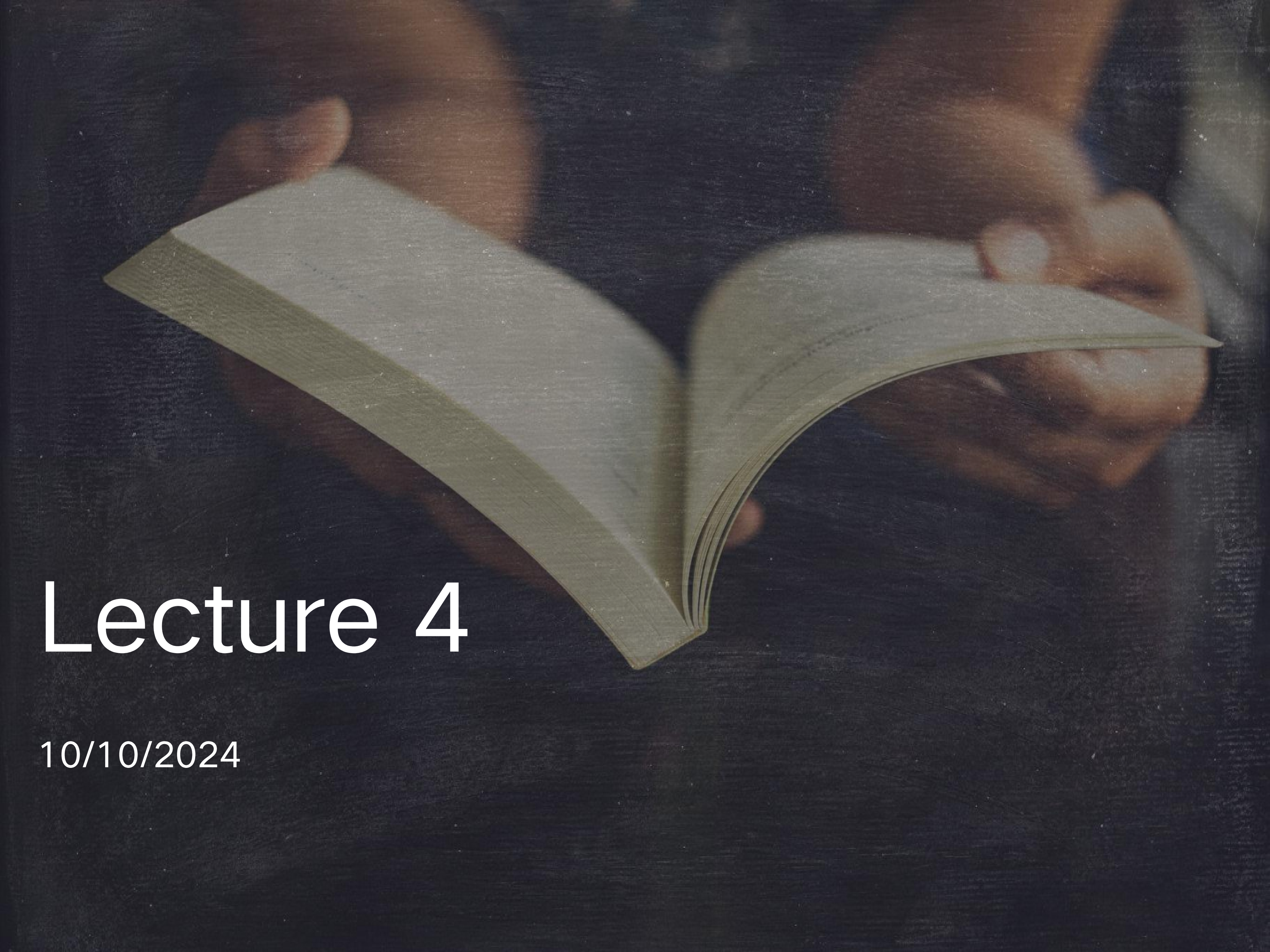


Lecture 4

10/10/2024

International Taxation

Chapter 2 Nationality and Residence for Taxation

Topics for Today

Nationality

- Taxing Jurisdiction
- Cook v. Tait (1924)

