# PRE-IMMIGRATION INCOME TAX PLANNING, PART I: U.S. TAX RESIDENCE

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## INTRODUCTION

Income tax planning for an individual preparing to immigrate to the U.S. involves both understanding the jurisdictional concepts of U.S. tax law and making intelligent life decisions to take advantage of the rules. In comparison to a business investment in the U.S., which involves the use of funds to accomplish a specific goal, individuals wishing to come to the U.S. make a series of personal changes that will affect all aspects of their lives. U.S. tax planning considerations are merely one part of the puzzle that must be solved. The key to the planning often requires a timely decision to accelerate or defer income, gain, or loss, so as to avoid unnecessary exposure to tax while in the U.S. In addition, it entails knowledge of the tax cost involved in the event an individual wishes to continue to live in an accustomed life style.

This article is the first in a series that will discuss the rules affecting individuals moving across borders. The series will address important considerations before, during, and after undergoing a period of U.S. tax residence, income tax planning opportunities for persons wishing to immigrate to the U.S., and ethical considerations that may apply when providing advice to the foreign individual. Departure taxes in other countries are beyond the scope of this article.

This installment discusses the tests by which a foreign individual is deemed to be a U.S. tax resident under domestic law and provisions for determining residence under income tax treaties. Domestic law applies the "Substantial Presence Test" and the "Green Card Test." If an individual meets the conditions of either test, he or she will be considered to be a resident for income tax purposes.[1]

## GREEN CARD TEST

A foreign individual becomes a resident with respect to a calendar year if he or she is a lawful permanent resident of the U.S. at any time during that calendar year.[2] A lawful permanent resident is an individual who has been lawfully granted the privilege of residing permanently in the United States as an immigrant in accordance with the immigration laws.

Resident status is deemed to continue unless it is rescinded or is administratively or judicially determined to have been abandoned. That occurs when a final administrative or judicial order of exclusion or deportation is issued with regard to the individual. For this purpose, an order that is no longer subject to appeal to a higher court of competent jurisdiction is considered a final judicial order. If a green card

1 Code §7701(b)(1)(A).

2 Treas. Reg. §301.7701(b)-1(b)(1).

has not been rescinded or administratively determined to have been abandoned, the individual technically remains a U.S. tax resident without being a U.S. resident for immigration purposes and at least one case has affirmed this conclusion.[3] This has both income tax issues and F.B.A.R. reporting issues under the Bank Secrecy Act and the penalties for the latter may far ourweigh the tax under the former. The regulations, however, are silent regarding the effective date of a formal abandonment and if a determination of abandonment is obtained from the Department of Homeland Security, U.S. Citizenship and Immigration Services, the Form I-407 (Abandonment of Lawful Permanent Resident Status) may identify any act of abandonment in a prior year that is countersigned by a government official.

## SUBSTANTIAL PRESENCE TEST

### In General

Under the Substantial Presence Test, a foreign individual is treated as a U.S. resident for income tax purposes if he or she is present in the U.S. 183 days or more during a rolling three-year period. The period begins anew for each year and comprises the second preceding year, the year immediately preceding, and the current year.[4] The individual must also be present for at least 31 days in the current year.[5] If the 31-day threshold is not met for a particular year, the individual cannot be treated as a resident during the year. The 31-day test has no relevance to years other than the current year being reviewed.

An individual is treated as being present in the U.S. on any day that he or she is physically present at any time during the day. It does not matter how short a period is involved. Thus, if a person were to arrive in the U.S. on a late flight landing at 11:00 P.M. on February 1, 1998, the individual would be deemed to be present in the U.S. for all of that day.

In computing the days present in the U.S., a weighting formula is applied under which days in the current year are given greater weight than days in the earlier two years. Days in the current year are fully weighted, days in the first preceding year are afforded a one-third weight, and days in the second preceding year are afforded a one-sixth weight.

To illustrate the effect of the weighting rule, assume that an individual will be present in the United States for 122 days in 2015. Assume further, that he will also be present in the United States for 122 days in each of 2014 and 2013. To determine tax residence status for 2015, the individual will count all 122 days in the United States in that year, plus one-third of the 122 days in the United States in 2014 (40.67 days), plus one sixth of the 122 days in the United States in 2013 (20.33 days). The total of 122 + 40.67 + 20.33 equals 183 days. The individual will be a U.S. resident for 2015 because the Substantial Presence Test is met. If, in comparison, if the individual were physically present in the U.S. for 121 days each year, tax residence would not be established.

