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U.S. Tax Issues for Aliens and Immigrants

How individuals are classified is key

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A continuous influx of folks from abroad come to the United States to live and work. As these new arrivals settle in, they are confronted by unique tax issues. To competently assist affected taxpayers, this article will address the importance of properly classifying individuals as either resident or nonresident aliens and will examine the tax treatment of income and expenses for nonresident aliens.

Unlike U.S. citizens and residents, nonresident aliens are taxed only on U.S.-sourced rather than worldwide income. As a result, they frequently have less taxable income to report to U.S. tax authorities, trading off the loss of favorable deductions, credits, filing statuses and preferential tax rates afforded to their American counterparts.

Determining residency

Under U.S. tax law, an individual is a nonresident alien if the individual is neither a citizen nor a resident of the U.S. While citizenship — obtained at birth or through naturalization — may be readily determinable, residency for tax purposes is often a bit murky. To establish proper tax treatment, the taxpayer's residency must be ascertained under one of two tests.

Green card test. Green cards are issued to lawful permanent residents by the U.S. Citizenship and Immigration Services (USCIS). Officially titled Form I-551, *U.S. Permanent Resident Card*, it looks much like any state-issued driver's license and is considered permanent unless residency status is (1) administratively or judicially removed [deportation], (2) voluntarily abandoned by application and remittance of the green card to the USCIS or a U.S. Consulate, or (3) forfeited by leaving the country for more than a temporary visit abroad. The mere expiration or casual abandonment of a green card does not terminate residency for tax purposes; once deemed to be a lawful permanent resident, such individuals continue to have U.S. tax filing requirements.

Substantial presence test. Individuals are considered to be U.S. residents for tax purposes if they have been physically present in the U.S. (including all 50 states and the District of Columbia, but not U.S. possessions or territories) for at least 31 days during the tax year and 183 days during the most recent three-year period, which includes all the days in the current year, one-third of the days in the previous year and one-sixth of the days in the year prior to that.[1]

The substantial presence test measures the days of presence in the U.S. As such, both the days of arrival and departure are added to the count. However, days that are not counted include days on which taxpayers regularly commute to work in the U.S. from either Canada or Mexico, days during which they are in the U.S. for less than 24 hours due to international transit, days in the U.S. if they are a crew member of a foreign vessel, and days that they are unable to leave the U.S. due to a medical condition.

COVID-19 relief: Up to 60 consecutive days starting on any date between February 1 and April 1, 2020, are not counted if the individual's stay was due to travel disruptions caused by the global pandemic.[2]

Certain individuals are deemed to be exempt and need not count their days in the U.S., including foreign government employees or diplomats who only temporarily reside in the U.S.; teachers on J or Q visas unless living in the U.S. longer than two years; students on F, J, M or Q visas unless living in the U.S. more than five years; and professional athletes in the U.S. to compete in a charitable event.[3] Exempt individuals must file Form 8843, *Statement for Exempt Individuals and Individuals with a Medical Condition*, with their tax return. Exempt individuals are subject to the substantial presence test for all periods before and after they held exempt status.

Because U.S. citizens and residents are taxed on worldwide income rather than U.S.-sourced income only, it's sometimes preferable to be treated as a nonresident alien for tax purposes. Therefore, even if the substantial presence test is met, taxpayers may be treated as nonresident aliens if:

- They are present in the U.S. for less than 183 days during the year; and
- They maintain a tax home in a foreign country; and
- They have a closer connection to one foreign country.

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

Dual-status aliens

Part-year residents are, by definition, deemed "dual-status" and must file as nonresidents for part of the year and as resident aliens for the remaining portion. The residency date begins on the first day the taxpayer is present in the U.S. or is issued a green card (whichever is earlier), assuming no travel in or out of the country ensues. Thus, to accumulate the requisite 183 days for residency status, an immigrant with no prior days of presence in an earlier year must enter the U.S. on or before July 2.

While taxed only on U.S.-sourced income during the portion of the year they are deemed to be nonresident, dual-status aliens are denied more favorable filing statuses, community property rights, the standard deduction and most tax credits. Such taxpayers often pay far more U.S. tax than citizens and resident taxpayers with similar incomes.

