



# Tax Planning and Compliance for Inbound Individuals

## Executive summary

The United States has a markedly different tax regime for individuals, depending on whether or not they are considered “tax residents” of the U.S. The rules are particularly complicated in the first year an individual arrives in the U.S., when they are considered “dual-status aliens”. Tax practitioners should take great care to plan with clients prior to their arrival in the U.S. to ensure the most tax beneficial path is taken.

Produced by MGI member



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## Introduction

Following is a summary of definitions applicable to dual-status aliens and a discussion of some elections that may be available to them in their first year of U.S. residence.

## Discussion

“**U.S. Resident**” for tax purposes – what is the definition? Meet one of two tests:

- Green Card test – individual has been issued a U.S. Green Card
- Substantial Presence test – individual has been present in the U.S. for at least:
  - » 31 days during the current year; and
  - » 183 days over the prior 3 year period (note that each day in the current year counts as 1 day; in the prior year and 2nd prior year, each day counts as 1/3 and 1/6 of a day, respectively)
  - » Note that there are exceptions, such as commuting to/from Canada or Mexico and days on which you are unable to leave the U.S. due to a medical condition

## Why is it important to make this determination?

- U.S. residents – are taxed on worldwide income, regardless of source
- Nonresident aliens – are taxed ONLY on U.S. source income, generally at a flat rate of 30% of gross income (unless a lower treaty rate applies). Most deductions are not allowable.



## Dual-Status Aliens

- May be both a U.S. Resident and Nonresident Alien in the same tax year (a nonresident alien is defined as any individual who is not a U.S. resident).
- In first year of U.S. residence – may elect to ignore up to 10 days of actual U.S. presence (for purposes of calculating # of days under Substantial Presence test) if:
  - » Have a closer connection to a foreign country; and
  - » Tax home was in that foreign country.
  - » Must file a statement with IRS and attach to income tax return in year of election

## How do Dual-Status Aliens file their U.S. income tax returns?

- Must write “Dual Status Return” across top of Form 1040
- Attach statement showing taxpayer’s income during non-residency period (may use Form 1040NR as a substitute to the statement)
- Statement should include date taxpayer became a resident and dates of residency during the year

## Deductions available to Nonresident Aliens

- State and local taxes
- Moving expenses, if moving to U.S. to earn taxable compensation;
- Business expenses related to income from a U.S. trade or business
- Personal exemption for taxpayer (also for spouse/dependents under most income tax treaties); CANNOT claim standard deduction
- Filing status – May NOT use MFJ or HOH rates

## Elections available to Dual-Status Aliens

### First-year election under IRC Sec. 7704(b)

- May elect to be treated as a U.S. Resident in year of arrival, even if Substantial Presence test is not met. Potential benefit – may claim same deductions and use same filing status available to U.S. residents. Requirements for making election:

- » Available only in year of arrival;
- » Taxpayer is a U.S. resident in year following year in which election is made;
- » Present in U.S. for at least 31 consecutive days in election year;
- » Present in U.S. for at least 75% of days starting with 1st day of 31 day period and ending on 12/31 of election year

### Election to File as a U.S. Resident for the Entire Year under Code Sec. 6013(g)

- Foreign national who is married to a U.S. citizen or resident may elect to be treated as a U.S. resident for entire tax year
- Benefit: joint return may be filed
- Both spouses must make election

### Election to File as a U.S. Resident for the Entire Year under Code Sec. 6013(h)

- Nonresident alien who becomes a U.S. resident before end of tax year, and is married to a U.S. citizen or resident on last day of year – may elect to be treated as U.S. resident for entire year
- Benefit: same as above (ability to file using MFJ status)
- Effect is that both spouses are treated as U.S. residents for entire year
- Is a one-time only election (i.e. does not apply to a later tax year); may NOT make election if either spouse has previously done so
- Election must be made before expiration of period for making a claim for refund

## Conclusion

Given the many choices available to taxpayers who are moving to the U.S., and the differing tax consequences of each, it is of utmost importance to consult with your clients about their specific situation. Having an understanding of the above rules will help you navigate the complexities in working with dual status alien taxpayers.



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