United States Tax Residency; COVID-19 and Beyond

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Please note: "The views expressed by the speakers are those of the individual speakers in their individual capacities only, and not necessarily those of their respective employers."

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Agenda

1. But First . . . The “Basics” – IRC § 7701(b) and Treaties
2. Beginning and Ending Residence
3. Special Rules, Traps and Anomalies
4. Relief under Revenue Procedures and FAQs
5. California Residence

But First… The "Basics"

- Worldwide taxation:
  - Income tax: Citizens & resident aliens (RAs), with no treaty benefits (to reduce U.S. tax, with limited exceptions)
  - Estate/Gift/GST: Citizens & domiciled aliens
  - Taxation of nonresident citizens is (almost) unique to the United States
- Limited NRA income taxation:
  - Certain U.S. source (FDAP) income – withholding
  - U.S. trade/business (ETB? ECI? FIRPTA?)
  - Treaty benefits
- Limited NRA Estate/Gift/GST Taxation:
  - Generally, only U.S. situs assets (defined differently for estate and gift taxes)
  - Minimal exemption: $60,000
  - Treaty benefits

Tax Status: Which Status Matters?

- U.S. citizen
  - NRA or RA: Income tax residency (§ 7701(b))
  - Residence: Sourcing personal property sales (§ 865(g))
- Estate, Gift & GST: Domiciled alien
- State tax residency
- Foreign nationality
- Foreign tax residency
- Impact of international tax treaties?
- Foreign versus domestic trust status
- Expatriation: Losing U.S. tax status

Residency: Increased U.S. Int'l. Reporting

Inbound, e.g.:

- Forms 1042/1042S, W-8BEN, 8233, 8288, 8804 (withholding)
- Form 1040 NR (trust too)
- Form 1120-F
- Form 5472 (related party transactions)
- Form 8833 (treaty)
- Form 8840 (closer connections)
- Form 8966 (FATCA Rpt.)
- Form 706-NA, -QDT

Outbound, e.g.:

- FINCen Form 114 (FBAR)
- Form 8938 (Foreign assets)
- Form 5471 (Corp.)
- Form 8621 (PFIC)
- Form 8865 (P/ship)
- Forms 8858, 8832
- Form 3520, 3520- A (Trust)
- Form 1116/8 (FTC)
- 706-CE (FTC)
- Form 8802 (treaty)
- Form 2555 (§ 911)
- Form 8854 (expat.)
- Form 708 (expat./prop.)

For many forms, failure to file or inaccurate filings can result in heavy penalties (unrelated to amount of undeclared or underdeclared income) and extended statute of limitations

Primary Definition of Residence under the Code

- Lawful permanent resident (green card) test: Individual is lawful permanent resident under the immigration laws. IRC § 7701(b)(1)(A)(i) and (6)
- Substantial presence test. IRC §§ 7701(b)(1)(A)(ii) and (3)(A)
  - Present in U.S. at least 31 days in current calendar year, and
  - Sum of days of presence in current year + $\frac{1}{3}$ of the days of presence in preceding year + $\frac{1}{6}$ of the days of presence in 2nd preceding year is 183 days or more (fractions are not rounded)

Substantial Presence – Closer Connection

- If alien is not present for 183 days in the current year, can avoid residence by showing foreign tax home and closer connection to foreign country. IRC § 7701(b)(3)(B)
- Alien must establish "tax home" in foreign country under IRC § 911(d)(3), which cross-refers to IRC § 162 for determination, i.e., regular or, if more than one, principal place of business or, if no place of business, regular or principal place of abode
- Closer connection refers to personal ties
- Cannot have taken affirmative steps to become lawful permanent resident. IRC § 7701(b)(3)(C); Reg. § 301.7701(b)-2(f) and see next slide
- Timely filing requirement

Steps to Obtain Green Card

- Filing any of the following is considered an affirmative act (non-exclusive list). Reg. § 301.7701(b)-2(f)
  - INS Form 1-508, Waiver of Immunities
  - INS Form 1-485, Application of Status as Permanent Resident
  - INS Form 1-130, Petition for Alien Relative (filed on alien's behalf)
  - INS Form 1-140, Petition for Prospective Immigrant Employee (filed on alien's behalf)
  - Labor Dept. Form ETA-750, Application for Alien Employment Certification (filed on alien's behalf)
  - State Dept. Form OF-230, Application for Immigrant Visa and Alien Registration
- Note that NRA physically in the U.S. may apply for adjustment of status under Immigration and Nationality Act

Substantial Presence – Exceptions

- Exceptions (discussed in later slides)
  - "Exempt individuals" (diplomats, students, teachers, medical necessity, the PGA exception). IRC § 7701(b)(5)
  - Closer connection and foreign tax home (requires fewer than 183 days present in current year). IRC § 7701(b)(3)(B)
  - Treaty tie-breaker

"Sign Me Up" – Elective Residence

- First-Year Election
  - Individual may elect to be treated as a resident for the last part of the year when s/he is a resident all of the following year. IRC § 7701(b)(1)(A)(iii) and (4)
    - Must spend a minimum of 31 consecutive days in the U.S.
    - Must be present in 75% of days from start of the 31-day period to December 31
- Joint Filers
  - One spouse resident and other spouse nonresident. IRC § 6013(g)
  - Both spouses residents at year end, one spouse became resident during year. IRC § 6013(h)

