US TAXATION OF FOREIGN NATIONALS

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CONTENTS

	Introduction	**1**
1.	**Residency**	**3**
	• Lawful Permanent Resident Test	3
	• Substantial Presence Test	5
	• Which Test Prevails?	9
	• Special Considerations	9
2.	**Case Study Background**	**11**
3.	**Income Taxation of Residents**	**13**
	• Income Tax Overview	14
	• Filing Status	15
	• Gross Income	15
	• Deductions from Gross Income	16
	• Itemized Deductions / Standard Deductions	16
	• Exemptions	17
	• Tax Credits (Foreign Tax Credit and Other Credits)	18
	• Filing Requirements and Procedures	23
4.	**Sourcing Rules**	**23**
	• Personal Services Income	23
	• Interest Income	24
	• Dividend Income	24
	• Rental and Royalty Income	25
	• Income from Sale of Personal Property	25
	• Income from Sale of Real Property	25
	• Partnerships	25
5.	**Taxation of Nonresidents**	**25**
	• Trade or Business Income	26
	• Passive Income	29
	• Filing Requirements and Procedures	32
6.	**Dual-Status Taxpayers**	**33**
	• Overview	33
	• Joint Return Election	37
	• Filing Requirements	38

Global Tax Network

7. **Other Taxes and Filing Requirements** **39**
- General Application of Social Security Tax 39
- Totalization Agreements 40
- Other Benefits 40
- State Income Taxes 41
- Gift and Estate Taxes 41
- Expatriation Tax 43
- Filing Requirement on Departure 43
- Foreign Bank Account Reporting Requirement 44
- Specified Foreign Financial Assets 44
- Form 5471 45
- Passive Foreign Investment Corporation (PFIC) 46

8. **Income Tax Treaties** **46**

9. **Other Income Tax Considerations** **48**
- Exchange Rate Issues 48
- Moving Expenses 49
- Foreign Earned Income and Housing Exclusions 49
- Capital Gains 50
- Dispositions of US Real Property Interests 51
- Sale of Principal Residence 51
- Rental of a Residence 53
- Investments in Foreign Corporations 54

Appendix A. 2018 US Individual Income Tax Rates **55**
Appendix B. List of US Tax Treaties **56**
Appendix C. Visas **57**
Appendix D. Checklist for Foreign Nationals **59**
Appendix E. US Withholding Tax Compliance Checklist **61**

This booklet is based upon tax law in effect as of January 1, 2018. The information contained in this booklet is general in nature, and is not a substitute for professional advice about individual tax situations. Please consult with a professional tax advisor whenever specific questions arise.

Any US tax advice contained in the body of this booklet was not intended or written to be used, and cannot be used, by the recipient for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code or applicable state or local tax law provisions. Our advice in this booklet is limited to the conclusions specifically set forth herein and is based on the completeness and accuracy of the facts and assumptions as stated. Our advice may consider tax authorities that are subject to change, retroactively and/or prospectively. Such changes could affect the validity of our advice. Our advice will not be updated for subsequent changes or modifications to applicable law and regulations, or to the judicial and administrative interpretations thereof.

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Introduction

Life in the United States can be unusually complicated. This is especially true for a foreign national (a citizen or national of a country other than the US) who relocates to the US or earns income from US sources. This book addresses the US tax impacts of accepting an assignment in the US and earning US source income, and provides you with a basic understanding of the US tax system and its application to foreign nationals.

The first and probably most important issue encountered by a foreign national is residency. Whether or not you are considered a US tax resident will have a large impact on your US tax liability. The first chapter of this book is devoted to US tax residency rules.

Since many of the concepts presented in this book will be new to the reader, we have included examples which are based on real-life situations and which apply the rules discussed throughout this book. These examples are based on the case study information contained in Chapter 2. It is our hope that such examples will allow for a clearer and faster understanding of the US tax system.

When you meet the criteria established for tax residency in the US, the scope of your income and activities that are subject to US tax reporting increase substantially. Chapter 3 of this book is an overview of the US taxation of residents.

Before moving on to the taxation of US nonresidents, it is important to gain a basic understanding of the US rules that determine whether an item of income is US source or foreign source. Chapter 4 outlines these rules and how they are applied to the more common types of income earned by individual taxpayers.

The fact that a foreign national does not meet the residency requirements does not mean that the individual escapes US tax reporting requirements or a US tax liability. Chapter 5 is dedicated to the US taxation of nonresident foreign nationals. It discusses the different types of income earned by nonresident taxpayers, how each type of income is taxed, and how the tax is collected.

Often, the busiest and most stressful periods of a US assignment are the first and last years of the assignment. These transition years can also be the most complicated from a US tax perspective. Chapter 6 deals with these years and some of the special considerations that require attention.

The majority of this book discusses the federal income taxation of foreign nationals. Besides federal income tax, foreign nationals may encounter state income taxes, social security taxes, estate and gift taxes, and miscellaneous filing

requirements. We take a break from federal income taxes in Chapter 7 and address some of these other tax-related concerns.

The US has executed tax treaties with many different countries. Chapter 8 outlines the general terms of a typical tax treaty, how a tax treaty works, and the potential benefits available to many foreign nationals.

Chapter 9 discusses the US tax treatment of activities that are commonly an issue with foreign nationals. These include the tax treatment of home sales, moving expenses, rental activities, US real estate investments, and non-US activities.

This book is based on US tax law as of January 1, 2018 and contains a number of general tax planning tips and suggestions for reducing tax. Due to the complexity of foreign national tax matters and the ever-changing US tax law, you should seek assistance from a US tax professional. This book is intended only to give the reader a basic understanding of the US tax system. It is not intended to be a substitute for the advice and counsel of a professional tax advisor. We strongly recommend that all foreign nationals seek such counsel before, during, and after an assignment in the US.

Global Tax Network US, LLC (GTN) provides tax return preparation and consulting services to foreign nationals. E-mail us at **help@gtn.com** if you have questions or need tax advice. You can also visit our website at **gtn.com** for a full description of our services.

Back to Table of Contents

1. Residency

As a foreign national working in the US, the first question that must be addressed to determine your US income tax liability is whether you are a US income tax resident. Note that we refer to "tax resident" as opposed to "resident" or "legal resident." The concepts discussed in this chapter and throughout the book relate only to income tax residency. A determination of tax residency may not bear any relationship to your legal or immigration status. It is possible, and quite common, for a foreign national to be a nonresident for legal or immigration purposes and yet be a resident for tax purposes. Further, residence status for income tax purposes may be different than residency for estate tax and social security tax purposes.

The residency determination is vital in calculating the US income tax liability related to an assignment in the US. Tax residents are taxed on worldwide income while nonresidents are taxed only on US source income. A casual reading of the preceding sentence would lead one to believe that it is always better to be considered a nonresident. However, this is not always true. In some cases it may be more beneficial for an individual to be treated as a US tax resident.

There are two tests used to determine whether you are a US tax resident. These two tests are:

- The lawful permanent resident test
- The substantial presence test

If you meet the requirements of either of these two tests, you will be treated as a US tax resident. These two tests are discussed in greater detail below.

Lawful Permanent Resident Test

A foreign national is considered a US lawful permanent resident taxpayer if he or she has been issued the official privilege of residing permanently in the US. This occurs when the foreign national receives an alien registration card or "green card." In the initial year that a "green card" is issued, the individual becomes a US resident from the first day of actual physical presence in the US after the "green card" is issued.

Maria, a citizen and resident of Spain, is offered a position with ABC Company (a US company). The position requires that she live and work in the US—specifically Denver, Colorado. Maria applies for permanent residence status and is issued a green card on December 15, 2017. Prior to December 15th, she made a preliminary trip to the US in November of 2017. She spent 6 days in the US on this preliminary trip looking for housing. She moves to the US on January 1, 2018 and begins her new job on January 5, 2018.

Maria is considered a tax resident in the US under the lawful permanent resident test from January 1, 2018 forward. January 1 is the first day she is physically present in the US while possessing a green card.

After Maria begins her duties with her new US employer, she is put in charge of a project. This project requires engineering expertise that neither Maria nor anyone else in the US company possesses. Maria contacts a former colleague in Spain named Pablo who works for a Spanish engineering firm (XYZ, SA). The Spanish firm agrees to a short-term contract of 4 months and makes arrangements for Pablo to go to the US Pablo is granted a US visa and arrives in Denver on August 1, 2018.

The lawful permanent resident test does not apply to Pablo as he is working in the US on a visa and not a "green card."

If you achieve tax residency under the lawful permanent resident test, this status continues until one of the following three events occurs:

- You voluntarily surrender the "green card" to immigration authorities; or
- The US immigration authorities revoke the "green card"; or
- A judicial body officially finds that you no longer qualify as a lawful permanent resident under the immigration laws.

If you have surrendered your green card, this does not necessarily mean that your status as a lawful permanent resident has changed. Your status will not change unless and until you get an official notice from the US Citizenship and Immigration Service (USCIS) that there has been a final administrative or judicial determination that your green card has been revoked or abandoned. You can contact the USCIS to check the status of your card.

If one of these conditions apply and you do not meet one of the residence tests in the next year, the general rule states that you are resident through the last day of the calendar year in which the event occurs. For example, if you surrender your green card in June of 2018 and you do not meet either residence test in 2019 the general rule results in your US tax residency ending

on December 31, 2018. There is an exception to this general rule. If you have established a tax home in a country other than the US and you have closer connections to that other country on the date your green card status ceases, your US residency is deemed to end on that date rather than the end of the calendar year. This exception often allows a foreign national to terminate residency prior to the US tax year-end of December 31.

Due to family matters, Maria decides in April of 2019 to resign her position and return to Spain. She returns to Spain on May 1, 2019. At the same time, she decides to voluntarily surrender her "green card." She begins this process and her "green card" status is officially abandoned on June 15, 2019. Maria takes a job with a new Spanish employer on July 1, 2019. This job requires her to make a subsequent business trip to the US in 2019. This trip to the US begins on October 5 and ends on October 11 which results in Maria spending 7 additional days in the U.S during 2019.

For 2018, Maria is considered a US tax resident under the lawful permanent residence test from January 1 through December 31.

For 2019, Maria is a US tax resident for the period January 1 through June 15. Maria qualifies for the exception to the general rule for her residency termination date. After surrendering her green card, Maria established a tax home in Spain and has closer connections to Spain as of June 15, 2019. As a result, this is deemed to be the date her US tax residency ends, rather than December 31, 2019.

Substantial Presence Test

The other tax residency test is the substantial presence test. This test is more complicated than the lawful permanent resident test. The substantial presence test looks at the number of days you are actually physically present in the US for any purpose over a three-year period of time. If the number of days you are physically present in the US equals or exceeds 183 days in the current tax year, or 183 days during a three-year period, which includes the current year and the two years immediately prior to the current year, you are treated as a US tax resident. The three-year period works as follows:

- For the current year, count all of your days physically present in the US;
- For the first year preceding the current year, count one third of your days physically present in the US;
- For the second year preceding the current year, count one-sixth of your days physically present in the US

For this purpose, a day of actual physical presence in the US is any day that you spend any amount of time in the US Therefore, days of arrival and departure each count as a full day of US presence. However, a day of presence does not include time spent in the US under the following circumstances:

- Time spent in the US while in transit between two non-US locations. This time cannot exceed 24 hours, nor can you conduct any business while in the US;
- Days spent commuting to work in the US from a residence in Canada or Mexico if you regularly commute from Canada or Mexico;
- Days that you are unable to leave the US due to a medical condition that you developed while you were in the US;
- Days spent in the US as an exempt person. Exempt individuals include certain government officials, teachers, students and athletes.

Maria first came to the US in late 2017 to look for housing. She spent 6 days in the US on this trip. She moved to the US permanently on January 1, 2018. She left the US on May 1, 2019. She also spent an additional 7 days in the US on business after May 1, 2019. Applying the substantial presence test to her situation results in the following:

2018 Tax Year

2018 days	(1 X 366)	365 days
2017 days	(1/3 X 6)	2 days
2016 days	(1/6 X 0)	0 days
Total days for substantial presence test		367 days

2019 Tax Year

2019 days	(1 X 128)	128 days
2018 days	(1/3 X 365)	122 days
2017 days	(1/6 X 6)	1 days
Total days for substantial presence test		251 days

Maria meets the substantial presence test for the years 2018 and 2019. Considering the substantial presence test only, Maria would be a US tax resident in 2018 and 2019.

Pablo, like Maria, arrived in the US for the first time in 2018. He arrived on August 1 and completed the short-term project on November 15. Pablo left the US on December 2, 2018 and returned to Spain. As calculated below, Pablo does not meet the substantial presence test.

