Domestic Tax Issues for Non-resident Aliens

Summary

This course will provide the practitioner seeking to keep pace with a shrinking world economy with the tools necessary to serve a diverse clientele. Topics will include the determination of residency for federal tax purposes, dual-status issues, tax treatment of income and expenses for non-resident aliens, available elections and tax credits, administrative issues, and departure filing requirements.

The information contained herein is for educational use only and should not be construed as tax, financial, or legal advice. Each individual's situation is unique and may require specialized treatment. It is, therefore, imperative that you consult with tax and legal professionals prior to implementation of any strategies discussed.

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I. Summary of Tax Treatment

Unlike United States (U.S.) citizens and permanent residents, non-resident aliens (NRAs) are taxed only on US-sourced income rather than worldwide income. As a result, NRAs frequently have less taxable income to report to U.S. tax authorities; on the other hand, they may not be entitled to favorable deductions, credits, exemptions, filing statuses and preferential tax rates.

NRA income that is U.S.-sourced income only is categorized as either (1) income that is "effectively connected" or (2) "not effectively connected". If connected, the income may be reduced by certain Itemized Deductions and the Personal Exemption, and is taxed using graduated tax rates. Income that is not connected is taxed at a flat rate of 30%.[1]

TAX TREATMENT OF NRAs

- ✓ Taxed only on U.S.-sourced income
- ✓ Effectively connected income (reduced by certain deductions & exemptions) is taxed at graduated rates
- ✓ Not effectively connected income is taxed at a flat rate of 30%

II. Determining Residency

Under U.S. tax law, an individual is an NRA if the individual is neither a citizen nor a resident of the U.S. While citizenship – obtained at birth or through naturalization – may be readily determinable, residency is often a bit murky.[2] Full-year residents of American Samoa, Guam, Puerto Rico, and the Commonwealth of Northern Mariana Islands, for example, are treated as residents for U.S. tax purposes although they may exclude all possession-sourced income (except amounts earned as U.S. government employees).[3] Interestingly, they may claim exemptions only for U.S. citizen dependents. Such tax treatment does not apply uniformly to individuals residing in all U.S. possessions or territories and so it is crucial to distinguish between residents of those territories listed above and those of Baker Island, the Howland Islands, Jarvis Island, Johnston Island, Kingman Reef, the Midway Islands, Palmyra, the U.S. Virgin Islands, and Wake Island.[4]

To establish proper tax treatment, the taxpayer's residency must first be ascertained under one of two tests.

A. Green Card Test

Green Cards are issued to Lawful Permanent Residents by U.S. Citizenship and Immigration Services (USCIS).[5] Officially titled **Form I-551, U.S. Permanent Resident**

[1] IRC §871(a).

[2] In California, Governor Jerry Brown (D) signed a measure into law removing the word "alien" from the state's Labor Code because the term is viewed as a derogatory description of individuals not born in the U.S. [SB 432, effective January 1, 2016].

[3] IRC §7701(b)(1)(B).

[4] Immigration law, on the other hand, distinguishes between U.S. citizens and U.S. nationals.[4] All U.S. citizens are U.S. nationals but not all nationals are citizens. A national is a person who was born in or has ties with an outlying U.S. possession – currently only American Samoa and Swains Island – owes permanent allegiance to the U.S. While nationals may hold a U.S. passport and may live and work without restrictions in the U.S., they cannot vote or hold elected office.

[5] The USCIS was formerly known as the U.S. Department of Immigration and Naturalization Service (INS) but became a part of the U.S. Department of Homeland Security (DHS) since March 2003.

Card, it looks much like a driver's license issued by most states. It is considered permanent unless residency status is (1) administratively or judicially removed (deportation), (2) voluntarily abandoned by application[6] and remittance of the Green Card to the USCIS or a U.S. Consulate, or (3) forfeited by leaving the country for more than a temporary visit abroad.[7]

GREEN CARD HOLDERS ARE…

✓ Permanent residents
✓ Taxed like U.S. citizens

B. Substantial Presence Test (SPT)[8]

A person is considered to be a U.S. resident for tax purposes if he has been physically present in the U.S. (including all 50 states and the District of Columbia, but not U.S. possessions or territories) *for at least 31 days during the tax year AND 183 days during the most recent 3-year period* which includes all of the days in the current year, 1/3 of the days in the previous year and 1/6 of the days in the year prior to that.[9]

Aviv was physically present in the U.S. for 120 days in each of the years 2013, 2014 and 2015. To determine if he meets the SPT for 2015, the following number of days must be counted:

120 days in 2015 *plus*
40 days in 2014 (1/3 of 120) *plus*
20 days in 2013 (1/6 of 120)

Since the 3-year total is only 180 days, he is not considered a resident under the SPT for 2015.

The SPT measures the days of *presence* in the U.S. As such, both the days of arrival and departure are added to the count. However, days that are not counted include:

- Days on which the taxpayer regularly commutes to work in the U.S. from either Canada or Mexico.
- Days during which he is in the U.S. for less than 24 hours due to international transit.
- Days in U.S. if he is a crew member of a foreign vessel.
- Days that he is unable to leave the U.S. due to a medical condition.[10]

Certain individuals are deemed to be exempt. Those who need not count their days in the U.S. include:[11]

- Foreign government employees or diplomats who only temporarily reside in the U.S.

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[6] Form I-407.

[7] Generally, the DHS makes a rebuttable presumption that a lawful permanent resident intended to abandon his U.S. residency status if a single trip abroad extends beyond six months.

[8] IRC §7701(b)(1).

[9] IRC §7701(b)(3).

[10] IRC §7701(b)(7).

[11] IRC §7701(b)(5).

- Teachers on "J" or "Q" visas [See **Appendix A** for commonly used immigration statuses] – UNLESS living in the U.S. longer than 2 years.
- Students on "F", "J", "M" or "Q" visas (UNLESS living in the U.S. more than 5 years).
- Professional athletes in the U.S. to compete in a charitable event.[12]

Exempt individuals must file **Form 8843 Statement for Exempt Individuals and Individuals with a Medical Condition** and attach it to the tax return. Exempt individuals are subject to the SPT for all periods before and after they held exempt status.

A foreign student F-1 visa-holder arrived in the US on January 1st, 2011 and is still considered an NRA for 2015. His wife (not a student) came with him on an F-2 visa and is also an NRA in 2015. However, both husband and wife will be considered residents in 2016, regardless of their academic status.

Because U.S. citizens and residents are taxed on *worldwide* income rather than U.S.-sourced income only, it is sometimes preferable to be treated as an NRA for tax purposes. Therefore, even if the SPT is met, the taxpayer may be treated as an NRA if he or she:

- is present in the U.S. for less than 183 days during the year AND
- maintains a tax home[13] in a foreign country AND
- has a closer connection to *one* foreign country.[14]

As per the Immigration and Nationality Act of 1952, every individual applying for a visitor visa is an intending immigrant eventually subject to U.S tax laws unless the purpose of the individual's trip is for business, pleasure or medical treatment, the trip is for a limited period, and the individual maintains a residence and binding ties outside of the U.S. Those claiming a closer connection a foreign country must file **Form 8840 Closer Connection Exception Statement** and attach it to the return.

Applicable tax treaties may override any of the rules stated above. If so, **Form 8833 Treaty-Based Return Position Disclosure** must be filed and attached to the tax return.

NOTE: An illegal immigrant may be illegal for immigartion purposes but can still be considered a Resident Alien for tax purposes and must, therefore, file a U.S. tax return.

SUBSTANTIAL PRESENCE TEST

- ✓ In the U.S. ≥ 31 days in a year AND ≥ 183 days during most recent 3-year period (count ALL days in current year + 1/3 days in previous year + 1/6 days in year prior to previous)
- ✓ Certain days are not counted & some individuals are exempt from counting
- ✓ If taxpayer maintains a foreign tax home & closer connection abroad, he may be an NRA despite satisfying SPT

[12] IRC §7701(b)(5)(A).