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[3] *Topsnik v. Commr.,* 143 T.C. __,No. 12 (2014).

[4] Code §7701(b)(3)(A)(ii).

[5] Code §7701(b)(3)(A)(i).

## Excluded Days

In determining whether a foreign individual meets the Substantial Presence Test based on days present in the U.S., certain days are excluded and are not counted as days present in the United States. A day is excluded if the individual falls within any of the following categories:

> ***"In determining whether a foreign individual meets the Substantial Presence Test based on days present in the U.S., certain days are excluded and are not counted as days present in the United States."***

*Exempt Individual*

A day is exempt if the individual is an "Exempt Individual" on that day. An Exempt Individual may be a foreign government-related individual, a teacher or trainee, a student, or certain professional athletes.

1. Government Official

   A foreign government-related individual is an individual who is temporarily present in the U.S. (i) as a full-time employee of an international organization, (ii) by reason of diplomatic status, or (iii) by reason of a visa that represents full-time diplomatic or consular status. An individual who falls within any of the foregoing foreign government-related categories is considered to be temporarily present in the U.S. as long as he or she is not a lawful permanent resident under the Green Card Test. For this purpose, the length of stay in the U.S. does not matter.

2. Teacher or Trainee

   A teacher or trainee is an individual, other than a student, who is admitted temporarily to the United States as a nonimmigrant under the provisions of the Immigration and Nationality Act relating to the admission of teachers and trainees to the United States.[6] The individual must substantially comply with the requirements of the visa status held.[7] This entails avoiding activities that are prohibited by the Immigration and Nationality Act and which could result in the loss of J visa status. If substantial compliance is questioned by the I.R.S., merely showing that a visa has been issued and not revoked is not suffieicent by itself for an individual to demonstrate substantial compliance. An independent determination of facts and circumstances may be made by the I.R.S. and the burden of proof is on the individual.

   This exception is designed to attract people for training during a limited period of time so that they may return home to engage in their trade or profession. It is not designed to allow people to remain indefinitely in the U.S. Consequently, time limits are provided. An individual is not treated as an Exempt Individual under the teacher or trainee provision if he or she has been exempt as a teacher, trainee, or student for any part of two of the six preceding calendar years.[8] However, if the individual has a foreign employer and receives compensation from that employer during prior years that is exempt from U.S. tax under Code §872(b)(3), the test is relaxed. In that situation, the individual will remain exempt in the current year unless he or she has been present in the U.S. as a teacher, trainee, or student for parts of four of the six preceding calendar years.[9]

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6 See §101(a)(15) of 8 U.S.C. 1101(a)(15)(J).

7 Treas. Reg. §301.7701(b)-3(b)(6).

8 Treas. Reg. §301.7701(b)-3(b)(7)(i).

9 Treas. Reg. §301.7701(b)-3(b)(7)(ii).

Several examples in the regulations[10] illustrate the limitations on the teacher or trainee exception. In the first example, an individual is temporarily present in the U.S. during the current year as a teacher. The individual does not receive compensation in the current year from a foreign employer that is exempt. The facts state that the individual was treated as an exempt student for the prior three years. The example concludes that, although the year at issue is the first year that the individual is seeking to be exempt as a teacher, he or she will not be considered an Exempt Individual for the year. The individual was exempt as a student for at least two of the past six years.

In the second example, the individual is temporarily present in the U.S. during the current year as a teacher and receives compensation in the current year from a foreign employer that is exempt. The facts state that the individual was treated as an exempt teacher for the prior two years, but the compensation for those years was not exempt because it was not received from a foreign employer. The example concludes that the individual will not be considered an Exempt Individual for the current year because he or she was exempt as a teacher for at least two of the past six years.

The third example illustrates the rule applicable to teachers receiving exempt compensation in prior years. The facts are the same as in the second example, except that all of the individual's compensation for the two preceding years was exempt by virtue of being received from a foreign employer. This example concludes that the individual will be an Exempt Individual for the current year because he or she was not exempt as a student, teacher, or trainee for four of the six preceding calendar years.

