Steve Leimberg's International Tax Planning
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Subject: Seth J. Entin - U.S. Income Tax Residence and the Coronavirus

"With the unfortunate emergence and rapid spread of the coronavirus pandemic, there are many individuals who are not U.S. citizens or green card holders who will be spending significantly longer than expected in the United States this year. A critical question is whether these individuals will be classified as U.S. residents for U.S. federal income tax purposes (referred to as 'U.S. income tax residents') by virtue of spending too many days in the United States. This newsletter provides a basic review of the rules governing when an individual becomes a U.S. income tax resident and some of the exceptions that may apply."

As a result of the coronavirus, individuals who are not U.S. citizens or green card holders may be spending significantly longer than expected in the United States this year. A critical question that **Seth Entin** examines in his commentary is whether these individuals will be classified as U.S. residents for U.S. federal income tax purposes by virtue of spending too much time in the United States.

Seth J. Entin, Esq., is a tax attorney in **Holland & Knight**'s Miami office who focuses his practice on international taxation. Mr. Entin was named Miami Lawyer of the Year in Tax Law for 2016 by *The Best Lawyers in America* guide. Mr. Entin has experience handling international taxation of high-net-worth individuals, international corporate taxation, Internal Revenue Service international tax audits and litigation, and offshore voluntary disclosures. In addition, Mr. Entin is a fellow of the American Tax Counsel, an adjunct professor of international taxation at the University of Miami School of Law, and regularly speaks at national and international tax conferences. He is also the director of International Tax Law for The Florida Bar Tax Section.

Here is his commentary:

EXECUTIVE SUMMARY:

An individual who is not a U.S. citizen or green card holder may become a "*U.S. income tax resident*" if he or she spends too many days during the year in the United States.

A U*.S. income tax resident* (like a U.S. citizen or a green card holder) is subject to:

- U.S. federal income tax on his or her worldwide income. (In some cases, this could include tax income earned by a non-U.S. entities that the individual owns, even if that income is not distributed by the entities.)
- Extensive information reporting requirements with respect to interests in non-U.S. entities, non-U.S. financial assets, distributions from non-U.S. trusts, gifts from non-U.S. persons, ownership of or signature authority over non-U.S. accounts, etc.

The discussion below provides a basic review of the rules governing when an individual becomes a *U.S. income tax resident* and some of the exceptions that may apply.

FACTS:

With the unfortunate emergence and rapid spread of the coronavirus pandemic, there are many individuals who are not U.S. citizens or green card holders who will be spending significantly longer than expected in the United States this year.

A critical question is whether these individuals will be classified as U.S. residents for U.S. federal income tax purposes (referred to as "*U.S. income tax residents*") by virtue of spending too many days in the United States.

COMMENT:

An individual who is not a U.S. citizen or a *U.S. income tax resident* is referred to as a "*nonresident alien*." A *nonresident alien* is only subject to U.S. federal income tax on certain "*U.S. source income"* and certain limited types of non-*U.S. source income* that are "*effectively connected*" with a *trade or business* of the *nonresident alien* in the United States.

On the other hand, a U.S. citizen or a *U.S. income tax resident* is subject to U.S. federal income taxation on his or her *worldwide* income. In many cases, this may include the income of non-U.S. companies that the individual owns, even if those companies do not distribute their income to their shareholders.

Furthermore, a U.S. citizen or U*.S. income tax resident* is subject to extensive IRS and Treasury Department reporting requirements, such as reporting with respect to his or her interests in non-U.S. companies, ownership of or distributions from non-U.S. trusts, gifts from *nonresident aliens*, ownership of non-U.S. financial assets, and ownership of or signature authority over non-U.S. financial accounts.

Definition of *U.S. Income Tax Resident*

In general, under the Internal Revenue Code (the "Code"), an individual is deemed to be a *U.S. income tax resident* if the individual either (i) holds a U.S. green card, or (ii) meets the "*substantial presence test*" (sometimes referred to as the "day-count" test).

An individual meets the *substantial presence test* (subject to certain exceptions) if he or she is present in the United States for 183 days or more during the current calendar year.

An individual also meets the *substantial presence test* (subject to certain exceptions) if he or she is present in the United States for (i) at least 31 days during the current year, and (ii) at least 183 days for the three-year period ending on the last day of the current year, using a "weighted average" formula. This weighted average formula equals the sum of:

- *All of* the number of days the individual is present in the United States during the current calendar year; plus

- *One-third (1/3)* of the number of days the individual was present in the United States during the preceding year; plus

- *One-sixth (1/6)* of the number of days the individual was present in the United States during the second preceding year.

Any day in which an individual is physically present in the United States, even for a brief amount of time, counts as a day of presence in the United States for purposes of this formula, unless the individual is in transit between two non-U.S. points and certain requirements are met, or unless certain other very limited exceptions apply.

It is important to note that, under the *substantial presence test*, an individual's residency starting date, as a general rule, is the individual's first day of physical presence in the United States during the year (subject to a limited exception).

