

The ABA logo is rendered in a bold, white, sans-serif font. The letters 'A', 'B', and 'A' are connected, with the 'A's having a slight shadow effect. The background of the entire slide is a vibrant orange with a grid of dashed white lines. Various isometric illustrations are scattered across the background, including a man in a suit, a person at a desk with a laptop, a person holding a lightbulb, a person at a desk with a laptop, a person walking, a person at a desk with a laptop, a person holding a lightbulb, a person at a desk with a laptop, and a person walking. There are also icons of a cloud, a padlock, a globe, and a lightbulb.

AMERICAN BAR ASSOCIATION

Tax Section

**VIRTUAL 2020 FALL TAX MEETING**

# Tax Residence and Nexus in the Time of the Plague

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# The Panel

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# Acknowledgments and Disclaimer

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- These slides were prepared by and represent the views of the non-government speakers and should not be construed to be those of the American Bar Association, Treasury, or IRS. This presentation is intended for educational and informational purposes only

# Overview

- Foreign individuals have always had to closely monitor application of U.S. tax residency rules given the significant tax consequences of being a resident alien, including taxation of worldwide income and extensive reporting requirements
- The COVID-19 pandemic has complicated this calculus, due to travel disruptions, quarantines, border closures, and infection risk. Workers trapped and working remotely in the United States may surprisingly find their earnings subject to tax, and these individuals' activities may unexpectedly create tax nexus or permanent establishment risk and expose their employers to U.S. tax liability
- This panel will discuss relief provided by the IRS to address these challenges and practical planning considerations to manage (if not avoid) these risks

# Agenda

1. But First . . . The "Basics" – IRC § 7701(b) and Treaties
2. Beginning and Ending Residence
3. Special Rules, Traps and Anomalies
4. Relief under Revenue Procedures and FAQs

# But First... The "Basics"

- **Worldwide taxation:**
  - Income tax: Citizens & resident aliens (RAs), with no treaty benefits to reduce U.S. tax, with limited exceptions
  - Estate/Gift/GST: Citizens & domiciled aliens
  - Taxation of nonresident citizens is (almost) unique to the United States
- **Limited NRA income taxation:**
  - Certain U.S. source (FDAP) income – withholding
  - U.S. trade/business (ETB? ECI? FIRPTA?)
  - Treaty benefits
- **Limited NRA Estate/Gift/GST Taxation:**
  - Generally, only U.S. situs assets (defined differently for estate and gift taxes)
  - Minimal exemption: \$60,000
  - Treaty benefits

# Code's Primary Definition of Residence

- Lawful permanent resident (green card) test: Individual is lawful permanent resident under the immigration laws. IRC § 7701(b)(1)(A)(i) and (6)
- Substantial presence test:
  - Present in U.S. at least 31 days in current calendar year, and
  - Sum of days of presence in current year +  $\frac{1}{3}$  of the days of presence in preceding year +  $\frac{1}{6}$  of the days of presence in 2<sup>nd</sup> preceding year is 183 days or more (fractions are not rounded). IRC §§ 7701(b)(1)(A)(ii) and (3)(A)

# Closer Connection Exception

- If alien is not present for 183 days in the current year, can avoid residence by showing foreign tax home and closer connection to foreign country. IRC § 7701(b)(3)(B)
  - Alien must establish "tax home" in foreign country under IRC § 911(d)(3), which cross-refers to IRC § 162 for determination, i.e., regular or principal place of business or, if no place of business, regular or principal place of abode
  - Closer connection refers to personal ties
  - Cannot have taken affirmative steps to become lawful permanent resident. IRC § 7701(b)(3)(C); Reg. § 301.7701(b)-2(f)
- Timely filing requirement



# Steps to Obtain Green Card

- Filing any of the following is considered an affirmative act (non-exclusive list). Reg. § 301.7701(b)-2(f)
  - INS Form 1-508, Waiver of Immunities
  - INS Form 1-485, Application of Status as Permanent Resident
  - INS Form 1-130, Petition for Alien Relative (filed on alien's behalf)
  - INS Form 1-140, Petition for Prospective Immigrant Employee (filed on alien's behalf)
  - Labor Dept. Form ETA-750, Application for Alien Employment Certification (filed on alien's behalf)
  - State Dept. Form OF-230, Application for Immigrant Visa and Alien Registration
- Note that NRA physically in the U.S. may apply for adjustment of status under Immigration and Nationality Act