[13] "Tax Home" is defined as the place of business or employment and not necessarily the place of the family home [IRC §911(d)(3)]. Facts and circumstances used to determine the closer connection to a foreign country include, but are not limited to country of residence, location of permanent home, family, personal belongings, affiliations, voting rights and driver's license.

[14] IRC §7701(b)(3)(B).

C. Part-year and Dual-Status Aliens

Part-year residents are, by definition, deemed "dual-status" and must file as non-residents for part of the year and as resident aliens for the other portion. The residency date begins on the first day that the taxpayer is present in the U.S or is issued a Green Card (whichever is earlier); assuming no travel in or out of the country ensues. Thus, to accumulate the requisite 183 days for residency status, the immigrant must enter the U.S on or before July 1st.

> Maria entered the U.S. on April 10th and was issued a Green Card on June 15th. Her residency would seemingly have begun on June 15th, but since the Green Card was *issued in the same year* that her substantial presence began, her residency actually began on the earlier date.

While taxed only on U.S.-sourced income during the portion of the year that they are deemed non-resident, dual-status aliens are denied more favorable filing statuses, community property rights, the Standard Deduction, dependency exemptions and most tax credits. Such taxpayers often pay far more tax than citizen and resident taxpayers with similar incomes.

As a result, and under certain circumstances, dual-status aliens may choose to be treated as residents for tax purposes:

1. First-Year Election[15]

If an immigrant arrives on or after July 2nd, he would not qualify under the SPT for residency until the year after his arrival but may elect to backdate his residency status to the year of arrival if (1) he was present in the U.S. for at least 31 consecutive days in the year of arrival AND (2) meets the SPT the year following arrival.

> Juan came to the U.S. on November 1st, 2015 and was here for 31 consecutive days before he returned to his home country for a 2-week visit on December 1st. He returned to the U.S. on December 15th and then stayed in the U.S throughout 2016. He will, of course be considered a resident for 2016, but may use the special election to be considered a resident for 2015 as well.[16]

NOTE: Since the taxpayer must have been present in the U.S. for at least 31 days in the year of arrival, an alien who enters the country after December 1 is ineligible for the election. Additionally, the alien must remain in the U.S. for at least 75% of the time after the beginning of the 31-day period.

> In the above example, Juan was in the U.S. for 31 days prior to his departure and another 17 days after his return for a total of 48 days; equal to 78% of the time since the 31-day continuous interval began. Had Juan, instead, returned any time after December 19th, he would have failed the 75% test. But because rules allow for reclassification of up to 5 days of absence as days of presence, Juan would still qualify for the election if his travels abroad ended on or before December 20th.

[15] IRC §7701(b)(4).

[16] To make the election, the taxpayer must attach a signed statement to his return declaring that he is making a "first-year election" for the current year, that he was not a resident in the prior year, and that he will satisfy the SPT in the following year.

2. Marriage Election[17]

A married individual entering the U.S. for the first time and considered to be dual-status may opt to be treated as a resident for the entire year if:

- he was an NRA at the beginning of the year and is a resident alien or citizen at the end of the year AND
- he is married to a U.S. citizen or resident alien at year-end.

Both spouses must agree to the election and must file a joint return. The election is made by attaching a statement signed by both spouses to the originally filed return or an amended return.[18] The election may be revoked by either or both spouses. The election is automatically terminated by death or legal separation. However, neither spouse may ever again make the election, even upon remarriage.

Danielle and Maxime are married and both are non-resident aliens at the beginning of the year. In June, Maxime became a resident alien and remained a resident for the rest of the year. Danielle and Maxime may both choose to be treated as resident aliens and must file a joint return for the election year but can file either joint or separate returns in later years.

A similar election[19] is available to citizen or resident taxpayer who is married to a non-resident spouse, even if that spouse lives abroad. Of course, the non-resident spouse will be required to obtain a taxpayer identification number.

Bob is a U.S. resident with $120,000 in worldwide income. His wife lives abroad and has no income. Bob can file separately or elect to file jointly, thereby lowering his tax liability.

Mathilda and her son live permanently in the U.S. Her husband Friedrich joins them during the year. They may elect to file jointly or Mathilda may file separately using the Head of Household status, even though she is married because her husband (not she) is an NRA. Friedrich would then be required to file his own non-resident or dual-status return.

DUAL STATUS (PART-YEAR) RESIDENTS MAY ELECT:

✓ To back-date residency to the year of arrival, even before he satisfies the SPT
✓ Residency treatment if NRA files joint return with U.S. citizen or resident alien spouse

D. Special Note for Residents of U.S. Territories[20]

Residents from American Samoa or Puerto Rico for the entire year are treated as Resident Aliens for U.S. tax purposes. These residents may exclude all Puerto Rico- or

[17] IRC §6013(h).

[18] Reg. §1.6013-6(a)(4).

[19] IRC §6013(g).

[20] If a taxpayer moves to or from a territory and has worldwide income of more than $75,000 that year, it is necessary to file **Form 8898 Statement for Individuals Who Begin or End Bona Fide Residence in a U.S. Possession**. The penalty for failure to file is $1,000.

American Samoa-sourced income[21], except amounts earned as U.S. government employees and can only claim exemptions for U.S. citizen dependents.

Taxpayers with income from U.S. possessions may have to file a tax return with the tax department of that possession only, or may have to file with both the possession and the IRS [Refer to *IRS Pub 570 Tax Guide for Individuals With Income From U.S. Possessions*].

III. Tax Treatment of Income and Expenses

A. Income

Where income is earned is a moot point for U.S. citizens and resident aliens who must report *worldwide* income. Although some income may be exempt from taxation under various treaties or be eligible for the Foreign Earned Income Exclusion, all income (regardless of its source) must be reported on **Form 1040**.

NRAs, however, need only report U.S.-sourced income. And they do so on **Form 1040NR.**

Dual-status aliens, on the other hand, may exclude all foreign-sourced income for the part of the year during which they are considered non-residents on **Form 1040NR**, but must then include worldwide income for the remainder of the year during which they are considered residents on **Form 1040**.

Certain types of income are deemed to be *not* U.S.-sourced and, therefore, not taxable to the NRA:

- Interest paid by a U.S. corporation if at least 80% of the company's gross income is *derived from sources outside the U.S.* due to active conduct of business in a foreign country in the preceding three years.[22]
- Interest if funds are *deposited in a foreign branch* of a domestic commercial bank.[23]
- Corporate dividends *received from a foreign corporation* if more than 25% of the company's gross income is effectively connected with U.S. business.[24]
- Personal service compensation received for *work performed outside the U.S.* However, personal service income received for work performed in the U.S. must be pro-rated based on the percentage of time worked in the U.S. and included in U.S.-sourced income.[25]

[21] Currently, the possession exclusion applies only to individuals who are bona fide residents of American Samoa and Puerto Rico. Individuals in the following U.S. possessions or territories are not eligible for the possession exclusion: Baker Island, Commonwealth of Northern Mariana Islands (CNMI), Guam, Howland Islands, Jarvis Island, Johnston Island, Kingman Reef, Midway Islands, Palmyra, U.S. Virgin Islands, and Wake Island.

[22] IRC §871(i)(2)(B).

[23] IRC §861(a)(1).

[24] IRC §861(a)(2).

[25] IRC §861(a)(3).

