

# Who has the Privilege of Being Taxed by the United States?

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According to the United States tax code there are domestic and foreign taxpayers. Domestic taxpayers, which include United States citizens, resident aliens and domestic corporations, are generally taxed on their worldwide income. (§ 61.) By contrast, foreign taxpayers such as nonresident aliens and foreign corporations are generally only taxed on certain income sourced within or connected to the United States. (§§ 871, 881, and 882.) This makes the question of which individuals or entities are domestic and which are foreign very important. An alien will be treated as a resident of the United States if they are lawfully admitted to the United States under the green card test or they meet the requirements of the substantial presence test. (§ 7701(b)(1)(A).)

## Green Card Test (Lawfully Admitted to the United States)

An individual will be a resident if he is a lawful permanent resident of the United States at any time during the calendar year. (§ 7701(b)(1)(A)(i).) He is considered a lawful permanent resident if he legally holds a green card at any time during the year and that green card has not been revoked or abandoned. Green cards are granted in accordance with immigration laws. This test is not met until the green card is actually granted to the individual.

## Substantial Presence Test

The substantial presence test is centered on the alien individual's physical presence within the United States. (§ 7701(b)(1)(A)(ii).) The individual must be present in the United States: (1) for at least 31 days during the current calendar year; and (2) for at least 183 days for the current year combined with the previous two years. (§ 7701(b)(3).) The first prong is straight forward, but the second prong is a little more complicated. The 183 days include all days in the current year, one third of the days in the previous year, and one sixth of the days in the year before that. (Ibid.)

Example 1. Gary, who is an alien individual, is in the United States for 120 days two years ago, 150 days last year, and 130 days this year. Gary was physically present within the United States for more than 31 days in the current calendar year. This satisfies the first prong. For the second prong, Gary will be able to count all 130 days for the current year. He will get 50 days from the prior year ( $150/3$ ). Finally, he will get an additional 20 days from two years ago ( $120/3$ ). The total of all three comes to 200 days. This exceeds the required 183 days to satisfy the substantial presence test.

## Exceptions to the Substantial Presence Test

Tax law would be boring if we did not have a few exceptions to a fairly bright-line rule. The first exception is for aliens that spend less than 183 days in the United States and are able to establish a closer connection to a foreign country. (§ 7701(b)(3)(B).) The code indicates that this connection is determined by the individual's tax home.

Regulations define tax home as the country where the alien has his regular or principal place of business or if there is no regular or principal place of business, that at his regular place of abode in a real and substantial sense. (§ 1.911-2(b).) This can be thought of as the individual's center of economic activity.

The second exception to the substantial presence test is for individuals that belonging to certain classes. These exempt individuals include those that are considered a foreign government-related individual, a teacher or trainee, a student, or a professional athlete who is temporarily in the United States to compete in a charitable sports event. (§ 7701(b)(5).)

The third allows a spouse of either a citizen or a resident alien to elect to become a resident of the United States for federal tax purposes. In order to take advantage of this option, the alien must attach a statement to the jointly filed return. This statement must include the name, address and identification number of each spouse. Additionally, the statement must declare that one spouse is a citizen or resident alien and that the alien spouse is making this election.

The fourth deals with international tax treaties. Tax treaties can override the standard rules in the internal revenue code. You would need to reference the appropriate treaty to understand how and if it modifies the standard rules talked about in this article.

The fifth is not so much an exception but a grace period for aliens that have been in this country, but are unable to leave due to a health problem. (§ 7701(b)(3)(D).) This statute stops the accumulation of additional days towards the required 183 days. This is afforded to individuals that are unable to leave the United States due to a medical condition that arose while the individual was in the United States. (Ibid.) It should be noted that this exception would do nothing for an individual that has already met the requirements of the substantial presence test.

## First Year Election

Individuals that are in the process of meeting the requirements of the substantial presence test may be able to elect to be treated as a resident in the current year. In order to make this election, the individual must meet five criteria. (1) she must have failed both the green card test and the substantial presence test; (2) must not have been a resident of the United States in the previous year; (3) must meet the substantial presence test in the year following the election; (4) must be present in the United States for 31 consecutive days in the election year; and (5) must be present for 75% of the period beginning with the first day of the 31-day period and ending with the last day of the election year. (§ 7701(b)(1)(A)(iii).)

Individuals may not make this election until the substantial presence test has been satisfied for the year following the election. (§ 301.7701(b)-4(c)(3).) The individual may request an extension to file the return until she has satisfied the substantial presence test. However, with the extension the individual must pay the amount of tax she expects to owe for the election year computed as if she were a nonresident alien through the election year.

Once this election is made it cannot be revoked unless you get the approval of the Commissioner.

## Residency Commencement

The commencement of residency depends on the manner in which the individual obtained residency status. (§ 7701(b)(2)(A); § 301.7701(b)-4.)

Passes green card test, but fails substantial presence test: residency starts on the first day of physical presence in the United States. If the individual is not present at all during the year he obtains his green card, his residency will start on the first day of the following year.

Fails green card tests, but satisfies substantial presence test: residency will generally start the first day on which the individual is physically present in the United States.

Passes green card test and substantial presence test: residency date will be the earlier of dates described above.

First year election: residency begins on the first day of the earliest physical presence meeting both the 31-day and 75% periods.

## Residency Termination

Like residency commencement, residency termination depends on the method by which the individual became a resident. (§ 7701(b)(2)(B); § 301.7701(b)-4.)

Passes green card test, but fails substantial presence test: residency terminates on the first day during the calendar year that the individual is no longer a lawful permanent resident, if the individual can establish that for the remainder of the year his tax home was in a foreign country and he maintained a closer connection to that foreign country. Otherwise the termination date will be the last day of the calendar year.

Fails green card tests, but satisfies substantial presence test: residency terminates on the last day during the year that the individual is physically present in the United States, if the individual can establish that for the remainder of the year his tax home was in a foreign country and he maintained a closer connection to that foreign country. Otherwise the termination date will be the last day of the calendar year.

Passes green card test and substantial presence test: residency terminates on the later of the first day the individual is no longer satisfies the green card test or the last day the individual was physically present in the United States, if the individual can establish that for the remainder of the year his tax home was in a foreign country and he maintained a closer connection to that foreign country. Otherwise the termination date will be the last day of the calendar year.

First Year Election: Since the election is conditioned upon satisfying the substantial presence test in the following year, the termination date is irrelevant.

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