Residence under Income Tax Treaties

- U.S. & OECD Model Definition
  - A person subject to tax by reason of domicile, citizenship, residence or similar criteria. U.S. Model, Art. 4(1)
  - Some treaties require additional nexus (e.g., substantial presence, permanent home, habitual abode) for U.S. citizens or residents to be U.S. residents for treaty purposes (e.g., Finland, Germany, UK)
- Person taxed only based on source not a resident
- Recent proposals/BEPS: person subject to a “special tax regime” not a resident

Treaty Tie-Breaker Rules

- Threshold requirement of “residence” in foreign treaty country before application of tie-breaker rules
  - Forfait regime
    - Special Swiss law permitting non-Swiss citizens to be taxed differently than citizens
    - U.S. Technical Explanation specifically states persons with forfait agreements cannot utilize section 4 of the Treaty
      - Switzerland disagrees
  - U.K. remittance based taxation
    - Special provision by which U.K. taxes only income/gain brought into the U.K.
    - U.S. Technical Explanation specifically excepts such a person from the definition of “resident” for purposes of Article 4
  - Technical Explanation is not consistent with plain language of treaty in either case – but not yet tested judicially

Treaty Tie-Breaker Rules

- For person who is a U.S. resident under the IRC and a resident of treaty country under its domestic law, tests applied sequentially to determine single residence for treaty purposes. US Model, art. 4(2)
  - Permanent home – need not be owned, may be a rental. Para. 12, OECD Commentary , Model Treaty Art. 4
  - Centre of vital interests: Closer personal and economic relations
    - Consider circumstances "as a whole." Ibid., para. 15
  - Habitual abode – purely day-count test
  - Nationality/citizenship (not all treaties)
  - Competent authority determination
- Must make affirmative claim on Form 1040NR, with accompanying Form 8833. IRC § 6114; Reg. §§ 301.6114-1(b)(8) and (c)(2); Reg. § 301.7701(b)-7(b)
- Consistency requirement. Reg. § 301.7701(b)-7(a)(1)

Non-Standard Treaties

- China (1984)
  - Proceeds directly to competent authority
- Australia
  - Switches habitual abode and center of vital interests
  - Does not have nationality as tie-breaker rule
- Older Treaties (No Tie-Breaker Rules)
  - Greece (1953)
  - Pakistan (1957)
  - Trinidad and Tobago (1970)
  - Former USSR (1973)
    - Still applicable to Armenia (though Armenia does not recognize), Azerbaijan, Belarus, Georgia, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan, and Uzbekistan

Treaty Tie-Breaker Rules

- Determination of residency under treaty typically turns on the "centre of vital interests" test
  - Enumerated by *Podd v. Comm'r*, T.C. Memo 1998-238, *aff'd,* T.C. Memo 1998-418
    - Similar to statutory "closer connection" test
    - Recognized that determination was on a year by year basis
    - Residency in one year does not affect the determination for separate year
    - Court ultimately determined residency turned on habitual abode, as centre of vital interests was too evenly split
  - Look to OECD commentary as well
    - Centre of vital interests deemed to be in the country to which the individual's personal and economic relations are closer

Treaty Tie-Breaker Rules

- Treatment as resident of treaty country limited to calculating income tax (including withholding). U.S. resident for all other purposes. IRC § 301.7701(b)-7(a)(3)
  - IRS considers treaty nonresident required to file information returns as resident (*e.g.*, Forms 5471, 8621, 8865 but not 8938 – see 2014 final regs.); numerous anomalies, esp. re trusts
  - U.S. resident for purposes of IRC § 957. Reg. § 301.7701(b)-7(a). Therefore:
    - Corporation may become CFC and other U.S. shareholders may have to report Subpart F income. Reg. § 301.7701(b)-7(e), Example 1
    - Would not be the case if treaty specifically addressed characterization of foreign corporations

Treaty Tie-Breaker Rules – FBARs and FATCA

- FBAR regulations do not address treaty tie-breaker for determination of U.S. residence
  - Preamble requires filing by green card holders (but not mentioned in regulations, form or instructions); silent on substantially present aliens
- What form does a treaty tie-breaker file (W-9 or W-8BEN)?
  - Chapter 3 withholding – Form W-8BEN
  - Chapter 4 (FATCA) – not clear, since this has both reporting and withholding elements
    - What will FFI do when it encounters alien with U.S. indicia which might even include a green card and receives a Form W-8BEN? Will it accept it?
    - Is there a requirement to submit both forms, one for withholding purposes and one for reporting purposes?

Treaties and Expatriation Rules

- Treaties do not protect against deemed sale or exchange of assets under section 877A because that is deemed to take place the day before the expatriation date
- But what about
  - Trust distributions?
  - Distributions from tax-exempt plans?
  - Section 2801 gifts
- No U.S. estate and gift tax treaty has been renegotiated since 2008 enactment

Other Definitions of Residence (1)

- Residence for personal property sales source rules
  - "U.S. resident" includes (1) U.S. citizen or resident that does not have foreign tax home and (2) nonresident alien with US tax home. IRC § 865(g)
- Domicile (estate, gift, GST taxes)
  - Domicile acquired by residence plus intent to remain indefinitely. Reg. §§ 20.0-1 and 25.2501-1(b)
  - Relevance of immigration status
    - Undocumented alien may be resident (or domiciliary) for tax purposes. Rev. Rul. 80-209
    - Long-term non-immigrant visa holder was domiciled in US. Rev. Rul. 80-363

Other Definitions of Residence (2)

- Bank Secrecy Act (FBARs)
  - Since 2010, cross-reference to Code, but "U.S." includes territories and there is uncertainty for treaty nonresidents
- State tax laws
  - Commonly use physical presence or domicile
- Foreign countries' tax laws

U.S. Territories – Bona Fide Residence Test

- Applies to all the territories. IRC § 937(a)
  - Must be present in territory for 183+ days in present year, and
    - If cannot satisfy current year test, may apply three year multiplier (549 days in current and two preceding years, so long as 60 days in each of the three years), or spend less than 90 days in the U.S. during current year. Reg. § 1.937-1(c)(1)
    - NRAs need only satisfy equivalent of substantial presence test enumerated in IRC § 7701(b)(3). Reg. § 1.937-1(c)(2)
  - Not have a tax home outside the territory, and
    - "regular or principal" home. Reg. § 1.937-1(d)(1)
    - Special rules for year of move to territory. Reg. § 1.937-1(d)(2)
  - Not have a closer connection to the U.S. or another foreign country. Reg. § 1.937-1(e)
- Day count inclusions for medical travel or evacuation due to natural disaster. Reg. § 1.937-1(c)(3)(i)

Estate & Gift Tax Residency = Domicile

- Relevance: Worldwide or situs taxation; exemption size
- Domicile:
  - Intention to remain indefinitely, without present intent to later remove
  - Facts-and-circumstances test
  - Extrinsic evidence used to determine of personal intent
  - Self-serving statements given lesser importance

When Does Residency Begin?

Green Card Test

U.S. resident for any year in which he/she is a lawful permanent resident (i.e., holds a green card) for *any* part of the year. Reg. § 301.7701(b)-1(b)(1)

- Residency Starting Date:
  - First day the person is physically present in the U.S. as a lawful permanent resident. IRC § 7701(b)(2)(A)(ii); Reg. § 301.7701(b)-4(a)
    - *This assumes the substantial presence test not already met*
    - *Also assumes not a resident in the prior year*
- Exception:
  - If person is also a resident of a treaty country (i.e., dual-resident taxpayer) and that treaty has a tie-breaker rule. Reg. § 301.7701(b)-7

Substantial Presence Test (1)

Must be present in the U.S. for at least 31 days in current year, and satisfy the 183 weighted average calculation as of the last day of physical presence in the current year. IRC § 7701(b)(3)(A); Reg. § 301.7701(b)-1(c)(1)

- Begin Date:
  - Use look-back rule to determine current year
  - If satisfy test, first day will be the *first day of physical presence* in U.S. during calendar year in which the test is satisfied. IRC § 7701(b)(2)(A)(iii); IRC § 301.7701(b)-4(a)
- Exceptions:
  - De Minimis Rule - Fewer than 31 days in current year, or
  - Nominal Presence – Up to 10 days disregarded
  - Closer Connection and Tax Home – if under 183 days

Substantial Presence Test (2)

De Minimis Rule - Must be present in the U.S. for at least 31 days in current year to satisfy the substantial presence test. IRC § 7701(b)(3)(A)(i); Reg. § 301.7701(b)-1(c)(4)

Nominal Presence - Up to 10 days of presence may be disregarded if person can establish a closer connection to a foreign country. IRC § 7701(b)(2)(C); Reg. § 301.7701(b)-4(c)(1)

- So as not to penalize for brief business trips or trips to find home
- 10 days still counted for purposes of meeting the substantial presence test. Reg. § 301.7701(b)-4(c)(1)
- ***Caveat*** – Unless all days during visit are excludable, none may be excluded. Reg. § 301.7701(b)-4(c)(1)
- **Example**: Flew to U.S. for 4 days in March, then again for 5 days in May, (1st through 5th) then returned June 1st to live (first day is June 1st)
- **Example**: Flew to U.S. for 4 days in March, then for 8 days in May (1st through 8th), then returned June 1st to live, cannot exclude any days in May because May is part of a continuous stay in which the 10-day limit exceeded (only exclude 4 days in March, first day is May 1st)

Both Tests Satisfied

What If Person Satisfies Both Tests for the First Time in the Same Year?

Substantial Presence Test and Green Card Test

The residency starting date is the earlier of (i) the first day the individual is physically present in the U.S. as a lawful permanent resident or (ii) the first day during the year that the individual is present for purposes of the substantial presence test. Reg. § 301.7701(b)-4(a)

When Does Residency End?

Green Card Test

- **General Rule:** Last day is December 31st if the person is a NRA for the following year. Reg. § 301-7701(b)-4(b)(1)
- **Exception**: Last day is the 1st day during the calendar year in which a person is no longer a green card holder **if**:
  1. He/she has a closer connection for the remainder of the year, ***and***
  2. He/she is not a U.S. resident in the next calendar year. IRC §§ 7701(b)(2)(B)(i) & (iii); Reg. § 301.7701(b)-4(b)(2)
- **Residency also ends if**:
  - Person notifies the IRS that he/she is a resident of another country having an income tax treaty with the U.S. IRC § 7701(b)(6)
    - Person files 1040NR with Form 8833
    - Does this rule only apply to long-term residents (see effective date provision to HEART Act of 2008)

      *Beware the potential exit tax issues that will be raised

Note: Person may still be a resident under substantial presence test.

Substantial Presence Test

- **General Rule:** Last day is December 31st if the person is NRA for the following year. Reg. § 301-7701(b)-4(b)(1)

  Exception: Last day is the last day during the calendar year in which a person is physically present **if**:

  1. He/she has a closer connection to a foreign country for the remainder of the year, ***and***
  2. He/she is not a U.S. resident in the next calendar year. Reg. § 301.7701(b)-4(b)(2)

  Note: May use nominal presence exception to apply 10 days at the end, as long as not part of continuous days.

Both Tests Satisfied

What if a person satisfies both the tests:

Green Card Test and Substantial Presence Test

The termination date will be the later of the two. Reg. § 301.7701(b)-4(b)(2)

3 Year Temporary Absence Rule

Anti-avoidance rule applies where alien ceases to be a U.S. resident, sells assets, and then reacquires residency. Specifically:

1. Alien must be a *long-term U.S. resident* (resident for at least three consecutive years, with partial years counting as full years – Reg. § 301.7701(b)-5(a)) who
2. ceases to be U.S. resident for a period of 3 years or less, and
3. reacquires U.S. residency

Alien treated as resident with respect to gain on disposal of asset if, during interim period of non-residency, alien disposed of U.S. assets in a manner that would generate gain and be taxed at a lower amount than if taxed as a resident. IRC § 7701(b)(10)

Special Rules, Traps And Anomalies

Substantial Presence Test – What Is a Day? (1)

Substantial presence test tracks the number of days spent "in" the United States each year.

- But how much of a day is a day? Any part of a day counts:
  - E.g., Day 1, arrive at 11 pm, remain Day 2, Day 3, leave at 4 am
  - That counts as three days. Reg. § 301.7701(b)-(3)(a)
  - Tracking records available on Customs and Border Patrol website at http://www.cbp.gov/travel/international-visitors/i-94-instructions
- Time spent in the U.S. in transit not counted
  - Trip must originate and end outside the U.S. Reg. § 301.7701(b)-(3)(a)(3)
    - Cannot remain in the U.S. for longer than 24 hours
    - Cannot conduct "business" during layover. Reg. § 301.7701(b)-(3)(d)
  - Regular commuter test. Reg. § 301.7701(b)-3(e)
    - Consider definition of "commute" and "workday"

Substantial Presence Test – What Is a Day? (2)

- Special Classifications
  - Student, with particular visas. IRC § 7701(b)(5)(D)
    - Must substantially comply with terms – full-time? work permitted? Reg. § 301.7701(b)-3(b)(6)
    - Rebuttable presumption that exemption expires after five years. IRC § 7701(b)(5)(E)(ii)
  - Teachers/Trainees. Classification as student or trainee in 2 or 4 of prior 6 years disqualifies exemption for whether teacher/trainee in current year. IRC § 7701(b)(5)(E)(i)
  - Foreign Government-Related Individual. IRC § 7701(b)(5)(B)
    - Includes diplomats and consuls and employees of certain international organizations (e.g., World Bank)
    - Not every diplomat qualifies
    - Status must be "full-time." Reg. § 301.7701(b)-3(b)(2)(i)(A) and (iii)
    - Exemption extended to official's immediate family, but not household employees. Reg. § 301.7701(b)-3(b)(8). Are dependent parents included?

Substantial Presence Test – What Is a Day? (3)

- Medical Necessity
  - Medical condition arising in the U.S. excepted from substantial presence test. Reg. § 301.7701(b)-3(c)
- Medical condition must arise while alien is in the U.S.
  - Condition is not considered to arise while the individual is present in the United States, if it existed prior to the individual's arrival in the United States and the individual was aware of the condition or problem
  - Day not excluded if alien is subsequently able to leave and then remains in the U.S. "beyond a reasonable period for making arrangements to leave"
- May not include dependents or caregivers (see discussion below)

Substantial Presence Test – What Is a Day? (4)

- Certain professional athletes (the “PGA exception”)
- Applies to professional athlete temporarily in the U.S. to compete in a charitable sports event described in IRC § 274(l)(1)(B). IRC § 7701(b)(5)(A)(iv)

Closer Connection Test – Timely Filing

- Form 8840 requesting treatment (which must include a statement in support) must be timely filed for recognition by IRS. Reg. § 301.7701(b)-8(d)(1)
- Reasonable cause exception exists, but higher bar and burden on taxpayer to show by "clear and convincing evidence." Reg. § 301.7701(b)-8(d)(2)

Closer Connection v Treaty Nonresidence

- “Foreign tax home” does not require residence in foreign country for that country’s tax purposes
- Location of principal place of business in foreign country and existence of closer connection to foreign country are separate requirements; personal and economic ties are considered on overall basis under treaty
- Treaty nonresident may still have to file information reports – see later slide
- Closer connection: Form 8840; Treaty nonresidence: Form 1040NR and, in most cases, Form 8833
- Failure to file timely does not vitiate treaty claim
- Consider filing treaty claim on protective basis to back up closer connection claim