Jean, an NRA, is a professional hockey player with a U.S. hockey club. Under Jean's contract, he received $98,500 for 242 days of play during the year which included pre-season training, regular season play and, and post-season play-offs. Jean spent 194 days performing services in the U.S. and 48 days playing in Canada. Jean's U.S.-sourced income is computed as follows: (194 ÷ 242 days) x $98,500 = $78,963.[26]

- Gain on sale of personal property, including furniture and equipment, as long as the *taxpayer's tax home is not in the U.S.*[27]
- Revenues from the sale of inventory is sourced where the property is sold regardless of where the items were originally *purchased*, but can be pro-rated if the items were *produced* in the U.S. and sold abroad.[28]
- Gain on sale in excess of allowable depreciation can be pro-rated based on the amount of the depreciation taken in the U.S. versus abroad.[29]
- Portfolio interest, unless NRA owns more than 10% of the outstanding stock.[30]
- Gain on sale of a personal residence may be excluded up to $250,000 if single, or $500,000 if married, as long as all other applicable provisions are satisfied.[31]
- U.S.-sourced employee compensation is tax-exempt if the NRA worked for a foreign company, the NRA was only temporarily present in the U.S. for periods less than 90 days at a time AND the wages received were less than $3,000 in total.[32]

Alfred, an NRA from Kenya, worked abroad for a U.S. company but was sent to work in the U.S. for 2 months. He was paid $2,500 in December 2014 and again in January 2015. Although U.S.-sourced, Alfred's wages would have been tax exempt had he earned less than $3,000 in total, but because he received $5,000 he will have to include his earnings in each of the taxable years.

1. Community Property Issues

State and foreign community property laws relative to community income (e.g., France, Spain, Mexico and Philippines) must be disregarded if both spouses are NRAs or one spouse is an NRA while the other is not and the marriage election under IRC §6013 is not claimed. Instead, business and partnership income is attributed to the spouse who earned it.

California, for example, has not conformed to this treatment of separate income. Since there are no Green Card or Substantial Presence Tests, immigrants to California are considered residents for tax purposes on the day that they arrive in state. It follows, then, that they must report worldwide income on the state tax

[26] As an aside, most states are similarly tax out-of-state players based on an allocation of income earned while playing in state. [Dundon, *How Professional Athletes Attribute "Rest Days" for State Income Tax Purposes: A Major Controversy Brews* (available at TaxConnections Blog, last accessed May 9, 2016)].

[27] IRC §865(a)(2).

[28] IRC §865(b).

[29] IRC §865(c).

[30] IRC §871(h)(3).

[31] IRC §121.

[32] IRC §861(a)(3).

return; of course, they may then also claim all deductions and credits to which any resident would be entitled. The tax liability is computed based on the ratio of California-sourced taxable to worldwide taxable income.

With few exceptions, taxpayers must use the same filing status for the California return as they did on the federal return.[33] Therefore, NRAs and part-year residents are generally required to file as Single if unmarried and as Married-Filing-Separately if married.

A married couple arrived in California on December 1st, 2015 from Japan and now resides permanently in the U.S. Since they did not meet the SPT for 2015, they must each file a non-resident federal return for 2015 and a part-year resident return for California using the MFS status. Alternatively, both spouses may agree to claim the First-Year Election, allowing them to file jointly for federal purposes. This, in turn, would allow them to file a joint **California Form 540NR**.

NOTE: Regardless of the federal election, a California resident spouse may choose to file separately if the non-resident spouse has no California-sourced income.

2. Connected or Not?

For the NRA, income may be either effectively or not effectively connected to the U.S. Effectively connected income is revenue which is derived from a U.S. trade or business, is reported on Page 1 of **Form 1040NR**, and can be reduced by personal exemptions and itemized deductions. The net taxable income is then subject to the graduated tax rates currently in effect. On the other hand, income which is not effectively connected is reported on Page 4 of **Form 1040NR** and cannot be reduced by exemptions and deductions. Instead, it is subject to a flat tax of 30%, unless a lower treaty rate applies.[34]

Effectively Connected Income is determined under the:

- **Asset-use Test:** Whether income is derived from assets used in the conduct of a U.S. business, or
- **Business-activities Test:** Whether the activities of the U.S. business were a material factor in the realization of income.[35]

Not Effectively Connected Income:

- Includes fixed, determinable or periodic income—such as interest, dividends, rents, royalties and annuities.[36]
- Any income that does not meet the Asset-use or Business-activities Tests.

[33] Exceptions to the uniform filing status rule may occur when an improper filing status was used on the federal return or when one spouse is a non-resident without state-sourced income [CA Rev & Tax §18521.].

[34] IRC §871(a).

[35] Reg. §1.864-4(c)(1)(i).

[36] Capital gains are *not* effectively connected and are taxed at a flat rate of 30% unless a lower treaty rate applies [IRC §871(a)(2)]. **NOTE:** Capital Gains are tax-exempt if NRA is in the U.S. for less than 183 days.

Effectively Connected (taxed at graduated rates)	Not Effectively Connected (taxed at 30% rate)
Wages earned in U.S.	Interest income [subject to certain limitations discussed later]
Nonqualified scholarships	Dividends
Business income, incl. foreign-sourced income if fixed place of business in U.S. and produced in ordinary course of business	Rental income
Partnership income	Royalty income
Gains on sale of U.S. real estate and business assets	Capital gains (exempt if taxpayer in U.S. less < 183 days)[37]
Pension income	Social Security benefits (85% includable unless exempt under treaty)[38]
Transportation income if fixed place of business in U.S. and ≥ 90% attributable to regularly scheduled transportation[39]	Transportation income earned for travel that begins or ends in U.S. but does not meet fixed place and 90% tests (taxed at 4% flat rate)[40]

Scholarships

Scholarships and fellowship grants are generally taxable if received from a U.S. payer. However, "qualified scholarships" by degree candidates for tuition, books and supplies at an eligible institution are exempt.[41] Scholarship payments are reported to the student on **Form 1042-S**. This amount must be transferred to **Form 1040NR,** Line 12. Any amount excluded is reported on Line 31. If the scholarship is excluded from taxation by an applicable international treaty, the amount is reported on **Form 1040NR**, Line 22 and Schedule OI, Item L.

Partnership Income

Individual foreign partners in a domestic partnership must file **Form 1040NR** on the allocated share of partnership income that is effectively connected, as well as U.S.-sourced income that is not effectively connected if U.S. taxes were not properly withheld at source.

Foreign partnerships with effectively connected income or income from U.S. sources must file **Form 1065** even if its principal place of business is outside the U.S. or all its members are foreign persons.[42] A foreign partnership with U.S.-sourced income is not required to file **Form 1065** if it qualifies for either of the following two exceptions:

a. Exception for foreign partnerships with U.S. partners, if the partnership
   - had no effectively connected income,
   - had U.S.-sourced income of $20,000 or less,

[37] IRC §871(a)(2).

[38] IRC §871(a)(3).

[39] IRC §863(c)(2)(A).

[40] IRC §887(c).

[41] IRC §117(b).

[42] Foreign corporations must file **Form 1120F**.

- had less than 1% of any partnership item allocable to U.S. partners AND
- is not a withholding foreign partnership.

b. Exception for foreign partnerships without partners, if the partnership
   - had no effectively connected income,
   - had no U.S. partners at any time during its tax year,
   - filed all requisite **Forms 1042** and **1042-S**,
   - has satisfied each partner's tax liability by withholding tax at source AND
   - is not a withholding foreign partnership.