The Residence of U.S. Citizen

- Bona fide test
- Physical presence test

The Residence of Foreign Nationals

- Green card test
- Substantial presence test

Nationality

Taxing Jurisdiction

Jurisdiction to tax

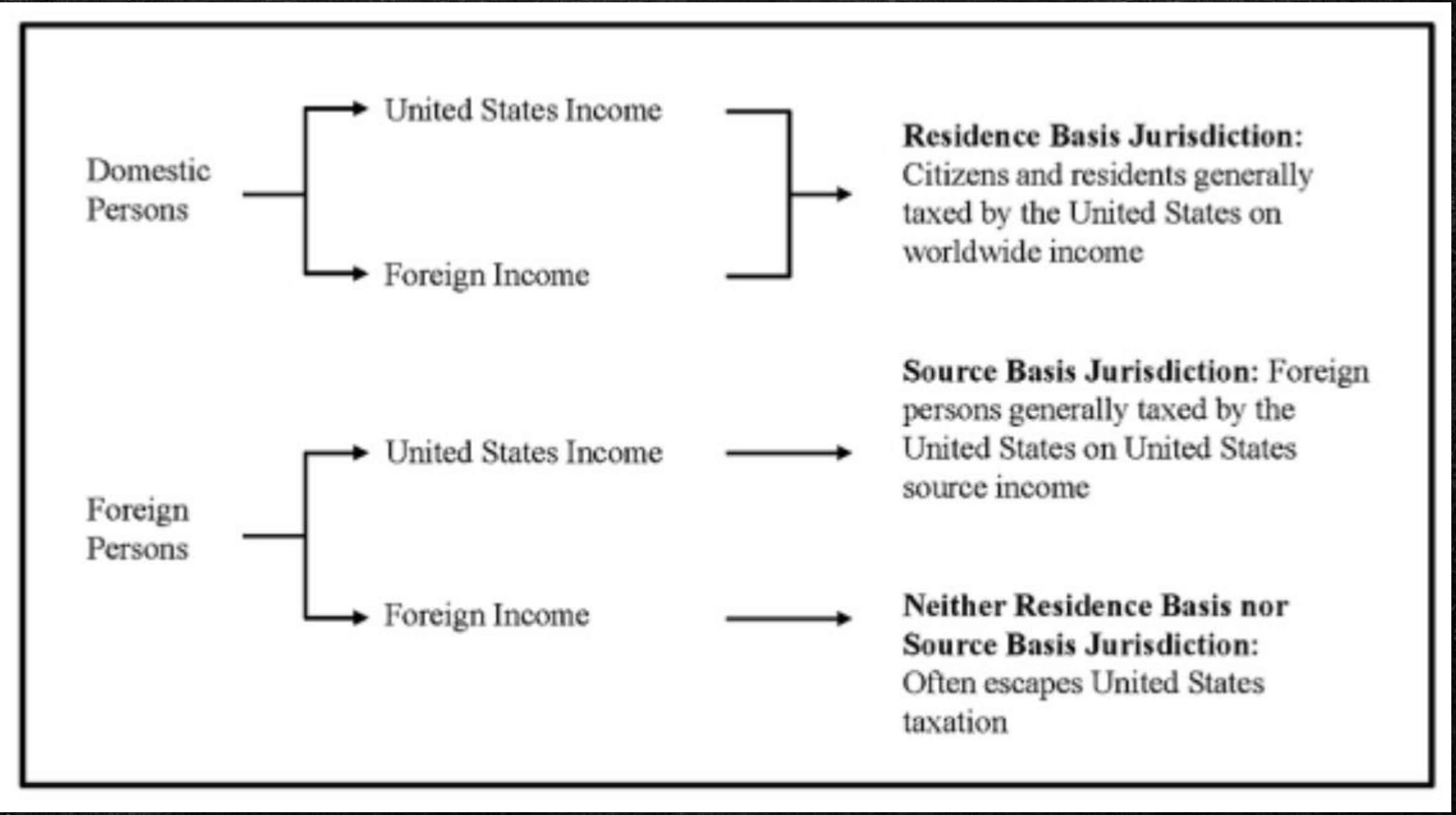
Source Jurisdiction	Residence Jurisdiction
• Income may be taxable under the tax laws of a country because a "**nexus**" exists between that country and the income.	• A country May also impose tax on income because a "**nexus**" exists between the country and the person earning that income.

What is a tax person?

Tax Person

- United States citizens, United States residents, and domestic corporations (“domestic persons”) are generally subject to tax on their worldwide incomes under § 61, while non-resident alien individuals and foreign corporations (“foreign persons”) are typically subject to United States taxation only on specified items or types of income under § 871 (applicable to foreign individuals) and § 881 and § 882 (applicable to foreign corporations).

U.S. Taxing Jurisdiction



Nationality

- According to Regulation § 1.1- 1(c), "every person born or naturalized in the United States and subject to its jurisdiction is a citizen."
- An individual who has filed a declaration of intent to become a citizen, but who has not been admitted to citizenship through naturalization, is deemed an alien and not a citizen.
- All United States citizens, even if they are also citizens of another jurisdiction, are subject to worldwide income taxation.

Nationality

Nationality (Citizenship)

tax consequences →

The United States taxes the incomes of its citizens from all sources worldwide.

Classic Law Cases

No 1. Cook v. Tait (1924)

Cook *v.* Tait (1924)

- The IRS made a demand against Mr. Cook to pay his tax. Mr. Cook paid it and sued for refund of the US$1,193 paid. the Revenue Act of 1921 imposed a top income tax rate of 8%.

- *"The question in the case . . . as expressed by plaintiff [Mr. Cook], whether Congress has power to impose a tax upon income received by a native citizen of the United States who, at the time the income was received, was permanently resident and domiciled in the city of Mexico, the income being from real and personal property located in Mexico."*

Supreme Court

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COOK v. TAIT, Collector of Internal Revenue.

265 U.S. 47 (44 S.Ct. 444, 68 L.Ed. 895)

COOK v. TAIT, Collector of Internal Revenue.

No. 220.

Argued: April 15, 1924.

Decided: May 5, 1924.

- **opinion**, McKENNA [HTML]

Messrs. Charles Claflin Allen and Charles Claflin Allen, Jr., both of St. Louis, Mo., for plaintiff in error.

Argument of Counsel from pages 47-49 intentionally omitted

Mr. Solicitor General Beck, of Washington, D. C., for defendant in error.

Argument of Counsels from pages 50-52 intentionally omitted

TOP

Mr. Justice McKENNA delivered the opinion of the Court.

Action by plaintiff in error, who will be referred to as plaintiff, to recover the sum of $298.34 as the first installment of an income tax paid, it is charged, under the threats and demands of Tait.

The tax was imposed under the Revenue Act of 1921, which provides by section 210 (42 Stat. 227, 233 Comp. St. Ann. Supp. 1923, § 6336 1/8 e):

'That, in lieu of the tax imposed by section 210 of the Revenue Act of 1918, there shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax of 8 per centum of the amount of the net income in excess of the credits provided in section 216: Provided, that in the case of a citizen or resident of the United States the rate upon the first $4,000 of such excess amount shall be 4 per centum.' [1]

Cook *v.* Tait（1924）

Can the United States impose worldwide taxation on U.S. citizens who permanently live overseas and who only have income from property or services outside the U.S.?

Cook *v.* Tait (1924)

- The rationale of the Court was explained in the opinion as follows, specific to the rights of citizenship:

  “. . . the scope and extent of the sovereign power of the United States as a nation and its relations to its citizens and their relation to it. And that power in its scope and extent, it was decided,

  is based on the presumption that government by its very nature benefits the citizen and his property wherever found, and that opposition to it holds on to citizenship while it ‘belittles and destroys its advantages and blessings by denying the possession by government of an essential power required to make citizenship completely beneficial. In other words, t**he principle was declared that the government, by its very nature, benefits the citizen and his property wherever found, and therefore has the power to make the benefit complete.**

  Or, to express it another way, the basis of the power to tax was not and cannot be made dependent upon the situs of the property in all cases, it being in or out of the United States, nor was not and cannot be made dependent upon the domicile of the citizen, that being in or out of the United States, **but upon his relation as citizen to the United States and the relation of the latter to him as citizen**. ”

Cook *v.* Tait (1924)

It is known as the evolution of citizenship taxation.

It justified the validity of worldwide taxation of U.S. citizens.

Residence

Residence

Residence

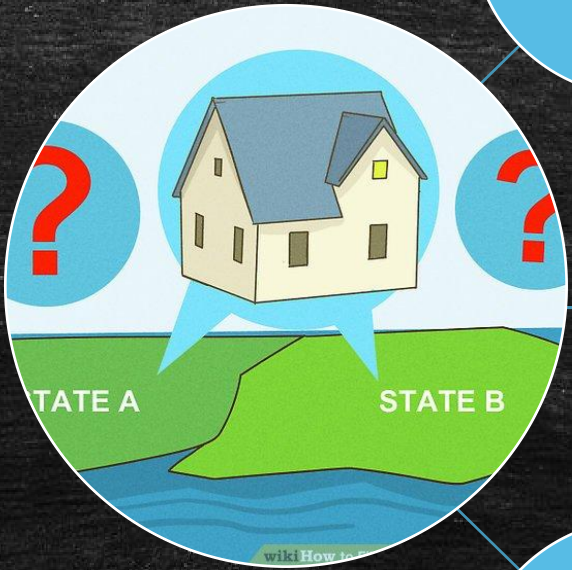
tax consequences →

The United States taxes the incomes of its residence from all sources worldwide.

Residence

Practical determinations of residence	
1	**The length of a stay in the United States** (the most important)
2	Dwelling arrangements there and abroad
3	Family ties
4	Civic and social activity

Residence



The residence of citizens

The residence of foreign nationals

The residence of a partnership

The Residence of Individuals

The residence of U.S. citizens	The residence of foreign nationals	The residence of a partnership
Bona fide residence test	Green card test	
Physical presence test	Substantial presence test	

The Residence of U.S. Citizens

The Residence of U.S. Citizens

- If you are a non-resident citizen, you may qualify for the foreign earned income exclusions (FEIE) and the foreign housing deduction.

Foreign Earned Income Exclusion (FEIE)

- **Foreign Earned Income Exclusion** is adjusted annually for inflation ($8400 for 2006, $92,900 for 2011,$97,600 for 2013, and $100,800 for 2015).

	Max FEIE
2020	$107,600
2021	$108,700
2022	$112,000
2023	$120,000
2024	$126,500

Exclusive FEIE

- Foreign tax credit or deduction.
  - Once you choose to exclude foreign earned income, you can't take a foreign tax credit or deduction for taxes on income you can exclude. If you do take a credit or deduction for any of those taxes in a later year, your election for the foreign earned income exclusion will be revoked beginning with that year.
- Additional child tax credit.
  - You can't take the additional child tax credit if you claim the foreign earned income exclusion.

The Residence of U.S. Citizens

Two tests for residence of U.S. citizens

1
Bona Fide Residence Test

2
Physical Presence Test

1. Bona Fide Residence Test

Intention or the purpose of your trip

The nature and length of your stay abroad

Must show the IRS that you have been a bona fide resident of a foreign country or countries for an **uninterrupted period that includes an entire tax year**

Determined on a case-by-case basis

1. Bona Fide Residence Test

An entire tax year is from January 1 through December 31 for taxpayers who file their income tax returns on a **calendar year basis**. During the period of bona fide residence in a foreign country, you can leave the country for brief or temporary trips back to the United States or elsewhere for vacation or business.

Then you are a bona fide resident of that country for the period starting with the date you actually began the residence and ending with the date you abandon the foreign residence. Your period of bona fide residence can include an entire tax year plus parts of two other tax years.

Bona Fide Residence Test

1. Intention or the **purpose of your trip**

2. Nature and length of your stay abroad

Bona Fide Residence Test

*you can leave the country for brief or temporary trips back to the United States or elsewhere for vacation or business

An entire tax year √

Your period of bona fide residence: an uninterrupted period that includes an entire tax year

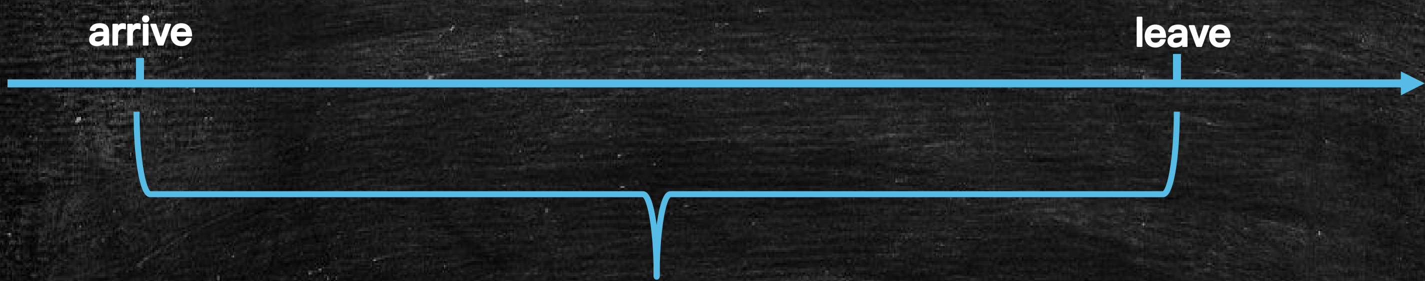
2. Physical Presence Test

You meet the physical presence test if you are physically present in a foreign country or countries 330 **full days** during a period of **12 consecutive months.**

2. Physical Presence Test

- The physical presence test is based only on how long you stay in a foreign country or countries.
- You can count days you spent abroad for any reason.
- A full day is a period of 24 consecutive hours, beginning at midnight. You must spend each of the 330 full days in a foreign country. When you leave the United States to go directly to a foreign country or when you return directly to the United States from a foreign country, the time you spend on or over international waters does not count toward the 330-day total.

Physical Presence Test



physically present in a foreign country or countries **330 full days** during a period of **12 consecutive months** √

*__A full day__ is a period of 24 consecutive hours, beginning at midnight.

More about Physical Presence Test

- Although the intention and the purpose of your trip doesn’t matter. You should be careful on some details when calculating days abroad.
- First, a full day is a period of 24 consecutive hours, beginning at midnight. You must spend each of the 330 full days in a foreign country.
- Second, when you leave the United States to go directly to a foreign country or when you return directly to the United States from a foreign country, the time you spend on or over international waters does not count toward the 330-day total.

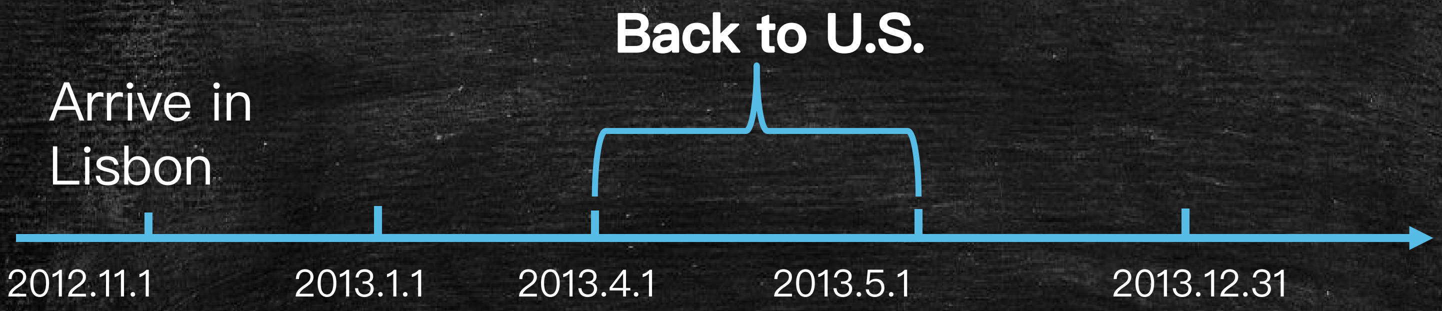
Practice: The Residence of U.S. Citizens