Tax on Capital Assets / 183 day rule

- No U.S. tax on gain from capital asset by NRA, except ECI gain or gain from U.S. real property interest (FIRPTA)
- However, U.S. source gains (net of losses) taxed at 30% if NRA present in U.S. for 183 days or more in current year. Reg. § 1.871-7(d)(2)(i)
  - Any part of a day counts. Reg. § 1.871-7(d)(3)(ii)
    - Certain exceptions for Mexican/Canadian residents
    - No deemed presence due to agency law
  - Gain has U.S. source if NRA has a U.S. tax home, as defined by IRC § 911(d)(3). See IRC § 865(g)(1)(A)(i)(II)
  - Payments received in subsequent year (so long as less than 183 days of presence by NRA) not subject to tax even if agreement reached in current year. Reg. § 1.871-7(d)(2), *example 1*

Termination of Lawful Permanent Residence (1)

- "Resident status is deemed to continue unless it is rescinded or administratively or judicially determined to have been abandoned." Reg. § 301.7701(b)-1(b)(1)
- Therefore, status can continue even if green card no longer valid for immigration purposes (e.g., expired).
  - Retroactive effect on persons who left U.S. pre-1985 with no intent to return but failed to formally terminate lawful permanent resident status?
  - Addressed in IRS Action Plan?

Termination of Lawful Permanent Residence (2)

- Intent to leave is not sufficient
  - Section 7701(b) requires formal notification/revocation or treaty tie-break. IRC § 7701(b)(6); Reg. § 301.7701(b)-1(b)(2)
    - No "informal" abandonment. See Reg. § 301.7701(b)-1(b)(3)
    - Prior to 1984, presumption was nonresident. Turned wholly on intent, evaluated according to length and nature of stay. Reg. § 1.871-2 (effective through December 31, 1984); *see Adams v. Comm'r*, 46 T.C. 352 (1966)
  - 1984 transitional rules: Lawful permanent residence for 1984 if the person at issue was (a) lawful permanent resident as defined by IRC § 7701(b)(5) throughout 1984, or (b) was present in the U.S. at any time during 1984 while such individual was lawful permanent resident under IRC § 7701(b)(5)

Termination of Lawful Permanent Residence (3)

- Informal abandonment not sufficient. *Topsnik v. Comm'r*, 143 TC No 12 (2014)
  - But unclear for individuals who left before 1985
- Should file USCIS (formerly INS) Form I-407 or letter with Permanent Resident Card (Form I-151 or I-551) with USCIS or a consular officer. Reg. § 301.7701(b)-1(b)(3)
  - If by letter, must clearly state intention to abandon
- USCIS issues final administrative order of abandonment
  - But if appeal, then not terminated until final judicial order affirms order of abandonment - Reg. § 301.7701(b)-1(b)(3)
  - ***Controlling date is date of surrender, not date processed*** – Reg. § 301.7701(b)-1(b)(3)
    - **But,** if USCIS initiated determination, date of issuance of final order (after appeals exhausted) is controlling. Reg. § 301.7701(b)-1(b)(2)

Correlation with Expatriation Rules (1)

- Green card holder becomes long-term resident after being a "resident" by virtue of green card in 8 out of immediately preceding 15 years. IRC § 877(e)(2)
  - Classification as long-term resident cannot be lost prospectively
  - Treaty tie-breaking or otherwise relinquishing green card in accordance with IRC § 7701(b)6) is an expatriation event *for a long-term resident*. IRC § 877A(g)(2)
- Exit tax due if taxpayer is a "covered expatriate." IRC § 877A(g)(1)(A), incorporating IRC § 877(a)(2). Note: regardless of net worth, taxpayer is a CE if cannot certify tax compliance for five preceding years.
  - What about the FBAR?

Correlation with Expatriation Rules (2)

- Once a covered expatriate, U.S. estate and gift tax rules forever apply to any gift/bequests to U.S. persons. IRC § 2801
  - IRS regulations proposed 9/10/2015
  - When regs. final, tax will be imposed retroactively to 2008
  - Apparently covered expatriate status continues if returns to the United States – in fact even if later becomes U.S. citizen
- Travel into US after abandonment
  - Visa-waiver programs
  - Substantial presence test potentially applies
  - Caution for acquiring residency within three years
  - The Reed Amendment (1992) only applies to U.S. citizens (inadmissibility of citizens who expatriated to avoid tax) and in any event is apparently not being enforced

Relief for Stranded Aliens – Revenue Procedure 2020-20

The Problem

- A non-immigrant alien becomes a U.S. resident based on days of presence
- The coronavirus pandemic has trapped many aliens in the United States for a variety of reasons:
  - Becoming infected or ill
  - Being responsible for a person who is infected, ill or unable to travel
  - Being unable to travel because of airline cancellations, quarantines
  - Being unable to return to the country in which they normally reside because of travel restrictions or outright bans
- This can affect their residence status:
  - Forcing them to stay 183 days or more in 2020
  - Causing the three-year formula to equal or exceed 183 days
  - Even if they can leave before spending too many days here, the number of days they can return to the United States may be limited not only in 2020 but also in 2021 and 2022

Limited Relief Has Been Granted

- On April 21, 2020, the Treasury Department and the Internal Revenue Service issued Revenue Procedure 2020-20
- It provides guidance to individuals and businesses impacted by travel disruptions arising from the COVID-19 pandemic
- Relief provided for nonresident individuals who, but for COVID-19 Emergency Travel Disruptions (as defined below), would not have been in the United States long enough during 2020 to be deemed resident aliens under the "substantial presence test" or to be ineligible for treaty benefits with respect to determining their tax residency status
- For many stranded foreigners, this guidance means that they have an extra 60 days they can be in the United States in 2020 without becoming increasing the day count that could lead them to becoming resident aliens