Gambling Winnings

Generally considered to be not effectively connected, an NRA's gambling winnings cannot be reduced by gambling losses and are taxed at a flat rate of 30%. However, certain types of gambling winnings are exempt from taxation and include blackjack, baccarat, craps, roulette, big 6-Wheel, and certain horse- and dog-racing winnings.[43] Additionally, some international tax treaties exempt gambling winnings for residents of the signatory countries.[44] Canadian residents may avail themselves of a special treaty provision that allows them to File **Form 1040NR** and use gambling losses to reduce or offset winnings.[45]

Rental and Royalty Income

Such income is considered to be not effectively connected and cannot be reduced by deductions typically applicable to the maintenance and management of rental property. Thus, the NRA is taxed on the gross rental revenue. However, the NRA may elect to treat the rental income as effectively connected under § 871(d) and would then be allowed to deduct rental expenses, so that he would ultimately be taxed on only the net rental income.[46]

Manel is a non-resident alien and is not engaged in a U.S. trade or business. She owns a single family house in the U.S. which she rents out for $10,000/year. It is her only U.S.-sourced income. Since the rental income is considered to be not effectively connected, it is subject to tax at a 30% rate. Manel receives a **Form 1042S Foreign Person's U.S. Source Income Subject to Withholding** showing that her tenants properly withheld this tax from rents paid to her. She does not have to file a U.S. tax return because her U.S. tax liability is satisfied by the withholdings. However, if she chooses to consider the rental income effectively connected, she can offset the $10,000 income by allowable rental expenses. The resulting net income is then taxed at the usual graduated rates.

[43] IRC §871(j).

[44] Austria, Czech Republic, Denmark, Finland, France, Germany, Hungary, Ireland, Italy, Japan, Latvia, Lithuania, Luxembourg, Netherlands, Russian Federation, Slovak Republic, South Africa, Spain, Sweden, Tunisia, Turkey, Ukraine and the United Kingdom.

[45] Article 22 (Protocol 3) of the Canada-India Income Tax Treaty.

[46] The election may be made on a property-by-property (but not year-by-year) basis by attaching a statement to the tax return for the initial year of choice and will remain in effect for all subsequent taxable years unless revoked with the permission of the Secretary of Treasury. Once revoked, the election may not be made again for five years.

NRA's TAXABLE INCOME:

- ✓ Must be U.S.-sourced
- ✓ Is effectively connected if used in a U.S. business
- ✓ Can only be reduced by associated deductions, if effectively connected
- ✓ Foreign community property laws are disregarded; income is attributed to the spouse who earned it
- ✓ Excludable income includes bank interest, most investment income, gain on sale of personal residence, & de minimis wage income if only on temporary assignment in U.S.

B. Cost Basis

While the general rule holds that assets of aliens obtaining U.S. residency do not receive a stepped-up basis,[47] NRAs may nevertheless take advantage of a pre-immigration tax planning opportunity. By engaging in certain transactions prior to becoming subject to U.S. taxation, the NRA may be able to re-set the cost basis of his assets.

TAX TIP: The NRA may sell U.S.-sited assets to an offshore entity, thereby engaging in a transaction that recognizes a step-up in basis for U.S. tax purposes without actually being subject to U.S. taxation. He may then sell the asset with its stepped-up basis in the year that he becomes a U.S. resident, avoiding most if not all taxable gains.

C. Deductions

Unlike U.S. citizens and resident aliens, NRAs may not claim the Standard Deduction. **QUIRKY EXCEPTION:** Students and business apprentices from India are eligible to use the Standard Deduction under special treaty provisions![48]

Since all allowable deductions must be related to effectively connected income,[49] state, local and real estate taxes paid may be deducted, but medical, personal property taxes, and mortgage interest may not. On the other hand, items that may be deducted include charitable contributions to qualified U.S. (not foreign) organizations, casualty losses and unreimbursed employee expenses.

NOTE: Dual-status aliens may not use the Standard Deduction, but may claim all of the same Itemized Deductions allowed to U.S residents and citizens.

Additionally, the NRA may make contributions to Individual Retirement Accounts and other qualified retirement plans under the same rules which apply to U.S. residents. He may claim moving expenses for coming to the U.S. under the same rules applicable to U.S. residents, but may not deduct the expenses related to a move which returns him to his foreign home. In other words, **in**coming moving expenses are deductible; **out**going expenses are not. The NRA may deduct student loan interest and even penalties on early withdrawals of savings if the interest income is effectively connected.[50]

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[47] **EXCEPTION:** Covered expatriates – defined as lawful permanent residents during at least 8 of the last 15 years [IRC §877(e)(2)] – are subject to the Expatriation Tax when renouncing their U.S. residency. The regime applies an exit tax on all of the departing taxpayer's assets valued on the date of departure; thereby marking these assets to market and establishing a stepped-up basis should the expatriate at some later time choose to repatriate to the U.S.

[48] Article 21(2) of the U.S.-India Income Tax Treaty.

[49] IRC §873(a).

[50] Reg. §1.882-5.

IV. Tax Credits

NRAs with effectively connected income are eligible to claim only some of the credits available to U.S. residents, including:

- **Adoption Credit** – only available to married NRAs *if they elect to file jointly* with their U.S. citizen spouse.[51]
- **Child and Dependent Care Credit** – only available to married NRAs *if they elect to file jointly* with their U.S. citizen spouse.
- **Child Tax Credit** – if the NRA has a qualifying child who is a U.S. citizen or resident and is claimed as a dependent on the tax return.
- **Credit for Prior Year Minimum Tax** – may be claimed by the NRA under the same rules which apply to U.S. residents.
- **Earned Income Credit** – only available to married NRAs *if they elect to file jointly* with their U.S. citizen spouse.
- **Education Credits** – only available to married NRAs *if they elect to file jointly* with their U.S. citizen spouse.
- **Energy Credits** – may be claimed by the NRA under the same rules which apply to U.S. residents.
- **Foreign Tax Credit** – may be claimed for income taxes paid to a foreign country on foreign-sourced income which is effectively connected to the U.S.
- **Retirement Savings Contribution Credit** may be claimed by the NRA under the same rules which apply to U.S. residents.

TAX DEDUCTIONS & CREDITS:

✓ NRAs may only claim Itemized (not Standard) Deductions and these must be related to effectively connected income
✓ Most tax credits are only available to NRA who is married to and files jointly with a U.S. citizen spouse
✓ Prior-year Minimum Tax, Energy, Foreign Tax and Retirement Savings Contribution credits are available to the NRA under the same rules applicable to U.S. citizens and residents

V. Tax Return Specifics

Once a practitioner has determined that the taxpayer is a non-resident alien (NRA), he must address various administrative and tax reporting issues. While U.S. citizens and resident aliens (residents) may use **Forms 1040, 1040A** or **1040EZ**, the NRA must use **Form 1040NR**[52] or **Form 1040NR-EZ**.[53]

A part-year resident, also known as a dual-status alien, must use:

- **Form 1040** if he entered the U.S. during the year and is a resident *on December 31st; or*
- **Form 1040NR** if he was a U.S. resident who left during the year and no longer resides in the U.S. *on December 31st*.

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[51] IRC §6013(g).

[52] Reg. §1.6012-1(b).

[53] A taxpayer may be able to use **Form 1040NR-EZ** if his only income from U.S. sources is wages, salaries, tips, refunds of state and local income taxes, scholarship or fellowship grants, and nontaxable interest or dividends. If the taxpayer had taxable interest or dividend income, he must use **Form 1040NR** [Department of the Treasury, *Instructions for Form 1040NR*].

In either case, the returns should bear a notation at the top indicating that they report the income of a dual-status alien and a statement should be attached to allocate income earned for during the periods of pre- and post-residency. If filing **Form 1040**, the resident taxpayer may use **Form 1040NR** in lieu of such statement; if filing **Form 1040NR**, the non-resident taxpayer may attach **Form 1040** in lieu of the requisite statement.

A. Filing Status

Only Single (S), Married Filing Separately (MFS) or Qualifying Widower (QW) filing statuses are available to the NRA unless the NRA is married to a U.S. citizen or resident and claims the Marriage Election. The Head of Household (HOH) status is not available to the NRA,[54] although a resident spouse may file HOH if married to an NRA who is not treated as a spouse for tax purposes.

