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# *An analysis of the new law's tests for an alien's status as a U.S. resident*

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*By defining "resident alien" for the first time, new Section 7701(b) attempts to overcome the subjective tests of prior law. The authors examine the green card test, the 183-day presence and cumulative tests, interaction with existing treaties.*

SECTION 138 of the Deficit Reduction Act of 1984 (the "Act"), P.L. 98-369, 7/18/84, adds as new Section 7701(b) a definition of "resident alien" that with effect from 1/1/85 substantially modifies pre-existing law for determining whether an alien will be regarded to be a U.S. resident for income tax purposes.[1] Under the new definition, many alien individuals who would not have been considered resident in the U.S. under pre-existing law will be so treated. Other alien individuals will be able to avoid treatment as a resident even though significant contacts are maintained in the U.S. provided they limit their U.S. presence to a specified number of days per year and do not maintain resident status for immigration purposes. As a result, tax professionals will be able to plan for their alien clients with a much greater degree of certainty than was possible under pre-existing law.

### *Effect of resident classification*

Significantly, Section 7701(b) does not alter the effect of being considered a U.S. resident. A resident alien, generally, is subject to U.S. Federal income tax on his worldwide income. In certain circumstances, this includes some portion or all of the income of a controlled foreign corporation (CFC) or foreign personal holding company (FPHC).[2] A resident alien also may incur U.S. excise or income tax on certain transfers of appreciated property to foreign entities; if he is the settlor, he may be treated as the owner of income of a foreign trust that may have a beneficiary who is a U.S. person.[3] Furthermore, resident aliens are subject to a number of filing requirements generally not required of nonresident aliens.[4] Moreover, classification of an alien as a resident may have an effect on others; it may, for example, have an effect on whether a foreign corporation in which the alien or any person "related" to him owns an interest qualifies as a CFC, a FPHC, a foreign investment company or a PHC.[5]

In certain cases, an alien who is a resident of a country with which the U.S. has an income tax convention and who is also a U.S. resident under U.S. internal law may, *for purposes of the treaty*, be regarded as resident only in the treaty country.[6] Nevertheless, he will be regarded as a U.S. "resident" *for purposes not covered by the treaty*.[7] For example, the determination that the alien is a U.S. resident under U.S. internal law will still affect the classification of a foreign corporation as a CFC, a FPHC, a foreign investment company or a personal holding company and may have collateral effects on other taxpayers (as discussed below). If the treaty in question has a provision reserving to the country of residence the right to tax all income not specifically covered by the treaty,[8] or expressly or impliedly limits taxation of foreign-source income, a U.S. resident who is only a resident of the treaty country for purposes of the treaty may avoid U.S. income tax on such income.

Consider, for example, the case of Panamanian corporation C, the majority of the shares of which are owned by individual A. The balance of the shares of C are owned by B, a U.S. citizen who is not otherwise related to A. Assume A is an alien who is a U.K. citizen and resident and that A maintains his permanent, and indeed his only, home in the U.K. Never having maintained a home in the U.S., A has not previously been considered a resident of the U.S. under U.S. internal law. Assume, however, that A is present in the U.S. for 183 days or more in 1985 and, therefore, will be regarded as a resident alien because of the "substantial presence" test of Section 7701(b)(3). Notwithstanding this, A will be regarded as a resident of the U.K. for purposes of the treaty. Assume C's income consists entirely of non U.S.-source interest. As a result, notwithstanding that corporation C will be regarded as a CFC or a FPHC, A will not be required to include as income subject to U.S. income tax any portion of the income of C (see, for example, the pending treaty, Article 22), but B will be required to do so. As a second illustration, a foreign corporation owned entirely by nonresident aliens is generally excluded from being considered a personal holding company.[9] If individual A in the first illustration owned any of the stock in such a foreign corporation, the corporation could suffer the personal holding company tax to the detriment of A's co-stockholders who are not "residents," even though they gain no U.S. tax advantage from utilization of the corporation for U.S. investments.[10]

As a third illustration, classification as a resident may also affect whether interest paid by the individual to a foreign person is U.S.-source income subject to tax and withholding. While "portfolio interest" on obligations incurred after enactment of the Act[11] will with certain exceptions not subject a non-U.S. person to U.S. income tax, this rule will generally not apply to interest paid on obligations in existence at the time of enactment.