Medical Relief Exception Expanded (1)

- Revenue Procedure 2020-20 expands on the medical condition exception to provide relief for foreigners stuck in the United States as a result of the COVID-19 Emergency
- The COVID-19 Emergency is defined for these purposes as the global outbreak of the COVID-19 virus
- The new Revenue Procedure creates a new exclusion, the “COVID-19 Medical Condition Travel Condition”
- This exclusion allows a qualifying alien (an “Eligible Individual” as defined in Section 3.04 of Revenue Procedure 2020-20) who intended to leave the United States during the individual’s “COVID-19 Emergency Period,” but was unable to do so due to the current “COVID-19 Emergency Travel Disruptions,” to exclude the individual’s COVID-19 Emergency Period from their day-count under the substantial presence test

Medical Relief Exception Expanded (2)

- This excluded COVID-19 Emergency Period extends for a period of up to 60 calendar days of continuous presence in the United States which commences between February 1 and April 1, 2020
- Further, “an Eligible Individual will be presumed unable to leave the United States for purposes of the substantial presence test on any day during the individual’s COVID-19 Emergency Period”
- The COVID-19 Emergency itself is considered a medical condition and is not considered to be a pre-existing one

Counting Days for Treaty Purposes

- A parallel to the Medical Condition Exception applies for purposes of income tax treaties
- Many U.S. income tax treaties exempt income from employment (or other dependent personal services) if the recipient is present in the United States for no more than 183 days in any twelve-month period that begins or ends in the relevant taxable year. See, e.g., Article 14(2) of the 2006 U.S. Model Income Tax Convention.
- Treaties generally provide that for purposes of computing days of presence in the United States under this type of test, days on which an illness prevented the individual from leaving the United States are not counted. Up to 60 days (i.e., the COVID-19 Emergency Period) may be excluded for this purpose under Rev. Proc. 2020-20

60 Day Extension (1)

- Therefore, up to 60 days of presence in the chosen Emergency Period are therefore excluded, which may enable the alien to avoid resident alien status for the year, assuming no disqualifying return to the United States for the alien in the balance of 2020
  - An alien who has applied or otherwise taken steps to become a lawful permanent resident of the United States may be eligible for relief but is not entitled to a presumption of an intent to leave the United States. They may nevertheless be able to demonstrate their intent to leave based on the rules in Reg. section 301.7701(b)-3(c)(2)
- For aliens with a full 60-day COVID-19 Emergency Period *and* entitled to use the closer connection exception, this means they may be able to stay up to a total of 242 days, not just 182 days in 2020
  - 242 is also the numerical limit for alien who spent zero days in 2018 and 2019

60 Day Extension (2)

- The Procedure specifically confirms that an alien individual can combine their excluded days of US presence under the COVID-19 Medical Condition Travel Exception with the closer connection exception
- Still, given the day count is mounting, clients stranded in the United States since February must remain vigilant with their day counts based on their own individual circumstances

Ineligibility Rules

- Rev. Proc. 2020-20 is based on an expansive reading of the medical condition exception. The exception requires an intent to leave the United States but the Rev. Proc. presumes such an intent
- Thus, those individuals who have steps pending to obtain green cards are not eligible
- Further, the Rev. Proc. only applies to non-residents at the close 2019 so those individuals who were U.S. residents at the close of 2019, even though they were not planning on being residents in 2020 will not get the 60 day medical exception benefit. Individuals whose residency terminated in 2019 may still be eligible.
- An Eligible Individual who does not qualify for the presumption of an intent to leave the United States outlined in section 4.02 of Rev. Proc. 2020-20 (meaning, the individual has applied, or otherwise taken steps, to become a lawful permanent resident of the United States but is not yet a lawful permanent resident), should also retain any documents that may support a "facts and circumstances" analysis of the Eligible Individual's intent to leave the United States under section 301.7701(b)-3(c)(2

Documenting Entitlement to COVID-19 Emergency Relief and Actual Medical Conditions

Filing and Documentation Requirements

- Importantly, for those foreigners who must file a nonresident tax return – Form 1040NR (e.g., filing is required to report US business income), in order to claim this new medical condition exception, the Procedure requires proper filing of Form 8843 -- *Statement for Exempt Individuals and Individuals with a Medical Condition*, as detailed in the Procedure
- For those who are not otherwise required to file Form 1040NR, there is no form filing requirement to get the relief under the Revenue Procedure
- Those not required to file currently can later file Form 8843 if the IRS challenges the individual's nonresident status for tax years 2020, 2021 or 2022
- Complete and accurate records related to the COVID-19 Emergency Period must be kept by all regardless of whether or not the current filing of Form 8843 is required

Filing and Documentation Requirements

- Five FAQs were issued on May 27 by Treasury and the IRS
- FAQ5 addresses documentation requirements arising out of earlier guidance
- An Eligible Individual claiming relief under Rev. Proc. 2020-20 should retain evidence of the individual's presence in the United States during the individual's claimed COVID-19 Emergency Period. Examples include:
  - Customs and Border Protection Form I-94 showing the individual's entries into the United States. Note this may be available at https://i94.cbp.dhs.gov/I94/
  - Hotel receipts, or travel reservations, including confirmation of changes or cancellations

FAQs for Sick or Infected Individuals

- On May 27, the IRS posted FAQs for Individuals Claiming the Medical Condition Exception in 2020
- FAQ1 removes the need to obtain a physician's signature on Form 8840 for actual illnesses of 30 days or less
- Instead, FAQ 2 instructs alien individuals claiming the 30-Day Medical Condition to retain documentary evidence that substantiates their medical condition, their inability to leave due to the medical condition, and the period of the medical condition such as
  - evidence of consultations with a heath care provider
  - receipts related to healthcare purchases
  - evidence of canceled or changed travel reservations
  - official medical records
  - or even written healthcare correspondence that the individual received (e.g., automated responses instructing an individual to self-isolate
- FAQs 3 and 4 provide additional guidance on how to complete Form 8840, including when an individual wishes to claim multiple Medical Condition Exceptions

Relief Under Revenue Procedure 2020-27 – 1

- In addition, the IRS concurrently issued a second Revenue Procedure 2020-27 to address the separate issue of US taxpayers residing abroad and claiming the exclusion from income for "foreign earned income" under section 911 where they have had to return early to the United States due to the pandemic, thereby jeopardizing their qualification to claim to the section 911 exclusion
- Revenue Procedure 2020-27 allows that the Secretary of the Treasury has determined that the global health emergency caused by the outbreak of COVID-19 is an adverse condition that disrupts the normal conduct of business globally
- Therefore, relief is provided to any US individual who reasonably expected to become a "qualified individual" in order to claim the foreign earned income exclusion under section 911 but left the foreign jurisdiction during the period described in this revenue procedure

Relief Under Revenue Procedure 2020-27 – 2

- While being stranded in the United States does not prevent someone from having a bona fide residence in another country for section 911 purposes, only earned income attributable to the time actually spent outside the US can be excluded under this guidance
- Thus, if an individual receives earned income from a foreign employer while stranded in the United States, the US source portion of earned income cannot be excluded under section 911

Personal Services and the FAQs

The Personal Services Problem

- Foreign individuals may have to render services while stranded in the United States
  - Those services may be related to the business for which they came to the United States or they may be related to home country business that can be carried on remotely
  - Under section 861(a)(3) and 864(b), compensation for services performed in the United States has a U.S. source and is treated as effectively connected with a U.S. trade or business (with a *de minimis* exception)
  - Such individuals may therefore be taxed on other compensation for services they continue to render while stranded

The ETB/PE Problem

- Foreign individuals (including U.S. citizens normally residing abroad) rendering services while stranded in the United States may create issues for employers and principals
  - May cause employer or principal to be engaged in a U.S. trade or business (USTB)
  - May, arguably, create a U.S. office or fixed place of business for purposes of (a) section 864(c)(4)(B) or (b) permanent establishment (PE) clause of treaties

April 21 FAQs – 1

- This problem was pointed out to the government by the Tax Residence and Coronavirus Working Group and the Florida Bar Tax Section
- The IRS responded by issuing two FAQs on April 21
- Question 1: Will a nonresident alien or foreign corporation not otherwise engaged in a USTB be treated as engaged in a USTB as a result of services or other activities conducted by one or more individuals temporarily present in the United States if, but for COVID-19 Emergency Travel Disruptions, those services or other activities would not have been conducted in the United States?
- Answer: Foreign persons (or a partnership in which a foreign person is a partner ("Affected Person")) may choose a 60-day period beginning between February 1 and April 1 during which services of nonresidents will not be taken into account in determining whether the Affected Person is engaged in a USTB
  - Services to be disregarded must have been performed by persons temporarily present and would not have been performed in the United States but for the COVID-19 Emergency Travel Disruptions
  - Can includes services of U.S. citizens and green card holders who had foreign tax home in 2019 and reasonably expect to have foreign tax home in 2020
  - Reason for inclusion of the 2019 tax home requirement is unclear

April 21 FAQs – 2

- Question 2: If a foreign person is engaged in a USTB (taking into account the application of the treatment in Question 1) but otherwise does not carry on such USTB through a PE under an applicable income tax treaty, will the foreign person be treated as conducting business through a PE due to services or other activities conducted by individuals temporarily present in the United States that would not have been conducted in the United States but for COVID-19 Emergency Travel Disruptions?
- Answer: During Affected Person's Emergency Period, services or other activities of temporarily present individuals not taken into account in determining whether the foreign person has a PE, again provided the services or other activities would not have occurred in the United States but for the Travel Disruptions

April 21 FAQs – Issues with the FAQs

- It was pointed out to the government that income excluded from USTB or PE treatment under the FAQs would arguably then be treated as FDAP income, taxable at 30%. On June 12, the government responded by adding a sentence:
  - An Affected Person's income earned during the COVID-19 Emergency Period will not be subject to the 30% gross basis tax imposed under section 871(a) or section 881(a) solely because the Affected Person is not treated as having a USTB or PE under these FAQs
- It is not clear what happens if a foreign person is found to be engaged in a USTB because their stay in the United States is longer than 60 days, something which is very possible given the progress of the epidemic and continuing travel disruptions. The government was informed of potential issues but chose not to lengthen the 60-day period

April 21 FAQs – Withholding Agents

- Employers and service recipients whose employees and independent contractors were unable to leave the United States as a result of the COVID-19 Emergency Travel Disruptions may have or have had wage and Chapter 3 withholding obligations, both for compensation paid before the issuance of the FAQs and for compensation with respect to periods outside the Emergency Period (which may not even have been determined at the time of payment)
- The IRS has not yet taken up recommendations to clarify the position of such employers or service recipients

April 21 FAQs – Procedure

- The FAQ do not explain how to claim the benefit of the COVID-19 Emergency Period for the purposes of the relief provided by the FAQ
- However, they instruct Affected Persons to retain contemporaneous documentation to establish the chosen Emergency Period and that the activities would not have been conducted in the United States
- The FAQ also permit foreign persons to make protective tax return filings
- The IRS states that it “will continue to monitor the evolving effects ofthe COVID-19 Emergency on nonresident alien individuals and foreign corporations and may update these FAQs as appropriate.”