3. Student

A student is any individual who is admitted temporarily to the U.S. as a nonimmigrant under the provisions of the Immigration and Nationality Act relating to the admission of students into the U.S.[11] The individual must substantially comply with the requirements of being admitted.[12] As with a trainee, this entails avoiding activities that are prohibited by the Immigration and Nationality Act and which could result in the loss of visa status. Again, an independent determination of substantial compliance may be made by the I.R.S. The regulations focus on undertaking unauthorized employment as an act that could cause a student to fail the substantial compliance test.

4. Professional Athlete

A professional athlete temporarily present in the U.S. to compete in a charitable sports event (i) for which all the net proceeds are contributed to an organization described in Code §503(c) and exempt from tax under Code §501(a) and (ii) for which substantially all work is performed by volunteers is an Exempt Individual.[13] Professional golfers and tennis players are likely the intended beneficiaries of this exemption.

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[10] Treas. Reg. §301.7701(b)-3(b)(7)(v).

[11] Treas. Reg. §301.7701(b)-3(b)(4). See, *inter alia*, §101(a)(15)(F) or (M) of 8 U.S.C. 1101(a)(15).

[12] Treas. Reg. §301.7701(b)-3(b)(6).

[13] Treas. Reg. §301.7701(b)-3(b)(5).

> The regulations provide a narrow reading of this exemption. Only days on which the athlete actually competes in the charitable sports event are excluded. Thus, days on which the individual is present to practice for the event, to perform promotional or other activities related to the event, or to travel between events are included for purposes of the Substantial Presence Test.

*Medical Condition*

An individual will not be considered present during days on which he or she intends to leave, but is unable to leave because of a medical condition or medical problem.[14] The medical condition or problem must have arisen while the individual was present in the U.S. Thus, if the condition or problem existed prior to the individual's arrival in the U.S., and the individual was aware of the condition or problem, the individual is not exempt on days during which departure from the U.S. is prevented by the condition or problem. Also, a day of presence will not be excluded if, after the medical condition or problem subsides, the individual is able to leave the U.S., but instead, remains in the U.S. beyond a reasonable period for making departure arrangements. A day will also not be excluded if the medical condition arose during a prior stay in the U.S. and the individual returns to the U.S. for treatment.

Two key elements for coverage under this provision are a demonstration that the individual intended to leave the U.S. on a particular day and a determination that the departure was prevented by the medical condition. These are factual considerations. The regulations establish the points of reference for making these determinations. The inability to depart is easily determinable; the intent to depart may be a trap for the unwary. As a general rule, an individual will be presumed to have intended to leave during a period of illness if he leaves the U.S. within a reasonable period of time after becoming physically able to leave.[15] This is the minimum period within which arrangements to leave may be made. However, if at the time an individual's medical condition or medical problem arose, the individual was present in the U.S. for a definite purpose which by its nature could not be accomplished without being viewed to be a resident under the Substantial Presence Test, the requisite intent to leave the U.S. will not exist.

Several examples in the regulations place this test in perspective.[16] In the first example, an individual is in a serious automobile accident on the way to an airport to depart the U.S on March 31. The departure ticket indicates that the individual intended to leave the U.S. on March 31, but was unable to leave as a result of the injuries suffered in the accident. He recovers from the injuries and is able to leave the U.S. on May 31. He departs from the U.S. on that date. The example concludes that the individual's presence in the U.S. during the period from April 1 through May 31 will not be counted as days of presence in the U.S. The days up to and including the date of the accident will be counted.

In the second example, the facts are the same, except that the intended date of the return flight is May 31, as evidenced by an airline ticket. The example concludes that the individual may not exclude any days of presence in the in the U.S. under the tests related to medical conditions.

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[14] Treas. Reg. §301.7701(b)-3(c)(1).

[15] Treas. Reg. §301.7701(b)-3(c)(2).

[16] Treas. Reg. §301.7701(b)-3(c)(4).

*Days in Transit*

A foreign individual may exclude days of presence in the U.S. if the individual is in transit between two foreign points, and is physically present in the U.S. for a period of time that is less than 24 hours.[17] An individual is considered to be in transit if he or she pursues activities that are substantially related to completing his or her travel to a foreign point of destination. For example, an individual who travels between airports in the U.S. in order to change planes en route to his or her destination will be considered to be in transit. However, if the individual attends a business meeting while present in the U.S., whether or not that meeting is within the confines of the airport, he or she will not be considered to be in transit. This provision is helpful for individuals who are strictly counting days in the U.S. and who are forced to be present in the U.S. overnight while transiting to a foreign destination.