As a result, and under certain circumstances, dual-status aliens may choose to be treated as residents for tax purposes by making one or the other of two available elections.

First-year election.[4] Immigrants arriving on or after July 3 cannot qualify under the substantial presence test for residency until the year after their arrival, but they may elect to backdate their residency status to the year of arrival if (1) they were present in the U.S. for at least 31 consecutive days in the year of arrival and (2) they meet the substantial presence test in the year following arrival.

Example: Juan came to the U.S. on November 1, 2018, and was here for 31 consecutive days before he returned to his home country for a two-week visit on December 1. He returned to the U.S. on December 15 and then stayed in the U.S. throughout 2019. He will, of course be considered a resident for 2019, but may use the special election to be considered a resident for 2018 as well.

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

Marriage election.[5] Married individuals who are entering the U.S. for the first time and considered to be dual-status may opt to be treated as residents for the entire year if (1) they were nonresident aliens at the beginning of the year and are resident aliens or citizens at the end of the year and (2) they are married to a U.S. citizen or resident alien at year-end.

Both spouses must agree to the election and must file a joint return. The election is made by attaching a statement signed by both spouses to the originally filed return or an amended return.[6] The election may be revoked by either or both spouses. The election is automatically terminated by death or legal separation. However, neither spouse may ever again make the election, even upon remarriage.

A similar election[7] is available to citizen or resident taxpayers who are married to a nonresident spouse, even if that spouse lives abroad. Of course, the nonresident spouse will be required to obtain a taxpayer identification number for U.S. tax filing purposes.

Beware: A nonresident alien who has elected to be treated as a U.S. resident alien — either under the first-year or the marriage election — is a "U.S. person" subject to foreign bank account reporting (FBAR) and the *Foreign Account Tax Compliance Act* (FATCA) filing obligations.

Tax treatment of income and expenses

The locale where income is earned is a moot point for U.S. citizens and resident aliens who must report worldwide income. Although some income may be exempt from taxation under various treaties or be eligible for the foreign earned income exclusion, all income (regardless of its source) must be reported on Form 1040, *U.S. Individual Income Tax Return*. Nonresident aliens, however, need only report U.S.-sourced income on Form 1040-NR, *U.S. Nonresident Alien Income Tax Return*.

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

Looking for more information? Join us for Foreign Tax Day on September 10, a series of webinars taught by author and instructor Monica Haven. Visit www.natptax.com/EventsAndEducation for details.

Income that is deemed to be non-U.S.-source income (not taxable to the nonresident alien) includes:

- Interest paid by a U.S. corporation if at least 80% of the company's gross income is derived from sources outside the U.S. due to the active conduct of business in a foreign country in the preceding three years.
- Interest if funds are deposited into a foreign branch of a domestic commercial bank.
- Corporate dividends received from a foreign corporation if more than 25% of the company's gross income is effectively connected with U.S. business.
- Personal service compensation received for work performed outside the U.S. However, personal service income received for work performed in the U.S. must be pro-rated based on the percentage of time worked in the U.S. and included in U.S.-sourced income.
- Gain on sale of personal property, including furniture and equipment, if the taxpayer's tax home is not in the U.S.
- Revenues from the sale of inventory is sourced where the property is sold regardless of where the items were originally purchased but can be pro-rated if the items were produced in the U.S. and sold abroad.
- Gain on sale in excess of allowable depreciation can be pro-rated based on the amount of the depreciation taken in the U.S. versus abroad.
- Portfolio interest unless the nonresident alien owns more than 10% of the outstanding stock.
- Gain on sale of a personal residence may be excluded up to $250,000 (single) or $500,000 (married) if all other applicable IRC §121 provisions are satisfied.
- U.S.-sourced employee compensation is tax exempt if (1) the nonresident alien worked for a foreign company; (2) the nonresident alien was only temporarily present in the U.S. for periods less than 90 days at a time; and (3) the wages received were less than $3,000 in total.

Example: Alfred, a nonresident alien from Kenya, worked abroad for a U.S. company but was sent to work in the U.S. for two months. He was paid $2,500 in December 2018 and again in January 2019. Although U.S.-sourced, Alfred's wages would have been tax exempt had he earned less than $3,000 in total. But because he received $5,000, he will have to include his earnings in each of the taxable years.