What's Next?

- In the April 21 FAQs, the IRS states that it "will continue to monitor the evolving effects of the COVID-19 Emergency on nonresident alien individuals and foreign corporations and may update these FAQs as appropriate."
- Might there be additional guidance? E.g.
  - Extending the 60-day period either generally or for specific categories of aliens
  - Revisit the uncertainties of the medical condition exception, including whether it applies to dependents

California and Other State Residency Rules

State Residency Considerations

- Variances in personal income tax rates:
  - E.g., CA & NY versus NV, TX, FL or WY.
  - CA top marginal rate of 13.3%, > $1 million.
  - Exacerbated by 2017 TCJA's SALT limitation.
- Each state can make its own definition of "resident."
- States also adopt their own sourcing rules for determining income situs, in taxing nonresidents.

CA Tax Residency Turns on Residency & Domicile

- Determination of Residency:
  - CA physical presence for other than a temporary or transitory purpose OR
  - CA domiciliary who is outside California for a temporary or transitory purpose.
  - Requires physical presence as a non-transitory inhabitant.
- Domicile Defined: Place of an actual home to which an individual intends to return whenever away traveling.
  - Requires physical presence & intent to make a permanent abode.
  - Facts and circumstances test.
  - A person may be CA domiciled but not be a CA resident or may be domiciled in another state but be a CA resident.

CA Tax Residency: Presumptions

- Non-conclusive presumption that an individual is not California resident where:
  - Physical presence within CA for <6 months during year;
  - Domiciled and has a personal residence outside CA; and
  - Non engaged in CA activity or conduct other than as a seasonal visitor, tourist or guest."
- Rebuttable presumption that an individual is CA resident where:
  - Physical presence in CA >9 months during year.
- Presumptions not conclusive; is there evidence that an individual was physically present in California merely for a temporary or transitory purpose (even more than 9 months)?

CA Residency: Safe Harbor

- An individual domiciled in California who is outside of California under employment contract for at least 546 consecutive days (uninterrupted) is nonresident if:
  - Individual's intangibles income <$200,000 in any contract year; and
  - No principal tax avoidance purpose for CA absence.
- Employment safe harbor covers spouse with employed individual out of CA for at least 546 consecutive days.
- Return CA visits during contract period of 45 days or less during any year are considered temporary.

CA Residency: Income Taxation

- CA residents taxed on worldwide income.
- CA nonresidents taxed only on CA-source income.
- Part-year CA residents taxed on worldwide income when resident and only on CA-source income when nonresident.

CA Nonresident: Income source
CA-source income in general:

- Income and gains from CA real or tangible property.
- Income form a CA business, trade or profession.
- Compensation for personal services performed in California.
- Income from intangible personal property from a CA business or CA-situs property.
- Rents or royalties for the use of patents, copyrights, secret processes, goodwill, formulas, etc. that have a CA business or CA taxable situs.

CA Residency: Special tax rules

Special Rules:

- Payments from a non-qualified deferred compensation plan are treated as taxable payments for services
  - Such payments for services rendered both within and outside of California are apportioned to determine source.
- The exercise of non-qualified stock options are treated as wages derived from personal services. If underlying services were performed in California, California will tax the income reasonably attributable to CA services.

CA Residency: Special tax rules (cont'd.)

Special Rules (cont'd):

- Payments from exercise and sale of ISO at the time an individual is a CA nonresident but services were performed in California are taxed.
- Qualified retirement income to a nonresident from pensions are not taxed, even if attributable to CA services.
- IRA distributions paid to a nonresident are not taxed.
- Income distributed to a nonresident from an estate or trust is taxed, only if the income is CA-source income.

Terminating CA Tax Residency

- Critical to show individual established domicile and residency outside of California
- Taxpayer has burden of proof.
  - Document credible evidence to substantiate.
- Sever all CA connections and show intent never to return.
- Consider filing CA nonresident income tax return to report CA-source income.
  - Starts statute of limitations running.

State Tax COVID-19 Relief

- AICPA survey of 50 states response to COVID-19 on residency and related issues
- https://www.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/coronavirus-state-filing-relief.pdf
- There is no indication California will take any action

Appendix A – U.S. Citizenship

- Definition
  - Sources of law:
    - 14th Amendment
    - Immigration and Nationality Act
  - Born in the United States (including territories that later became states, esp. Alaska and Hawaii)
  - Naturalized in the United States. 8 USC section 1401
    - Born abroad to two U.S. parents
    - Born abroad to one U.S. parent
    - Adoption
- Nationality and Tax Law Intersect
  - See 8 USC §§ 1431 and 1433
  - See *Carlebach v Commissioner*, 139 T.C. No. 1 (2012) (child born abroad to U.S. parents not a citizen for purposes of dependent exemption until naturalized)

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