Bona Fide Residence Test: Example

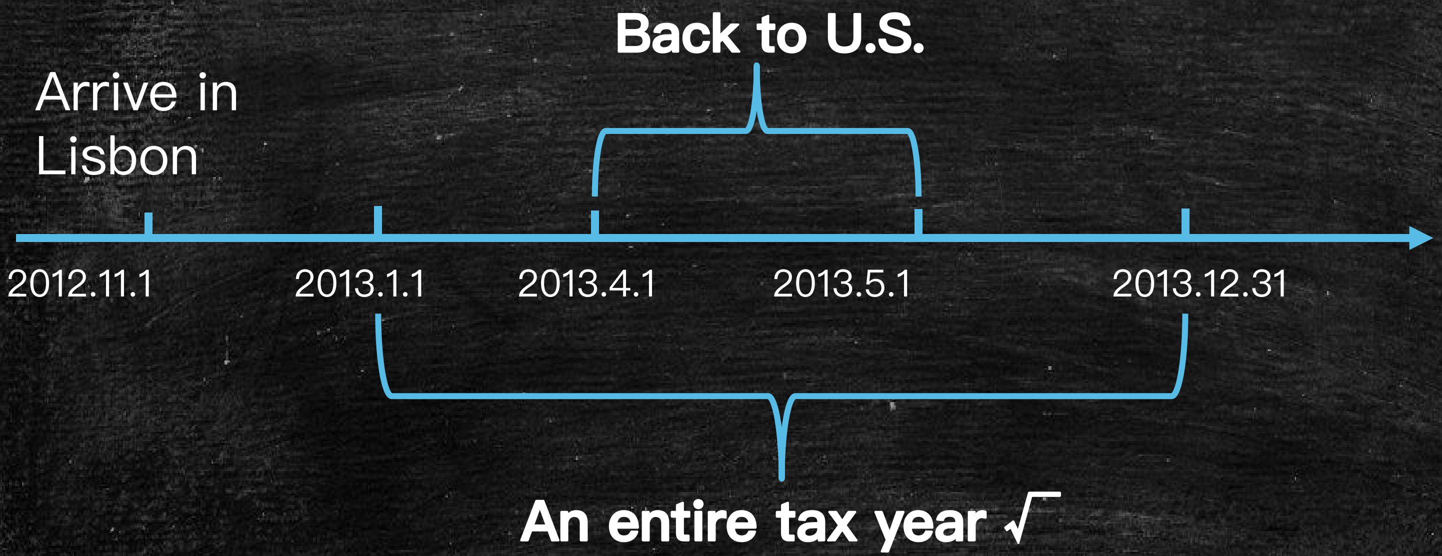
You (as U.S. citizen) are the Lisbon representative of a U.S. employer. You arrived with your family in Lisbon, Portugal on November 1, 2012. Your assignment is indefinite, and you intend to live there with your family until your company sends you to a new post. You immediately established residence there. On April 1, 2013, you arrived in the United States to meet with your employer, leaving your family in Lisbon. You returned to Lisbon on May 1, and continued living there.

- Can you claim for FEIE for 2013?

Bona Fide Residence Test: Example



Bona Fide Residence Test: Example



Bona Fide Residence Test: Example

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- Can you claim for FEIE for 2013?

On January 1, 2014, you completed an uninterrupted period of residence for a full tax year (2013), and you may qualify as a bona fide resident of a foreign country.

Physical Present Test: Example

You (as U.S. citizen) are the Lisbon representative of a U.S. employer. You arrived with your family in Lisbon on November 1, 2012. Your contract is only for one year, and you would return to U.S. at the end of 2013. On April 1, 2013, you arrived in the United States to meet with your employer, leaving your family in Lisbon. You returned to Lisbon on May 1, and continued living there.

You left Portugal by air at 9:30 a.m. on Dec 13. You passed over a part of France at 11:00 p.m. on Dec 13 and arrive in Chicago at 12:30 a.m. on Dec 14.

Can you exclude your foreign earned income for 2013?

Physical Present Test: Example

2012: Nov30+Dec31

2013:**Jan**31+Feb28+Mar31+Apr0+May31+Jun30+Jul31+Aug31
+Sep30+Oct31+Nov30 +Dec12

Physical Present Test: Example

2012: Nov30+【Dec31

2013:Jan31+Feb28+Mar31+Apr0+May31+Jun30+Jul31+Aug31+Sep30+Oct31+Nov30】+Dec12

31+31+28+31+0+31+30+31+31+30+31+30 = 335

335 > 330 **Physical Present Test** √

Physical Present Test: Example

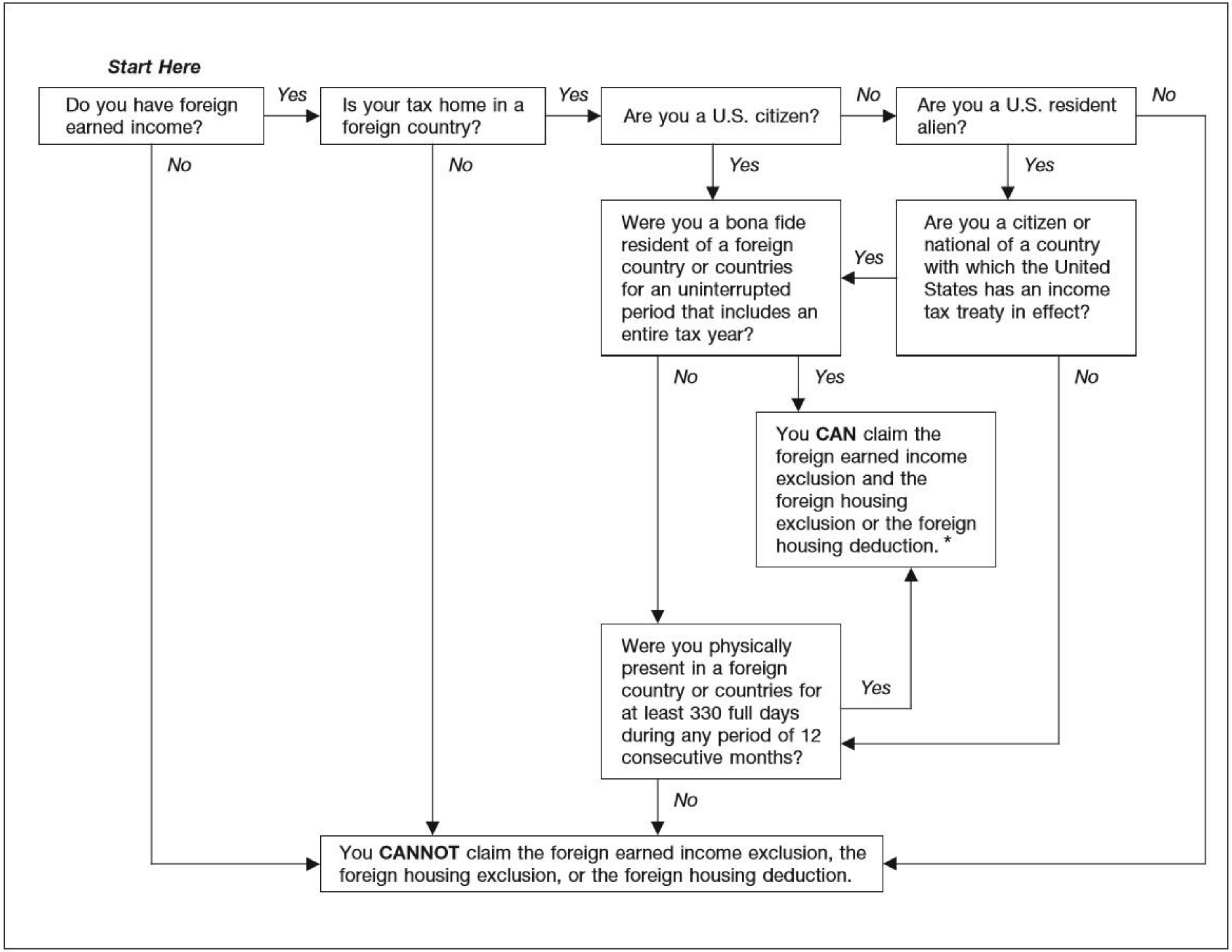
You (as U.S. citizen) are the Lisbon representative of a U.S. employer. You arrived with your family in Lisbon on November 1, 2012. Your contract is only for one year, and you would return to U.S. at the end of 2013. On April 1, 2013, you arrived in the United States to meet with your employer, leaving your family in Lisbon. You returned to Lisbon on May 1, and continued living there.

You left Portugal by air at 9:30 a.m. on Dec 13. You passed over a part of France at 11:00 p.m. on Dec 13 and arrive in Chicago at 12:30 a.m. on Dec 14.

Can you exclude your foreign earned income for 2013?

From Dec 2012 to Nov 2013, your physical presence in Portugal is more than 330 days.

Figure 4-A. **Can I Claim Either Exclusion or the Deduction?**



Topics for Today

Nationality

- Taxing Jurisdiction
- Cook v. Tait (1924)

Residence

The Residence of U.S. Citizen

- Bona fide test
- Physical presence test

The Residence of Foreign Nationals

- Green card test
- Substantial presence test

Expatriation

The Residence of Foreign National

What are the tax consequences for residents and nonresidents ?

The Residence of foreign nationals

Two tests for residence of foreign nationals

1
Green Card Test

2
Substantial Presence Test

Green Card Test

Green Card Test

- A lawful permanent resident, know as a "green card" holder, is an individual entitled to remain permanently in the United States in accordance with the immigration laws
- Immigration status and tax status are explicitly allied:

  Absences of more than six months are presumed to break continuous residence unless the permanent resident can show that he/she did not terminate US employment and was not employed abroad and that the applicant retained his or her abode (need a re-entry permit or returning resident visa while abroad).

  Absences of greater than one year automatically break the period of continuous residence unless the applicant is employed by the US government or a recognized US research institution, the permanent resident is employed by an employer engaged in foreign trade, or the permanent resident works for a public international organization where the US is a member and the lawful permanent resident did not work for the organization until after permanent residency was granted.

Substantial Presence Test

- 183-day rule: A foreign national present in the United States for 183 or more days during a calendar year is a United States resident in that year. § 7701 (b) (3).
- It is easy to work around this test by spending 182 days for several years in a row, a foreign individual could maintain a substantial permanent connection with the United States without ever become a U.S. resident.

Substantial Presence Test

- Extended 183-day rule: An individual meets this test if the individual is present in the United States for at least 31 days during the current year and at least 183 days for the three-year period ending on the last day of the current year using a weighted average. I.R.C. § 7701 (b) (3).
- The weighted average rule: days present in the current year are multiplied by 1; days in the immediate preceding year are multiplied by 1/3; days in the next preceding year are multiplied by 1/6.

Substantial Presence Test（183-day rule）

Strict 183-day rule	present in the United States for 183 or more days during a calendar year
Extended 183-day rule	(1)present in the U.S. for at least 31 days during the current year and (2) at least 183 days for the three-year period ending on the last day of the current year using a ***weighted average.*** I.R.C. § 7701 (b) (3).

You will be considered a U.S. resident for tax purposes if you meet the substantial presence test for calendar year 2016. To meet this test, you must be physically present in the United States on at least:

1. 31 days during 2016, and
2. 183 days during the 3-year period that includes 2016, 2015, and 2014, counting:
   a. All the days you were present in 2016, and
   b. ⅓ of the days you were present in 2015, and
   c. ⅙ of the days you were present in 2014.