Married NRAs may elect to file as single, *only* if:

- they reside in Canada, Mexico, or South Korea or are married to a U.S. national (a resident of American Samoa or Northern Mariana Islands who has sworn allegiance to the U.S.) AND
- have lived apart from their spouse for the last six months of the tax year.

In addition to U.S. citizens, residents of Canada, Mexico, South Korea, American Samoa, and Northern Mariana Islands may file as QW if all other criteria are satisfied.

B. Personal Exemptions

The NRA may claim only one personal exemption on his U.S. tax return. Special treaty-based exceptions are available to:

- A student or business apprentice from India may be eligible to claim exemptions for a spouse with no gross income and children who are U.S. citizens or residents.
- A South Korean resident whose spouse and children lived with him in the U.S. at some time during the tax year may claim pro-rated exemptions based on the ratio of his U.S.-sourced effectively connected income with his entire income from all sources during the tax year.
- A resident of Canada, Mexico, American Samoa, or Northern Mariana Islands whose spouse has no U.S.-sourced income and is not the dependent of another taxpayer. This NRA may also claim exemptions for qualified dependents under the same rules which apply to U.S. residents.[55]

Since 1996, Individual Taxpayer Identification Numbers (ITIN) have been issued by the IRS to taxpayers who are otherwise not eligible to apply for Social Security Numbers (SSN) and may be used for tax filing purposes only.[56] They do not affect the taxpayer's immigration status or work eligibility. NRA dependents and spouses must have an ITIN,

[54] IRC 2(b)(3)(A).

[55] IRC §873(b)(3).

[56] An ITIN is a nine-digit number that always begins with the number 9 and has a range of 70-88 in the fourth and fifth digit. Effective **April 12, 2011,** the range was extended to include 900-70-0000 through 999-88-9999, 900-90-0000 through 999-92-9999 and 900-94-0000 through 999-99-9999.

as do NRAs seeking to avail themselves of tax treaty benefits or reduced withholding rates (if they do not already have an SSN).[57]

To obtain an ITIN, **Form W-7 Application for IRS Individual Taxpayer Identification Number** and all documentation required to certify identity and foreign status must be attached to the front of a paper copy of the taxpayer's return and mailed[58] to:

Internal Revenue Service
ITIN Operation
P.O. Box 149342
Austin, TX 78714-9342

Once **Form W-7** has been processed and an ITIN has been assigned, the IRS will then process the tax return which may take up to ten weeks. **NOTE: Taxpayers** cannot electronically file a tax return using an ITIN in the calendar year that the ITIN is issued but may e-file returns in ensuing years. However, taxpayers should never request ITINs in advance for a spouse and dependents and should instead wait to make the request with a timely filed tax return.[59]

Under certain circumstances, **Form W-7** may be filed independently if a tax return is otherwise not required to be filed (e.g., to claim reduced withholdings).

FILING STATUS & EXEMPTIONS:

- ✓ Single NRA may only file S or QW; he may not file HOH
- ✓ Married NRA may only file MFS (or MFJ if § 6013(g) election is made)
- ✓ Generally, NRA may only claim one exemption
- ✓ To claim a Personal Exemption for a spouse or dependent, these individuals must have an ITIN (if they do not already have an SSN)

VI. Administrative Issues

A. Due Dates & Mailing Addresses

Like U.S. residents, the NRA must file annually by April 15th. If however, he did not receive any wages subject to withholdings, he may file as late as June 15th.[60] Upon proper application, an NRA's return may be extended to October 15th. The completed **Form 1040NR** should be sent to:

No balance due:	With payment:
Department of the Treasury	Internal Revenue Service
Internal Revenue Service	P.O. Box 1303
Austin, TX 73301-0215	Charlotte, NC 28201-1303

[57] Reg. §1.1441-1(e)(4)(vii)(A).

[58] Do not mail the tax return to the address listed in the instructions for Forms 1040, 1040A or 1040EZ.

[59] ITINs, if not used on a federal income tax return for any year during a period of five consecutive years, will expire [IR-News Release 2014-76, June 30, 2014; codified by the Consolidated Appropriations Act, 2016, Division Q Protecting Americans from Tax Hikes (PATH) Act of 2015 (P.L. 114-113) on December 18, 2015].

[60] Reg. §1.6072-1(c).

Estates and trusts should mail form to:

No balance due:	With payment:
Department of the Treasury	Internal Revenue Service
Internal Revenue Service	P.O. Box 1303
Cincinnati, OH 45999-0048	Charlotte, NC 28201-1303

B. Tax Treaties[61]

The U.S. has income tax treaties with several foreign countries which provide for reduced tax rates or exemptions from taxation of certain types of income received in the U.S. and abroad by NRAs.[62] If a treaty does not address a particular type of income, or if there is no treaty between the foreign country and the U.S., the income is taxed as per the instructions for **Form 1040NR**.[63] It is important to note that not all states conform to the federal treatment of income; as a result, international tax treaty provisions may not apply at the state level.

Tax treaties reduce the U.S. tax of NRAs. With certain exceptions, they do not reduce the tax of U.S. citizens or residents. Treaty provisions generally are reciprocal and apply to both treaty countries. Treaty-based positions must be disclosed on **Form 8833 Treaty-based Return Position Disclosure** which should be attached to a timely filed return.[64] A return must be filed even if a treaty-based position eliminates all taxable income. Failure to file **Form 8833** may result in a $1,000 penalty.

Yoshi is an NRA who is single and a resident of a foreign country that has a tax treaty with the U.S. He received gross income of $25,500 in 2015 from U.S. sources, consisting of the following items: $1,400 dividends on which the tax is limited to a 15% rate by the tax treaty and $24,100 compensation for personal services on which the tax is not limited by the tax treaty. Yoshi's dividends are not effectively connected and he has no deductions other than his own personal exemption. His tax liability is determined as follows:

Personal service compensation	$24,100
Less: Personal exemption[65]	4,000
Taxable income	$20,100
Tax as per tax table for Single	$2,558
Plus: Tax on gross dividends	210
Total Tax Due	**$2,768**

A foreign government employee's wage (not pension) income will be exempt from U.S. taxation by treaty or by U.S. law if the NRA performs services for the foreign government similar to those services that would be required by his U.S. government employee

[61] Refer to *IRS Publication 901—US Tax Treaties* for additional information. **BEWARE:** Unless licensed to give legal advice, a practitioner should urge that his client to consult with an attorney about interpretation and application of treaty provisions.

[62] IRC §894(a).

[63] The IRS has announced that it will not issue letter rulings or determination letters whether a person is entitled to benefits of a foreign tax treaty or whether, in fact, the taxpayer has met the SPT or is an NRA [IRB 2015-1, §3.01].

[64] IRC §301.6114.

[65] Applicable exemption amount in 2015.

counterparts.[66] **BEWARE:** The foreign taxpayer must obtain a certification of eligibility under IRC § 893(b) from the U.S. Secretary of State that a similar exemption is available to U.S. government employees performing services in the foreign country from which the taxpayer hails.[67]

1. Foreign Account Reporting (FBAR)

A Green Card holder who under a tax treaty elects to be treated as a non-resident for U.S. tax purposes, must nevertheless comply with all foreign account reporting applicable to U.S. citizens and residents. **FinCEN 114** must be electronically filed on or before June 30 each year[68] if the individual has a financial interest in or signature authority over a foreign financial account valued in excess of $10,000 at any time during the prior calendar year. Penalties for non-compliance are steep!