2018 Tax Year

2018 days	(1 X 124)	124 days
2017 days	(1/3 X 0)	0 days
2016 days	(1/6 X 0)	0 days
Total days for substantial presence test		124 days

Pablo is not considered a resident under the substantial presence test.

There are certain exceptions to the substantial presence test.

31-Day Exception

If you are present for less than 31 days in the current year, the substantial presence test is not applied to determine residency. The test is not applied even if the 183-day threshold is met when the two preceding years are considered. Remember that this does not mean that you automatically qualify as a nonresident. If you have a "green card," under the lawful permanent resident test you are generally a tax resident regardless of the number of days spent in the US.

Maria cannot use the 31-day exception for 2018 or 2019, as she was present for more than 31 days in each of these years.

Closer Connection Exception

If you meet the substantial presence test it is still possible to argue that you are a full-year nonresident if the following conditions are satisfied:

- You are present in the US for fewer than 183 days in the current year; and
- You maintain a "tax home" in another country during the entire current year; and
- You maintain a closer connection to the foreign country in which you have a tax home during the current year.

In order to show that you maintained a "tax home" in another country, you must demonstrate that you have a "regular or principal place of business" or a "regular place of abode" in that country. To meet the closer connection requirement, it is necessary to show that you have more significant contacts with the foreign country as compared to the US. These are rather subjective determinations that consider personal as well as business connections.

Maria could not use the closer connection exception for full-year nonresident status for 2018 or 2019. She is present for more than 183 days in 2018. Although she spends less than 183 days in the US in 2019, she did not maintain a tax home in Spain for the entire year. As such, Maria would be a US resident for at least part of the 2019 calendar year.

When Does Tax Residency Begin?

If you qualify as a resident under the substantial presence test in the current year and you did not qualify in the prior year, your residency period begins on the first day that you are physically present in the US However, certain days can be ignored when determining a residency start date. These days are referred to as "nominal" days of US presence. A "nominal day" is a day spent in the US while you have a tax home in another country and while you maintain a closer connection to that other country. Up to 10 days of "nominal" presence can be ignored. An example of a "nominal" day is one during a pre-assignment house-hunting trip. However, it is important to note that these days are ignored only for purposes of establishing a residency start date. All days of presence in the US are considered when determining days under the substantial presence test.

Maria's residency for the substantial presence test is deemed to begin on January 1, 2018 – the day she moved to the US. Although she was in the US prior to January 1, these days can be ignored as they are not current year days. These days also qualify for the exception outlined above as they are "nominal" in nature and are fewer than 10 days.

When Does Tax Residency End?

Like the lawful permanent resident test, the general rule for termination of US tax residency is the last day of the calendar year. However, there is an exception to this general rule. Under this exception, your residency is deemed to end on the last day that you are present in the US in the year that you move from the US and establish a residence in another country. You must establish a tax home in another country and also a closer connection to that country from this day forward. Similar to the determination of the residency start date, up to 10 "nominal" days of US presence can be ignored after you move from the US.

Maria's residency terminates under the substantial presence test on May 1, 2019. This is the day Maria moves back to Spain. She establishes a tax home in Spain and closer connections to Spain from this day forward. Although she spends some additional time in the US on a subsequent business trip, these days of US presence are ignored for the purpose of fixing her residency ending date. These days qualify for the "nominal" presence exception outlined above.

Which Test Prevails?

It is common for a person to meet both the lawful permanent resident test and the substantial presence test. This raises the question—which test is used to determine when residency begins and when it ends? The answer is the test that results in the earliest starting date is used to determine the start date. The test that results in the latest ending date is used to determine the residency ending date.

According to the substantial presence test, Maria's resident status begins on January 1, 2018 and ends on May 1, 2019. Under the lawful permanent resident test, her resident status begins on January 1, 2018 and ends on June 15, 2019.

Both tests result in the same start date so in this case either test can be used for her start date. The lawful permanent resident test results in a later ending date so this test prevails for that purpose. Maria's US tax residency begins on January 1, 2018 and ends on June 15, 2019.

Special Considerations

First Year Election

Sometimes it is better to be treated as a resident rather than a nonresident. There is an election available that allows foreign nationals to be taxed as a resident in the initial year of a US assignment even if one of the residency tests is not met for that year. To qualify for this election, the following requirements must be satisfied:

- You must have been a US nonresident in the year immediately proceeding the initial year of the US assignment.
- You must satisfy the substantial presence test in the year following the initial year of the US assignment.
- You must be present in the US for at least 31 consecutive days in the initial year of the US assignment.
- During this initial year, you must be present in the US for at least 75% of the days from the start of the 31-consecutive-day period (see above) through the end of the year.

Whether or not this election makes sense for you depends on the specific facts of your individual situation. If this is the initial year of your US assignment and you will not meet either of the two residency tests, you should consult with a tax professional to determine whether this election will reduce your US tax liability. If the election is beneficial, a professional tax advisor can also ensure that a valid election is made.

It is also important to consider your foreign tax liability during the first and last years of a US assignment. Your tax advisor must take into account both your US and foreign tax matters to minimize your total worldwide tax burden.

No Lapse Rule
If, after terminating residency in one year, a foreign national returns to the United states and resumes residency at any time during the following year, the residency shall be considered as never having lapsed between the two residency periods.

Break in US Residency for Period of Less Than Three Years
If an individual interrupts their period of US residence with a period of non-residence, there are special rules that apply. If you were in the US for the last three years, leave the US, but become a resident again within the next three years, you may be subject to US tax under the special rule if the tax is more than it would have been as a nonresident alien.

Impact of Tax Treaties
This chapter has covered the general rules used to determine whether a foreign national is treated as a tax resident in the US. Please note that this discussion has not considered the impact of tax treaties on the question of residency. The United States has implemented numerous income tax treaties with other countries. The purpose of a tax treaty is to minimize double taxation which may arise due to differences in the tax laws of each jurisdiction. It is quite possible that you could meet one of the residency tests for the US (outlined above) and also be considered a tax resident in your home country

or other country. As a result, both countries could treat you as a resident and you could be subject to double taxation. Income tax treaties usually contain residency tie-breaker rules which can be utilized in this type of situation. These rules determine which of the two countries possess the right to tax you as a resident. Income tax treaties and their impact are discussed in greater detail in Chapter 8.

Back to Table of Contents

2. Case Study Background

This chapter provides additional information about Maria and Pablo's US assignments. If you recall from Chapter 1, Maria is a US resident taxpayer in 2018, and a part-year resident in 2019. Pablo is a nonresident taxpayer in 2018. These conclusions and the information outlined below are used in later chapters to provide examples of the US taxation of foreign nationals.

Maria

Maria's income, expenses, and a brief description of her living and work situation for 2018 and 2019 are outlined below.

2018

Maria's job in the US started on January 5, 2018. Her salary from this job through the end of 2018 totaled $80,000. Maria had Colorado income tax withholding of $3,500 and US federal income tax withholding of $18,500 deducted from these wages. Maria also made $4,000 of charitable contributions to a qualified US charity in 2018. In addition to her employment income, Maria earned the following income in 2018.

Dividends from stock held in a US corporation ($400 paid each quarter on March 15, June 15, September 15, and December 15)	$ 1,600
Interest Income from US bank accounts	$ 800
Interest Income from Spanish bank accounts	*$ 800

* This represents total 2018 interest income from Spanish bank accounts. $100 of Spanish tax was withheld from this amount so Maria actually received $700.

2019

Maria worked for her US employer through April 30, 2019. After leaving the US, she accepted a job with a Spanish employer (effective July 1, 2019). Her wages from her US employer for 2019 were $35,000. US federal income tax of $6,000 and Colorado income tax of $1,200 was withheld from these wages. The wages from her Spanish employer amount to $65,000 of which $3,500 relates to her services performed in the US. Spanish income tax of $13,500 was withheld from these wages. Maria made charitable contributions of $2,500 to a qualified US charity in 2019. In addition, Maria earned the following income in 2019:

Dividends from stock held in a US corporation ($400 paid March 15, June 15, September 15, and December 15)	*$ 1,600
Interest Income from US bank accounts	$ 800
Interest Income from Spanish bank accounts	**$ 800

* This represents the gross dividends paid to Maria in 2019. There is $180 of US federal tax withheld from these payments so Maria only receives a net amount after withholding of $1,420.

** This represents gross interest paid to Maria in 2019. There is $100 of Spanish tax withheld from this interest so Maria receives the net of $700.

Pablo

Following is a summary of Pablo's income and expenses in 2018.

2018

Pablo earned a total of $70,000 in 2018. Of this amount, Pablo earned $30,000 for the services provided in the US during the short-term project. Pablo was paid by his Spanish employer (XYZ, SA) for the services performed in the US. No US taxes were withheld from Pablo's wages. While in the US, Pablo incurred transportation expenses and temporary living expenses (meals, lodging, etc.) of $6,500. These expenses were reimbursed by XYZ, SA.

In addition to his wage income, Pablo earned the following income:

Dividends from stock held in a US corporation ($100 paid March 15, June 15, September 15, and December 15)	*$ 400
Dividends from Spanish investments	$ 2,000
Interest Income from US bank accounts	$ 600
Interest Income from Spanish bank accounts	$ 2,500

* This represents the gross dividends declared by the US corporation. The corporation withheld $60 of US tax from the amount actually paid Pablo.

Chapters 3, 5, and 6 contain an analysis of the US tax rules associated with Pablo's and Maria's activity in the US. Chapter 3 discusses the taxation of full-year residents so Maria's tax situation for 2018 will be discussed first. Pablo's 2018 US tax situation is analyzed in Chapter 5. Chapter 5 covers the taxation of full-year nonresidents. Maria's 2019 tax year is addressed in Chapter 6 which discusses the taxation of part-year resident taxpayers, also referred to as "dual-status" taxpayers.

Because this case study includes tax year 2018 (tax rates and tax law have yet to be determined), we have applied US tax law and tax rates that are in effect as of January 2018. The intent of this case study is to illustrate the mechanics of the current law. Please keep in mind that changes in tax law could occur that would alter the outcome of this analysis.

Back to Table of Contents

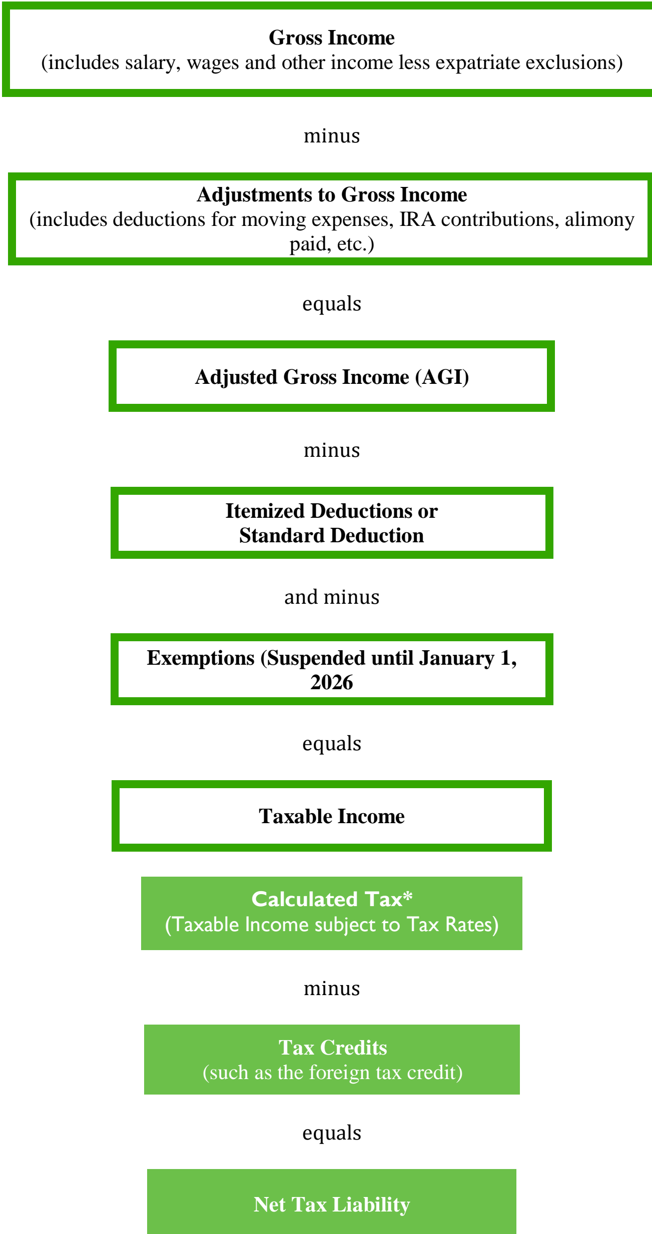
3. Income Taxation of Residents

If you are a resident taxpayer, you are taxed in the United States as if you are a US citizen. You are taxed on the worldwide income that you earn during your period of residence. Following is a general discussion of the US tax law and how it applies to resident taxpayers. This chapter covers the taxation of a resident taxpayer who is tax resident for the entire year.