# Treaty Residence and Tie-Breaker Exception

- Definition: a person subject to tax by reason of domicile, citizenship, residence or similar criteria. U.S. Model, Art. 4(1)
  - Some treaties require additional nexus (e.g., substantial presence, permanent home, habitual abode) for U.S. citizens or residents to be U.S. residents for treaty purposes.
- For person who is resident of the U.S. and of treaty country under respective domestic laws, tests applied sequentially to determine single residence for treaty purposes. US Model, art. 4(2)
  - Permanent home
  - Center of vital interests (personal and economic ties)
  - Habitual abode (day-count test)
  - Nationality/citizenship
  - Competent authority determination
- Must file Form 1040NR with Form 8833. IRC § 6114; Reg. §§ 301.6114-1(b)(8) and (c)(2); Reg. § 301.7701(b)-7(b)

# Substantial Presence Test: What Is a Day?

- Any part of a day counts – does not mean 24 consecutive hours. Reg. § 301.7701(b)-(3)(a)
- Time spent in the U.S. in transit not counted if trip originates and ends outside the U.S. Reg. § 301.7701(b)-(3)(a)(3)
  - Cannot remain in the U.S. for longer than 24 hours.
  - Cannot conduct "business" during layover. Reg. § 301.7701(b)-(3)(d)
- Regular commuter test. Reg. § 301.7701(b)-3(e)

# Substantial Presence Test: "Exempt Individuals"

- Students, with particular visas. IRC § 7701(b)(5)(D)
- Teachers/Trainees. IRC § 7701(b)(5)(E)(i)
- Foreign Government-Related Individual. IRC § 7701(b)(5)(B)
- Certain professional athletes (the "PGA exception"). IRC § 7701(b)(5)(A)(iv)

# Substantial Presence Test: Medical Condition (1)

- Person with a medical condition arising in the U.S. excepted from substantial presence test. Reg. § 301.7701(b)-3(c)
  - Medical condition must arise while alien is in the U.S.
    - Condition is not considered to arise while the individual is present in the United States, if it existed prior to arrival in the United States and the individual was aware of the condition or problem
      - What about a significant unexpected worsening of a pre-existing condition? Pre-existing condition may prevent application of the exception even if the individual did not require treatment when he or she entered the United States
    - Day not excluded if alien is subsequently able to leave and then remains in the U.S. "beyond a reasonable period for making arrangements to leave"
- May not include dependents or caregivers – this issue has never been the subject of a case or further IRS guidance

# Medical Condition Exception (2)

- A day of presence will not be excluded if the individual, who was initially prevented from leaving, is subsequently able to leave the United States and then remains beyond a reasonable period for making arrangements to leave
- An individual must have an intent to leave that is prevented by illness. Conversely, intent to leave will be presumed where the individual leaves within reasonable period after becoming physically able to do so
- A day will not be excluded if the medical condition arose during a prior U.S. stay and the individual returns to the United States for treatment of the medical condition or medical problem that arose during the prior stay
- Intent to leave determined based on facts and circumstances, including original purpose of the stay

# Medical Condition Exception (3)

- When regulations were promulgated in 1992, the IRS said: The legislative history of section 7701(b) clearly states that Congress *intended* that the exclusion of days of presence under the medical exception would apply in very few cases. See H.R. Rep. No. 432, Part 2, 98th Cong., 2d Sess. 1527 (1984)
- This is not quite what the legislative history says, however. Rather it says:  
"The Committee [on Ways and Means] *anticipates* that few individuals will be physically unable to leave the United States"
- In other words, the language of the Committee relates only to its anticipation (not its intention) and only to the physical ability to leave

# The COVID-19 Problem

- A non-immigrant alien becomes a U.S. resident based on days of presence
- The coronavirus pandemic has trapped many aliens in the United States for a variety of reasons:
  - Becoming infected or ill
  - Being responsible for a person who is infected, ill, or unable to travel
  - Being unable to travel because of airline cancellations, quarantines
  - Being unable to return to the country in which they normally reside because of travel restrictions or outright bans
- This can affect their residence status:
  - Forcing them to stay 183 days or more in 2020
  - Causing the three-year formula to equal or exceed 183 days
  - Even if they can leave before spending too many days here, the number of days they can return to the United States may be limited not only in 2020 but also in 2021 and 2022



# Limited Relief Granted: Revenue Procedure 2020-20

- In response to representations by various professional organizations, on April 21, 2020, the Treasury Department and the Internal Revenue Service issued [Revenue Procedure 2020-20](#)
- It provides guidance to individuals and businesses impacted by travel disruptions arising from the COVID-19 pandemic
- Relief provided for NRAs who, but for COVID-19 Emergency Travel Disruptions (as defined), would not have been in the U.S. long enough during 2020 to be deemed resident aliens under the "substantial presence test" or to be ineligible for treaty benefits with respect to determining their tax residency status
- For many stranded foreigners, this guidance means that they have an extra 60 days they can be in the U.S. in 2020 without becoming increasing the day count that could lead them to becoming resident aliens