2. State Conformity

Tax treaties are agreements between foreign governments and the U.S. – as such, they are federally binding. States, on the other hand, are not bound and often do not conform to federal tax treatment. California's *FTB Publication 1031*, for example, states that "[w]hen you are present in California for temporary or transitory purposes, you are a non-resident of California. For instance, if you come to California for a vacation, or to complete a transaction, or are simply passing through, your purpose is temporary or transitory." Therefore, the specific facts and circumstances of each taxpayer's situation will govern whether income is taxable by the state, not federal tax treaties with foreign governments.

C. Special Reporting Rules

Calendar Year

If income was earned abroad in countries which use a different tax year, the taxpayer must allocate income and expenses to properly reflect and report what was earned on a calendar-year basis on his U.S. return.

Foreign Currency

All amounts reported on U.S. tax returns must be reported in U.S. dollars. If income was earned abroad and received in foreign currency, it must be converted into U.S. dollars at the prevailing exchange rate on the date the income was received. If income was earned evenly throughout the year, the taxpayer may use an average exchange rate for the period if the foreign currency was in fact reasonably stable.[69]

[66] Reg. §1.1441-4(b)(1).

[67] *Harrison* (2012), 138 TC No. 17.

[68] **NOTE:** Beginning with the FBAR that is due in 2017 for the 2016 calendar year, the filing deadline for the FBAR has been changed to April 15 with a six-month extension until October 15 available upon request by the taxpayer. The FBAR filing deadline for U.S. citizens and residents residing abroad will be automatically extended until June 15, with an additional four-month extension available until October 15 [Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 (Pub. Law 114-41)].

[69] Many online currency converters are available; for example, www.oanda.com/currency/converter/.

Depreciation

Real property outside of the U.S. used in a trade or business must be depreciated on a straight-line basis over a 40-year period; personal property held abroad must be depreciated over a 12-year life.[70]

The depreciable basis equals the cost of acquisition converted to U.S. dollars using the currency exchange rate on the date of acquisition. For resident aliens, basis must be reduced by the amount of depreciation that would have been allowable (under U.S. rules) during the period that the individual was an NRA, prior to changing residency status. **NOTE:** There is no step-up in basis on the date of residency change.

Sales Proceeds

Capital gains resulting from the sale of property held abroad must be computed based on the difference between the sales proceeds (converted to U.S. dollars using the exchange rate in effect on the date of sale) and the acquisition cost (converted to U.S. dollars using the exchange rate in effect on the date of purchase). **NOTE:** Due to varying currency exchange rates, the taxpayer may be taxed on an unrealized gain.

Additional Disclosures

- Gifts and inheritances received from abroad must be disclosed on **Form 3520 Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts** if they exceed $100,000.
- Owners of foreign entities may be required to file **Form 5471 Information Return of U.S. Persons with Respect to Certain Foreign Corporations, Form 8858 Information Return of U.S. Persons with Respect to Foreign Disregarded Entities, Form 8865 Return of U.S. Persons with Respect to Certain Foreign Partnerships,** amongst others.
- Certain transfers of property to foreign corporations must be disclosed on **Form 926 Return by a U.S. Transferor of Property to a Foreign Corporation.**

D. Net Investment Income Tax (NIIT)

As of January 1, 2013, certain high-income U.S. taxpayers (as well as some estates and trusts) are required to pay a 3.8% surtax on the lesser of (1) net investment income or (2) the amount of modified adjusted gross income (MAGI) which exceeds the applicable threshold ($200,000 for Single; $250,000 for Married-Filing-Joint).

Although the surtax does not apply to NRAs,[71] it does apply to U.S. citizens and resident aliens who, if married to an NRA, must file as unmarried – unless claiming the Marriage Election – and are, therefore, subject to a MAGI threshold amount of only $125,000.

The NIIT, of course, was instituted under the Affordable Care Act of 2010 to help fund the expansion of healthcare coverage. The act requires that citizens and resident aliens

[70] IRC §168(g).

[71] Bona fide residents of U.S. territories may be subject to the surtax depending upon whether they are residents of Guam, Northern Mariana Islands or the U.S. Virgin Islands (not subject to the surtax); or Puerto Rico or American Samoa (subject to surtax). Proposed Treas. Reg. 1.1411-2(a)(2)(iv).

must have minimum essential health insurance or be subject to a shared responsibility payment [read: penalty]. Residents of U.S. territories, foreign nationals who have not satisfied the SPT and U.S. citizens living abroad for at least 330 days within a 12-month period are not required to have insurance coverage and are, therefore, not subject to the penalty.

F. Estimated Tax Payments

NRAs must make estimated tax payments (ES) under the same rules as U.S. residents. However, if an NRA does not have any wages subject to withholding, the first ES payment can be made by June 15th instead of April 15th. In that case, one-half of the total annual ES liability must be paid by June 15th; the remaining balance may be paid in quarterly installments on September 15th and January 15th.

G. Withholdings

The NRA is subject to tax withholdings on wages earned and must provide his employer with **Form W-4** indicating "Single and 1" or preferably "Single and 0", since he cannot in all likelihood claim dependency exemptions. The NRA is also subject to Social Security and Medicare withholdings unless he is in the U.S. on a student visa performing only on-campus work[72] or can claim an exemption from withholdings based on an applicable treaty.[73] **NOTE:** An NRA who is self-employed is not subject to FICA taxes unless he is a resident of Puerto Rico, Virgin Islands, Guam or Northern Mariana Islands.

> Raul authored and published a book in Argentina while he was a resident there. He later moved to the U.S., received his Green Card and continued to receive royalties from the foreign publisher. He must report these royalties as self-employment income received on his U.S. return and must pay self-employment tax on these earnings.

If a Social Security or Totalization Agreement is in effect between the U.S. and a foreign country, the employee will only pay Social Security tax to the country in which he is working.[74] However, if he normally works abroad but is sent to the U.S. to work temporarily, he will pay Social Security taxes only to his home country.[75]

Although an NRA may be subject to Social Security tax in the U.S., he will not necessarily be entitled to collect future benefits. Much will depend on the taxpayer's place of residence, current citizenship and applicable bilateral agreements (or lack thereof) in effect at the time the taxpayer seeks to collect. He should contact the Social Security Administration for evaluation of his status and potential processing of his claim.

[72] IRC §3121(b)(19).

[73] The NRA must file **Form 8233 Exemption from Withholding on Compensation for Independent (and Certain Dependent) Personal Services of a Nonresident Alien Individual** with his employer to claim a treaty-based exemption.

[74] Reg. §301.6114-1(c)(vi).

[75] The United States currently has Social Security agreements in effect with 25 countries - Australia (2002), Austria (1991), Belgium (1984), Canada (1984), Chile (2001), Czech Republic (2009), Denmark (2008), Finland (1992), France (1988), Germany (1979), Greece (1994), Ireland (1993), Italy (1978), Japan (2005), Luxembourg (1993), the Netherlands (1990), Norway (1984), Poland (2009), Portugal (1989), Slovak Republic (2014), South Korea (2001), Spain (1988), Sweden (1987), Switzerland (1980), and the United Kingdom (1985). [as per Social Security Administration, https://www.ssa.gov/international/agreements_overview.html (last accessed May 9, 2016)].