Where appropriate, the concepts discussed are applied to the case study information outlined in the previous chapter (Chapter 2).

Income Tax Overview

The flowchart below outlines the major steps in calculating federal taxable income and the federal tax liability for an expatriate taxpayer:



*It is important to note that under the current tax laws, the tax is computed after adding back the section 911 exclusion, so the higher income tax rates will apply.

Filing Status

Your filing status is important in the calculation of many items that affect your tax. Some of these items are the amount of standard deduction available to you; the phase-outs of itemized deductions, exemptions and certain credits (all discussed later); as well as the tax rate schedule which dictates your marginal tax bracket. Following are the filing statuses to choose from:

- Single Individual
- Married Filing Jointly
- Married Filing Separately
- Head of Household
- Qualifying Widow(er) with Dependent Child

IN OUR CASE STUDY, Maria will file as a single individual as she is not married and has no children or other dependents.

Gross Income

For federal income tax purposes, "gross income" means all income from whatever source, except for those items specifically excluded by law. Gross income includes such items as:

- Wages, salaries and other compensation
- Interest and dividends
- State income tax refund (if claimed as an itemized deduction in prior years)
- Income from a business or profession
- Alimony received
- Rents and royalties
- Gains on sales of property
- S Corporation, trust, and partnership income

IN OUR CASE STUDY, Maria's gross income for 2018 consists of the following:

Compensation (salary)	$ 80,000	
Interest Income	$ 1,600	($800 + $800)
Dividend Income	$ 1,600	
Total Gross Income	$ 83,200	

Deductions from Gross Income

Deductions from gross income are used to arrive at your adjusted gross income (AGI). These deductions apply even if you use the standard deduction rather than itemizing your deductions. Your AGI will be important in many of the phase-out calculations that are discussed later. Available deductions from gross income include:

- IRA contribution deduction
- Student loan interest deduction
- Tuition and fees deduction
- Medical and health savings account contribution deduction
- Penalty incurred on early withdrawal of savings
- Alimony paid
- Self-employed health insurance
- Self-employed SEP, SIMPLE, and qualified plans
- One half of self-employment tax

IN OUR CASE STUDY, Maria does not have any of these items in 2018 and has no deductions from gross income.

Itemized Deductions / Standard Deduction

Taxpayers may reduce AGI by the greater of the appropriate standard deduction or their allowable itemized deductions. The amount of the standard deduction varies depending on your filing status. For 2018, the standard deduction amounts are as follows:

- Single Individual / Married Filing Separately..$12,000
- Married Filing Jointly / Qualifying Widow(er)....................................$24,000
- Head of Household $12,000

If the sum of your allowable itemized deductions is greater than the standard deduction allowed based on your filing status, you should itemize. The following are examples of amounts that can qualify as itemized deductions:

- Greater of state and local income taxes or general sales taxes
- Foreign taxes (if you elect to deduct rather than take a credit)
- Real estate taxes
- Personal property taxes

- Qualified home mortgage interest and points
- Mortgage insurance premiums, if applicable
- Charitable contributions to qualified US charities
- Investment interest, if applicable

The Tax Cuts and Jobs Act enacted January 1, 2018, changed how itemized deductions are calculated. Beginning with calendar year 2018, itemize deductions for state and local income taxes is capped at $10,000. These taxes include state and local income taxes, sales, real estate, and property taxes.

IN OUR CASE STUDY, Maria has the following 2018 expenses which qualify as itemized deductions:

Colorado Income Tax	$3,500
Charitable Contributions	4,000
Total Itemized Deductions	$7,500

It appears that Maria should take the standard deduction of $12,000 versus the itemized deductions of $7,500.

Exemptions

Prior to January 1, 2018, you could deduct $4,050 (indexed annually for inflation) for each allowed exemption. You were allowed one exemption for yourself, and if you are married and file a joint tax return, one exemption for your spouse. You were also allowed one exemption for each person you are able to claim as a dependent.

Beginning January 1, 2018, the deduction for exemptions has been suspended. Therefore, you are no longer allowed a deduction for exemption(s). Under current law, the exemption will be allowed again beginning January 1, 2026.

IN OUR CASE STUDY, Maria can not claim one exemption (for herself). Starting in 2018, the deduction for exemptions is not allowed.

Case Study Summary

Adjusted Gross Income	$ 83,200
Standard Deduction	(12,000)
Exemptions	0
Taxable Income	$71,200

Once you have calculated your taxable income, the next step is to calculate your tax. The Federal tax rate schedules for 2018 are included in Appendix A.

Maria's tentative US federal income tax liability for 2018 is $11,604. This is calculated using the "single individual" tax rate schedule provided in Appendix A.

New Medicare Tax as of 2013

Starting with tax year 2013, a new 3.8% Medicare tax on net investment income will be assessed for Single and Head of Household filers with AGI exceeding $200,000 and Joint filers with AGI exceeding $250,000 ($125,000 MFS).

A .9% incremental Medicare tax on earned income will be assessed for Single and Head of Household filers with wages, compensation or self-employment income exceeding $200,000 and Joint filers exceeding $250,000 ($125,000 MFS).

Tax Credits

Foreign Tax Credit

The US allows for a credit against the US income tax paid on income that is also subject to foreign income tax. This is referred to as the foreign tax credit. To qualify for the credit, the foreign tax incurred must be imposed on you and levied on your income.

The foreign tax credit is limited to the lesser of the actual foreign tax paid or accrued or the US tax liability associated with the income that attracts the

foreign tax (foreign source taxable income). This limitation is calculated by applying the following formula:

$$\frac{\text{Foreign Source Taxable Income}}{\text{Total Taxable Income Before Exemptions}} \times \text{US Tax Liability} = \text{Foreign Tax Credit Limitation}$$

Please note the use of the phrase "foreign source" in the above formula. Income sourcing and the rules for distinguishing US source income from foreign source income are covered in Chapter 4. Also, note that the formula considers foreign source taxable income rather than foreign source gross income. Foreign source taxable income is calculated by allocating a portion of the various deductions used to arrive at overall taxable income to your foreign source gross income. If the total foreign taxes incurred in a given year cannot be used as a credit due to this limitation, the unused portion must be carried back one year and then carried forward to the next ten years.

To further complicate matters, the foreign tax credit limitation is applied separately to statutorily defined classifications of income. These classifications are often referred to as "baskets" in discussions regarding the US foreign tax credit. Two common classifications encountered by foreign nationals are the "general" basket which includes business income, salary, and wages, and the "passive" basket which includes dividends, interest, capital gains and retirement income.

In 2018 – Maria does pay some foreign tax. This is the Spanish tax of $100 that is withheld on the interest income from Spanish bank accounts. All of her foreign source income falls within one basket so it will only be necessary to perform one calculation for her foreign tax credit. Maria's total 2018 foreign source income consists of the interest earned from her Spanish bank accounts. This item falls within the passive basket.

The first step in the overall computation is calculating her foreign source taxable income. We know that her gross foreign source income is $800. It is necessary to allocate a portion of the deductions used to arrive at taxable income to her gross foreign source income. We will do this based on her ratio of gross foreign source income to total gross income that equals $800/$83,200 or .0096%. Applying this ratio to the standard deduction of $12,000 results in $115. Maria's foreign-source taxable income equals $685 ($800 - $115).

The next step is calculating Maria's 2018 foreign tax credit limitation. Using the formula provided above, Maria's 2018 limitation is calculated as follows:

$685 / $71,200 X $11,604 = $ 112

Maria's 2018 foreign tax credit is $100. The foreign tax credit is the actual foreign tax she paid because it is less than the US tax ($112) on the foreign source taxable income. This assumes that the $100 Spanish tax withheld is equal to her actual Spanish tax liability on that income.

Another important aspect related to the foreign tax credit is an election to deduct the foreign taxes as an itemized deduction. If this election is made, the taxes are no longer available for credit. In most cases, it is more beneficial to elect the credit as this can provide a dollar-for-dollar benefit. However, in limited cases, deducting the taxes results in a greater benefit. You should always consult a tax advisor before claiming the foreign tax credit or before making the deduction election to help ensure you receive the maximum available benefit.

Other Credits

Child Tax Credit and Additional Child Tax Credit

For tax year 2018, you may be entitled to a child tax credit of $2,000 for each of your qualifying children. To qualify, the child:

- must be under age 17 at December 31, 2018,
- must be a citizen or resident of the US,
- must be someone you have claimed as a dependent,
- must be your child, stepchild, grandchild or eligible foster child,

- did not provide over half of their own support, and
- must have lived with you for more than half of 2018

PHASE-OUT OF CHILD TAX CREDIT

The amount of your child tax credit starts to phase-out once your AGI exceeds a threshold amount for your filing status. The threshold amounts for 2018 are as follows:

- Single individuals / Qualifying widow(er)..$200,000
- Married filing jointly..$400,000
- Married filing separately ....$ 200,000
- Head of household...$200,000

If your modified AGI is above the threshold amount for your filing status, you must reduce your credit by $50 for each $1,000, or part of $1,000, that your modified AGI exceeds the threshold amount. Unlike other phase-outs in the tax law, the income level at which the child tax credit is completely phased out is higher for each additional child. For the additional child tax credit, if the usable child tax credit is greater than your tax liability and taxable income is greater than $2,500, or if you have three or more children, and the Social Security and Medicare tax you paid is more than your Earned Income Credit, a portion of the credit may be refundable. New for 2018: The child must have a valid Social Security Number to claim the nonrefundable and refundable credit.

IN OUR CASE STUDY, Maria has no children and therefore cannot claim any child tax credit.

Higher Education Tax Credits
There are two federal tax credits available to help you offset the costs of higher education for yourself or your dependents.

The American Opportunity Credit (AOC).

- The maximum amount of AOC is $2,500 per student. The credit is phased out (gradually reduced) if your modified adjusted gross income (AGI) is between $80,000 and $90,000 for single and head of household filers ($160,000 and $180,000 if you file a joint return).
- The credit can be claimed for the first four years of post-secondary education.
- Generally, 40% of the AOC is a refundable credit for most taxpayers, which means that you can receive up to $1,000 even if you owe no taxes.

- The term "qualified tuition and related expenses" has been expanded to include expenditures for "course materials." For this purpose, the term "course materials" means books, supplies, and equipment needed for a course of study, whether or not the materials must be purchased from the educational institution as a condition of enrollment or attendance.

The Lifetime Learning Credit

The Lifetime Learning Credit is not limited to students in the first four years of post-secondary education. Qualified expenses for this credit include the cost of instruction taken to acquire or improve existing job skills, if taken at a qualified educational institution. The amount of the credit is 20% of the first $10,000 you pay for qualified expenses. The maximum Lifetime Learning Credit you can claim per year is $2,000 (20% x $10,000).

PHASE-OUT OF LIFETIME LEARNING CREDIT

The allowable credit is reduced for taxpayers who have AGI above certain amounts. For 2018, the phase-out begins for single individuals, and head of household filing statuses when modified AGI reaches $56,000. For "married filing jointly" taxpayers, the credit begins to be phased-out range when AGI reaches $112,000.

IN OUR CASE STUDY, Maria did not incur any costs related to higher education and cannot claim any higher education tax credits.

Case Study Summary

Adjusted Gross Income	$ 83,200
Deductions from AGI	(0)
Standard Deduction	(12,000)
Exemptions	(0)
Taxable Income	$ 71,2000
Tentative Tax Liability	11,604
Foreign Tax Credit	(100)
Net Federal Tax Liability	$ 11,504
Federal Tax Withheld from Salary	(18,500)
Federal Tax Refund due Maria	$ (6,996)

Filing Requirements and Procedures

As a full-year US tax resident, you are required to file Form 1040 and pay any taxes due with the return by April 15 of the year following the reporting year. If you are not ready by April 15 to file your return because of missing information, you can get an automatic extension of six months (to October 15) to file your return. This extension only applies to the filing of your Form 1040 and not to the payment of any tax liability. Therefore, it is necessary to estimate your tax liability by April 15 and pay any remaining tax owed in order to avoid penalties and interest charges. The automatic extension can be obtained by filing Form 4868 by April 15. Any estimated tax liability should be remitted with Form 4868. A separate extension request may be required if you have a state tax filing requirement.

In most cases, there are no available extensions beyond October 15. Note that if you are residing outside the US on April 15, you are allowed an automatic two-month extension of time to file your US federal tax return. It is not necessary to file any forms to receive this extension.

Your tax advisor can file extension requests on your behalf, so this process can be relatively easy and pain-free, unless, of course, you owe money.

Where you file your US tax return depends on where you reside in the US Check with your tax advisor or with the Internal Revenue Service for the locations of the service centers where you should send your tax return, extension requests, and any necessary tax payments. In many cases, the relevant forms can be e-filed.

Back to Table of Contents

4. Sourcing Rules

Before we get into the rules regarding the taxation of nonresidents, it is necessary to spend some time on the topic of "sourcing". Up to this point, we have mentioned that nonresidents are generally taxed in the US only on US source income that they receive. We have also referred to the concept of foreign source income in our discussion of foreign tax credits. How does one determine what constitutes US source income versus that which is treated as foreign source income? This chapter will go over the sourcing rules for the most common types of income.

Personal Services Income

This category of income includes wages, salary, bonuses, and deferred compensation such as pensions that are paid by an employer. It also includes fees and other compensation earned by self-employed individuals.

The determining factor for the source of this type of income is typically where the services are physically performed. Compensation earned for services physically performed in the United States is considered US source income, regardless of who the employer is or what payroll the income is paid from. Likewise, compensation for services physically performed outside the United States is considered foreign source income. If compensation is related to the work performed both in the US and outside the US, the compensation is typically sourced based on the relative workdays in the various locations. For example, if you worked 50% of the time in the US, then 50% of your compensation would be US source income. In certain cases, exceptions may apply (e.g., certain compensation may be sourced based on geographical location).

An exception exists for certain amounts earned by foreign nationals. Under this exception, compensation for services performed in the US is not considered US source income if the following conditions are satisfied:

- The services must be performed by a nonresident taxpayer who is temporarily present in the US for a period of 90 days or less.
- The total compensation for these services does not exceed $3,000.
- The services must be performed as an employee of or under contract (in the case of a self-employed contractor) with one of the following:
    - A nonresident individual, foreign partnership or foreign corporation which is not engaged in a trade or business in the US, or
    - A foreign office or foreign branch of a US resident, US partnership, or US corporation.

Interest Income

The general rule for determining the source of interest income looks at the residence of the payor. Interest that is paid by a US resident, partnership, or corporation is deemed to be US source income. Interest paid on obligations issued by the US government or by any political subdivision in the United States such as a state government is also considered to be US source income.

Interest paid by a foreign entity (corporation, partnership, individual, government, etc.) is classified as foreign source income.

Dividend Income

Similar to interest, the general rule for dividends looks at the residence of the corporation paying the dividend. If the dividend is paid by a US corporation it is deemed to be US source income. Conversely, dividends paid by a foreign corporation are deemed to be foreign source income.

Rental and Royalty Income

The source of rental and royalty income depends on the location of the property that generates the income. If the property is located in the United States, the rental or royalty payment is deemed to be US source. For property that is located outside the US, the rental or royalty payment is treated as foreign source income.

Income from the Sale of Personal Property

Income generated from the sale of personal property is sourced according to the residence of the seller. Personal property includes assets such as stocks, bonds, cars, equipment, and furniture. Residence for this purpose is based on the "tax home" concept which was discussed briefly in Chapter 1. Generally speaking, gain from the sale of personal property by a US nonresident will not be considered US source income.

Income from the Sale of Real Property

The source of this type of income depends on the location of the property. Real property generally includes land and buildings. Gain on the sale of real property that is located in the United States is considered to be US source income regardless of the residency of the seller. The sale of real property located outside the US generates foreign source income.

There are special rules related to the disposition of an interest in US real property. Please see Chapter 9 for an analysis of these rules.

Partnerships

If you own an interest in a partnership, the source of the income is determined at the partnership level. The income retains this source when it flows into your individual tax return.

Back to Table of Contents

5. Taxation of Nonresidents

As a general rule, nonresident taxpayers are taxed in the US only on income from US sources. There are limited situations where the US will also tax certain types of foreign source income earned by nonresidents. However, this is beyond the scope of this book, so the remainder of this chapter is devoted to a discussion of US source income and the US tax impact to nonresident taxpayers.

There are two separate classifications in US tax law for US source income. In the previous chapter we covered the most common types of income earned by nonresident individuals and the rules for determining whether it is US source income or foreign source income. Once the source of each category of income

is determined, it is necessary to further categorize all items which are US source into one of the following two categories:

- Trade or business income, or
- Passive income (e.g., non-trade or business income)

The distinction between these two types of income is important because trade or business income is taxed differently than income from other sources.

Trade or Business Income

Trade or business income is income generated in the US through an activity which demands a certain level of active participation. Compensation for the performance of personal services as an employee is an example of trade or business income. In addition, compensation for the performance of services as an independent contractor (self-employed individual) is trade or business income. Other activities are also considered US trade or business income, including selling products in the US through a US based office, ownership of a US business, and ownership in a partnership with a US business.

Income which is trade or business income is taxed on a net income basis using graduated tax rates. Net income is determined by accumulating the gross trade or business income, and reducing it by allowable deductions that are attributable to this gross income.

Allowable Deductions

Business Deductions

If you have a business in the US, you may typically deduct most ordinary and necessary expenses that are directly related to the business. These business deductions could include wages paid to employees, depreciation of assets, marketing and advertising costs, taxes, insurance, interest, etc. Employee compensation income is generally not considered "business" income for business deduction purposes. Expenses incurred as an employee are considered "itemized deductions".

Any expense that is personal in nature is usually not deductible unless it qualifies as an adjustment to gross income or is an itemized deduction.

Adjustments to Gross Income

Similar to US residents, nonresidents can claim certain deductions from gross income. Allowable deductions from gross income include:

- Educator expenses
- IRA contribution deduction
- Medical savings account contribution deduction
- Self-employed SEP, SIMPLE, and qualified plans

- One half of self-employment tax
- Domestic production activities deduction
- Student loan interest deduction
- Unreimbursed deductible moving expenses
- Penalty incurred on early withdrawal of savings
- Self-employed health insurance deduction
- Scholarship and fellowship grants excluded

It is uncommon for nonresidents to have these types of deductions. Also, note that these expenses must relate to income earned from a US trade or business to be deductible.

Itemized Deductions
Nonresidents can also claim the following itemized deductions:

- State and local income taxes
- Gifts to qualified US charities
- Casualty and theft losses
- Unreimbursed employee business expenses and miscellaneous deductions (subject to limitations)

Please note that many of the itemized deductions which are available to residents (see chapter 3) cannot be claimed by a nonresident taxpayer. Nonresidents are also not allowed to take the standard deduction.

IN OUR CASE STUDY, Pablo cannot claim any itemized deductions as he did not incur any of the above-mentioned expenses.

Personal Exemptions
Starting in 2018, the deduction for exemptions is not allowed.

IN OUR CASE STUDY, Pablo cannot claim the one personal exemption.

Short-Term Assignments
Not all foreign nationals who accept a US assignment establish a tax home in the US. In those cases where a US tax home is not established, the individual is

treated for tax purposes as being on a “temporary assignment” in the US. A temporary assignment is defined as an assignment where the tax home (principal place of work or employment) does not change. If the intent of the assignment is to return to the original work location within one year, the assignment is considered a temporary assignment (all other assignments are considered indefinite or long-term).

The tax advantage of a temporary assignment is that employer-provided benefits such as lodging, meals, travel, and certain other items related to the assignment might not be (if properly structured) considered taxable wages to the employee. In the case of a long-term assignment, these items are typically considered taxable wages.

IN OUR CASE STUDY, Pablo is on a temporary assignment in the US The $6,500 of related meals and lodging that were reimbursed by XYZ, SA are not taxable compensation and can be ignored when calculating his US tax liability.

If these expenses are not paid or reimbursed by the employer, the individual might be allowed to deduct those costs related to the assignment (lodging, meals, transportation, etc.) as an itemized deduction (subject to certain limitations).

IN OUR CASE STUDY, Pablo cannot deduct these costs as they are not included in his compensation for US tax purposes.

Tax Rates

After reducing the trade or business income by any allowable deductions and the personal exemption, the net trade or business income is subject to graduated tax rates. The rates at which net trade or business income is taxed depends on whether or not you are married. If you are a married nonresident, generally the married filing separately rate schedule (see Appendix A) applies to your net trade or business income.

Please note that the “married filing separately” tax rates must be used because nonresidents are not allowed to file a joint tax return with a spouse. However, if you find yourself in the situation that you are married to a US citizen or resident and you do not meet the US residency requirements, you can elect to be treated as a resident and therefore file a joint return with your spouse.

If you are not married, you must use the 'single taxpayer' tax rate schedule (see Appendix A).

IN OUR CASE STUDY, Pablo does have US trade or business income in 2018. The trade or business income is the compensation he receives while working in the US on the short-term project. Note that this income does not qualify for the personal services exception outlined on page 26 as it exceeds the $3,000 threshold and Pablo is present in the US for more than 90 days. Pablo should file a US tax return and include this income in his return. Pablo's US tax return would include the trade or business compensation of $30,000, but would not include the assignment related expenses of $6,500 that are reimbursed by XYZ, SA.

Trade or business income	$ 30,000
Less:	
Business Deductions	(0)
Deductions from gross Income	(0)
Itemized Deductions	(0)
Net Trade or Business Income	$ 30,000
Taxable income from US trade or business	$ $30,000

As Pablo is unmarried, this income is taxed according to the single taxpayer rate schedule.

It is very important to note that this conclusion does not take into account a more favorable treatment that might be available to Pablo under an income tax treaty. We will revisit this when we discuss tax treaties in Chapter 8.

Passive Income

Unlike trade or business income, US source passive income is taxed on a gross basis at a flat tax rate of 30%. "Gross basis" means that no deductions or exemptions are allowed against this income. For purposes of this discussion, the most typical types of income which fall into the "Passive Income" category are interest, dividends, royalty, rents, alimony, certain capital gains, and 85% of US social security benefits.

The flat tax of 30% is usually collected through a withholding mechanism with the burden to withhold placed upon the payor of the income. For example, a US corporation is generally required to withhold the 30% tax from any dividends it pays to nonresident taxpayers, and remit this withholding to the US government on behalf of the individual.

The 30% tax rate can be reduced (or in some cases eliminated) if a tax treaty is in place between the US and the country of residence of the taxpayer. Please see Appendix B to determine whether a treaty exists between your home country and the US. A more thorough discussion of treaties can be found in Chapter 8.

If you are a nonresident taxpayer and your only US source income consists of passive income, you are not required to file a US tax return. The withholding tax generally satisfies any US tax liability.

IN OUR CASE STUDY, Pablo does have US source income which meets the definition of passive income in 2018. The income consists of the dividends of $400 he received from the US corporation. US tax in the amount of $60 was withheld from the actual cash paid to him. Why does this tax not equal 30% of the gross amount? The answer is that the income tax treaty between Spain and the US provides for a 15% withholding tax rate on dividends. Again, see Chapter 8 for a more thorough discussion of tax treaties.

Pablo also earned $600 of interest income from a US bank account in 2018. The reason that there is no tax withheld on these earnings is discussed in the next section.

Special Rules for Passive Income

Portfolio Interest Exemption - For many nonresidents, interest earned from certain debt instruments that have been issued by a US resident entity will not be subject to the withholding tax. To qualify for this exemption, the following requirements must be satisfied:

- The nonresident taxpayer cannot have a substantial ownership stake (10% ownership or more) in the US entity paying the interest.
- The obligation that generates the interest income must have been issued after July 18, 1984.
- The recipient of the income must not be a resident of a country which is on a list issued by the IRS. This list includes those countries which do not have an adequate system of information exchange with the US to prevent tax evasion by US taxpayers. Most developed countries are not on this list, so this will not present a problem in most cases.

US Bank Deposits - Interest earned by nonresidents from deposits in US banking institutions is exempt from US income tax. This income must not be connected to a US trade or business to qualify for this exemption.

IN OUR CASE STUDY, the interest Pablo earns from his US bank account in 2018 qualifies for this exemption.

Real Estate Rental Income - This type of income is usually classified as passive income. As a result, the gross rental income is subject to the 30% withholding tax (unless reduced by a treaty). Because this could present an undue tax burden on many nonresidents and discourage foreign investment in US real property, there is an election available to treat the rental activity as trade or business income. This allows the nonresident landlord to be taxed on a net basis using graduated tax rates. Because the landlord is taxed on a net basis (gross rental income less associated deductible costs) this will often result in a lower US tax liability. If you own US real property and lease this property, you should seek the advice of a US tax advisor regarding this election and whether it is beneficial in your specific situation.