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

Connected or not? For the nonresident alien, income may be either effectively or not effectively connected to the U.S. Effectively connected income is revenue derived from a U.S. trade or business and is reported on page 1 of Form 1040-NR; it can be reduced by itemized deductions. The net taxable income is then subject to the graduated tax rates currently in effect. On the other hand, income that is not effectively connected is reported on page 4 of Form 1040-NR and cannot be reduced by deductions. Instead, it is subject to a flat tax of 30%, unless a lower treaty rate applies.[8]

Effectively connected income is determined based on one of two tests: (1) the asset-use test, which judges whether income is derived from assets used in the conduct of a U.S. business; or (2) the business-activities test, which is used to evaluate whether activities of the U.S. business were a material factor in the realization of income.[9]

Income that is not effectively connected includes (1) fixed, determinable or periodic income (e.g., interest, dividends, rents, royalties and annuities); and (2) any income that does not meet the asset-use or business-activities tests. **Note:** Capital gains of nonresident aliens present in the U.S. for 183 days or more are deemed to be not effectively connected and are taxed at a flat rate of 30%, unless a lower treaty rate applies.[10]

See Table 1 on page 13 for types of income that are effectively connected and not effectively connected.

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

Foreign partnerships with effectively connected income or income from U.S. sources must file Form 1065, *U.S. Return of Partnership Income*, even if the principal place of business is outside the U.S. or all members are foreign persons.

A foreign partnership with U.S.-sourced income is not required to file a U.S. tax return if it is a partner-

ship (1) with U.S. partners that had no effectively connected income, had U.S.-sourced income under $20,000, had less than 1% of any partnership item allocable to U.S. partners, and is not a withholding foreign partnership; or (2) without U.S. partners that had no effectively connected income, had no U.S. partners at any time during its tax year, filed all requisite Forms 1042, *Annual Withholding Tax Return for U.S. Source Income of Foreign Persons*, and 1042-S, *Foreign Person's U.S. Source Income Subject to Withholding*, had satisfied each partner's tax liability by withholding tax at source, and is not a withholding foreign partnership.

Rental and royalty income. Such income is considered to be not effectively connected and cannot be reduced by deductions typically applicable to the maintenance and management of rental property. Thus, the nonresident alien is taxed on the gross rental revenue. However, the nonresident alien may elect to treat the rental income as effectively connected under §871(d) and would then be allowed to deduct rental expenses so that he would ultimately be taxed on only the net rental income. The election may be made on a property-by-property (but not year-by-year) basis by attaching a statement to the tax return for the initial year of choice and will remain in effect for all subsequent taxable years unless revoked with the permission of the Secretary of Treasury. Once revoked, the election may not again be made for five years.

Example: Manel is a nonresident alien and is not engaged in a U.S. trade or business. She owns a single-family house in the U.S. that she rents out for $10,000/year. It's her only U.S.-sourced income. Since the rental income is considered to be not effectively connected, it is subject to tax at a 30% rate. Manel receives a Form 1042-S showing that her tenants properly withheld this tax from rents paid to her. She does not have to file a U.S. tax return because her U.S. tax liability is satisfied by the withholdings. However, if she chooses to consider the rental income effectively connected, she can offset the $10,000 income by allowable rental expenses claimed on Form 1040-NR. The resulting net income is then taxed at the usual graduated rates.

Cost basis. Although the general rule holds that assets of aliens obtaining U.S. residency do not receive a stepped-up basis, nonresident aliens may take advantage of some pre-immigration tax planning opportunities. By engaging in certain transactions prior to becoming subject to U.S. taxation, nonresident aliens could potentially re-set the cost basis of their assets. For example, a nonresident alien could transfer U.S.-sited assets to an offshore entity,

TABLE 1

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

thereby engaging in a transaction that recognizes a step-up in basis for U.S. tax purposes without actually being subject to U.S. taxation. Then, in the year that the nonresident alien becomes a U.S. resident, the taxpayer could sell the asset with its stepped-up basis, avoiding most, if not all, taxable gains.