Pension income is subject to an automatic withholdings rate of 30% unless the NRA uses **Form W-8ECI** to elect that his pension be treated as effectively connected and taxed at graduated rates. And upon disposition of real property, 10% of the amount realized will be automatically withheld.[76] **Form W-8BEN** may be filed to request an exemption or reduction from automatic withholdings due to treaty provisions.[77]

PAYROLL TAX WITHHOLDINGS

- ✓ NRA's wage income is subject to income tax & FICA withholdings
- ✓ NRA students working on-campus are exempt from FICA taxes
- ✓ Self-employed NRAs are subject to SE Tax
- ✓ Totalization agreements ensure that Social Security taxes are paid only to the country in which the employee works (not lives)

G. State Rules

Individual states may have differing rules applicable to non-residents which should be verified on a case-by-case basis. California, for example, considers everyone present in the state—regardless of the length of time spent—to be a "resident".[78] Therefore, everyone must file either **Form 540** if present in-state for the entire year or **Form 540NR** if present only part of the year. Additionally, California requires the filing of **Form 592 Resident and Nonresident Withholding Statement** along with **Form 592-V Payment Voucher for Resident and Nonresident Withholding** by any individual or entity making payments of California-sourced income to non-resident (out-of-state) individuals, partnerships, corporations, estates or trusts that do not have a permanent place of business in-state.

Tax is required to be withheld at a rate of 7% on compensation for services performed, rents and royalties for properties in California, estate and trust distributions, prizes and lottery winnings, as well as partnership income. **Form 592** must be filed and withholdings must be submitted to the tax authority quarterly on April 15th, June 15th, September 15th and January 15th.

VII. Gift and Estate Taxes

U.S. citizens and residents are subject to the U.S. estate and gift tax laws. For these purposes, residency is not determined in the same manner as it is for income tax purposes. Rather than by application of the Green Card or Substantial Presence Tests, a decedent quite simply is considered to have been a "resident" *if he was domiciled in the U.S. at the time of his death*. If

[76] IRC §1445(a).

[77] Reg. §1.1441-1(d).

[78] In fact, California's tax regime is domicile-based, whereby the state defines "domicile" as the place where a taxpayer voluntarily establishes himself, not merely for a special or limited purpose but with the intention of making it his true, fixed and permanent home. It is the place where, whenever absent, the taxpayer intends to return. It is , therefore, very difficult to escape state taxation unless most (if not all) ties to the state are cut. However, California offers a Safe Harbor Rule which provides that an individual domiciled in California who is outside California under an employment-related contract for an uninterrupted period of at least 546 consecutive days will be considered a non-resident unless the individual has intangible income exceeding $200,000 in any taxable year during which the employment-related contract is in effect or the principal purpose of the individual's absence is to avoid personal income tax [California Revenue and Taxation Code §17014].

he lived in the U.S., even for a brief period of time, and did not have any definite intention of returning to a foreign country, he was domiciled in the U.S.[79] The executor of the estate must file an **Affidavit of Domicile** to certify the decedent's place of residence at the time of death.

The gross estate of U.S.-domiciled NRAs subject to U.S. estate taxation includes *all tangible and intangible property located in the U.S.*[80] The deduction for allowable administrative expenses is limited by the ratio of the NRA decedent's U.S. gross estate to his worldwide gross estate. NRAs are entitled to a marital deduction of $147,000 and only allowed the unlimited marital deduction *if the surviving spouse either already is a U.S. citizen or becomes a U.S. citizen by the due date (plus extensions) of the tax return*, or if the assets are left to a qualified domestic trust, or if treaty provisions stipulate accordingly.[81] NRAs are allowed a mere $60,000 estate exclusion (and no portability of a deceased spouse's unused estate tax exemption) rather than the inflation-adjusted $5 million[82] exclusion currently allowed to U.S. citizens.[83] To ensure proper application of these provisions, NRAs must use **Form 706NA, United States Estate Tax Return - Estate of Nonresident Not a Citizen of the United States**.[84]

Foreign estates—defined as those of U.S. citizens who are permanent residents of foreign countries, whose assets are located entirely abroad, and whose fiduciaries are foreign corporations located abroad—are subject to U.S. taxation only on income derived from U.S. sources or income that is effectively connected.

NRAs are subject to tax on gifts of U.S.-situated property (i.e. real estate and tangible personal property located within the U.S.). However, NRAs generally are exempt from gift tax on transfers of intangibles, such as stock and securities, regardless of where the property is situated.[85] Cash gifts are subject to U.S. gift tax. NRAs enjoy the same annual gift tax exclusion as U.S. citizens[86] but may not elect gift-splitting between spouses.[87] NRAs must report taxable gifts and compute the attendant gift tax liability on **Form 709 United States Gift (and Generation-Skipping Transfer) Tax Return** but must diligently apply the nuanced rules since **Form 709** is shared with U.S. citizen and resident taxpayers and only the form's instructions – but not line entries – serve to highlight applicable rule differences.

[79] *Estate Planning Tools for Nonresident Aliens* available at Lexis Hub for New Attorneys.

[80] IRC § 2103.

[81] IRC §2056(d).

[82] Applicable Unified Credit in 2015 is $2,117,800 which equates to an estate exclusion of $5.43 million.

[83] IRC §2102(b).

[84] In 2014 – the last year for which the IRS has published statistics – only 182 non-resident estate tax returns were filed, representing average taxable estates of $489K, resulting in an average estate tax liability of $159K [available at https://www.irs.gov/uac/SOI-Tax-Stats-Nonresident-Alien-Estate-Tax-Returns-with-Non-Treaty-Status, last accessed May 10, 2016)].

[85] IRC §2501(a)(2).

[86] IRC §2503(b).

[87] IRC §2513(a)(1).

ESTATE & GIFT TAX RULES

- ✓ Only U.S. citizens & residents are subject to U.S. estate tax
- ✓ Residency is based on "domicile" (determined by the taxpayer's intent to remain in the U.S.)
- ✓ Gross Estate of U.S.-domiciled NRAs consists only of U.S.-based property
- ✓ Deductions & exclusions for U.S.-domiciled NRAs are limited
- ✓ NRAs must pay gift tax on transfers of real estate & tangible (but not intangible) property

VIII. Leaving the U.S.

Aliens leaving the U.S. must apply for an exit permit in person at a local IRS office no sooner than 30 days prior to their scheduled departure by filing **Form 1040C U.S. Departing Alien Income Tax Return** and paying any tax due. The taxpayer may instead file the shorter **Form 2063 U.S. Departing Alien Income Tax Statement** if he has previously filed all requisite income tax returns, paid all taxes due, and does not have any taxable income in the year of departure or the preceding year.[88] Filing **Forms 1040C** or **Form 2063** does not, however, satisfy the taxpayer's final tax return filing requirement; he must, therefore, file his normal U.S. return on **Form 1040** or **Form 1040NR**, whichever is applicable. Any amounts paid with **Form 1040C** may be deducted against his final tax liability.

Certain aliens are exempt from exit permit filing, including

- Foreign government diplomats.
- Employees of international organizations whose wages are tax-exempt and who receive no other income from U.S. sources.
- Students who entered the U.S. on "F2", "H3", "H4", "J1", "J2" or "Q" visas and who receive no U.S.-sourced income.
- Students on "M1" or "M2" visas who receive only interest income that is not effectively connected.
- NRAs only temporarily in the U.S. who receive no taxable income during their stay in the U.S.
- Residents of Canada or Mexico who commute in and out of the U.S. and whose U.S. wages are subject to payroll withholding.[89]

[88] Reg. 1.6851-2(b).

[89] IRC §6851(d)(1).