Disposition of US Real Property - Unlike other types of capital gains or losses, any gain or loss from the sale of a real property interest located in the US is automatically deemed to be trade or business income. The gain or loss is therefore taxed on a net basis at graduated tax rates. Even though the gain or loss is taxed on a net basis, in many cases a withholding tax of 10% is levied on the gross receipts of the transaction. A more detailed discussion on the disposition of US real property can be found later in this booklet.

Case Study Summary

Trade or Business Taxable Income	$30,000
Tax (Using single rates at Appendix A)	$ 3,410
Taxable Passive Income	$ 400
Tax Rate under Treaty	15%
Tax	$ 60
Total Tax	$ 3,470
Less:	
Withholding on Wages	(0)
Withholding on Dividends	(60)
Pablo's US Tax Due	$ 3,410

Note again that this does not take into account more favorable treatment that might result from the application of a tax treaty. Go to Chapter 8 for a discussion of tax treaties as well as a case study update which applies the US / Spain treaty to Pablo's 2018 US tax situation.

Filing Requirements and Procedures

The filing requirements for nonresidents depend on whether wages were received that are subject to US income tax withholding. If you received wages which were subject to US income tax withholding, then you should file your US tax return (Form 1040NR) by April 15 of the year following the reporting year. If you did not receive wages subject to withholding, you have until June 15 to file Form 1040NR. If you cannot file your return by these due dates, you may file Form 4868 to get an automatic extension until October 15th. Form 4868 must be filed by the original due date for your return to obtain a valid extension. Note that this extension does not apply to the payment of any tax due. If you owe tax, you must pay it by the original due date of your tax return to avoid penalty and interest charges. Check with your US tax advisor if you need additional time to file your tax return.

Back to Table of Contents

6. Dual-Status Taxpayers

The US tax rules would be much simpler if everyone fit neatly into a certain category such as a resident or a nonresident. Unfortunately, it is possible, and quite common, for someone to be a US resident and a nonresident in the same tax year. This can occur in the year that a foreign national moves to the US, and in the year that he or she departs the US to resume residence in another country. Individuals in this category are referred to as "dual-status taxpayers". This chapter covers the rules that apply to dual-status taxpayers and some opportunities for these individuals to minimize their US tax liability.

Overview

If you are a dual-status taxpayer, you are treated as a nonresident for one portion of the tax year and as a resident for the other portion of the year. The tax rules for residents discussed in Chapter 3 apply to that part of the year that you are considered resident. For the nonresident part of the year, the rules covered in Chapter 5 apply.

Income

Your income for the entire year needs to be allocated between the residency and nonresidency periods. You will be taxed on the worldwide income you received in the period of residence. Only your US source income will be taxed in the period of nonresidence. In addition, the US source income in the period of nonresidence must be split between that which is "trade or business income" and that which is "passive income" (see Chapter 5 for more details).

Maria is a dual-status taxpayer in the final year of her job with the US company. Maria is a US resident at the start of 2019. Her residency ends on June 15, 2019. She is taxed on her worldwide income from January 1, 2019 through June 15, 2019. Her worldwide income consists of the following:

(*continues*)

(*continued from page 33*)

Salary from US employer	$35,000	
Dividends from US corporation	$ 400	($400 paid on March 15)
Interest from US bank accounts	$ 367	($800 X 5.5 months / 12 months)
Interest from Spanish bank accounts	$ 367	($800 X 5.5 months / 12 months)
Worldwide income during US residency in 2019	$36,134	

The income Maria earned during her period of nonresidence needs to be examined to determine which portion of this income is US source. Clearly, the dividends she receives from the US corporation during her nonresident period (June 16 - December 31, 2019) are US source income. She earns no US source interest during this period (US bank account interest is exempt from tax - see page 31). She does earn US source compensation during this period. This is the $3,500 she earns for services performed while on a business trip to the US in October. Note that this compensation does not qualify for the exception outlined in Chapter 5 (see page 24) as it exceeds $3,000. Therefore, her US source income during the nonresident period consists of income which is trade or business income (the $3,500 of compensation) and passive income (the $1,200 of dividends from the US corporation).

The trade or business income earned in the period of nonresidence is pooled with the worldwide income earned during the period of residence. This income pool is taxed at graduated rates. The passive income earned during the nonresidence period is taxed at the withholding tax rate of 30% (or lower rate if a treaty applies).

Maria's total 2019 income which is taxed at the graduated rates is $39,634. This includes her worldwide income she earns during her residence period of $36,134 and the trade or business income of $3,500 she earns during the period of nonresidence.

Note again that this does not take into account more favorable treatment that might result from the application of a tax treaty. Go to Chapter 8 for a discussion of tax treaties as well as a case study update which applies the US / Spain treaty to Maria's 2019 US tax situation.

The passive income that Maria earns during the nonresidency period is potentially subject to the 30% flat tax. Again, the Spain/US tax treaty provides for a reduced withholding rate of 15%. This tax is withheld by the US corporation which pays the dividends.

Deductions
A dual-status taxpayer faces certain limitations related to deductions and personal exemptions. Dual-status taxpayers are not allowed the standard deduction, but instead are limited to actual itemized deductions that are paid in the period of residency, and deductions attributable to trade or business income earned during the period of nonresidency.

Unless a special election is made (discussed below), dual-status taxpayers are not allowed to file joint returns. If you are married, you must use the "married filing separately" tax rates.

Maria has the following itemized deductions in 2019:

State taxes	$1,200
Charitable contributions	2,500
Total	$3,700

The standard deduction ($12,000) is greater than the $3,700 of itemized deductions, but Maria is not allowed to use the standard deduction in 2019 as she is a dual-status taxpayer. Due to the new tax laws in effect for tax year 2018, Maria is not allowed to claim an exemption.

2019 Case Study Summary

(using 2018 tax laws and tax rate tables)

Worldwide income earned during residence	$36,134	
Trade or business income - nonresidence	3,500	
Total Income	39,634	
Itemized deductions	(3,700)	(see above)
Taxable income subject to graduated rates	$35,934	
Tentative tax	$ 4,122	

(see single taxpayer rate schedule at Appendix A)

Passive income	$ 1,200
Treaty withholding tax rate	15%
Tax on Passive income	$ 180

Credits

Dual-status taxpayers are allowed to take certain credits against the US tax attributable to income earned during the period of residence. These credits are discussed in greater detail in Chapter 3. The most important credit to dual-status taxpayers is the foreign tax credit.

Maria has some foreign income tax withheld on the Spanish interest she receives during her period of residence in 2019. These taxes total $100. Maria has Spanish source income during this period of $367 related to interest earnings.

Referring to the detailed discussion in Chapter 3, the first step in this calculation is computing foreign-source taxable income.

To arrive at foreign-source taxable income we need to allocate a portion of the deductions to her gross foreign source income. The deductions allocable to this income and other Spanish income equal $11 ($367 / $39,634 X $1,200). Maria's foreign-source taxable income is therefore $356 ($367-$11).

To arrive at Maria's 2019 foreign tax credit limitation amount, it is necessary to apply the formula outlined in Chapter 3. This is done below.

$356 / $35,934 X $4,122 = $41

The actual foreign taxes that Maria paid are greater than her 2019 limitation of $41. As such, she can claim a foreign tax credit equal to the limitation of $41.

Case Study Summary

Tax on Income subject to graduated tax rates	$ 4,122
Less: Foreign Tax Credit	(41)
Net Tax Liability on Trade or Business Income	$ 4,081
Tax On Passive Income	180
Total Net Tax liability	$ 4,261
Income Tax withheld on Salary	(6,000)
Withholding Tax on Interest	(180)
Federal Tax Refund Due Maria	$ 1,919

Again, note that Maria may be able to claim tax treaty benefits to reduce her US tax burden. See Chapter 8.

Joint Return Election

The general rule reads that a joint return is not allowed when either spouse is a nonresident at any time during the year. However, an election can be made to file a joint return if you are a nonresident during the year if the following conditions are satisfied:

- You have achieved residency status at the end of the year; and
- Your spouse is either a US citizen or a US resident at the end of the year.

This election can have profound effects on your US tax liability. If the election is made, your worldwide income for the entire year (and that of your spouse) is subject to US tax. The rules discussed in Chapter 3 would dictate your tax treatment. It is also worth noting that the various limitations accompanying a dual-status taxpayer disappear. For instance, the election not only allows you to file a joint tax return and be taxed at the married filing joint rates, it also allows you to claim the standard deduction or other deductions related to your nonresident period.

So when is it appropriate for you to make the election? The only way to know for sure is to calculate your tax under an election scenario and under a scenario with no election and compare the results. This election can affect your tax situation for future years so this must also factor into your decision. This is another area where the advice of an experienced tax advisor can be especially helpful.

Filing Requirements

The filing requirements for dual-status taxpayers depend on whether a joint return election (discussed above) is made and whether it is the initial year or final year of the residence period.

Initial Year of Residency

If you forego the joint return election or it does not apply to you, then you have to file Form 1040 to report your income and deductions for the period of residency. You will also need to attach a Form 1040NR statement to the Form 1040. The Form 1040NR is used to report any US source income and related deductions for the period of nonresidence.

If it is the initial year of your US residence and you decide to make the joint return election, you need only file Form 1040. However, you and your spouse's worldwide income for the entire year must be reported rather than just that earned during the period of actual US residence. The joint return election is made by attaching a statement to your return (Form 1040) which declares you and your spouse's intent.

Final Year of Residency

These filing requirements are very similar to those for the initial year of residency. Your income and deductions for the period of residence are reported on Form 1040. The US source income and deductions earned during the period of nonresidence are reported on Form 1040NR. However, under this scenario, Form 1040NR is the lead form which you need to file, with the Form 1040 statement included as an attachment instead of the other way around.

When and Where to File
Regardless of whether it is the initial or final year of your assignment, you must file your tax return by April 15 of the year following the tax reporting year. If you are a dual-status taxpayer your return should be filed at the following location:

> **Internal Revenue Service**
> **Austin, TX 73301-0215**
> **USA**

If you make the joint return election, check with your US tax advisor or with the Internal Revenue service to determine where your return should be filed.

If you are unable to file a complete and accurate tax return by April 15, you can receive an automatic extension of six months (until October 15) to file your return by filing Form 4868. Form 4868 must be filed by April 15 to receive the extension. Please note that this extension only applies to filing the return. It does not extend the due date for paying any tax liability. Therefore, it is necessary to estimate your liability and balance of tax owing (if any) by April 15, even if you can't file a complete return. If you estimate that tax is due, you should pay in the estimated shortfall along with Form 4868 by April 15. This will avoid most of the unnecessary interest or penalties. If it is the initial year of your assignment or transfer to the US, and you will make the first year election described in Chapter 1, it will be necessary to file for the extension as you will not meet the substantial presence test for the subsequent year until after April 15 (see page 9 for an explanation of the first year election).

Back to Table of Contents

7. Other Taxes and Filing Requirements

General Application of Social Security Tax

Expatriates who are employed by a US employer during the foreign assignment generally remain subject to US social security taxes. Social security taxes will continue to be withheld from compensation, including the expatriate allowances and reimbursements that are included in taxable wages. Expatriates who are employed by a foreign corporation are not subject to US social security taxes (except in rare situations), but are usually subject to social security taxes of the country in which they are working.

If an expatriate is employed by a US employer and is subject to US social security, it is also possible for the expatriate to be subject to foreign social security taxes. The application of foreign social security taxes must be determined on a country-by-country basis. In order to avoid double social

security tax obligations, the US has entered into Social Security Totalization Agreements ("Totalization Agreements") with a number of foreign countries.

Totalization Agreements

Totalization agreements have two principal purposes:

- **Relief from double taxation -** The agreements provide that a taxpayer is subject to social security tax in one of the two countries that are party to the agreement. Generally, if you are employed by a US employer temporarily and sent on assignment (generally 5-year limit), you will only be subject to US social security tax while on your foreign assignment. In order to claim benefits under a totalization agreement, you must request coverage from the Social Security Administration. Your employer and tax advisors can help with these matters.

- **Coordination of benefits -** The totalization agreements provide continuity of benefits for persons who have worked in multiple countries. It may be possible to qualify for partial benefits through use of combined coverage credits even if you would otherwise not meet eligibility requirements under domestic rules.

At present, the US has totalization agreements with Australia, Austria, Belgium, Canada, Chile, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Japan, Luxembourg, the Netherlands, Norway, Poland, Portugal, Slovak Republic, South Korea, Spain, Sweden, Switzerland, and the United Kingdom.

Other Benefits

Expatriates must also consider the effect of their foreign assignment on benefits other than social security. Similar to social security taxes, the determination of the other benefits that apply to you depends primarily on the company for which you work.

Generally, expatriates on assignment will remain employees of the US Company and will stay on the US payroll so that they can continue to participate in the US benefit plans including 401(k) plans, pension plans, stock option plans, health and dental plans, life insurance, etc. Employers may also supplement health and dental plans to ensure that the expatriate has access to health and dental care in the foreign country.

Note that benefit plans that have tax deferred status in the US, such as the 401(k) plan, may be subject to foreign tax on a current basis.

If you are on the payroll of a foreign corporation, you may be eligible to participate in the benefit plans of the foreign corporation. These benefit plans

may be substantially different than common US benefit plans and could be part of the social security scheme. Many countries will have retirement savings plans similar to the 401(k) plan. These retirement savings plans receive tax advantaged status for tax purposes in the foreign country, but may be taxable in the US on a current basis.

You should consult with your employer to understand the benefits that apply to you while you are on foreign assignment and how such benefits are taxed while on assignment.

IN OUR CASE STUDY, Pablo would be subject to Spanish social security taxes during his US assignment (due to his Spanish employer) and Maria would be subject to US social security taxes (due to her US employer).

State Income Taxes

In addition to federal income and social security taxes, foreign nationals who are working and/or living in the US also have to contend with state and possibly local (city or county) taxes. The rules governing income taxation vary from state to state. There are some states, such as Florida, which do not have an individual income tax, but these states are the exception.

The determination of your residency position is important in understanding your state filing requirements and tax liabilities, with state rules potentially differing from the US federal law. Also, even if you are not a resident in a certain state, the fact that you perform services in that state is often enough to subject you to some level of state taxation.

Gift and Estate Taxes

Foreign nationals working or living in the US also need to be aware of non-income related taxes. Estate and gift taxes deserve careful attention. When is a foreign national exposed to US gift and estate taxes? Unlike the income tax rules covered earlier, estate and gift taxes are not based on the concept of residence. Foreign nationals who are domiciled in the US are subject to gift and estate tax rules. Domicile in the US occurs when a foreign national maintains a permanent home in the US. A permanent home can exist, for example, when the individual lives in the US and has no intention of leaving.

Gift tax can be levied any time that an individual, who has a US domicile, transfers property for less than adequate consideration. Gift tax can apply regardless of the type of property or where the property is located. Both tangible and intangible properties qualify. Property which is located in a foreign country qualifies as well as property which is in the US.

In 2018, an individual is allowed to make $15,000 of annual gifts to a specific donee without incurring gift tax. The number of donees can be unlimited as long as each does not receive more than $15,000 in a given year. If the individual has a spouse who is a US citizen, the individual and the spouse can elect to pool their gifts and split the gifts evenly between themselves. Using this election a couple can gift up to $30,000 annually to a specific donee without incurring a gift tax. In addition to the $15,000 threshold, certain types of gifts are exempt from the tax. These exemptions include an unlimited amount of gifts made to a spouse who is a US citizen and gifts to qualified charitable organizations. Gifts to non-citizen spouse have a limited exemption ($152,000 for 2018).

Any non-exempt gifts (those that exceed the annual thresholds listed above) are then subject to gift tax. The gift tax is calculated by accumulating all taxable gifts made by an individual during his or her lifetime. A tentative tax is determined by applying this lifetime total to the estate tax rates (which are separate from the individual income tax rates). A credit is allowed for any gift tax paid by the individual in prior years. In addition, a unified credit is available to reduce any remaining tax liability. For 2018, the lifetime gift and estate tax exemption for US citizens and domiciliaries is $11,180,000. If you apply gifts against this exemption during your lifetime, the available exemption available at death will decrease accordingly.

If you are a foreign national and have a domicile in the US, you should always consult a tax advisor before making a gift which exceeds $15,000.

Estate tax is based on the same rate schedule used to calculate gift tax. Estate taxes are levied on an individual's gross estate at the time of death. The property which is included in a gross estate depends on whether the individual is a US resident for estate tax purposes at the date of death (a nonresident being defined as a non-US citizen, domiciled outside the US). For residents, a gross estate takes into account all property of the individual regardless of where the property is located. For nonresidents, only property located in the US is considered. A gross estate includes property owned by the individual and certain gifts of property made by the individual within the three year period preceding death. After all property which is to be included in an individual's estate is accumulated, certain deductions are allowed to arrive at the gross estate. These include deductions for obligations attached to the included property, certain charitable contributions, funeral expenses, and costs related to the administration of the estate. A marital deduction is allowed for the value of any property which passes to a surviving spouse who is also a US citizen. The marital deduction does not apply if the spouse is not a US citizen.

Once the gross estate is determined, the tentative estate tax is calculated using the rates found at Appendix E. The tentative tax is reduced by the amount of any unified credit which has not been used by the individual previously to

reduce his or her gift tax in the case of a resident individual. For nonresidents, a credit of $15,000 is available to reduce the tentative estate tax. Due to the current uncertainty regarding the future of estate taxes, you should consult a qualified tax advisor to obtain up-to-date estate tax advice.

The US has executed a number of estate and gift tax treaties with other countries that may expand the exemption benefits available to foreign nationals in the estate and gift tax area. A list of the countries with which the US has executed both estate tax and gift tax treaties is included at Appendix B. State gift and/or estate taxation may also need consideration.

Expatriation Tax

Resident taxpayers who meet the lawful permanent resident test (green card test) should also be aware of the expatriation tax provisions. This tax applies to long-term holders of green cards who voluntarily surrender the green card. A long-term holder is an individual who has held a green card in at least 8 of the last 15 years, ending with the year your residency ends. The 15-year period ends on the date that the green card is surrendered. Individuals will be subject to the expatriation rules if any of the following three conditions exist:

- The individual had an average annual US income tax liability which exceeded specified amount that is adjusted for inflation ($165,000 for 2018) for the five year period preceding the expatriation or termination, if you expatriated or terminated residency.
- The individual has a net worth at the expatriation or termination date of $2,000,000 or more.
- The individual fails to certify on Form 8854 that they have complied with all US federal tax obligations for the 5 preceding years.

The expatriation tax rules impose a tax on the net unrealized gain (or loss) of the individual's property as if the property had been sold at fair market value on the day before expatriation.

This mark to market approach does provide an exemption of $711,000 for 2018. The mark to market approach does not incorporate deferred compensation vehicles, but this income is captured in other ways.

<u>If you are a long-term green card holder you should speak with a tax advisor prior to surrendering your green card.</u>

Filing Requirement on Departure

As a general rule, foreign nationals who work in the US must secure a tax compliance certificate before leaving the US. This rule applies to both resident and nonresident taxpayers. To receive this certificate, commonly called a

"sailing" or "exit" permit, the individual must file a Form 1040C (Departing Taxpayer Income Tax Return) or Form 2063 (Departing Taxpayer Income Tax Statement).

In many cases, an employer will provide a letter that could be presented to the appropriate authorities to assist the foreign national in departing the US without an exit permit. This letter would state that the employer guarantees the foreign national will comply with their US tax filing requirements.

Foreign Bank Account Reporting Requirement

Any US person having an interest in a foreign bank account or other foreign financial account during the year may be required to report that interest on FinCEN Form 114.

This form is used to report any foreign financial accounts (this includes bank accounts, brokerage accounts, mutual funds, unit trusts, and other types of financial accounts) with which you have a financial interest or have signature authority. If the aggregate balance of these accounts does not exceed $10,000 at any time during the year no report needs to be filed. If the aggregate balance does exceed $10,000 at any time during the year, this form must be completed and filed by April 15th of the following year and can be extended until October 15th. This is merely a reporting requirement and will not result in any type of tax liability. However, the penalties that can be imposed for failing to file this particular form can be very severe (including potential jail time), so compliance with this requirement is imperative.

Specified Foreign Financial Assets

Form 8938, *Statement of Foreign Financial Assets*, is a reporting requirement effective for 2011 and future tax years and is required as part of the implementation of the Hiring Incentives to Restore Employment Act (HIRE Act). These provisions are part of a broad initiative by the federal government to increase tax compliance, particularly by those with foreign accounts or foreign assets.

This reporting requirement is in addition to the Report of Foreign Bank and Financial Accounts, FinCEN Form 114.

Common examples of reportable foreign financial assets include the following:

- Any financial account from a foreign financial institution
- Stock or securities that are issued by a person that is not a US person
- Any interest in a foreign entity
- Any financial instrument or contract that has an issuer or counterpart that is not a US person

You will need to file Form 8938 if you have an interest in specified foreign financial assets with an aggregate value that is dependent on whether or not you are living in the US or living abroad and your marital and filing status.

If you are living in the US, the thresholds are as follows:

- Unmarried individuals must file Form 8938 if the total value of specified foreign assets is more than $50,000 on the last day of the tax year or more than $75,000 at any time in the year.
- Married individuals must file Form 8938 if the total value of specified foreign assets is more than $100,000 if filing jointly ($50,000 if filing separately) on the last day of the tax year or more than $150,000 if filing jointly ($75,000 if filing separately) at any time in the year.

If you are living abroad, the thresholds are as follows:

- Unmarried individuals must file form 8938 if the total value of specified foreign assets is more than $200,000 on the last day of the tax year or more than $300,000 at any time in the year.
- Married individuals must file Form 8938 if the total value of specified foreign assets is more than $400,000 if filing jointly ($200,000 if filing separately) on the last day of the tax year or more than $600,000 if filing jointly ($300,000 if filing separately) at any time in the year.

The IRS defines an individual as living abroad as a US citizen that either has a tax home in a foreign country and qualifies for the bona fide residence test or who is physically present in a foreign country or countries for at least 330 days in a 12 month period ending in the tax year.

If you meet the requirements to file Form 8938 you must do so annually together with your US federal individual income tax return.

Form 5471

"Information Return of US Persons With Respect to Certain Foreign Corporations"

If you are a US tax resident and you are a 10% or more shareholder, officer, or director in a foreign (non-US) corporation, you may have to file Form 5471 with your individual income tax return. This is an informational form that discloses certain information about the foreign corporation, your relationship to the foreign corporation, and any transactions that occurred between you and the foreign corporation. If you think this requirement might apply to you, check with your tax advisor to determine if disclosure is necessary and what information needs to be disclosed given your specific situation. If required,

Form 5471 should be attached to the individual income tax return that you file (Form 1040 or 1040NR).

Passive Foreign Investment Corporations (PFICs)

A Passive Foreign Investment Corporation (PFIC) is a non-US company that derives income from investments (passive income). A PFIC is defined as a company where 75% or more of the company's income is passive, or where at least 50% of the company's assets produce or are held for the production of passive income (i.e., interest, dividends, and/or capital gains).

A US citizen, green card holder or resident who holds shares in a PFIC is subject to arduous reporting and taxation rules on their share of the income within the PFIC. These rules can be mitigated by making an appropriate election (QEF election). This election enables the individual to report their share of the company's income on a year to year basis. Unfortunately, many foreign companies are unwilling or unable to provide the necessary information to allow the election to be made.

The most commonly seen PFICs are non-US based mutual funds. There will often be a notice on such funds that they are not open to US residents for these very reasons. This does not, however, provide protection for the non-US individual who becomes a US resident after investing in such a fund.

It is beyond the limit of this document to provide a full description of the tax implications of PFICs. If you believe you are invested in a PFIC, you should contact your tax advisor to discuss your options.

Back to Table of Contents

8. Income Tax Treaties

Up to this point, this book has covered the US domestic tax law and how it applies to foreign nationals. However, the US has executed numerous tax treaties with various countries. The goal of these agreements is to eliminate the double taxation of income which can occur due to differences between the domestic tax laws of two countries. It is not uncommon for a foreign national to find that income he has earned while in the US is subject to tax in both the US and his or her home country. While many countries have integrated mechanisms within their domestic law to alleviate this double burden, for instance, the foreign tax credit, these mechanisms do not always completely remedy the problem. This chapter presents an overview of income tax treaties and how a treaty can be used to a foreign national's benefit.

Tax Residence

One of the most important elements of an income tax treaty are guidelines which are used to determine residency. These guidelines are often referred to

as “tie-breaker rules” and can be implemented when an individual is considered a tax resident in two or more countries. If a treaty is in place between the US and another country, which have both determined that an individual is tax resident, the individual may be able to implement the tie-breaker rules to his or her advantage.

If an individual can argue that he or she is a resident of a foreign country and not the US, then he or she would be taxed as a nonresident in the US. The US would then only tax US. source income rather than worldwide income. Remember, however, that it is not always better to be treated as a nonresident.

Compensation

Income tax treaties often provide benefits for individuals who have trade or business income such as compensation for personal services. These terms usually do not include reduced tax rates but instead enlarge the potential pool of trade or business income which does not attract any income tax at all. If you will remember from the chapter on sourcing (Chapter 4), US domestic law excludes certain personal services income from the definition of US source income. This exclusion covers income that is less than $3,000, that is paid by a non-US entity, and that is earned by an individual who is present in the US for fewer than 90 days. Many treaties effectively expand this exclusion by providing for larger amounts of allowable earnings and longer periods of US presence.

IN OUR CASE STUDY, Pablo can use the US/Spain income tax treaty to his advantage in 2018. The US / Spain income tax treaty places no limit on the amount of compensation and provides for a period of presence up to 183 days in any 12-month period. Since Pablo is in the US for less than 183 days in any 12-month period, and because he is paid by XYZ, SA, a non-US entity, he can exclude the compensation he earns during the short-term project in the US under this treaty provision. This will almost eliminate his 2018 US tax liability. The only item that would continue to attract US tax is the US source dividends that he receives.

Maria may be able to apply the US/Spain tax treaty to her advantage in 2019. This is the year that she is a dual-status taxpayer. She earns some trade or business income in 2018 during the period of nonresidence. This is the $3,500 of compensation related to services performed in the US while on a business trip in late 2019. This income is taxed in the US under US tax law because it does not qualify for the US source exclusion. Maria left the US on May 1, 2019 and returned on October 5, 2019 for 6 days on business. Although the US/Spain tax treaty is based on 183 days in any 12 month period, the US would disregard days while US tax resident for purposes of counting days for this treaty provision. Depending on factors, such as her US presence in 2019 and the Company’s intra-company handling of her expenses, an exemption from US taxation for the income relating to this business trip may be possible. Maria should consult her tax advisor..

Passive Income

Another important aspect of treaties is that they often provide for a reduced withholding tax rate on certain types of income. These reduced withholding tax rates apply to income which is sourced in one of the treaty countries and is earned by a resident of the other treaty country. These rates typically apply to income which is of the type that is considered "passive income" for US tax purposes (see Chapter 5).

IN OUR CASE STUDY, both Pablo and Maria earn dividends from a US corporation during periods when they are considered Spanish tax residents. This income would normally be taxed, through withholding by the payor, at a flat rate of 30%. The US/Spain income tax treaty reduces this rate to 15%.

If you are a citizen or resident of a country which has executed a treaty with the US, you should seek the advice of a professional tax advisor to determine whether you can benefit from the provisions of the specific treaty which may apply to your situation. Although most treaties are very similar in structure, the specific terms, such as reduced withholding rates, vary from treaty to treaty.

Back to Table of Contents

9. Other Income Tax Considerations

Exchange Rate Issues

When a foreign national prepares a US tax return, the income and expenses reported on the tax return must be stated in US dollars regardless of the currency in which income was earned or expenses were paid. As such, it is important that you track taxable income and deductible expenses that are paid in anything other than the US dollar. We recommend tracking the amounts paid in foreign currency and the date paid so that your tax advisor can accurately prepare your US tax returns using applicable exchange rates.

Further, when a US resident taxpayer enters into lending arrangements, purchases, sales, or other agreements that are denominated in a currency other than the US dollar, taxable exchange gains or non-deductible exchange losses may result. These taxable gains and non-deductible losses can arise due to changes in the relative value of currencies. You should consult your tax advisor if you enter into a large transaction that is denominated in foreign currency, particularly the purchase or sale of a foreign home and payment of a mortgage.

Moving Expenses

Beginning January 1, 2018, the deduction and/or exclusion of moving expenses has been suspended until January 1, 2026. Any moving expenses paid to your or on your behalf must be included in taxable compensation. In addition, any moving expenses paid directly by you and not reimbursed by your employer are no longer deductible for U.S tax purposes.

Taxable Moving Expense Reimbursements

All moving expenses that a company reimburses directly to the employee or pays on behalf of the employee, will be included in the employee's gross income as taxable wages.
Some of the common taxable moving expense reimbursements include:

- Transportation of you household goods and personal effects
- Storage fees
- Travel expenses from your old residence to your new residence
- House hunting expenses
- Temporary living expenses
- Expenses for meals
- Expenses of selling or buying a home
- Reimbursement of loss on the sale of your home
- Spousal assistance programs
- Tax assistance or gross-up payments

Taxable moving expense reimbursements will be reported in Box 1 of your Form W-2.

Lump Sum Payments

Some companies will pay you a lump sum from which you must pay your own moving expenses. In this case, the entire lump sum payment is included in your taxable wages.

Foreign Earned Income and Housing Exclusions

Under certain circumstances, the US grants tax privileges to US citizens and residents who are living and working in foreign countries. Taxpayers who qualify for these privileges are allowed to exclude foreign source earned income (up to $103,900 for 2018). In addition, a qualifying taxpayer can claim an exclusion for eligible foreign housing costs (over a defined base amount) but the exclusion is generally limited to 30% of the maximum foreign earned income exclusion ($31,170 [30% x $103,900]). This limitation amount will be adjusted to the extent that a qualifying taxpayer resides in certain high-cost geographic areas. These exclusions generally do not apply to resident taxpayers living and working in the US (i.e., residents of the US under the Substantial Presence test).

Some foreign nationals are US resident taxpayers solely because they hold a "green card" (they meet the lawful permanent resident test). In certain cases, these individuals are able to claim these exclusions. If you are a US tax resident because you hold a "green card" and your principal residence and place of business is in another country, you should consult a US tax advisor to see if you qualify for these benefits. More information on these exclusions can be obtained in our booklet Taxation of US Expatriates. Please contact GTN if you want a copy of this booklet.

Capital Gains

Capital gains are gains from the sale of capital assets such as stocks, bonds, real estate, and other investment property. The US taxation of capital gains depends on the length of time that a taxpayer holds the property. If you hold the asset for more than one year before you dispose of it, your capital gain or loss is long-term. If you hold it one year or less, your capital gain or loss is short-term. All long term capital gains and losses are netted together and all short-term capital gains and losses are netted together. If there is a net long-term gain and this gain exceeds any net short-term loss, this excess is subject to the capital gains tax instead of being taxed at the normal graduated rates. For 2018 the maximum rate on long-term capital gains is 20% and applies to those in the top income tax bracket. Individuals in the 22% to 35% brackets will be subject to a 15% long-term capital gains rate. Those in the 10% and 12% brackets have a 0% capital gains rate. If net short-term capital gains exceed net long-term losses (if any), the excess is subject to income tax at the normal graduated rates.

If there is a net overall capital loss, the taxpayer is allowed to take a deduction of $3,000 per year. Any unused loss can be carried forward to be used in future years.

Nonresident taxpayers are not subject to US tax on gain resulting from the sale of a capital asset. An exception to this rule is when the property that is sold is an interest in US real property. This is discussed in more detail below.

It is also important to note that, unlike other countries, the US generally does not allow a step-up in the basis of assets as of the day you begin or cease tax residency. Therefore, you will be taxed on the entire gain associated with an asset rather than the portion of the gain related to appreciation during the residence period.

If you will be accepting a US assignment or will be coming to the US to live and you anticipate selling certain capital assets in the near future, you may want to consider selling the assets before you become a US tax resident.

Dispositions of US Real Property Interests

Foreign nationals who own an interest in real property located in the US should be aware of special US tax rules that can affect the sale or other disposition of real property. If you do own an interest in US real property, you will want to pay particular attention to this section. An interest in US real property includes any ownership in US real estate, ownership in a mine, well, or other natural deposit, and ownership in certain corporations that have a substantial investment in US real property. Ownership not only includes direct investments but indirect investments held through a partnership or trust.

These rules only apply to dispositions by nonresident taxpayers. As stated in the chapter on the taxation of nonresidents, any gain is treated as if it is trade or business income. It is taxed on a net basis at the appropriate graduated tax rates. However, similar to passive income, these transactions are often subject to a US withholding tax. This withholding tax is collected by the purchaser of the property and remitted on behalf of the nonresident seller. The tax is withheld at a rate of 10% of the gross sale proceeds. The nonresident seller should also file a US tax return (Form 1040NR) to report the gain. Any additional tax due on the transaction is paid with the return or, if the 10% withholding exceeds the actual liability, the taxpayer will receive a refund of this excess. It is necessary to file a return to claim any refund.

It is possible to reduce or eliminate the 10% withholding tax. However, you must make certain filings prior to the sale to obtain permission to not have the tax withheld.

If you are a nonresident taxpayer who owns a US real property interest, you should always consult a US tax advisor before disposing of the interest to gain a full understanding of how these rules will impact the transaction and your US tax situation.

Sale of Principal Residence

Foreign nationals should be aware of the US tax consequences of selling a foreign principal residence or a principal residence in the US. If a sale of a residence results in a loss, whether located in a foreign country or in the US, the loss is treated as a personal loss and no deduction is allowed for US tax purposes. Any gain resulting from a sale of a principal residence can be subject to US tax. Whether or not such gain is subject to US tax largely depends upon whether you are a resident or nonresident, the amount of the gain, and the length of time that you occupied the home as your principal residence. We first address the sale of a residence located in the US and then move on to the sale of a foreign residence.

US Residence

For sales after May 6, 1997, gain on the sale of a US residence constitutes taxable income in the US and is subject to US tax. However, the US grants an

exclusion from income for gain up to $500,000 on the sale of a principal residence if you meet the following conditions:

- You file a joint return with your spouse in the year of the sale.
- You have owned the home for two of the last five years prior to the date of the sale.
- You have occupied the home as your primary residence for two of the last five year prior to the date of the sale.
- During the entire period you have owned the property, it has not been used for business purposes (such as office-in-home) or as a rental property.
- You or your spouse has not claimed this exclusion on the sale of another home within two years prior to the date of the sale of the current home.

Please note that if any of the conditions above are not met, it may still be possible to claim a pro-rated portion of the $500,000 maximum exclusion amount. It may also be possible (depending on your exact circumstances) to fully exclude the entire gain, if the gain is less than $500,000.

As of 1/1/2009, additional limitations were added which restrict the ability to exclude gain relating to periods of "nonqualified use." Nonqualified use consists of any period after 2008 when the property is not used as the principal residence of the taxpayer or spouse. In general, the gain allocated to periods of nonqualified use is not excludable. However, there are a number of exceptions to the nonqualified use rule. If your home has been left vacant, rented or otherwise not used as your principal residence, you should consult with a US tax advisor in advance of selling the property to understand the rules that will apply for your specific disposition.

If you are a nonresident taxpayer at the time that you dispose of the US residence, you may be subject to US tax on the sale of the residence. This tax will be collected through the withholding provisions described in the section above on "Dispositions of US Real Property Interests." However, if the buyer of the home is an individual who will use the home as a residence and the sale price does not exceed $300,000, no withholding is necessary (but the gain will still be subject to tax). In any case, the sale by a nonresident should be reported on Form 1040NR. Any additional tax owed above and beyond the amount withheld is paid with the return. Likewise, any excessive withholding will be refunded after filing the return. If you purchase a US home while you are on a US assignment, you should consider the home and host tax position relating to the timing of any sale prior to departure from the US.

Foreign Residence

The US taxation of the sale of a foreign principal residence depends on whether or not you are a US resident on the date of the sale. If you are a US nonresident when you sell a foreign residence, there are no US tax consequences as a result of the transaction. Any gain is considered foreign source income and completely escapes US taxation. If you are considering the sale of a foreign principal residence or, for that matter, any foreign property, it is best (from a US tax perspective) to sell at a time when you are a nonresident.

If you are a US resident at the time the foreign home is sold then any gain could be taxed in the US. The gain exclusion (discussed above) is available for foreign residences as well as US residences, so if you meet the requirements above, you may be able to exclude up to $500,000 of the gain. Any taxable gain, as a result of not qualifying for the exclusion or exceeding the exclusion threshold, is reported on the resident portion of your tax return (Form 1040). Note that even though the gain would be taxed, it would represent foreign source income and any foreign tax paid on the gain will be available for foreign tax credit in the US. Note also that the gain related to depreciation during a rental period cannot be excluded and will be subject to tax at graduated tax rates, not to exceed 25%.

Finally, note that exchange gains and losses need to be considered on the sale of a foreign residence and the retirement of a mortgage denominated in a foreign currency. See page 48 for a discussion regarding exchange rate gains and losses.

Rental of a Residence

It is common for foreign nationals to rent their foreign residence while on assignment in the US It is also possible that a foreign national may own a residence in the US which is rented out while away from the US.

The rental of a foreign residence will only be taxed in the US during the time that a foreign national is a US tax resident. Referring back to the rules on sourcing, the rental of foreign real property is foreign source income. However, US residents are taxed on worldwide income so this activity is subject to US tax while the owner/lessor is a resident. Rental activity is taxed on a net basis in the US. You are allowed to deduct ordinary and necessary expenses incurred on the rental property. These expenses include mortgage interest, property taxes, repairs, and maintenance costs. A deduction for depreciation of the house and furniture and fixtures is also allowed. Rental activities are subject to the US passive loss rules. These rules usually only allow a taxpayer to recognize passive losses to the extent of any passive income. However, the rules do contain an exception for rental activities. If you actively participate in a real estate rental activity you are permitted to deduct related

excess passive loss up to an annual maximum of $25,000. This $25,000 maximum is completely phased out if your modified AGI exceeds $150,000.

The rental of a US residence will always be taxed in the US regardless of whether you are a resident or a nonresident because this is considered US source income. If you are a resident, you are taxed on a net basis as described above. The activity is also subject to the passive loss rules as described above.

If you are a nonresident, you are only taxed in the US on the rental of a US residence. The taxation of this activity depends on whether you make the election described on page 31. If you do make the election, you are taxed on a net basis at the graduated income tax rates. If you forego the election, you are taxed at the flat withholding rate that applies to passive income on the gross rental income.

If you have rental properties in the US or you are a resident and have foreign rental property, seek the advice of a US tax advisor to ensure that you comply with the law concerning this activity and take the right course of action to minimize any resulting tax liability or maximize the use of any resulting loss.

Investments in Foreign Corporations

If you are a resident in the US, and you own shares in a foreign corporation, it is possible that you may have to pay US tax on your share of the corporation's current year earnings even if these earnings are not distributed to you. These rules apply to foreign corporations that earn a high proportion of passive type income such as dividends, interest, and royalties or other types of transitory income. If you have invested in a foreign corporation you should consult with a professional to see if these rules will apply to you. If so, you may want to sell these shares or restructure your investment prior to becoming a US resident.

Please note that you might also have to file Form 5471 or other forms if you have an interest in a foreign corporation. Please see page 45 for a discussion of Form 5471 and to whom it applies.

Back to Table of Contents

Appendix A

2018 US Individual Income Tax Rates

SINGLE INDIVIDUALS

TAXABLE INCOME		
If Over	But Not Over	Tax Is
$ 0	$ 9,525	10%
9,526	38,700	12%
38,701	82,500	22%
82,501	157,500	24%
157,501	200,000	32%
200,001	500,000	35%
500,001	No limit	37%

MARRIED FILING JOINTLY

TAXABLE INCOME		
If Over	But Not Over	Tax Is
$ 0	$ 19,050	10%
19,051	77,400	12%
77,401	165,000	22%
165,001	315,000	24%
315,001	400,000	32%
400,001	600,000	35%
600,001	No limit	37%

MARRIED FILING SEPARATELY

TAXABLE INCOME		
If Over	But Not Over	Tax Is
$ 0	$ 9,525	10%
9,526	38,700	12%
38,701	82,500	22%
82,501	157,500	24%
157,501	200,000	32%
200,001	300,000	35%
300,001	No limit	37%

HEAD OF HOUSEHOLD

TAXABLE INCOME		
If Over	But Not Over	Tax Is
$ 0	$ 13,600	10%
13,601	51,800	12%
51,801	82,500	22%
82,501	157,500	24%
157,501	200,000	32%
200,001	500,000	35%
500,001	No limit	37%

Back to Table of Contents

Appendix B

List of US Tax Treaties

US Income Tax Treaties

Armenia
Australia
Austria
Azerbaijan
Bangladesh
Barbados
Belarus
Belgium
Bulgaria
Canada
Peoples Republic of China
Cyprus
Czech Republic
Denmark
Egypt
Estonia
Finland
France
Georgia
Germany
Greece
Hungary
Iceland
India
Indonesia
Ireland
Israel
Italy
Jamaica
Japan
Kazakhstan
Korea, Republic of
Kyrgyzstan
Latvia
Lithuania
Luxembourg
Malta
Mexico
Moldova
Morocco
Netherlands
New Zealand
Norway

US Income Tax Treaties (cont'd)

Pakistan
Philippines
Poland
Portugal
Romania
Russia
Slovak Republic
Slovenia
South Africa
Spain
Sri Lanka
Sweden
Switzerland
Tajikistan
Thailand
Trinidad & Tobago
Tunisia
Turkey
Turkmenistan
Ukraine
United Kingdom
Uzbekistan
Venezuela

US Estate and Gift Tax Treaties

Australia
Austria
Canada*
Denmark
Finland
France
Germany
Greece
Ireland
Italy
Japan
Netherlands
Norway
South Africa
Sweden
Switzerland
United Kingdom

**Included in Canada Income Tax Treaty*

Back to Table of Contents

Appendix C

Visas

The main thrust of this book is aimed at the US tax concerns of foreign nationals. However, it is also worthwhile to spend a few minutes on the various types of visas available to foreign nationals. The various types of visas not only govern the type of activity that is permitted and the length of stay but also carry varying tax implications. Following is a brief description of the most common work visas available and the general tax characteristics associated with each.

L Visa

L visas are the preferred visas for employees who are entering the US to work for extended periods of time. L visas are issued to intracompany transfers - those employees who are transferred from a foreign company to a related US entity. Depending on the type of L visa that is issued, individuals who secure an L visa can stay in the US for a period of 5 to 7 years.

To qualify for an L visa, both the individual and the employer must meet certain requirements:

- The individual must be an executive, or in a management position, or have specialized skills or knowledge.
- The individual must have worked for the foreign company for at least 1 out of the 3 years previous to the transfer.
- The foreign company and the US company to which the employee is transferred must have a certain level of common ownership.

B-1 Visa

Foreign nationals who are visiting the US on a temporary basis are often issued a B visa. For those who are on short term business assignments, a B-1 visa is available. The difference between a B-1 visa and an L visa relates to the length of stay and purpose of work. A B-1 visa is issued to employees who remain on a foreign payroll and who are in the US for reasons such as business meetings, conferences, seminars, and training courses, whereas an L visa is issued to individuals who will be performing services similar to actual local employment in the US.

Stays in the US under B-1 visas cover very specific periods of time which depend on the business purpose for the visit.

H1-B Visa
H1-B visas are issued to foreign nationals who will be employed in the US in certain types of professions. A successful applicant for an H1-B visa must have a certain level of education or experience that is relevant to the position that the visa holder will be assuming. An H1-B holder may remain on a foreign or US payroll during his or her employment in the US.

J-1 Visa
Foreign nationals who will be visiting the US as a student, teacher, or a trainee in certain types of training programs is usually issued a J visa. Individuals who hold J visas are allowed to work for limited periods of time in the US. These periods of work, which are referred to as academic training, are usually limited to a period of 18 months. In certain cases the period can be extended to 36 months. J visa holders from certain countries or in specific cases are required to return to their home country for a period of at least two years before they can apply for long-term work visas (L or H visas) or for permanent resident status.

In some cases, J visas can be an attractive option because a J visa holder is exempt from US social security tax on income received during the period of academic training. Subject to certain limitations, individuals may also be able to disregard presence in the US while holding the J visa for US federal tax residency determination and may also be able to obtain an exemption from US federal income tax for compensation paid by a foreign employer (exemption may also apply for state purposes for states that follow the US federal tax treatment).

Back to Table of Contents

Appendix D

Checklist for Foreign Nationals

Below is a list of items that a foreign national may want to consider before coming to the US for a work related assignment.

1. Gather copies of the last 2 years of foreign tax returns and US tax returns (if any) and bring these with you to the US. Your US tax advisor may need these to properly prepare your US income tax returns.

2. During the assignment, keep a daily log that records where you are physically present on each day and whether the day is a work day, non-work day, or a travel day. This information will be used to determine whether you are a US tax resident and also for certain tax calculations.

3. If you continue to earn income from foreign (non-US) sources during your assignment, keep careful track of the amounts earned, the currency in which they are paid, and the exact date received. This is especially important if you remain on a foreign payroll and continue to be paid in non-US currency.

4. If you will remain on a foreign company payroll, carefully keep track of the various components of your compensation (the type and amount of each). The foreign payroll reporting practices may not be set up to track all of the various items that are needed to correctly file your US income tax return.

5. If you rent out your foreign home during your assignment or you have other foreign rental properties, gather information related to the cost basis in the property (purchase price plus subsequent improvements). Your tax preparer will need this information along with records of income received and costs incurred to accurately prepare your US return.

6. During your move to the US keep detailed records of the expenses you incur such as transportation, storage, lodging, meals, and other incidentals. Also keep track of those expenses which are reimbursed by your employer.

7. If you are on a temporary assignment in the US, keep track of all assignment -related expenses that you incur. These could include transportation, lodging, laundry, utilities, meals, and other incidental expenses. Most reimbursed temporary assignment expenses will not be taxable in the US. Generally speaking, a temporary assignment is one that will last less than one year.

8. Before coming to the US, you may want to make a list of bank accounts, investments, and other income producing activities that you possess. It is often easy to forget about certain accounts or investments while on

assignment. Making a list and keeping it updated will help ensure that all relevant items are addressed when it becomes time to prepare your tax returns.

9. Speak with your foreign and US tax advisors prior to relocating to the US to gain a complete understanding of the foreign country tax implications of your US assignment, as well as gain an understanding of your US tax situation and to discuss any available tax planning techniques. It should be noted that some planning techniques can only be accomplished if done prior to your arrival in the US.

Back to Table of Contents

Appendix E

US Withholding Tax Compliance Checklist

US withholding tax is one concern that the majority of foreign nationals, whether resident or nonresident, will have to deal with when living in the US or when earning income from US sources. Following are some of the more common US tax compliance forms. This list will help ensure that you comply with the US withholding tax rules and minimize the impact of withholding tax.

- **Form W-7**
  If you are a nonresident taxpayer or a resident foreign national who is not subject to the US social security system, it is necessary to apply for an individual taxpayer identification number (ITIN). The ITIN is used only for tax purposes and does not have any effect on your social security status, employment status, or immigration status. Form W-7 "Application for IRS Individual Taxpayer Identification Number" is the form through which an ITIN is obtained. This form is also used to apply for ITINs for any dependents that will be listed on your tax return.

- **Form W-4**
  If you are a nonresident or a resident who is employed and is providing services in the US, your income from these services will be taxed as trade or business income according to the appropriate graduated tax rates. This statement assumes that income from these services is not covered under the exception outlined on page 24 and that this income is not covered under any treaty exemption. If you are employed by a US employer, your wages or salary will be subject to the US income tax withholding. Form W-4 "Employee's Withholding Allowance Certificate" will provide the necessary information to your US employer to ensure that a proper amount of tax is withheld. You should complete this form according to the provided instructions and submit it to your employer. Note that nonresidents should also consult the special instructions provided in IRS Publication 519, "US Tax Guide for Aliens," when completing this form.

- **Form W-9**
  If you are a foreign national who has become or will become a US tax resident, and you previously earned US source income which was subject to withholding tax (because of your prior nonresident status) you will need to inform the payors of these income items of the change in your status and of your correct social security or tax identification number. This can be done by completing Form W-9 "Request for Taxpayer Identification Number and Certification" and submitting this form to the payor(s) of these income items.

- **Form W-8ECI**
  If you are a nonresident taxpayer who has a US trade or business you can use Form W-8ECI to inform the payor(s) of income items which are connected to this trade or business of this fact. This will allow the payor to remit payment of this income without withholding any tax based on the premise that you will report this income on your annual return and will pay tax on any net income resulting from the trade or business. Form W-8ECI "Certificate of Foreign Person's Claim for Exemption from Withholding on Income Effectively Connected with the Conduct of a Trade or Business in the United States" should be completed and sent to each payor of an income item which is connected to your US trade or business.

- **Form 8233**
  If you are a nonresident who earns self-employment income or compensation for dependent personal services in the US, you can use Form 8233 "Exemption from Withholding on Compensation for Independent (and Certain Dependent) Personal Services of a Nonresident Alien Individual" to inform the payor of any treaty exemption from withholding that applies to your situation. See Chapter 8 for a discussion of treaties and when such benefits apply. If you can claim a treaty benefit for withholding on such earnings, this form should be completed and given to the payor of your earnings. The payor will review the form, sign it, and send it to the IRS for final approval. Note that Form 8233 can also be used to claim a treaty exemption that may apply if you are a student, trainee, teacher, or researcher working in the US.

- **Form W-8BEN**
  If you are a nonresident who earns income from US sources other than income from personal services, this form is used to inform the payor of such income that you are entitled to a reduced withholding rate under an income tax treaty (see Chapter 8 for a discussion of treaties). This income includes US sourced income from interest, dividends, rents, royalties, premiums, annuities, compensation for services performed, and other fixed or determinable annual or periodical gains, profits or income. Form W-8BEN "Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding," should be completed and filed with each payor of income items for which a reduced treaty rate applies.

Back to Table of Contents