Deductions and adjustments. Unlike U.S. citizens and resident aliens, nonresident aliens may not claim the standard deduction and must instead itemize.

> Like nonresident aliens, dual-status aliens may not use the standard deduction but may claim all the same itemized deductions allowed to U.S. residents and citizens.

Since a nonresident alien's allowable deductions must be related to effectively connected income,[11] only state, local and real estate taxes paid, as well as contributions to qualified U.S. (not foreign) charities, may be deducted; but medical expenses, personal property taxes and mortgage interest may not be deducted.

Note: Like nonresident aliens, dual-status aliens may not use the standard deduction but may claim all itemized deductions allowed to U.S. residents and citizens.

Additionally, the nonresident alien may make contributions to Individual Retirement Accounts and other qualified retirement plans under the same rules that apply to U.S. residents. The nonresident alien may deduct student loan interest and even penalties on early withdrawals of savings if the interest income is effectively connected.[12]

Tax credits. Nonresident aliens with effectively connected income may claim some tax credits under the same rules that apply to U.S. residents, including the credit for prior year minimum tax and the energy, foreign tax and retirement savings contribution credits. However, other credits are available only to married nonresident aliens if they elect to file jointly with their U.S. citizen spouse, including the adoption, child and dependent care, and education credits. The earned income and child tax credits may be claimed only if the nonresident alien has a qualifying child who is a U.S. citizen or resident and is claimed as a dependent on the tax return. The credit for other dependents is available only to U.S. nationals, residents of Canada, Mexico or South Korea, as well as qualified students and business apprentices from India.

Tax return specifics

While U.S. citizens and residents may use Form 1040, nonresident aliens must use Form 1040-NR. Part-year residents, also known as a dual-status aliens, must use Form 1040 if they entered the U.S. during the year and are a resident on December 31, or Form 1040-NR if they were a U.S. resident who left during the year and no longer reside in the U.S. on December 31. Such returns must be notated as "Dual-Status" at the top of the form; a statement must be attached to allocate income earned during periods of pre- and post-residency. If filing Form 1040, the resident taxpayer may use Form 1040-NR in lieu of the statement; if filing Form 1040-NR, the nonresident taxpayer may attach Form 1040 in lieu of the requisite statement.

Filing status. Only single (S), married filing separately (MFS) or qualifying widower (QW) filing statuses are available to nonresident aliens unless they are married to a U.S. citizen or resident and claim the marriage election. The head of household (HOH) status is not available to nonresident aliens,[13] although a resident spouse may file HOH if married to a nonresident alien who is not treated as a spouse for tax purposes.

Married nonresident aliens may elect to file as single only if (1) they reside in Canada, Mexico or South Korea or are married to a U.S. national (a resident of American Samoa or Northern Mariana Islands who has sworn allegiance to the U.S.); **and** (2) have lived apart from their spouse for the last six months of the tax year. Residents of Canada, Mexico, South Korea, American Samoa and Northern Mariana Islands may file as QW if all other criteria are satisfied.

Dependents. While the *Tax Cuts and Jobs Act* (TCJA) suspended the personal exemption for the taxpayer and each qualified dependent for tax years 2018–2025, it nevertheless remains critical to determine which members of the taxpayer's household may be claimed as dependents for the purpose of claiming tax credits and other tax benefits. As determined under the rules applicable to U.S. citizens and residents, a dependent is a qualifying child or relative who is

a U.S. citizen or resident, or a resident of Canada or Mexico.

Nevertheless, most nonresident aliens may not claim even otherwise qualified dependents except those nonresident aliens who are eligible for the following treaty-based exceptions:

- Students or business apprentices from India may claim exemptions for a spouse with no gross income and children who are U.S. citizens or residents.
- South Korean residents whose spouse and children lived with them in the U.S. at some time during the tax year may claim pro-rated exemptions based on the ratio of their U.S.-sourced effectively connected income relative to their aggregate income from all sources.
- Residents of Canada, Mexico, American Samoa or Northern Mariana Islands whose spouse has no U.S.-sourced income and is not the dependent of another taxpayer may claim qualified dependents under the same rules that apply to U.S. residents.[14]