IX. Tabular Summary of Filing Requirements

	U.S. Citizen & Resident	Non-resident Alien (NRA)	Dual-Status Alien	Exempt (Teachers/Students)	Illegal Alien
Lives in U.S.?	Yes	No	Part-Year	Yes	Yes
Which form?	1040	1040 NR	• 1040 if resident on 12/31 • 1040NR if non-resident on 12/31	1040NR	1040
Taxable Income?	Worldwide	U.S.-sourced	• U.S.-sourced while NRA • Worldwide while resident	U.S.-sourced	Worldwide
Tax Rules	All familiar rules apply	• Cannot file MFJ unless Marriage Election made • Generally no dependency exemptions • Only incoming moving expenses • Cannot claim standard deduction • Only limited itemized deductions allowed	• Cannot file MFJ unless full year residence or Marriage Election made • Cannot file HOH • Cannot claim standard deduction • Can claim all allowable itemized deductions	• Cannot file MFJ unless Marriage Election made • Generally no dependency exemptions • Only incoming moving expenses allowed • Cannot claim standard deduction • Only limited itemized deductions allowed	All familiar rules apply

APPENDIX A
Visa Types: Employment Restrictions & NRA Taxation

Type of Visa	Work Restrictions	NRA Withholding Requirements
Foreign Government Officials		
A-1 & **A-2** Officials and their dependents	Some dependents may work if USCIS-approved	Exempt for SPT day count; subject to FICA
A-3 Attendant or personal employee of official	May only work for A-1 or A-2 visa holder	N/A since employed by foreign govt.
Visitors		
B-1 Temporary visitors for business	No work authorization	N/A
B-2 Temporary visitors for pleasure	No work authorization	N/A
Aliens in Transit		
C-1 Transit visa	No work authorization	N/A
C-2 In transit to United Nations	No work authorization	N/A
C-3 Attendant of govt. official in transit	No work authorization	N/A
Crewmen		
D Foreign crewmen	May only work for vessel or aircraft	N/A
Treaty Trades and Investors		
E-1 Treaty trader, spouse or child	Work authorized for the sponsoring employer only	SPT day count required; subject to FICA
E-2 Treaty investor	Work authorized for the sponsoring employer only	SPT day count required; subject to FICA
Academic		
F-1 Academic Students	On-campus work authorized for ≤ 20 hours/week	SPT exempt for 1st 5 years; FICA exempt
F-2 Dependents of F-1	No work authorization	N/A
International Organizations		
G-1, **G-2**, **G-3** and **G-4** Employees	Work authorized for the sponsoring employer only	SPT day count required; subject to FICA
G-5 Attendant or employee of G-1, 2, 3, or 4	May only work for G-1, 2, 3, or 4	N/A since employed by foreign organization
Temporary Workers		
H-1B Worker in Specialty Occupation	Work authorized for the sponsoring employer only	SPT day count required; subject to FICA
H-1C Registered Nurse	Work authorized for the sponsoring employer only	SPT day count required; subject to FICA
H-2A Agricultural Workers	Work authorized for the sponsoring employer only	SPT day count required; subject to FICA
H-2B (Un)skilled Workers for Labor Shortage	Work authorized for the sponsoring employer only	SPT day count required; subject to FICA
H-3 Trainee	Work authorized for the sponsoring employer only	SPT day count required; subject to FICA
H-4 Dependents of H-visa holders	No work authorized	N/A
Foreign Media		
I-1 Journalists	Work authorized for the sponsoring employer only	N/A since employed by foreign news org.
Exchange Visitors		
J-1 Visitors incl. exchange students & scholars	May work only for program sponsor only	SPT exempt for 1st 5 years; FICA exempt
J-2 Dependents of J-1	Work authorized under certain circumstances	SPT exempt for 1st 5 years; FICA exempt
Fiancés		
K-1 Fiancé of U.S. citizen	Work authorized & must marry w/i 90days	SPT day count required; subject to FICA
K-2 Fiancé's child	No work authorized	N/A
Intra-company Transferees		
L-1 Transf'd fr. overseas subsidiary or affiliate	Work authorized for the sponsoring employer only	SPT day count required; subject to FICA
L-2 Dependents of L-1	May work if authorized	SPT day count required; subject to FICA
Vocational and Language Students		
M-1 Vocational Student	Work authorized under certain circumstances	SPT exempt for 1st 5 years; FICA exempt
M-2 Dependents of M-1	No work authorization	N/A
Workers with Extraordinary Abilities		
O-1 Science, education, bus., athletics or arts	Work authorized for the sponsoring employer only	SPT day count required; FICA exempt
O-2 Accompanying Workers	Work authorized for the sponsoring employer only	SPT day count required; FICA exempt
O-3 Dependents of O-1 or O-2	No work authorization	N/A
Athletes and Entertainers		
P-1 Intrnatl'ly known athletes & entertainers	Work authorized for the sponsoring employer only	SPT day count required; subject to FICA
P-2 Performers under exchange program	Work authorized for the sponsoring employer only	SPT day count required; subject to FICA
P-3 Culturally unique entertainers	Work authorized for the sponsoring employer only	SPT day count required; subject to FICA
P-4 Dependents of P-1, 2, 3	No work authorization	N/A
Cultural Exchange Visitors		
Q-1, Q-2 International Cultural Exchange	Work authorized for the sponsoring employer only	SPT exempt for 1st 5 years; FICA exempt
Q-3 Dependents of Q-1 & Q-2	No work authorization	N/A
Religious Workers		
R-1 Religious Workers	Work authorized for the sponsoring employer only	SPT day count required; subject to FICA
R-2 Dependents of R-1	No work authorization	N/A
North Amer Free Trade Agrmt (NAFTA)		
TN Canadian (TN-1) or Mexican (TN-2)	Work authorized for the sponsoring employer only	SPT day count required; subject to FICA
TD Dependents of TN-1 or TN-2	No work authorization	N/A
Lawful Permanent Residents (LPR)		
V-1 Souse of LPR	Work authorized	SPT day count required; subject to FICA
V-2 Unmarried child of LPR	Work authorized	SPT day count required; subject to FICA

APPENDIX B
Glossary of Terms

Abode	Taxpayer's domestic home where he maintains his family, social and political ties
Alien	A person from another and very different family, people, or place; a creature from outer space; a plant or animal that occurs in a region to which it is not native; a person who owes political allegiance to another government; a non-U.S. citizen
Asset-use Test	Effectively connected inc. is derived fr. assets used (in)directly by a U.S. business
Business-activities Test	Effectively connected inc. results fr. bus. activities that are material to its production
Domicile	Permanent home to which the taxpayer intends to eventually return
Dual-status Aliens	Also known as Part-year Residents
Dual Citizen	An individual regarded as a national by more than one country, with the option to be treated as a citizen by one or both based on treaty provisions
Effectively Connected Income	Is taxed at graduated rates
Green Card	Also known as Alien Registration Card
Illegal Alien	An undocumented alien who entered the U.S. without authorization or an alien who once entered legally and then overstayed his welcome
Immigrant	An alien who has been granted the right by the USCIS to reside permanently in the U.S. and work without restrictions
ITIN	Individual Taxpayer Identification Number issued by IRS in lieu of Social Security Number (SSN) or Employer Identification Number (EIN)
Long-term U.S. Resident (LPR)	A lawful permanent resident who has resided in the U.S. for at least 8 of 15 years
No-match Letters	Issued if SSN on W-2 does not match Social Security Administration's records
Non-immigrant	An alien who has been granted the right to reside temporarily in the U.S.
Not Effectively Connected Inc.	Is taxed at 30%
NRA	Non-resident Alien
Physical Presence Test (PPT)	Taxpayer must be physically present in a foreign country for at least 330 full days during a period of 12 consecutive months to be eligible for the Foreign Earned Income or Foreign Housing exclusions
Sailing or Departure Permit	Certification required verifying that aliens leaving the U.S. do not have any outstanding tax liabilities
§ 871(d)	Election to treat rental income as effectively connected
§ 7701	First-Year Election to be treated as a resident
§ 6013	Election by a married couple to treat NRA spouse as a resident
Substantial Presence Test (SPT)	Used to determine U.S. residency status
Tax Home	The taxpayer's place of business or employment
Totalization Agreements	Eliminate dual coverage and dual contributions of social security taxes
USCIS	U.S. Citizenship and Immigration Services (formerly INS)
U.S. National	A resident of American Samoa or Northern Mariana Islands who has sworn allegiance to the U.S.