Certainly this discussion should be conducted on a state by state basis as results do vary from state to state. For more information on state residency issues, please consult us separately.

#### Starting Date:

For persons who were not US 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) SPT- their first day that they enter the US in the year in which they meet the SPT, excluding up to 10 de minimus days of prior presence, and 2) green card test- the first time that they land on US soil with a valid green card.

In cases where an individual goes from an exempt to a non-exempt visa status, 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:

For persons obtaining US resident alien status as a result of US 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 \$600,000. (Old Rules required- the continuance to file US nonresident alien Form 1040NR tax returns on all US source investment income for a period of ten subsequent years.)

For persons obtaining US resident alien status as a result of compliance with the SPT, US 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 they file a "closer connection" white paper statement claiming a "tax home" and "closer connection" to a foreign country as at their actual physical date of departure. A wise move as it is required to avoid continued US residence and taxation on worldwide income. However where joint taxpayers choose to remain US residents up to December 31 for tax minimization reasons departing earlier, 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 US tax residency in one calendar tax year a non resident alien returns to the US and resumes US tax residency at any time during the subsequent calendar tax year, the intervening period between non residency and residency is deemed to be a resident period and thus there are worldwide US 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 US resident alien who after having been a US resident during three consecutive calendar years and then having ceased becoming a US resident alien, again becomes a US resident alien 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 US nonresident aliens, but they are thrown into the regime for taxation of US citizens and residents, that is graduated rates of taxation on all income except that generally only US source income is taxed.

IRS Form(s) 1040C- US Departing Alien Tax Return- and/or -2063- US Department Alien Income Tax Statement- are very misunderstood and are used to obtain a very misunderstood certificate or permit. The purpose of both forms is to obtain Certificates of Compliance or Sailing or Departure Permits for SPT non-expected US resident aliens who depart the US permanently, in order to ensure that all of their US tax is paid in full prior to or on departure from the US.

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 US, in addition to the payment all US 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 and on the regular due date. Theoretically, any alien that tries to leave the US 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 US 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 US Customs have any idea that you are an alien departing permanently the US when in fact you finally exit the US. So in the author's opinion 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 US, 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 punitive situation. For the purposes of US nonresident and US resident aliens alike the following income tax treaty articles have been highlighted as relevant to possibly providing you relief:

- Article IV- Residence- will seek to determine where an individual is tax resident if they are found to be tax resident of two or more countries under these respective countries domestic tax laws, commonly referred to as the "treaty tie-breaker rules".
- 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 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.
- Article X- Dividends- seeks to reduce the US 30% flat tax lower as per specific treaty country.
- Article XI- Interest- seeks to reduce the US 30% flat tax lower as per specific treaty country.
- Article XIII- Gains- covering capital gains from the disposition of assets- seeks to reduce the US 30% 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.
- Article XIV- Independent Personal Services- seeks to address the taxation of income from self-employed persons.
- 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 US 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 US, taxation would not be in the US.
- Article XVI- Artistes and Athletes- seeks to address the taxation of income from such persons.
- Article XXII- Other Income- - seeks to address the taxation of all other income not addressed elsewhere.
- 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.
- 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:

- 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.
- Typically in the case of US persons- citizens and green card holders- the US has conveniently slipped in to most income treaties in various articles however usually, under Miscellaneous Rules, a provision to enable them to continue to tax their people as if the income tax treaty did not exist. This is typically referred to as a “Savings Clause”. So US persons should consult us separately as to which income tax treaty articles may or may not apply to them.
- F, J or Q visa holders remaining as US nonresident aliens, shall not include in their gross income for US tax purposes compensation paid to them by a foreign employer.
- Under the IRS IRC, the compensation of non US citizen employees received from a foreign government or international organization for work performed in the US shall not be included in gross income and shall be exempt from US taxation.
- Under the IRS IRC, while a US nonresident alien, interest income derived from US bank deposits is exempt from US taxation.
- Foreign national individuals ineligible to obtain a US social security number (SSN) since they are not US citizens, not US green card holders or do not have valid US work authorization are able to obtain a US 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, TX USA for processing. As either original or notarized copies of originals are required to accompany the Form W-7 application, it is the author’s suggestion that you either: 1) if in the US- approach an IRS office directly or 2) outside the US- approach a US embassy or consulate or “Acceptance Agent” to certify your documents, as the transfer of original documents is an unwarranted risk. A US notary may notarize copies of such documents.
- 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 = 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 expats 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):

- Nonresident aliens filing Form 1040NR with a Schedule C- Profit or Loss from Business- are exempt from US self-employment FICA tax on their net income from that business.
- F, J or Q visa holders remaining as US nonresident aliens, shall not have withheld from their compensation FICA taxes. All other foreign nationals present in the US on any other work visa type, are subject to US FICA taxes.
- If your country of nationality or former residence as the case may be has a negotiated Totalization or Social Security treaty with the US (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 US. Please visit <http://www.ssa.gov/international/> to determine if such an agreement exists in your circumstances.

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