

U.S. RESIDENCY

PRIMER

Introduction

For federal income tax purposes, individuals who are “United States (U.S.) persons” are subject to tax on their worldwide income. Section 7701(a)(30)(A) of the Internal Revenue Code (IRC) defines “United States persons” as “a citizen or resident of the United States.”

Individuals who are not “United States persons,” are only taxed on U.S. source income.¹ However, foreign individuals who are not U.S. citizens (“aliens”) may be taxed like citizens if they qualify as residents.² Consequently, it is important for individuals to know whether or not they are a U.S. resident because there may be significant tax implications of being found to be a resident alien.

This primer explains the rules for determining whether a foreign individual is considered a “U.S. resident alien” for the purpose of federal income taxation. First, it reviews how an individual may qualify as a U.S. resident alien under the “green card” test, First Year Elections, and the substantial presence test. Then, it discusses exceptions to these tests, which can allow an individual to claim the status of a non-resident alien. Finally, it explains how Tax Foresight can provide legal certainty by assessing an individual’s residency status using cutting-edge predictive research tools.

Overview

Under § 7701(b)(1)(A), an alien is considered a resident if the individual:³

- Is a lawful permanent citizen of the U.S./ meets the “green card” test;
- Makes a First Year Election; or
- Meets the substantial presence test.

“Green Card” Test

Under the “green card” test, an individual will be considered a U.S. resident alien in a given tax year if they are a Lawful Permanent Resident of the U.S. at any time during the calendar year.⁴

An individual is a Lawful Permanent Resident of the U.S. if they have been given the privilege of residing permanently in the U.S. as an immigrant.⁵ A person generally has this status if they have the “green card” (i.e. alien registration card, Form I-551).⁶

Under this test, an individual continues to have U.S. resident status unless:

- They voluntarily renounce and abandon this status in writing to the U.S. Citizenship and Immigration Services (USCIS);
- Their immigration status is administratively terminated by the USCIS; or
- Their immigration status is judicially terminated by a U.S. federal court.

Generally, simply leaving the U.S. for another country or letting the green card expire (for immigration purposes) does not automatically discharge the individual’s associated tax obligations.

If an individual meets the green card test at any time during the calendar year but does not meet the substantial presence test (see below) for that year, their residency starting date is the first day on which they are present in the U.S. as a Lawful Permanent

Resident.

First-Year Elections

A non-resident alien can elect to be treated as a resident of the U.S. with respect to the election year if:

- They were a non-resident alien under the green card test or the substantial presence test in the previous year;
- They were a non-resident alien under the “green card” test or the substantial presence test in the election year, that is, the current year;
- They were present in the U.S. for at least 31 consecutive days in the election year;
- They were present in the U.S. at least 75% of the days in the current year beginning with (and including) their first day of the 31 consecutive days of presence; and
- They satisfy the substantial presence test in the subsequent year.⁷

If an individual meets these requirements, they can make an election and be treated as a U.S. resident for that election year. Consequently, that individual’s tax return for the election year will be treated like a U.S. resident’s tax return, provided that the election did not occur before the individual has met the substantial presence test in the following year.⁸

Substantial Presence Test

An individual will be considered as U.S. resident alien for federal income tax purposes in a given tax year if they meet the substantial presence test for that calendar year. This test is outlined in IRC § 7701(b)(3).

To qualify under the substantial presence test, an individual must be physically present in the U.S. on at least:

1. 31 days during the current tax year, and

2. 183 days during the 3-year period that includes the current year and the 2 years immediately before that, counting:
 - o All the days they were present in the current year;
 - o 1/3 of the days they were present in the first preceding year; and
 - o 1/6 of the days they were present in the second preceding year.⁹

For instance, Anne was physically present in the U.S. on 120 days in each of 2017, 2018 and 2019. Suppose she is trying to determine if she meets the substantial presence test for 2019. To do so, she would add:

$$\begin{aligned}
 &120 \text{ days of presence in 2019} + 1/3 \text{ of } 120 \\
 &\quad \text{days of presence in 2018} + 1/6 \text{ of} \\
 &\quad \text{120 days of presence in 2017} \\
 &= 120 + 40 + 20 \\
 &= 180 \text{ days}
 \end{aligned}$$

Because she was 3 days short, she will *not* be considered a resident under the substantial presence test for 2019.

Physical presence: An individual is treated as present in the U.S. on any day they are physically present in the country, at any time during the day.

U.S.: This includes all 50 states and the District of Columbia, the territorial waters of the U.S., and the seabed and subsoil of the submarine areas that are adjacent to U.S. territorial waters and over (i.e. where the U.S. has exclusive rights under international law to explore and exploit natural resources). This does **not** include U.S. possessions and territories or U.S. airspace.