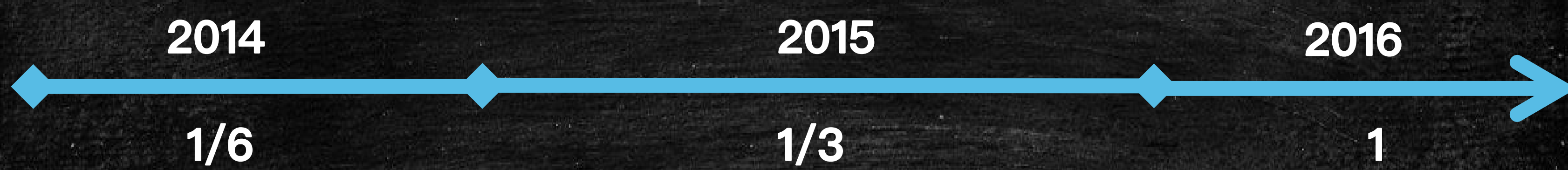
Weighted Average Rule

next preceding year	immediate preceding year	current year
1/6	1/3	1

Example : substantial presence test for 2016 calendar year

(1) Present in the U.S. for at least 31 days during 2016

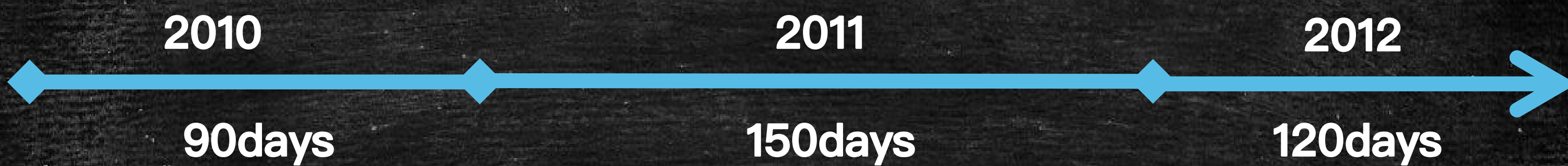
(2) Present in the U.S at least 183 days for the three-year period that includes 2016, 2015 and 2014 using a weighted average.



Practice: Substantial Presence Test

A foreign national (who has never before been to the United States) spends 90 days in the United States in 2010, 150 days in the United States in 2011, and 120 days in the United States in 2012. According to the substantial presence test, is the individual a U.S. resident in 2011, 2012, respectively?

Example : substantial presence test (2)



- According to the substantial presence test, is the individual a U.S. resident in 2011, 2012?

Pop quiz

What is the greatest constant-level number of days that can be spent in the United States year in and year out without triggering United States residence?

Practice : substantial presence test

- Does the individual satisfy the substantial presence test?
- What if the individual were present in the United States 122 days each year?

Days of Presence

You are treated as present in the United States on any day you are physically present in the country at any time during the day.

Exceptions to the Days of Presence

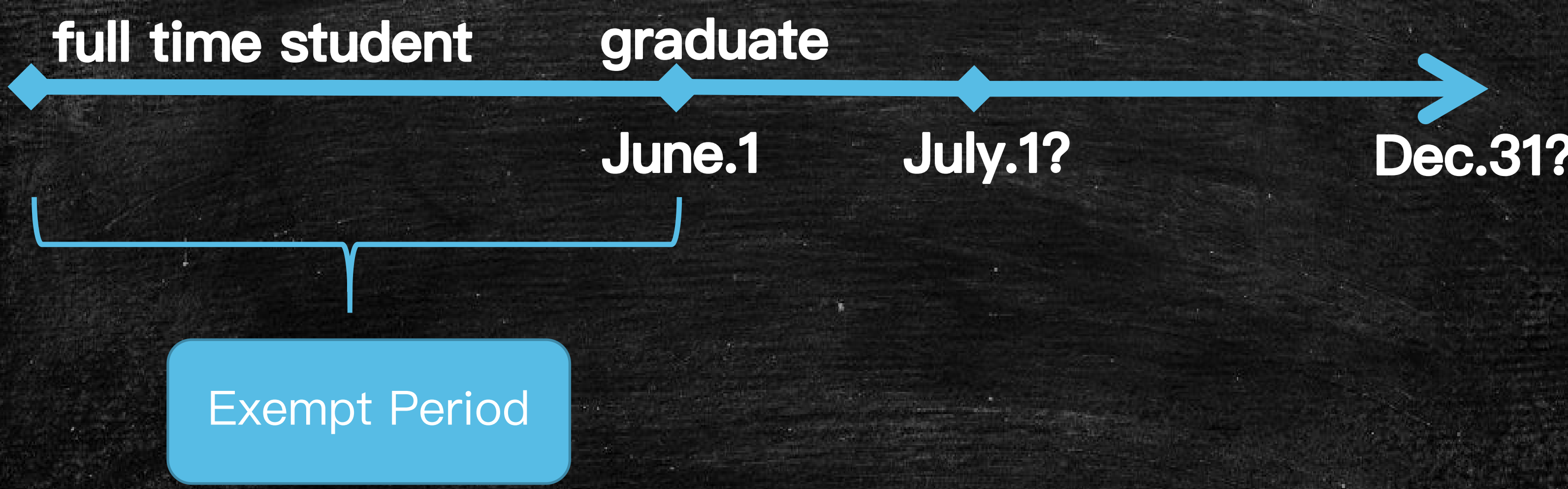
Exceptions to the Days of Presence	Days you commute to work in the United States from a residence in Canada or Mexico if you regularly commute from Canada or Mexico.
	Days you are in the United States for less than 24 hours when you are in transit between two places outside the United States.
	Days you are in the United States as a crew member of a foreign vessel.
	Days you are unable to leave the United States because of a medical condition that arose while you are in the United States.
	Days you are an exempt individual.
Exempt individual	full-time diplomats
	consular officials
	teachers or trainees
	students

Example

- A full time student who graduates on June 1 from a degree program
- If the student leave U.S. in one month after his/her graduation, does he/she pass the substantial presence test?
- If the student then stays on in the US until the end of the year, another 213 days, does he/she pass the substantial presence test?