Since 1996, individual taxpayer identification numbers (ITINs) have been issued by the IRS to taxpayers who are ineligible to apply for a Social Security number (SSN) and may be used for tax-filing purposes only. Spouses and dependents of nonresident aliens must have an ITIN, as do nonresident aliens seeking to avail themselves of tax treaty benefits or reduced withholding rates (if they do not already have an SSN).[15]

Due dates. Like U.S. residents, nonresident aliens must file annually by April 15. Nonresident aliens who did not receive any wages subject to withholdings may file as late as June 15.[16] Upon proper application, using Form 4868, *Application for Automatic Extension of Time to File U.S. Individual Income Tax Return,* a nonresident alien's return may be extended to October 15.

COVID-19 relief: Due to the global pandemic, all taxpayers who have a filing or payment deadline that falls between April 1 and July 15, 2020, are entitled to an automatic extension until July 15, 2020.[17] The extended deadline applies to Form 1040-NR and any FATCA forms required to be attached to the individual income tax return.

Tax treaties. The U.S. has income tax treaties with several foreign countries that provide for reduced tax rates or exemptions from taxation of certain types of income received in the U.S. and abroad by nonresident

Review Questions (answers on page 17)

1. Which of the following acts will terminate a taxpayer's U.S. residency under the green card test?
   A. The taxpayer spends three weeks in another country vacationing with his family.
   B. The taxpayer's green card expired.
   C. The taxpayer is deported due to criminal acts.
   D. The taxpayer marries a nonresident alien.

2. Individuals are considered to be U.S. residents for tax purposes if they have been physically present in the U.S. for a certain number of days. Certain individuals are deemed to be exempt and need not count their days in the U.S. under the substantial presence test. What individuals are considered "exempt" from the substantial presence test?
   A. Taxpayers who are students living in the U.S. for three years and have a J visa.
   B. Teachers who have a J visa in the U.S. for three years.
   C. A taxpayer who is a resident of the United Kingdom who is present in the U.S. to compete in the Olympics.
   D. A nonresident alien spouse of a U.S. green card holder who lives and works in the U.S.

3. In the first year the taxpayer enters the U.S., the individual is considered a "dual-status" taxpayer. As such, the individual is required to file as a nonresident for part of the year and as a resident for the remaining portion of the year. Residency begins on the first day the taxpayer is present in the U.S. or is issued a green card, whichever event occurs earlier. On what date must the taxpayer enter the U.S. to be considered a resident for the entire year?
   A. August 1.
   B. July 3.
   C. July 3 but the individual was present in the U.S. for 42 days in the prior year.
   D. March 11 but the individual spent the month of July in Africa. The taxpayer spent the rest of the year in the U.S.

aliens.[18] If a treaty does not address a particular type of income, or if there is no treaty between the foreign country and the U.S., the income is taxed as per the instructions for Form 1040-NR. It's important to note that not all states conform to the federal treatment of income; as a result, international tax treaty provisions may not apply at the state level.

Tax treaties reduce the U.S. tax of nonresident aliens. With certain exceptions, treaties do not reduce the tax of U.S. citizens or residents. Treaty provisions generally are reciprocal and apply to both treaty countries. Treaty-based positions must be disclosed on Form 8833, *Treaty-Based Return Position Disclosure*, which should be attached to a timely filed return.[19] A return must be filed even if a treaty-based position eliminates all taxable income. Failure to file Form 8833 may result in a $1,000 penalty.

Example: Yoshi is a nonresident alien who is an unmarried resident of a foreign country that has a tax treaty with the U.S. He received gross income of $25,500 in 2019 from U.S. sources consisting of the following items: $1,400 dividends on which the tax is limited to a 15% rate by treaty and $24,100 compensation for personal services. Yoshi has no deductions. His tax liability is determined as follows:

Personal service compensation	$24,100
Personal exemption	
($0 as per TCJA for TY '18 – '25)	- 0
Taxable income	$24,100
Tax as per TY '19 tax table for single	$2,701
Tax on gross dividends ($1,400 x 15%)	+ 210
Total tax due	**$2,911**

Special reporting rules

If income was earned abroad in countries that use a different tax year, taxpayers must allocate income and expenses to accurately reflect and report what was earned on a calendar-year basis on their U.S. return.

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

Nonresidential real property outside the U.S. used in a trade or business must be depreciated under the alternative depreciation system (ADS) on a straight-line basis over a 30-year period; personal property held abroad must be depreciated over a 12-year period.[20]

The depreciable basis equals the cost of acquisition converted to U.S. dollars using the currency exchange rate on the date of acquisition. For resident aliens, basis must be reduced by the amount of depreciation that would have been allowable (under U.S. rules) during the period the individual was a nonresident alien prior to changing residency status. **Note:** There is no automatic step-up in basis on the date of residency change, although certain transactions such as the sale of an asset to an offshore business entity may yield a basis step-up.

Capital gains resulting from the sale of real property held abroad must be computed based on the difference between the sales proceeds (converted to U.S. dollars using the exchange rate in effect on the date of sale) and the acquisition cost (converted to U.S. dollars using the exchange rate in effect on the date of purchase). Nonresident aliens may claim the §121 exclusion of the gain on sale of a personal residence (if otherwise eligible) but will be subject to the exclusion's limitations when filing MFS. **Note:** Due to varying currency exchange rates, the taxpayer may also be taxed on an unrealized gain if the exchange rate declined between the date of purchase and the date of sale.

If the property was encumbered by a mortgage on the date of sale, the taxpayer must calculate the gain or loss resulting from the foreign exchange rate conversion when the loan is paid off. If the exchange rate

increased in the period between loan inception and loan pay-off, it will cost the taxpayer more to repay the debt; therefore, the taxpayer will realize a loss. If the mortgage was used to purchase a personal residence, this loss is non-deductible.[21] On the other hand, any gain attributable to a decrease in exchange rates will be reportable as ordinary income.

As of January 1, 2013, certain high-income U.S. taxpayers (as well as some estates and trusts) are required to pay a 3.8% surtax on the lesser of (1) net investment income or (2) the amount of modified adjusted gross income (MAGI) that exceeds the applicable threshold ($200,000 for single; $250,000 for married filing joint). Although the surtax does not apply to nonresident aliens, it of course applies to a nonresident alien's spouse who is a U.S. citizen or resident alien. These individuals must file as married filing separately — unless claiming the marriage election — and are, therefore, subject to a MAGI threshold amount of only $125,000.

The net investment income tax (NIIT) was instituted under the *Affordable Care Act of 2010* to help fund the expansion of healthcare coverage. The act required citizens and resident aliens to have minimum essential health insurance or be subject to a shared responsibility payment. Residents of U.S. territories, foreign nationals who had not satisfied the substantial presence test, and U.S. citizens living abroad for at least 330 days within a 12-month period were not required to have insurance coverage and were, therefore, not subject to the penalty. **Note:** The federal penalty was repealed for tax years 2019 and beyond.

Estimated tax payments and withholdings

Nonresident aliens must make estimated tax payments under the same rules as U.S. residents. However, if a nonresident alien does not have any wages subject to withholding, the first estimated tax payment, normally due April 15, may be postponed until June 15, at which time one-half (rather than one-quarter) of the total annual estimated tax liability must be paid. The remaining balance may then be paid in quarterly installments on September 15 and January 15.

COVID-19 relief: Due to the COVID-19 pandemic, the IRS has extended the payment deadlines for both first and second quarter payments (normally due April 15 and June 15) until July 15, 2020.[22] Therefore, nonresident aliens — already exempt from the April 15 deadline — may defer payment of the combined estimated tax liability until July but must then

Review Answers

1. A. Incorrect. A temporary absence from the U.S. will not terminate a taxpayer's residency.
B. Incorrect. The mere expiration or casual abandonment of a green card does not terminate residency for tax purposes.
C. **Correct.** A taxpayer's green card is terminated if they are administratively or judicially removed from the U.S.
D. Incorrect. Once a taxpayer obtains a green card, it is considered permanent unless residency status changes. Marriage in itself does not change residency status unless the couple leaves the U.S.

2. A. **Correct.** Foreign students who are present in the U.S. on an F, M, J or Q visa do not count their days in the U.S. unless they are present in the U.S. for more than five years.
B. Incorrect. Teachers who have a J or Q visa do not count their days present in the U.S. unless they are present for more than two years.
C. Incorrect. Professional or amateur athletes who are present in the U.S. to compete in a charitable event do not count the days present in the U.S. under the substantial presence test.
D. Incorrect. If a spouse is not a resident of the U.S. at any time during the year, they are not considered a U.S. resident unless an election to treat them as such is made.

3. A. Incorrect. Taxpayers must be present in the U.S. for 183 days. If the taxpayer enters the U.S. on August 1, the individual is only present in the U.S. for 153 days and must file a dual-status return.
B. Incorrect. The individual has not met the 183-day physical presence test because the taxpayer was present in the U.S. for only 182 days.
C. Incorrect. Taxpayers may elect to backdate their residency status to the year of arrival if they were present in the U.S. for at least 31 consecutive days in the year of arrival and they meet the substantial presence test the year following arrival. The taxpayer was only in the U.S. in year 2 for 182 days.
D. **Correct.** The taxpayer has met the physical presence test because the individual was present in the U.S. for a total of 265 days. The vacation in Africa for the month of July is considered a temporary absence.

submit an amount equal to one-half the total annual estimated tax liability.

Nonresident aliens are subject to tax withholdings on wages earned and must provide their employer with Form W-4, *Employee's Withholding Allowance Certificate*, indicating "single" or "married filing separately" regardless of actual marital status. The IRS recommends that nonresident aliens complete Form W-4 using the modified instructions in Notice 1392 since they most likely cannot claim any dependents and their itemized deductions and adjustments to income are limited. **Exception:** No withholdings are required for a nonresident alien employee of a foreign employer if the employee's pay is less than $3,000/year and the employee is temporarily present in the U.S. for fewer than 90 days.

Nonresident aliens are also subject to Social Security and Medicare withholdings unless they are in the U.S. on a student visa performing only on-campus work[23] or can claim an exemption from withholdings based on an applicable treaty. **Note:** Nonresident aliens must file Form 8233, *Exemption from Withholding on Compensation for Independent (and Certain Dependent) Personal Services of a Nonresident Alien Individual*, with their employer to claim a treaty-based exemption and should not complete Form W-4.

If a Social Security or Totalization Agreement is in effect between the U.S. and a foreign country, employees will only pay Social Security tax to the country in which they are working.[24] However, if they normally work abroad but are sent to the U.S. to work temporarily, they will pay Social Security taxes only to their home country.

Although nonresident aliens may be subject to Social Security tax in the U.S., they will not necessarily be entitled to collect future benefits. Much will depend on their place of residence, current citizenship and applicable bilateral agreements (or lack thereof) in effect at the time they seek to collect. Nonresident aliens should contact the Social Security Administration for evaluation of their status and potential processing of their claims. ■

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Endnotes

1. IRC §7701(b)(3)
2. Rev. Proc. 2020-20
3. IRC §7701(b)(5)
4. IRC §7701(b)(4)
5. IRC §6013(h)
6. Reg. §1.6013-6(a)(4)
7. IRC §6013(g)
8. IRC §871(a)
9. Reg. §1.864-4(c)(1)(i)
10. IRC §871(a)(2)
11. IRC §873(a)
12. Reg. §1.882-5
13. IRC §2(b)(3)(A)
14. IRC §873(b)(3)
15. Reg. §1.1441-1(e)(4)(vii)(A)
16. Reg. §1.6072-1(c)
17. IRS Notice 2020-23
18. IRC §894(a)
19. IRC §301.6114-1
20. IRC §168(g)
21. IRC §165
22. IRS Notice 2020-23
23. IRC §3121(b)(19)
24. Reg. §301.6114-1(c)(1)(vii)

About the author

Monica Haven, EA, J.D., LL.M. is an alum and guest faculty member of the National Tax Practice Institute, a recognized speaker on the professional circuit, and a welcomed lecturer on college campuses and at community organizations. Monica eagerly embraces every opportunity to share her experience and expertise even as she maintains her California-based tax practice, which serves clients throughout the nation and abroad. For additional information, published articles and loads of useful tax information, please head to Monica's website at www.mhaven.net.