Days of presence: The following scenarios will *not* be counted as days of presence in the U.S. for the substantial presence test:

- Regular commuters from Canada or Mexico

- on days they so commute;
- People present in the U.S. for less than 24 hours while in transit between two places outside the U.S.;
- People present in the U.S. as a crew member of a foreign vessel;
- People with certain medical conditions preventing them from leaving the U.S.;¹⁰
- Days they are an exempt individual such as:¹¹
 - o An individual temporarily in the U.S. as a foreign government-related individual;¹²
 - o A teacher or trainee temporarily present in the U.S.;¹³
 - o A student temporarily in the U.S.;¹⁴
 - o A professional athlete temporarily in the U.S. to compete in a sports event organized by a qualifying organization.¹⁵

Exceptions

Substantial Presence Test Exception: Closer Connection

Section 7701(b)(3)(B) provides that if a foreign individual meets the substantial presence test, they may still be treated as a non-resident alien if the individual can demonstrate a “closer connection” to one or two foreign countries (no more than two).

To qualify, the following must be satisfied during the current year:

1. Individual is present in the U.S. on fewer than 183 days in the current year;
2. Has a *tax home* in a foreign country; and
3. Has a *closer connection* to that foreign country than to the U.S.

This exemption allows an individual to be treated as a non-resident alien for all income tax purposes. However, if the individual takes steps towards

becoming a U.S. resident, such as filing Immigration and Naturalization Form I-485 (Application for Status as Permanent Resident) they cannot claim a closer connection to a foreign country for that year.

Tax Home: The term describes an individual's "regular or principal (if more than one regular) place of business".¹⁶ If this cannot be determined, the "tax home" is the individual's personal home "in a real and substantial sense."

Closer connection: This is a circumstantial inquiry to determine whether the individual "maintained more significant contacts" with a foreign country than with the U.S.¹⁷ The IRS may consider the following facts and more:

- The location of the individual's tax home;
- Permanent home;
- Family and personal belongings;
- Social, political, cultural and professional ties;
- The jurisdiction in which the individual holds a driver's license and votes.

"Green Card" AND Substantial Presence Test Exception: Treaty Exemption

An individual who meets the green card or substantial presence test can be treated as a non-resident alien if the individual is a resident of both the U.S. and a treaty partner country under each country's tax laws, and it is determined under the residency provisions of the tax treaty that the individual is a tax resident of the partner country ("dual resident").¹⁸

This exemption allows an individual to be treated as a non-resident only in computing his or her personal tax liability while remaining a resident for other purposes (e.g., filing and reporting, calculating residency time period).

Tax Foresight

The Residency Navigator is a module on Tax Foresight that helps professionals navigate the rules governing resident status in the United States. The user will be asked to answer a series of questions relevant to the U.S. residency law. Each answer prompts a subsequent question, leading to a result of either "U.S. resident" or "non-resident alien" for federal tax purposes.

The navigator also calculates the days in which the individual was present in the U.S. under the substantial presence test. The user will be prompted to select all the days that the individual was physically present in the U.S. during the relevant years. Using the answer given, Tax Foresight will perform the calculations and provide the user with the number of days they were physically present in the U.S.

The navigator thus allows individuals to predict how taking certain actions might affect their tax position. It also allows tax professionals to navigate the law on U.S. Residency with minimal time and effort. This will help to improve research efficiency and provide legal certainty, thereby assisting with tax planning process.

Endnotes

- 1 See: <https://www.irs.gov/businesses/taxation-of-nonresident-aliens-1>.
- 2 See: <https://www.dhs.gov/immigration-statistics/lawful-permanent-residents>.
- 3 IRC § 7701(b)(1)(A).
- 4 IRS, Alien Residency – Green Card Test, IRS, (Jun. 13, 2019, 10:14 AM), <https://www.irs.gov/individuals/international-taxpayers/alien-residency-green-card-test>.
- 5 8 U.S. Code § 1101(a)(20).
- 6 See: 8 USC § 1153.
- 7 IRC § 7701(b)(4)(A).
- 8 IRC § 7701(b)(4)(E).
- 9 IRS, Substantial Presence Test, IRS, (Jun. 13, 2019, 10:16 AM), <https://www.irs.gov/individuals/international-taxpayers/substantial-presence-test>.
- 10 *Id.*
- 11 IRC § 7701(b)(5)(A).
- 12 For the definition of the term “foreign government-related individual,” see IRC § 7701(b)(5)(B).
- 13 For the definition of the term “teacher or trainee,” see IRC § 7701(b)(5)(C).
- 14 For the definition of the term “student,” see IRC § 7701(b)(5)(D).
- 15 For the requirements of qualifying as an “organization,” see IRC § 7701(b)(5)(A)(iv)(I)-(III).
- 16 Treasury Regulations § 301.7701(b)-2(c)(1).
- 17 Treasury Regulations § 301.7701(b)-2(d)(1).
- 18 Treasury Regulations § 301.7701(b)-7.