Example : Exempt individual

A full-time student who graduates on June 1 from a degree program.

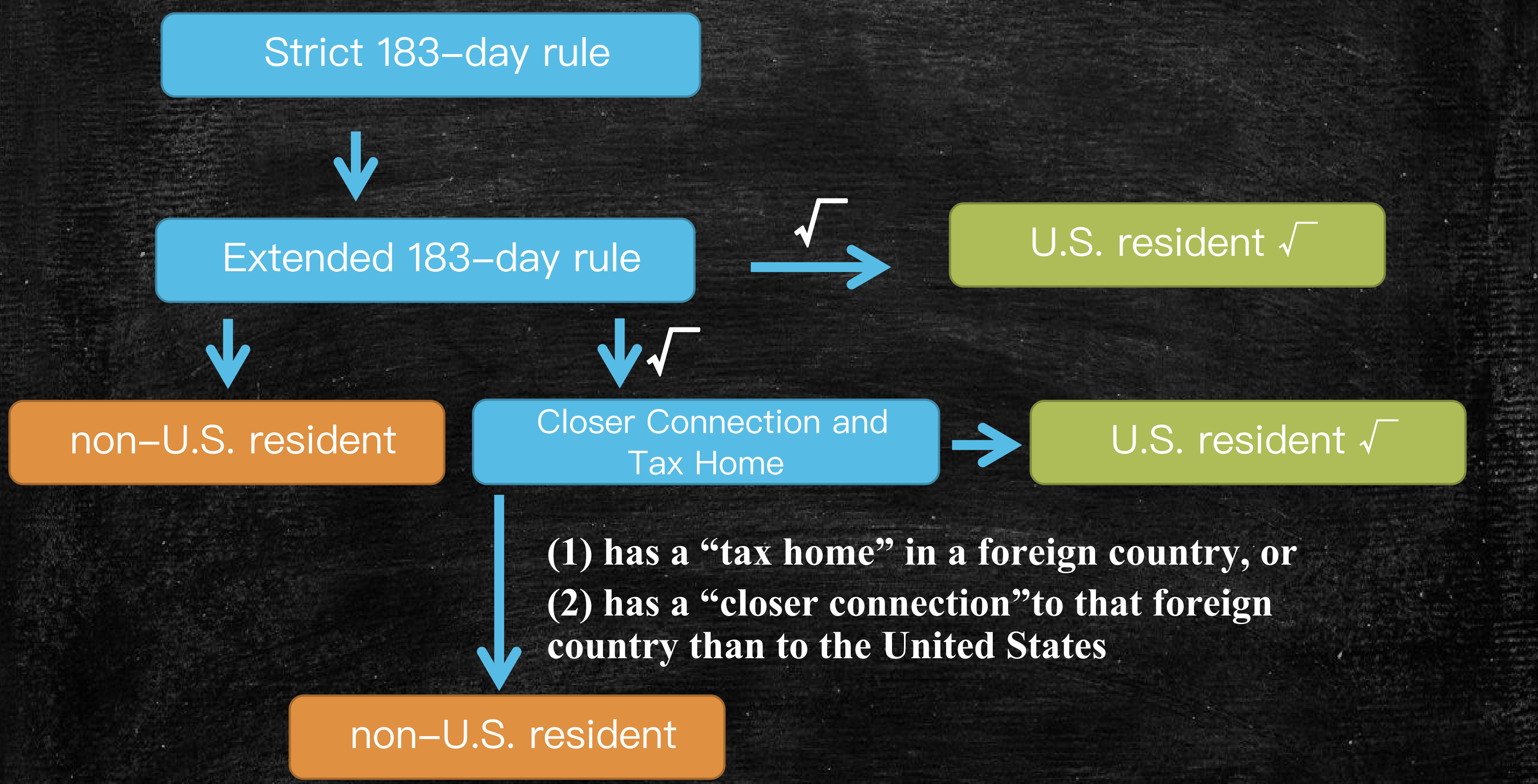


Closer Connection and Tax Home of a Foreign Country

- For individuals who meet substantial presence by carryover of days during a calendar year, but are actually present fewer than 183 days, the application of the 183-day test is **<u>not absolute</u>**.

- An individual actually present in United States on fewer than 183 days during a calendar year, despite an extended count of days exceeding 183, is not treated as a U.S. resident if it is established that for the year the individual
    1) has a “tax home” in a foreign country
    2) has a “closer connection’ to that foreign country than to the United States

Closer Connection and Tax Home of a Foreign Country



Tax Home

- Your tax home is the general area of your main place of business, employment, or post of duty, regardless of where you maintain your family home.
- Your tax home is the place where you permanently or indefinitely work as an employee or a self-employed individual.
- If you do not have a regular or main place of business because of the nature of your work, then your tax home is the place where you regularly live.
- For determining whether you have a closer connection to a foreign country, your tax home must also be in existence for the entire current year, and must be located in the same foreign country.

Closer Connection

the facts and circumstances to be considered include, but are not limited to：

a. Your permanent home,
b. Your family
c. Your personal belongings, such as cars, furniture, clothing, and jewelry
d. Your current social, political, cultural, professional, or religious affiliations
e. Your business activities (other than those that constitute your tax home)
f. The jurisdiction in which you hold a driver's license,
g. The jurisdiction in which you vote, and
h. Charitable organizations to which you contribute.