### *Pre-1985 law*

Under pre-existing law, an alien is presumed to be a nonresident of the U.S., particularly if his stay in the U.S. is limited to a definite period by the immigration laws.[12] A contrary presumption exists if an alien remains in the U.S. for a period of one year or more. Neither of these presumptions are very significant, since either is rebutted by other facts and circumstances indicating the alien's intent with regard to his U.S. presence.[13]

An alien is regarded as a U.S. resident for income tax purposes if he is present in the U.S. with an intent to remain here for an indefinite period, and is regarded as a nonresident if his U.S. presence has as its objective *(e.g.,* vacation or work) that which can be accomplished in a relatively short period of fixed duration.[14]

Determining an individual's intent is difficult at best, requiring an analysis of all facts and circumstances which may bear on the issue. Several factors have consistently been considered to be significant in this regard. Included among these factors are the length and pattern of the U.S. presence over a period of years,[15] whether a place of accommodation is generally available in the U.S. and, if so, the nature of such accommodation and length of its availability[16] in comparison to the place(s) of accommodation available elsewhere, the purpose of the U.S. visits,[17] whether the U.S. or another place is the center of the individual's economic and/or personal life,[18] whether the individual spends more time at any other place than he spends in the U.S.,[19] whether the individual claims residence elsewhere and whether the individual has otherwise manifested an intent to acquire U.S. residency, such as the application for or the acquisition of a permanent residency card (known commonly as a "green card")[20] or the filing of any form indicating the U.S. as a place of residence[21] or a declaration of U.S. residence in a will. However, no one factor is controlling. Thus, an individual may be regarded as a nonresident even though he has been present in the U.S. for more than 183 days in any one year,[22] for example, to undertake a particular project or to vacation. Similarly, an individual who has a green card but is rarely in the U.S., who does not have a place of accommodation available in the U.S. and who regularly resides elsewhere is not likely to be regarded as a resident merely because he may freely travel to the U.S.[23]

Finally, under pre-existing law, an alien's status as a U.S. resident continues until he departs from the U.S. with an intent to relinquish U.S. residence.[24]

### *The new statutory definition*

Intentionally departing, in most cases, from the subjective "intent" test of pre-existing law, Section 7701(b) provides a series of mechanical tests for determining whether an alien is to be treated as a resident or nonresident for income tax purposes. Superimposed on the general rules are exceptions and special rules, certain of which resort to new and as yet judicially undefined tests requiring a subjective consideration of facts and circumstances relating to the alien's connections with another jurisdiction. To a large extent, the new rules do provide a greater degree of certainty to the issue of whether an alien is taxable as a resident. The new definition will treat as a resident for income tax purposes an alien who does not actually reside in the U.S. at all, but who (1) has a "green card" but no other U.S. contacts and little or no U.S. presence; (2) spends 183 days or more in the U.S. in a calendar year, for example, in order to accomplish a specific objective even though he has no continuing pattern of substantial U.S. presence; or (3) spends a lesser but still significant time in the U.S. over a period of years and either does not have a "tax home" in another country, cannot establish that his contacts are more closely connected to a foreign country in which he has his "tax home," or has applied for a green card. At the same time, an alien who would have been taxable as a resident under pre-existing law because he actually resides in the U.S. may be treated as a nonresident under Section 7701(b) provided he can confine his U.S. presence to a prescribed allowable period even if the alien's only home is in the U.S.

Section 7701(b) applies only to determine the residence in the U.S. of an alien for Federal income tax purposes, and does not affect the determination of whether an alien will be regarded as resident for estate or gift tax purposes. Residence for estate and gift tax will continue to mean domicile, as under existing law.[25] Moreover, Section 7701(b) is not intended to replace pre-existing law for the purpose of determining whether an alien is a bona fide resident of a foreign country for purposes of Section 911(d)(1)(A).[26] Nor does Section 7701(b) apply at all for the purpose of determining the residence of a U.S. citizen.

Since treatment of an alien as a resident under Section 7701(b) will, subject to a contrary treaty obligation, subject such an alien to U.S. Federal income tax

[1] For an analysis of the earlier versions of the provision, see Alpert and Feingold, "Proposal Before Congress to Define U.S. Resident Status," 31 *Canadian Tax J.* 853-62 (Sept.-Oct. 1983).

[2] Sections 951 and 551.

[3] Sections 1491, 367, 1057 and 679.

[4] *E.g.,* Form 926, for transfer of property to a foreign corporation, foreign estate or trust or foreign partnership; Form 5713, international boycott; Form 5471, related to CFCs.

[5] Sections 957(a), 552(a)(2), 1246 and 542(c)(7).

[6] See, *e.g.,* the Convention Between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains (hereinafter cited as "U.S.-U.K. Treaty"), Article 4(2); the Convention Between the United States of America and Canada with Respect to Taxes on Income and Capital (hereinafter cited as "U.S.-Canada Treaty"), Article IV(2); U.S. Model Income Tax Convention, 6/16/81, Article 4(2).

[7] The legislative history specifically notes that an alien who would be treated as a U.S. resident under Section 7701(b) but as a resident of a treaty partner under that treaty would be treated as a U.S. resident for internal law purposes such as determining whether a foreign corporation would be a CFC. See H. Rep't No. 98-861, 98th Cong., 2nd Sess. 967 (1984).

[8] See, *e.g.,* U.S.-U.K. Treaty, Article 22.

[9] Section 542(c)(7).

[10] Act, Section 132 added new Section 554(c)(1) to prevent stock owned by a nonresident alien individual from being attributed to a U.S. person who is a blood relative but who does not own any stock directly or indirectly. This provision was added because Congress felt it was generally inappropriate to attribute stock from a foreign person to a U.S. relative who owned no stock, with the result of causing a third person to suffer taxation under the foreign personal holding company provisions. Nevertheless, Congress chose not to extend this idea to prevent stock ownership by an alien who would be a resident of a treaty partner under that treaty but resident of the U.S. under internal law to cause a foreign corporation to be characterized as a FPHC or CFC. See H. Rep't No. 98-432, part 2, 98th Cong., 2nd Sess. 1534-36 (1984). See also *Estate of Miller,* 43 TC 760 (1965), *nonacq. Cf.* U.S.-U.K. Treaty, Article 10(6).

[11] Apart from an exemption or reduced rates of tax afforded by an applicable provision of an income tax convention, and except to the extent eliminated by Act, Section 127, nonresident aliens are subject to tax on interest from U.S. sources. Section 871(a)(1)(a). The rule for determining the "source" of interest differs depending on whether the payor is a U.S. "resident." Section 861(a)(1). Act, Section 127 eliminates the 30% tax for "portfolio interest" with respect to interest received after the date of enactment on obligations issued after that date. See Sections 871(h) and 881(c). In general, in the case where the obligor is a corporation or partnership, "portfolio interest" does not include interest paid on an obligation owned by a 10% or greater owner of the obligor. Sections 871(h)(3), 881(c)(3)(B).

[12] Regs. 1.871-4(b), 1.871-2(b) (last sentence); *Rev. Rul.* 69-611, 1969-2 CB 150.

[13] See Regs. 1.871-4(c), 1.871-2(b).

[14] Reg. 1.871-2(b).

[15] *Tongsun Park,* 79 TC 252 (1982).

[16] Compare *Tongsun Park, supra,* and *Goldring,* 36 BTA 779 (1937), *acq.* (taxpayers purchased homes), with *Barocas,* TCM 1975-172 (taxpayer rented apartment on month-to-month basis).

[17] *Adams,* 46 TC 352 (1966), *acq.*

[18] *Adams, supra; Dawson,* 59 TC 264 (1972).

[19] *Tongsun Park, supra* note 15.

[20] *Lemery,* 54 TC 480 (1970), *acq.; Hechavarria,* 374 F. Supp. 128 (DC Ga., 1974).

[21] *E.g.,* Form 1078 or an application for a driver's license.

[22] *Stemkowski,* 76 TC 252 (1981), *rev'd on another issue and remanded in part,* 690 F.2d 40 (CA-2, 1982).

on his worldwide income, such treatment should render the alien a resident of the U.S. for the purpose of applying income tax conventions to which the U.S. is a party. Such an alien may, under the internal law of another country, also be considered a resident of such other country, rendering such alien subject to tax as a resident in two jurisdictions. In this connection, as previously noted, Section 7701(b) treatment, at least in general, is not intended to override treaty obligations of the U.S. Thus an individual treated as a resident for purposes of Section 7701(b) may for purposes of a treaty still be considered a resident of such a treaty country. However, still other issues may arise.

Consider the case of an alien who is a resident of a second country under its laws. Assume the alien actually resides only in the second country and has little or no U.S. presence or other contacts but happens to also have a green card. As is discussed below, such an alien will be treated as a U.S. resident under Section 7701(b). While he may be considered a resident only of the second country for purposes of the income tax treaty between the U.S. and the second country, such treatment should not affect the determination of whether such alien would be treated as a resident of the U.S. for the purpose of, for example, the income tax convention between the U.S. and a third country. The issue may arise where the tax convention between the U.S. and the third country provides a lower rate of tax on income arising in the third country than the tax convention, if any, between the third country and the second country. In such case it would seem that the alien may be entitled to the benefits of the convention between the U.S. and the third country even though as a result of the tax convention between the U.S. and the second country he would be subject to tax on such income only in the second country.[27] Whether the third country would readily agree to this result is another matter. While the result was possible under pre-existing law in the case of a dual resident, Section 7701(b) will render as dual residents many individuals who would not have been so treated before (as discussed below). It is therefore possible the third country would consider the application of Section 7701(b) to such an alien a fundamental change in the application of the treaty with the U.S.

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### *Mechanical tests, exceptions*

*Green card.* Under the new rules, an alien who is a lawful permanent resident of the U.S. (that is, he has a green card) *at any time during the calendar year* will be regarded as a U.S. resident. This rule will apply even though the individual is not present in the U.S. at any time during the year or regardless of any other factors.[28] Moreover, in the case of an alien who has a green card at some time during 1985, had a green card throughout 1984 or was present in the U.S. at some point in 1984 while he had a green card, this rule will apply to make such an alien a resident from 1/1/85 regardless of whether he is physically present in the U.S. at any time in 1985. Thus, an alien with a green card who spends relatively little time in the U.S. will be well-advised to relinquish his green card prior to 1985 if he does not wish to be regarded as a U.S. resident for income tax purposes.

*Presence for 183 days during year.* Except in the case of an "exempt individual" described below, an alien who is present in the U.S. for 183 days or more during a calendar year will be regarded as a U.S. resident for that year.[29] This rule applies (with certain exceptions discussed below) regardless of the purpose of the U.S. presence during the year. Thus, an individual who is not an "exempt individual" is to be regarded as a resident for a calendar year if he is present in the U.S. for an aggregate of 183 days or more during the year even if he maintains his "tax home" elsewhere and no home in the U.S., if he is present in the U.S. solely for the purpose of completing a project of relatively short duration that in fact is completed during one calendar year[30] or is present because he came to the U.S. for the purpose of receiving medical attention, or, literally, even if he is present on an involuntary basis. On the other hand, an alien who manages to have his presence straddle two calendar years may avoid the rule. For example, an individual who first comes to the U.S. on 7/3/85 and remains in the U.S. through 7/1/86 will not automatically be regarded as a resident for 1985 or 1986, even though he will have been present in the U.S. for a continuous period of 364 days.[31]

*Cumulative presence test.* Except in the case of an "exempt individual" and unless the "tax home" and "closer connection" exceptions (discussed below) apply, an alien who is present in the U.S. during the current year and the two preceding years for a weighted aggregate of 183 days or more will be regarded as a resident. For this purpose, the number of days of U.S. presence for the first preceding year is multiplied by a factor of one-third, and the number of days of U.S. presence for the second preceding year is multiplied by a factor of one-sixth.[32] For example, an individual could be present in the U.S. for up to 121 days each year without being regarded as a resident even if his "tax home" and "closer connections" are in the U.S.[33]

In order to determine the number of days an alien may be present in the U.S. for the current calendar year without being considered to have been present for 183 days on a cumulative basis, a simple algebraic formula may be used which may be expressed as follows:

$$X = 182 - [1/3\ Y + 1/6\ Z].$$

X represents the maximum number of days of U.S. presence in the current year, Y represents the number of days of U.S. presence in the first preceding year and Z the number of days of U.S. presence in the second preceding year. Applying this formula to the situation illustrated above, the alien who first arrives in the U.S. on 7/3/85 may continue to be present in the U.S. through 5/1/86 (provided he leaves on that date and does not return for the balance of the year) without having been present in the U.S. for 183 days on a cumulative basis (*i.e.*, 121 days in 1986 + [⅓ × 182 days in 1985] is less than 183). Thus, the alien would have been present for 303 days without being treated as a resident in 1985 or 1986. However, if the alien were to be present in the U.S. for more than 111 days in 1987, he will have met the cumulative presence test for 1987 (but not for 1985 or 1986).

The cumulative presence test does not apply for a year unless an individual was actually present in the U.S. for 31 days during that year. In addition, the cumulative presence test does not apply if the individual comes within

the "tax home" and "closer connection" exception described below.

An alien who meets the cumulative presence test but who is not present in the U.S. for 183 days during the current year will not be regarded as a resident alien if he can establish that, *for the current year*, he has a "tax home" in a foreign country *and* that he has a closer connection to that foreign country than he has to the U.S.[34] This may have to be established on a form to be prescribed by Regulations.[35]

As a preliminary point, it is unclear as to when during the current calendar year the alien must have had his tax home in a foreign country. For example, this issue may arise if an alien relinquishes his foreign tax home on July 15 of a year in order to take up residence in the U.S. Must he be able to establish that he had a tax home elsewhere for the entire calendar year, or for only the part of the year when he was present in the U.S.? It appears that the foreign tax home literally must be in existence for the entire year.

The term "tax home" is assigned the meaning given to that term under Section 911(d)(3).[36] Under that provision, an individual generally has his tax home at his principal place of business; if an individual has no principal place of business, his tax home generally is the place where he has his regular place of abode.[37]

Establishing that an individual's tax home is in a foreign country is insufficient, of itself, to come within the exception from the application of the cumulative presence test. The individual also must establish that he has "closer connections" to the same foreign country in which he has a tax home than he has with the U.S.[38] It is unclear whether the significant contacts are those of a business or personal nature. If the former, given that the principal place of business will ordinarily be the tax home, the closer contact test may add little. If the latter, however, new difficulties may arise. For example, an alien who regularly resides in foreign country A but who has his principal place of business in foreign country B may find it difficult to establish that his personal contacts are more closely connected with foreign country B than with the U.S.

An alien who has an application pending for lawful permanent residency will not be able to avail himself of the "tax home" and "closer connection" exception to the "cumulative presence test."[39] Thus, if such an alien was present in the U.S. for a sufficient period to meet the cumulative presence test, he would be regarded as a resident regardless of any other fact or circumstance.

*"Presence" and its exceptions.* Ordinarily, under Section 7701(b)(6)(A) an alien will be regarded as present in the U.S. on any day in which he is present in the U.S. for any portion of the day. Thus, both the day of arrival and the day of departure each count as one day or a total of two days. (Days in transit are not included; see below.) There are, however, four exceptions to this rule:

1. Medical conditions. If an individual who was already in the U.S. is unable to leave the country because of a medical condition which arose while he was in the U.S., any day in which he could not leave because of the medical condition does not count.[40]

2. Commuters. An individual who regularly commutes to the U.S. from a place of residence in Canada or Mexico will not be regarded as present in the U.S. on any day during which he so commutes, under Section 7701(b)(6)(B). Presumably, "commutation" means a trip that is completed within a 24-hour period.

3. In transit. An individual who spends less than 24 hours in the U.S. while in transit between two foreign points will not be considered present on that day, under Section 7701(b)(6)(c).

4. Exempt individuals. An alien who does not have (and has not applied for) a green card will not be regarded as present on any day that he qualifies as an "exempt individual."

*Exempt individuals.* The term "exempt individual" means foreign-government-related individuals, teachers or trainees, and students and members of their immediate families.[41] In general, a foreign-government-related individual is one who has been temporarily admitted to the U.S. because of his diplomatic status or because he is a full-time employee of an international organization. Teachers, trainees, and students must be admitted under the appropriate provision of the Immigration and Nationality Act relating to their special status and must comply substantially with the conditions for admission. Some special limitations apply:

1. Teachers or trainees will not be exempt individuals during the current year if, for any two calendar years during the preceding six calendar years, the person was exempt as a teacher, trainee, or student.

2. A student will not be an exempt individual during any calendar year after the fifth calendar year for which he

[28] *Adams, supra* note 17.

[34] Reg. 1.871-5.

[35] However, the residence of a trust or estate determined under Sections 7701(a)(30) and 7701(a)(31) may be affected to the extent that the determination of the residence of these entities depends upon the residence or nonresidence of an individual such as a fiduciary. H. Rep't No. 98-861, *supra* note 7, at 967; see also *B. W. Jones Trust*, 132 F.2d 914 (CA-4, 1943); *Rev. Rul.* 60-181, 1960-1 CB 257.

[36] H. Rep't No. 98-432, part 2, *supra* note 10, at 1528.

[37] *Cf. Rev. Rul.* 73-354, 1973-2 CB 435. A different result would obtain depending on the treaty involved if the individual were a U.S. citizen, since Section 7701(b) would literally not apply to treat such individual as a resident. Compare, *e.g.*, U.S.-France income tax convention, Art. 3, U.S.-U.K. income tax convention, Art. 4, and U.S.-Australia income tax convention, Art. 4 (which do not automatically treat citizens as residents; *Rev. Rul.* 75-489, 1975-2 CB 511), with U.S.-Canada income tax convention, Art. IV (not yet in effect), U.S.-Denmark income tax convention, Art. 4 (not yet in effect), 1981 U.S. Treasury Model income tax convention, Art. 4 and 1977 OECD Model Convention, Art. 4 (which do treat U.S. citizens as residents for purposes of the treaty).

[38] Section 7701(b)(1)(A)(i). Previously, the U.S. never maintained that resident status for immigration purposes alone is determinative of the issue of residence. See *Rev. Ruls.* 76-82, 1976-1 CB 192; 72-140, 1972-1 CB 211; and 72-297, 1972-1 CB 212. ("Admission to the United States for permanent residence pursuant to the Immigration and Nationality Act does not per se establish residence for purposes of the Federal income tax.") See also *Adams, supra* note 17 (holding a Canadian individual to be a nonresident alien notwithstanding that he applied for and obtained an immigrant visa).

[39] Sections 7701(b)(1)(A)(ii) and 7701(b)(3). See *infra* for special rules relating to first and last years of residency.

[40] In *Stemkowski, supra* note 22, the petitioner, a Canadian hockey player, was actually present in the U.S. for more than 200 days. Notwithstanding this presence, no assertion was made that the petitioner was a U.S. resident.

[41] Unless the "tax home" and "closer connection" exception applies, he could nevertheless be considered a resident under the cumulative presence test described *infra*.

[32] A special transitional rule will exclude days of presence for 1984 and 1983 in many cases.

[33] It is assumed that for the purpose of the calculations required under the cumulative presence test, fractional values derived by using the applicable factor for the first and second preceding years are to be regarded as fractional values.

[31] Section 7701(b)(3)(B).

[85] Section 7701(b)(7).

[32] Without regard to the second sentence in Section 911(d)(3) dealing with an "abode" in the U.S. A U.S. citizen or resident qualifying for the benefits of Section 911 may exclude from income subject to U.S. Federal income tax a limited amount of earned income from foreign sources. To qualify for the benefit of Section 911, an individual must establish, among other things, that his tax home is in a foreign country.

is exempt as a student, teacher or trainee unless he established no intent to reside permanently in the U.S.

It seems that in the case of teachers or trainees, as well as in the case of students, the years taken into account start with the first year for which the new provisions will be in effect, that is, 1985. Whether this was intended, however, is not certain.

### *Timing and related matters*

*Taxable year and first and last year of residence.* If an alien is a resident under one of the three tests described above, he will generally be treated as a resident for the entire calendar year whether or not the alien's taxable year coincides with the calendar year. In a case where an alien's taxable year is not a calendar year, he is taxable as a resident for that portion of his taxable year which is within the calendar year for which he is treated as a resident. Since an alien who has not previously established a taxable year other than a calendar year is to be treated as having a calendar taxable year, this rule will have little application.[42]

Important exceptions to treating an alien as a resident for an entire calendar year are provided in Section 7701(b)(2) for an alien who first becomes resident during a year and for an alien who abandons residency during a year.

*First acquisition of residence.* If an alien was not a resident in the U.S. at any time during the preceding calendar year, but is regarded as a resident in the current year, he is regarded as resident in the U.S.:

1. Only from the first day he is present in the U.S. in the current year if he is regarded as a resident of the U.S. for the year under either the 183-day presence rule or the cumulative presence test. Any days for which it can be shown that the alien had a closer connection to a foreign country than he had to the U.S. will be disregarded. This is subject to the limitation that the number of days disregarded cannot exceed ten.[43]

2. If he is not regarded as a resident by virtue of either of the two rules noted above but is regarded as a resident because he has acquired a green card, only from the first day he was present in the U.S. while he had a green card.

*Abandonment of residence.* An alien who does not have a green card will not be regarded as a resident of the U.S. after the last day during a year (the "current year") in which he was present in the U.S. if two conditions are met:

1. He is not treated as a resident of the U.S. at any time during the succeeding calendar year.

2. He must show that he has a closer connection to a foreign country than he has to the U.S. during the balance of the current year.

An alien who has a green card must, in addition, relinquish his permanent-resident status before this rule can apply. The *de minimis* 10-day rule noted above also applies for purposes of determining the last day the alien would be treated as a resident in the current year.

*Anti-abuse provision.* Because the mechanical tests for residence treatment can easily be avoided for a year, a concern arose that aliens could plan their affairs to avoid residence treatment for a year (or more) between years of residence and by so doing avoid U.S. income tax on U.S.-source income realized during that period. Section 7701(b)(9) was enacted to deal with this concern. It provides that if an alien is treated as a U.S. resident for at least three consecutive calendar years[44] and then is not treated as a resident for an interim period, the duration of which lasts less than three calendar years, then although he will be treated as a nonresident during the interim period, he will be subject to tax on his U.S. source income at the rates which apply to U.S. residents under the same provisions which apply to U.S. citizens who renounce U.S. citizenship for tax avoidance purposes.[45]

In connection with this special anti-abuse rule, several observations are in order. First, if an individual is again treated as a resident within the proscribed three-year period, he will be subject to the taxation rules of Section 877(b) regardless of whether his treatment as a nonresident during the interim period had as one of its principal purposes the avoidance of U.S. tax. U.S. citizens may fare better, since they may avoid Section 877(b) if their loss of U.S. citizenship did not have as one of its principal purposes the avoidance of U.S. tax.[46] Moreover, this appears to be true regardless of whether the U.S. citizen was also a resident (under pre-existing law standards) since Section 7701(b) in general and Section 7701(b)(9) in particular do not apply to U.S. citizens.

[37] See Prop. Reg. 1.911-2(b). The tax home concept has been borrowed from Section 162(a)(2), relating to the deductibility of travel expenses incurred while "away from home." The cases have arisen under that section. Whether an individual has a tax home and if so where that place might be is a mixed question of fact and law. Understandably the courts have had some difficulty applying the concept to specific fact situations. See, *e.g., Sherman, Jr.*, 16 TC 332 (1951); (which city is tax home when taxpayer has two different businesses, but his earnings from the business located at the city where he and his family do not reside exceeds the earnings from the city where he resides?); *Miller*, TCM 1979-87; (taxpayer worked for 34 continuous months at construction site as a "temporary" job. Job site held not to be "tax home").

[38] Section 7701(b)(3)(B)(ii). *Cf.* Art. 4(2)(a) of the 1977 OECD Model Income Tax Convention (using the term "center of vital interests"). It has been stated that determining the country of closer personal and economic relations will involve factual determinations in each case which may be extremely difficult to make and which may be very controversial. Treasury Technical Explanation of the 1969 U.S.-Netherlands Estate Tax Treaty, 1976-1 CB 477, 479. See also Jones *et al.*, "Dual Residence of Individuals: The Meaning of the Expressions in the OECD Model Convention," 1981 *British Tax Rev.* (Nos. 1 and 2) 15 and 104 at 104-110.

[39] Section 7701(b)(3)(C). If the application for permanent residence is filed by a relative of the alien, this will not count. Only when the alien himself takes some affirmative step in the immigration process will he be treated for tax purposes as having an application pending. Refer to the H. Rep't No. 98-432, part 2, *supra* note 10, at 1526.

[40] Section 7701(b)(3)(D)(ii). In contrast, an individual who comes to the U.S. for purposes of medical treatment will be considered a resident if he stays here long enough to meet the mechanical test. H. Rep't No. 98-432, part 2, *supra* note 10, at 1525.

[41] Section 7701(b)(4); H. Rep't No. 98-432, part 2, *supra* note 10, at 1526, note 26.

[42] See Sections 7701(b)(8)(A) and (B). Generally, a new taxpayer, including an alien who has not had a prior tax liability, was entitled to adopt a taxable year other than a calendar year. *Rev. Rul.* 80-352, 1980-1 CB 160. It is unclear whether Section 7701(b)(8)(A) eliminates this right for all aliens or merely limits this right to an alien who has adopted a fiscal taxable year in accordance with *Rev. Rul.* 80-352 prior to the first year he is treated as a resident. In either case issues under a nondiscrimination provision of an income tax convention may arise.

[43] This provision enables an alien to come to the U.S. (for example, to house-hunt) prior to actually moving here, without being treated as a resident for the period prior to his actual move. See H. Rep't No. 98-432, part 2, *supra* note 10, at 1529.

[44] It appears that the alien must have been treated as a U.S. resident under Section 7701(b) for this provision to apply. See H. Rep't No. 98-861, *supra* note 7, at 967.

[45] See Section 877(b).

[46] The Joint Committee expressed a concern regarding Section 877 generally and this may be the subject of further legislation. H. Rep't No. 98-861, *supra* note 7, at 967.

[47] See Roberts, *Is* Revenue Ruling *79-152, which taxes an expatriate's gain, consistent with the Code?*, 51 JTAX 204 (October 1979).

[48] Some newer treaties to which the U.S. is a party specifically extend the savings clause to permit taxation under Section 877. See, *e.g.*, U.S.-Canada Treaty, Art. XXIX(2).

[49] See, *e.g.*, U.S.-U.K. Treaty, Art. 1(3).

[50] But *cf.* note 7, *supra*.

[51] Act, Section 138(b)(1).

[52] Act, Section 138(b)(2).

[53] Act, Section 138(b)(3).

Second, it is unclear how this anti-abuse rule is intended to operate if in the interim period the alien is a resident of a country with which the U.S. has a treaty the provisions of which provide an exemption from or reduced rate of tax for the U.S.-source income falling within the Section 877(b) net.

In *Rev. Rul.* 79-152, 1979-1 CB 237, the Service confronted a similar although somewhat different issue. The Ruling dealt with the case of an individual who relinquished his U.S. citizenship for the purpose proscribed by Section 877(a) by acquiring residence in a country with which the U.S. had a treaty. Pursuant to the provisions of that treaty, a resident of the treaty country was exempt from U.S. tax on the type of U.S.-source income that under Section 877(b) would have been taxable at regular U.S. tax rates. The treaty did not specifically reserve the right of the U.S. to tax expatriates under Section 877. Notwithstanding what appears to be contrary expressions of intent in the legislative history of Section 877 (not to mention the literal terms of the provisions of the statute itself[47]), the Service ruled that Section 877(b) overrode the contrary treaty provision. While not entirely clear, it appears that the basis of the decision is that the treaty in question had (as all treaties do) a "savings clause" that preserved the right of the U.S. to tax its citizens regardless of any other provisions of the treaty and that taxation on the basis of Section 877 "is a manifestation of United States taxation on the basis of citizenship."[48]

Interestingly, savings clauses at least under our newer treaties[49] do not apply to non-U.S. citizens who are considered under the treaty as residents of the other state. Thus, the savings clause rationale of *Rev. Rul.* 79-152 (if that *is* the rationale) does not appear dispositive. However, it is certainly possible to read into Section 7701(b)(9) an intent to override a conflicting treaty provision.[50]

Third, it appears that Section 7701(b)(9) literally does not apply if an alien continues to be treated as a U.S. resident, for example because he has a green card. Suppose such an alien becomes a resident of a treaty country and under the governing fiscal domicile article of the treaty is treated (for purposes of the treaty) as resident only in the treaty country. Is it possible for the Service to take the position that such "treatment" under a fiscal domicile article is a "manifestation of treatment under section 7701(b) as a nonresident" so that Section 7701(b)(9) may apply?

Finally, as in the case of Section 877(b), Section 7701(b)(9) has no application to foreign-source income realized during the interim period but the special-source rules of Section 877(c) would apply. For example, gain on the sale of stock in a U.S. corporation would automatically be treated as U.S.-source income.

*Effective dates and transitional rules.* The statute will, with the exceptions noted below, be effective for taxable years beginning after 1984.[51] For purposes of the cumulative presence test, days of U.S. presence in 1983 count for purposes of the 1985 calculation only if the alien was a resident of the U.S. under pre-existing law as of the close of calendar years 1983 and 1984. Furthermore, U.S. presence during calendar year 1984 counts for purposes of the calculation required for 1985 only if an alien was a U.S. resident under pre-existing law as of the close of the calendar year 1984.[52] Thus an individual, who under current law was not a resident in the U.S. as of the close of either calendar year 1983 or 1984, may be present in the U.S. for up to 182 days in 1985 without being regarded as a resident in 1985. Of course, such presence would count for the calculation that would be required for 1986 and 1987. Presence in 1985 would likely be considered for purposes of determining whether, under pre-existing law, an alien was a resident for any period prior to 1985.

For purposes of the application of the "green card" test during 1985, an alien will be treated as a resident for 1984 if either he had a green card for the entire calendar year 1984 regardless of whether he was physically present in the U.S., or he had a green card during some part of 1984 and was physically present at any time during 1984 when he had the green card.[53] Accordingly, an alien who has a green card but who has no other significant U.S. contacts should consider whether to give up his green card before the end of 1984 to avoid being treated as a resident for 1985.

### *Conclusion*

Under pre-existing law, except in the clearest cases, it was very difficult to decide whether an alien was to be regarded as a U.S. resident for income tax purposes. To make the determination one had to evaluate all facts and circumstances that could bear on the issue of whether the alien was more or less likely to have had the intention to remain in the U.S. for an indefinite period. Moreover, that evaluation was left in the first instance to the alien, hardly an effective method for enforcing the rules, particularly when even if the alien sought advice on his particular situation he was likely to be told that his situation fell in the gray area.

While one may quarrel with whether limiting the number of permitted days of U.S. presence to the days allowed under the "183 day" and "cumulative presence" tests of the new definition, or with whether taxing an alien as a resident merely because he has a "green card" represents sound policy, that aside, there can be no quarrel that the new rules will to some extent reduce the uncertainty of pre-existing law. Thus aliens who wish to do so may avoid classification as a resident by giving up a green card, if they have one, prior to 1985 and by limiting their U.S. presence to the period allowed under the "183 day" and "cumulative presence" tests.

To be sure, the new rules may cause some hardship, for example, to an alien whose business temporarily requires his presence in the U.S. for 183 days or more in a year. With proper planning, however, even this hardship may be avoided (for example, by having the presence straddle two years, or subject to the new "anti-abuse" rule, deferring a realization of income until the year of nonresidence).

Perhaps the greatest disappointment is that not all of the uncertainty of pre-existing law has been eliminated at least for those aliens who, while not actually present in the U.S. for 183 days or more in a year, satisfy the cumulative presence test. An alien falling within this category who wishes to avoid classification as a U.S. resident must be prepared to establish that his "tax home" is in a foreign country and that he has "closer connections" to that foreign country than he has to the U.S. In some cases, hardships will arise because it will not be possible to point to one foreign country that is both the "tax home" of the alien and the one to which he is more closely connected than he is to the U.S. In those cases, aliens will be well advised to avoid the cumulative presence threshold, which they can do by never being present in the U.S. for more than 121 days in any one calendar year. ☆