**“A foreign individual who believes that he or she is exempt on a particular day of presence in the U.S. and does not wish that day to count toward substantial presence in the U.S. must file a statement with the I.R.S. on or before the due date of a tax return.”**

## Procedural Requirements

A foreign individual who believes that he or she is exempt on a particular day of presence in the U.S. and does not wish that day to count toward substantial presence in the U.S. must file a statement with the I.R.S. on or before the due date of a tax return.[18] Form 8843 (Statement for Exempt Individuals and Individuals With a Medical Condition), is used for this purpose. The statement must contain sufficient information describing the reasons why the day's presence should be exempted under the applicable test described above. If an individual claims that a day is exempt because of a medical condition or a problem that developed while present in the U.S., the statement must be signed by the treating physician. If a medical condition prevented an individual from leaving the U.S., the treating physician must certify that fact and that there was no indication of a pre-existing condition.

Unless the I.R.S. determines otherwise, a failure to timely file the statement will result in all days present in the U.S. being counted toward substantial presence.[19] The I.R.S. may waive the procedural requirement if the individual can show by clear and convincing evidence that he or she took (i) reasonable actions to become aware of the filing requirements and (ii) significant affirmative steps to comply with those requirements. Also, the I.R.S. may choose to ignore the requirement if in the best interest of the Federal government.[20]

## Closer Connection Test

A foreign individual who meets the Substantial Presence Test may nevertheless be considered to be a nonresident with regard to the current year if he can demonstrate that closer connections are maintained to another, single, foreign country.[21]

To come within this exception, three conditions must be satisfied. First, the individual must be present in the U.S. for fewer than 183 days in the current year. Thus, this exception applies to persons who are in the U.S. for more than 183 days during the rolling three-year period, computed in light of the weighting rules discussed above, and who are present for up to 182 days in the current year.

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[17] Treas. Reg. §301.7701(b)-3(d).

[18] Treas. Reg. §301.7701(b)-8(c).

[19] Treas. Reg. §301.7701(b)-8(d)(1).

[20] Treas. Reg. §301.7701(b)-8(e).

[21] Treas. Reg. §301-7701(b)-2(a).

Second, the individual must maintain a "Tax Home" in a foreign country during the year. The concept of a Tax Home originated in the context of the deduction of travel expenses incurred while away from home. While there is no uniform definition in court cases, and the view of the I.R.S. is somewhat different from that of many courts, in broad terms a Tax Home is the place where a person generally should live in light of his employment responsibilities. Thus, if a person works in New York, it is reasonable for him to have a home in the New York area; living expenses incurred in New York would not be deductible. Living expenses incurred while temporarily outside New York would be deductible. However, if a person generally works in Los Angeles, but takes a short-term assignment in New York that is scheduled to last for less than one year, it would not be reasonable for him to permanently move to New York. His Tax Home would continue to be Los Angeles. Expenses incurred while in New York temporarily would be deductible. Finally, if a person merely moves from one job to another, staying at each place only temporarily, the person's Tax Home would be wherever he or she happened to be at the time.[22] The same rule applies if the individual does not work and merely lives in several places during the year. Each place at which he is present is his or her tax home for the period of presence at that place.

***"If a person merely moves from one job to another, staying at each place only temporarily, the person's Tax Home would be wherever he or she happened to be at the time."***

Third, the individual must have a closer connection during the year to a single foreign country in which he or she maintains a Tax Home than the connections maintained to the U.S. To meet this requirement, the individual must demonstrate that he or she has maintained more significant contacts with the foreign country than with the U.S. The regulations look to the following factors:

- The location of the individual's permanent home;
- The location of the individual's family;
- The location of personal belongings, such as automobiles, furniture, clothing, and jewelry owned by the individual and his or her family;
- The location of social, political, cultural, or religious organizations with which the individual has a current relationship;
- The location where the individual conducts his or her routine personal banking activities;
- The location where the individual conducts business activities (other than those that constitute the individual's Tax Home);
- The location of the jurisdiction in which the individual holds a driver's license;
- The location of the jurisdiction in which the individual votes;
- The country of residence designated by the individual on forms and documents; and
- The types of official forms and documents filed by the individual, such as Form 1078 (Certificate of Alien Claiming Residence in the United States), Form W-8BEN (Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding), or Form W-9 (Payer's Request for Taxpayer Identification Number).

