

U.S. Tax Residency Rules

‘For U.S. tax purposes, there are four categories of individuals: (i) U.S. citizens, (ii) permanent resident aliens (i.e., “green card holders”) and immigrants, (iii) resident aliens for tax purposes, and (iv) Nonresident aliens for tax purposes.’

‘There are two tests that are used to determine whether a non-U.S. citizen should be treated as a U.S. resident for tax purposes: (i) the “green card” test, and (ii) the “substantial presence” test. If the non-U.S. citizen satisfies (or “passes”) either test, he is a U.S. resident for tax purposes; if he satisfies neither test, he is taxed as a nonresident alien.’

Substantial U.S. Presence Test

This is a mandatory test that is done on a yearly basis by Personnel and Payroll services.

Under the general rule for U.S. tax residency, foreign nationals are “substantially present,” in the United States if they are present for at least 31 days in the current calendar year, and their U.S. days over 3 calendar year equal or exceed 183 days based on a formula. The 183-day formula considers all of the U.S. days in the current calendar year, plus 1/3 of the U.S. days in the prior year, plus 1/6 of the days in the year before the prior year. Foreign nationals whose presence in the United States satisfies the substantial presence formula are resident aliens and taxed like U.S. citizens.

For policy reasons, foreign students are nonresident aliens for U.S. income tax purposes for 5 calendar years. Therefore, they are subject to U.S. income tax only on their U.S. income (unless an exemption applies), but not on their foreign income. This results from the fact that the U.S. days of foreign students do not count for purposes of determining substantial presence in the United States for 5 calendar years.

The 5 calendar years include any year of presence as an “exempt individual” in F, J, M or Q status since 1985. Special transitional rules apply to students who were already in the United States in 1985. Calendar years include years in which foreign students spent in the United States in high school, or even as young children accompanying a student parent.

Whether taxes are lower for foreign students who are resident aliens or nonresident aliens depends upon their type and source of income. Foreign students engaged in optional practical training in their 6th calendar year of U.S. presence frequently wish to remain nonresident aliens to avail themselves of the social security and Medicare Tax exemption that applies to nonresident aliens in F-1 and J-1 status. However, foreign students who are intending to change status to H-1B Specialty Worker are not eligible for the closer connection extension of their non-residency status.

Nonresident Alien Tax Compliance: A Guide for Institutions Making Payments to Foreign Students, Scholars, Employees, and Other International Visitors Volume One by Donna E. Kopley Arctic International LLC.

Example:

An F-1 student, who is subject to the five-year exempt individual rule, arrives in the U.S. for the first time on June 1, 1999. Her first calendar year as an exempt individual will be 1999, and her remaining years of exempt individual status will be 2000, 2001, 2002 and 2003. Beginning on January 1, 2004, she will count days in the U.S. toward the substantial presence test. Assuming she is present in the U.S. for 183 days during 2004, she will meet the substantial presence test on July 2, 2004, and be considered a resident alien for that year.