<u>Closer Connection Exception</u>

There are several exceptions to the *substantial presence test*. One important exception to the *substantial presence test* that is of great importance to non-U.S. individuals who are compelled to spend more time in the United States due to the coronavirus is known as the "*closer connection exception*."

This exception applies where an individual is present in the United States for less than 183 days during the current year, but the weighted average formula (described above) equals or exceeds 183 days (due to the individual's presence in the United States in the two preceding years).

For this exception to apply, it must be established that, for the current year, the individual has a (i) "*tax home*" in a country other than the U.S., and (ii) "*closer connections*" to that other country than to the United States.

The Treasury Regulations (the "Regulations") provide that an individual's *tax home* is the individual's regular or principal (if there is more than one regular) place of business. If the individual has no regular or principal place of business because of the nature of the individual's business, or because the individual is not engaged in carrying on a trade or business, the individual's tax home is his or her "regular place of abode in a real and substantial sense."

The Regulations list ten non-exclusive factors that are considered in determining whether a *closer connection* exists. These factors include the: (i) location of the individual's permanent home; (ii) location of the individual's family; (iii) location of personal belongings, such as automobiles, furniture, clothing, and jewelry owned by the individual; (iv) location of social, political, cultural or religious organizations in which the individual has a current relationship; (v) location of the individual's personal bank accounts; (vi) location where the individual conducts business activities other than those that constitute the individual's principal business; (vii) type of driver's license held by the individual; (viii) country of residence designated by the individual on forms and documents; (ix) types of official forms and documents filed by the individual; and (x) where the individual votes.

As noted above, the *closer connection exception* will not apply if the individual is present in the United States for 183 days or more during the current year. This exception will also not apply if the individual is a lawful permanent resident of the United States (that is, a *green card* holder), or the individual has applied, or "taken other affirmative steps" to change his or her status to that of a lawful permanent resident during the current year, or has an application pending for adjustment of status during the current year.

An individual must file IRS Form 8840 (Closer Connection Exception Statement for Aliens) by the applicable deadline to claim this exception.

Treaty *Tie-Breaker* Claim

Even if an individual meets the *substantial presence test* (and is therefore a U.S. income tax resident under the Code), if the individual continues to also be a tax resident in a country that is party to an income tax treaty with the United States (referred to herein as a "treaty party country"), he or she may be able to avoid being taxed as a *U.S. income tax resident* under relief provided by the applicable treaty.

This relief provision, often referred to as a "*tie-breaker*" provision, allows an individual who is deemed a tax resident of both the United States and a treaty party country to only be subject to tax as a resident of one of the two countries, based on a set of rules that determine of which country the individual will be deemed a tax resident. In order to obtain *tie-breaker* relief to be taxed as a resident of the treaty party country rather than the United States, the individual would have to meet certain requirements set forth in the applicable treaty, which often involves having certain closer ties to the treaty party country than the United States.

If an individual were to claim *tie-breaker* relief, the individual would calculate his or her U.S. income tax liability as if he or she were a *nonresident alien*. This would potentially allow the individual to avoid worldwide U.S. federal income taxation.

However, unlike the *closer connection exception*, an individual who makes a treaty *tie-breaker* claim would have to file IRS Form 1040NR (U.S.

Nonresident Alien Income Tax Return), and the individual is subject to many of the reporting requirements that are applicable to *U.S. income tax residents* (for example, the individual must report certain ownership of non-U.S. entities, financial interests or signature authority over non-U.S. financial accounts, gifts from a *nonresident alien*, *etc*.). The individual would also be required to file IRS Form 8833 (Treaty-Based Return Position Disclosure), on which the individual would claim the *tie-breaker* position.

<u>Medical Exception</u>

The Code provides for a "*medical exception*" from the *substantial presence test*. Unfortunately, however, the scope of individuals covered by this *medical exception* is somewhat limited.

Under the Code, a day of presence in the United States is disregarded for purposes of the *substantial presence test* if the taxpayer is "unable to leave the United States on such day because of a medical condition which arose while such individual was present in the United States."

Under the Regulations, this exception applies only if "the individual intends to leave and is unable to leave the United States because of a medical condition…that arose while the individual was present in the United States." It does not apply if the "condition or problem existed prior to the individual's arrival in the United States [and] the individual was aware of the condition or problem, regardless of whether the individual required treatment for the condition or problem when the individual entered the United States."

Furthermore, even if an individual initially qualifies for the *medical exemption*, the *medical exception* ceases to apply if, on becoming well enough to travel, the individual "remains in the United States beyond a reasonable period for making arrangements to leave."

Conclusion

It is critical for a non-U.S. individual who is at risk of becoming a *U.S. income tax resident* to carefully review his or her status and, if possible, take steps to avoid becoming a *U.S. income tax resident.* If the individual will become a *U.S. income tax resident*, careful tax analysis and planning is required to assess the situation and attempt to mitigate adverse consequences.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Seth Entin

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CITE AS: