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U.S. TAXATION OF FOREIGN NATIONALS

Foreign nationals are taxed in the U.S. based on a variety of factors - treaties, residency, visas, and length of stay. All factors must be considered to determine U.S. residency and taxation. U.S. residency is determined first by visa status and then based on the substantial presence test, a counting of days of presence in the U.S. over a 3 year window of time. The substantial presence test is a year-by-year determination. Foreign nationals from income tax treaty countries may be able to use the treaty to alter their taxation in the U.S.

RESIDENCY TESTS UNDER INTERNAL REVENUE CODE

- Lawful Permanent Resident Test – Individuals who have acquired lawful permanent residence in the U.S. are taxed on their worldwide income for the entire time period they retain their "green card".
- Substantial Presence Test – Individuals without a green card look to the number of days present in the U.S. If the sum of current year U.S. days plus 1/3 of U.S. days in the first preceding year plus 1/6 of U.S. days in the second preceding year equals 183 or more, the individual is resident of the U.S. for at least part of the current year. Partial days in the U.S. are counted as a full days.

Residency Test Example

	Actual Days	Days for Test	
2015	75	12.5	1/6 of second preceding year
2016	81	27	1/3 of first preceding year
2017	144	144	all current year days
Total Days for Test		183.5	

The individual has more than 183 U.S. days in the substantial presence test; therefore, he/she would be resident in the U.S. for the 2017 tax year.

SHORT-TERM VISITORS TO U.S.

Internal Revenue Code (IRC) Section 861(a)(3) exempts non-residents from U.S. federal income tax on compensation for workdays in the U.S. if all three tests are met:

1. The nonresident alien is present in the U.S. for 90 days or less in the tax year.
2. Compensation related to those days does not exceed $3,000.
3. The compensation is for services as an employee of a foreign person not engaged in a trade or business in the U.S., or as the employee of an office maintained outside the U.S. by a U.S. person.

These individuals are not required to file a U.S. income tax return to report exemption under IRC Section 861(a)(3).

NON-RESIDENTS

Residency Test under Internal Revenue Code

Foreign nationals with less than 31 days in the U.S. in the current year are automatically considered non-residents. Individuals who do not meet the lawful permanent resident test or the substantial presence test are also considered non-residents.

Exceptions to the Substantial Presence Test

Foreign nationals exempt from the substantial presence test include:

- Individuals with F, J, Q or M visas if within their length of stay requirements.
- Individuals employed by a foreign government in a diplomatic or consular status.
- Individuals employed by an international organization.
- Professional athletes competing in certain charitable sporting events, but only for days of competition, not training.

Individuals meeting any of the above exceptions are considered non-resident for U.S. taxation.

Closer Connection under Internal Revenue Code

Foreign nationals who meet the substantial presence test in a calendar year may be considered non-resident if they satisfy all the following conditions:

- The individual has less than 183 U.S. days in the current year;
- The individual maintains a tax home in a foreign country during the current year; and
- The individual has a closer connection during the current year to a single foreign country in which he/she maintains a tax home than to the U.S.

Factors which establish a closer connection to a foreign country include maintaining a primary residence, financial interests, and family/social contacts in that country.

Filing Requirements

In the aforementioned cases, the individual must file a U.S. tax return. Exempt individuals, must file an annual statement with the IRS to establish their claim. Short-term visitors meeting IRC Section 861(a)(3) do not have an income tax return filing requirement.

Taxation of Non-residents

Non-residents are taxed on U.S. source income, which includes wages allocable to U.S. workdays and U.S. situs assets. No standard deduction is allowed and only one personal exemption is allowed (exception for residents of Canada and Mexico)[1]. Married individuals must file separate returns. Special federal income tax withholding rules apply for the Form W-4, filed with the U.S. employer's payroll department.

RESIDENTS

Residency Test

Foreign nationals who meet the lawful permanent residence test or the substantial presence test are considered residents.

Dual-Status Individuals

A foreign national may be taxed as a non-resident and as a resident in the same year. This can apply in the years of U.S. entry and exit.

- Married individuals must file a separate return.
- Personal exemptions[1] for spouse and children are available.
- Standard deduction is not available.
- Married individuals are not allowed to deduct rental losses.
- Special federal income tax withholding rules apply for the Form W-4 since no standard deduction is available.

1 Starting in 2018, the personal tax exemption is suspended through tax year 2025.

Taxation of Residents

Residents are taxed on their worldwide income. They receive benefit of the same itemized deductions, standard deduction and personal exemptions[1] as those available to U.S. citizens, if they are taxed in the U.S. for the full calendar year.

Treaty Exceptions

Fiscal Residence

In cases of dual residency due to meeting the substantial presence test, a treaty can allow the home country residency to override the U.S. residency. One must look to the treaty's fiscal residence clause for the tie breaker provisions to determine which country can claim residency. Fiscal residence can also be used to delay the residency start date in the year an individual enters the U.S. if he/she had days of presence in the U.S. before the start of the assignment. The result would be non-resident taxation on U.S. source income prior to the assignment and worldwide income taxation after the start of the assignment.

Dependent Personal Services

In certain cases of double taxation, a treaty can allow home country taxation to override U.S. taxation (Dependent Personal Services article). All of the following three requirements must be met:

1. The individual cannot be present in the U.S. for more than one of the following:
   a. 183 days in any 12 month period beginning or ending in the current year, OR
   b. 183 days in a calendar year. Each treaty should be consulted for the wording with respect to this requirement.
2. Compensation must be paid by a non-U.S. employer.
3. The compensation cannot be borne by a U.S. permanent establishment.

1 Starting in 2018, the personal tax exemption is suspended through tax year 2025.

EXPATRIATION TAX

U.S. citizens giving up their citizenship and long-term residents terminating their lawful permanent residence (by voluntarily surrendering their green card with a U.S. consular or immigration officer) will be subject to IRC Section 877A expatriation rules. Long-term residents are individuals who have a green card in at least 8 of the last 15 tax years ending within the year the residency ends. Partial years of residency are counted as one year. For example, an individual who received a green card on December 31, 2002 and relinquished it on January 1, 2016 would be considered a long-term resident. Exceptions are available for certain dual-citizens and certain minors. Expatriation includes the acts of relinquishing U.S. citizenship and terminating long-term residency.

The IRS automatically assumes tax avoidance is the principal purpose for ceasing U.S. citizenship or long-term residency. An individual is deemed a "covered expatriate" and is subject to expatriation tax if he/she falls into any of the following categories:

- The individual's average annual net income tax liability for the 5 years ending before the date of expatriation is more than a set amount ($162,000 for 2017).
- The individual's net worth is $2 million or more on the date of expatriation.
- The individual fails to certify on Form 8854 that he/she has complied with all U.S. federal tax obligations for the 5 years preceding the date of the expatriation.

The rules outlined above apply to individuals who are considered to have expatriated after June 16, 2008.

The expatriation tax regime requires all property of the individual to be treated as if sold for fair market value on the day before the expatriation date. Gains from deemed sales are taken into account without regard to other U.S. internal revenue laws. Losses from deemed sales are taken into account to the extent otherwise allowed under U.S. internal revenue laws. However IRC Section 1091 (relating to the disallowance of losses on wash sales of stocks and securities) doesn't apply. The net gain that would otherwise be included in gross income due to the deemed sale rules is reduced by $699,000 (in 2017). Exceptions to the mark-to-market tax apply to certain types of deferred income.

The above information is a summary of complex tax laws and is general in nature. Individuals should seek additional professional advice before applying this information to specific situations.