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[22] See I.R.S. Publication 17 (Your Federal Income Tax for Individuals), Chapter 26 (Car Expenses and Other Employee Business Expenses).

*"Generally, the Residency Termination Date will be the last day of the calendar year."*

If an individual moves between two foreign countries during the year, he or she may demonstrate closer connections to each of the two foreign countries during the period of residency in such country.[23] To come within this rule, the individual must remain a resident for tax purposes within one of the foreign countries for the entire year or must be subject to taxation as a resident in one of the foreign countries for the period where a Tax Home is maintained and in the other foreign country for the balance of the year. An individual may not make this determination for three or more countries.

The closer connection exception is not available to a foreign individual who has personally applied, or taken other affirmative steps, to change his or her status to that of a permanent resident during the current year or has an application pending for adjustment of status during the current year.[24] Affirmative steps include the filing of the Department of Homeland Security, U.S. Citizenship and Immigration Services ("U.C.I.S.") Form I-508 (Waiver of Immunities), Form I-485 (Application for Status as Permanent Resident), Form I-130 (Petition for Alien Relative), Form I-140 (Petition for Prospective Immigrant Employee), Department of Labor Form ETA-750, (Application for Alien Employment Certification), and Department of State Form OF-230, (Application for Immigrant Visa and Alien Registration).

A filing requirement is a condition of coming within this exception to residence under the Substantial Presence Test.[25] Form 8840 (Closer Connection Exception Statement for Aliens) is used to claim the closer connection exception.

## PERIOD OF RESIDENCE

### General Rule

Residence generally begins on the "Residency Starting Date" and ends on the "Residency Termination Date." These are defined terms under the regulations.

The Residency Starting Date for an individual who meets the Substantial Presence Test is the first day during the calendar year on which the individual is present in the United States. The Residency Starting Date for an alien who meets the Green Card Test is the first day during the calendar year in which the individual is physically present in the United States as a lawful permanent resident. If both tests are met, the Residency Starting Date is the earlier of the two dates on which the tests were met.

Generally, the Residency Termination Date will be the last day of the calendar year. Thus, it is not the last day of presence in the U.S. during the calendar year. This rule, however, is subject to an exception. If the individual establishes that, for the remainder of the calendar year, (i) his or her Tax Home was in a foreign country and (ii) he or she maintained a closer connection to that foreign country than to the United States, the Residency Termination Date will be the last day of presence in the U.S. under the Substantial Presence Test and the last day of lawful permanent residence under the Green Card Test. If the individual satisfied both residence tests, it is the latter of the two dates.

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[23] Treas. Reg. §301-7701(b)-2(e).

[24] Treas. Reg. §301-7701(b)-2(f).

[25] Treas. Reg. §301-7701(b)-2(g).

## *De Minimis* Presence

An alien individual may be present in the United States for up to 10 days without triggering the Residency Starting Date under the Substantial Presence Test or extending the Residency Termination Date under that test.[26] To come within this "*De Minimis* Rule," the individual must establish that, during the period covering the 10 days of presence, (i) the individual's Tax Home was in a foreign country and (ii) he or she maintained a closer connection to that foreign country than to the U.S.

The regulations contain several technical rules. First, the days in the U.S. need not be consecutive, but the total cannot exceed ten days. Second, if all the days that occur during a period of continuous presence cannot be excluded, none of the days can benefit from the *De Minimis* Rule. Finally, although the days in the *De Minimis* period are not considered in determining the Residency Starting Date, the days are taken into account in computing the Substantial Presence Test.

## Elective Residency Starting Date

If a foreign individual, who otherwise does not meet the Substantial Presence Test or the Green Card Test for the current year, is physically present in the United States for at least 31 consecutive days during the current year and for at least 75% of the subsequent days in balance of the year, the individual may elect to have the residency starting be the first day of that 31-day period.[27] This elective procedure applies only if the individual was not a resident in the immediately preceding year and continues to be a resident under the Substantial Presence Test in the subsequent year. This means that the election cannot be made until it is known that residence is established for the subsequent year, and an extension may be obtained. The election is important for individuals arriving in the U.S. from a jurisdiction that has a soak-up rule allocating tax residence to that country if an individual departing therefrom is not a resident of any other country.

## No-Lapse Rules

The Code and regulations contain two rules designed to prevent an individual from managing his or her residence to avoid tax. The first of these no-lapse rules provides that an individual who was a U.S. resident during any part of the preceding calendar year and who is a U.S. resident for any part of the current year will be considered to be taxable as a resident at the beginning of the current year.[28] It also provides that an individual who is a U.S. resident for any part of the current year and who is also a U.S. resident for any part of the following year will be taxable as a resident through the end of the current year. It does not matter that the individual has a closer connection to a foreign country than the United States during the current year.

The second no-lapse rule coordinates taxation with the expatriation provisions of Code §877 that generally cover expatriates for years prior to the effective date of Cod §877A.[29] In brief, they extended U.S. jurisdiction to impose ordinary income tax on net income for a period of ten years for items of income actually arising from U.S.

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[26] Treas. Reg. §301.7701(b)-4(c)(1).

[27] Treas. Reg. §301.7701(b)-4(c)(3).

[28] Treas. Reg. §301.7701(b)-4(e).

[29] Code §7701(b)(10); Treas. Reg. §301.7701(b)-5(a).

sources or deemed to arise from U.S. sources. The second no-lapse rule applies to persons who have had U.S. residence in the past (the initial residency period), relinquish that residence for a period of years (the intervening period), and reestablish residence in the U.S. If the initial residency period covers at least three taxable years of at least 183 days each, and residence is reestablished before the close of the third complete calendar year following the residency terminations date, the individual will be subject to tax during the intervening period in the manner prescribed by Code §877. The special tax regime applies only if it results in the imposition of a greater tax liability than the 30% withholding tax ordinarily imposed on persons who are neither citizens nor residents of the U.S. with regard to U.S.-source income that is not effectively connected with the conduct of a trade or business in the U.S.

*"The residence article of an income tax treaty generally contains a tiebreaker provision under which the dual resident individual is classified as a resident of one, and only one, country for purposes of the income tax treaty."*

## RESIDENCE UNDER INCOME TAX TREATIES

### In General

Even though a foreign individual may be deemed to be a resident of the U.S. under domestic U.S. tax law, the individual may, nonetheless, be taxed as if he were a nonresident with regard to the U.S. if so mandated by treaty.

With limited exception, the income tax treaties of the U.S. now in effect or awaiting Senate approval contain a residence provision. Under these provisions, the standard for determining the residence of individuals and corporations is established. Residence status is important because only residents qualify for the benefits provided by the treaty.

Ordinarily, if an individual is taxed as a resident of a treaty country for purposes of the domestic tax laws of that country, the individual will be treated as a resident of that country for purposes of the income tax treaty. Where, under the domestic tax laws of each of the two treaty jurisdictions, the individual would be treated as a resident, he or she is potentially subject to double taxation of income. This type of individual is commonly referred to as a "dual resident." The residence article of an income tax treaty generally contains a tiebreaker provision under which the dual resident individual is classified as a resident of one, and only one, country for purposes of the income tax treaty.[30] In that way, the tiebreaker is one of the few provisions of an income tax treaty which overrides U.S. domestic law.[31]

### Tiebreaker Provision

Under the tiebreaker provision, a series of tests is applied in a specific order to the particular facts and circumstances of the dual resident. Once the individual's residence is determined under a particular test, there is no need to proceed to another test. In general, exclusive residence is determined by applying the following tests in the following order:

- First, the individual is deemed to be a resident of the country in which a permanent home is available;

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[30] See, *e.g.*, Article 3 (Fiscal Residence) of the Israel-U.S. Income Tax Treaty; Article IV ( Residence) of the Canada-U.S. Income Tax Treaty; and Article 4 (Residence) of the U.K.-U.S. Income Tax Treaty.

[31] H.R. Rep. No. 432 (Part 2), 98th Cong., 2d Sess. 1528 (1984).

- If the individual has a permanent home in both countries or in neither country, he or she will be deemed to be a resident of the country with which his personal and economic relations are closer – this is known as the center of the individual's vital interests;

- If the closer economic relations cannot be determined, the individual will be a resident of the country in which he has an habitual abode; and

- If he has a habitual abode in both countries or in neither one, he will be deemed to be a resident of the country of which he is a national.

If the issue cannot be settled by the application of these tests, the competent authorities of both countries (*viz.*, the I.R.S. and its counterpart overseas) will decide by mutual agreement the country of which the individual will be considered an exclusive resident.

## Use of the Tiebreaker

The tiebreaker rule is important for individuals who wish to retain a green card but who do not wish to pay U.S. tax on income derived from sources outside the U.S. The closer connection test of domestic law, discussed above, is not relevant for an individual who is a permanent resident of the U.S. If residence can be allocated exclusively to the jurisdiction that is the tax treaty partner of the U.S., the individual may be able to retain the benefits of the green card without incurring the tax detriments of U.S. tax residence.

In this regard, it should be noted that many countries defer the imposition of tax on certain types of income for newly-arrived, non-domiciled individuals. For example, investment income of a non-domiciled individual who resides in the U.K. may be deferred until the investment income or gains are remitted to the U.K. (After seven years, a fixed remittance charge is imposed for continuing this tax treatment.) The State of Israel will not impose tax on gains from the disposition of foreign assets held offshore at the time an immigrant first establishes residence. Canada allows for a step-up in basis of capital property held at the time Canadian residence is established by an individual. The income tax treaty with a country whose laws contain any of those types of provisions must be examined closely to determine the interplay between foreign tax law and the income tax treaty benefit desired. In many instances, income that is taxed only upon remittance will not qualify for the full range of treaty benefits.[32] However, each treaty is unique and the specific terms

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[32] *E.g.*, Article 1(7) (General Scope) of the U.K.-U.S. Income Tax Treaty provides as follows:

> Where under any provision of this Convention income or gains arising in one of the Contracting States are relieved from tax in that Contracting State and, under the law in force in the other Contracting State, a person, in respect of the said income or gains, is subject to tax by reference to the amount thereof which is remitted to or received in that other Contracting State and not by reference to the full amount thereof, then the relief to be allowed under this Convention in the first-mentioned Contracting State shall apply only to so much of the income or gains as is taxed in the other Contracting State.

See also Article 4(5) (Fiscal Domicile) of the Bangladesh-U.S. Income Tax Treaty; Article 4(5) (General Rules Of Taxation ) of the Cyprus-U.S. Income Tax Treaty; and Article 6(6) (General Rules of Taxation) of the Israel-U.S. Income Tax Treaty.

of the applicable treaty must be examined. There may continue to be benefits for offshore investment income.

**Reporting**

The U.S. income tax regulations set forth certain rules of general application that must be followed in order for a dual resident to be able to take advantage of the tiebreaker tests and be treated as a resident of the other treaty country for purposes of an applicable treaty and other U.S. income tax purposes. These rules are similar to those discussed above in connection with individuals contending that they are exempt for certain days.[33] Under these rules, the individual must prepare an income tax return computing tax liability as a nonresident alien. The return is filed on Form 1040NR. Generally, the return is due on June 15 of the year following the taxable year. The due date can be extended up to six months, if timely requests are filed.

A disclosure statement is provided on Form 8833 (Treaty-Based Return Disclosure Under §§6114 or 7701(b)) attached to the Form 1040NR which:

- Contains a statement that the taxpayer is claiming a treaty benefit as a non-resident of the United States; and
- Describes the facts relied upon to support the position taken, the nature and approximate amount of income that is exempted, and the specific treaty provision for which the taxpayer is claiming a treaty benefit.

The Form 1040NR and the attached statement are filed with the Department of the Treasury, Internal Revenue Service Center, in Austin, Texas, 73301-0215.

## PATH FORWARD

As part of the series addressing an overall plan to provide pre-mmigration tax planning, this article explained the standard that is applied to determine:

- Whether an individual is a tax resident of the U.S.,
- When the period of residence begins and ends,
- The interface with comparable provisions in income tax treaties, and
- Reporting obligations.

The next installment will address the tax consequences of relinquishing U.S. citizenship or becoming a former long-term resident of the U.S. Once the bookends of tax residence are explained, this series will address the planning choices that are available.

[33] Treas. Reg. §301.7701(b)-7.