# COVID-19 Medical Condition Travel Exception (1)

- Revenue Procedure 2020-20 expands on the medical condition exception to provide relief for foreigners stuck in the U.S. as a result of the COVID-19 Emergency, i.e., the global outbreak of the COVID-19 virus
- The Revenue Procedure creates a new exclusion, the "COVID-19 Medical Condition Travel Exception":
  - Allows an "Eligible Individual" (as defined in Section 3.04 of Revenue Procedure 2020-20) who intended to leave the United States during the individual's "COVID-19 Emergency Period," but was unable to do so due to "COVID-19 Emergency Travel Disruptions," to exclude the individual's COVID-19 Emergency Period (up to 60 days) from their day-count under the substantial presence test

# COVID-19 Medical Condition Travel Exception (2)

- The COVID-19 Emergency itself is considered a medical condition and is not considered to be a pre-existing one
- An Eligible Individual is presumed unable to leave the United States for purposes of the substantial presence test on any day during the individual's COVID-19 Emergency Period, unless they have applied for or taken steps to become a lawful permanent resident
- COVID-19 Emergency Period is up to 60 consecutive days starting on or between February 1 and April 1 and during which Eligible Individual was continually present in the U.S.

# Eligible Individual

- Eligible Individual must meet the following:
  - was not a U.S. resident at the end of 2019;
  - is not a lawful permanent resident at any time during 2020;
  - is present in the U.S. on each day of their COVID-19 Emergency Period; and
  - does not become a U.S. resident due to days present in the U.S. outside of the COVID-19 Emergency Period
- An individual who does not qualify for the presumption of an intent to leave the United States outlined in section 4.02 of Rev. Proc. 2020-20 (because the individual has taken steps to become a lawful permanent resident — see slides 8 and 9), should retain any documents that may support a "facts and circumstances" analysis of their intent to leave under Reg. § 301.7701(b)-3(c)(2).

# Counting Days for Treaty Purposes

- A parallel to the Medical Condition Exception applies for purposes of income tax treaties
- Many U.S. income tax treaties exempt income from employment (or other dependent personal services) if the recipient is present in the U.S. for no more than 183 days in any 12-month period that begins or ends in the relevant taxable year. E.g., U.S. Model, art. 14(2) (2006)
  - Treaties generally provide that for purposes of computing days of presence in the U.S. under this type of test, days on which an illness prevented the individual from leaving the U.S. are not counted.
- Up to 60 days (i.e., the COVID-19 Emergency Period) may be excluded for this purpose under Rev. Proc. 2020-20

# 60-Day "Extension"

- Up to 60 days of presence in the chosen COVID-19 Emergency Period may be excluded, which enables the alien to avoid resident alien status for the year, assuming no disqualifying return to the U.S. for the alien in the balance of 2020
- An individual can combine the COVID-19 Medical Condition Travel Exception with other applicable exceptions, including exempt individual status, the general medical condition exception, the closer connection exception, and treaty tie-breaker
  - Example: Aliens who exclude a full 60-day COVID-19 Emergency Period and are entitled to use the closer connection exception, may be able to stay up to a total of 242 days, not just 182 days, in 2020
    - 242 is also the numerical limit for alien who spent zero days in the U.S. in 2018 and 2019
- Still, given the day count is mounting, clients stranded in the U.S. since February should remain vigilant based on their specific circumstances

# Filing and Documentation Requirements (1)

- NRAs who must file a nonresident tax return (Form 1040NR) must file Form 8843, *Statement for Exempt Individuals and Individuals with a Medical Condition*, as detailed in the Revenue Procedure, to claim the COVID-19 Medical Condition Travel Exception
- For those not otherwise required to file Form 1040NR, there is no filing requirement to get the relief under the Revenue Procedure
  - Those not required to file currently can later file Form 8843 if the IRS challenges the individual's nonresident status for tax years 2020, 2021 or 2022
- Complete and accurate records related to the COVID-19 Emergency Period must be kept by all, regardless of whether or not the current filing of Form 8843 is required

# Filing and Documentation Requirements (2)

- Treasury and IRS issued five FAQs on May 27
- FAQ5 addresses documentation requirements arising out of earlier guidance
- An Eligible Individual claiming relief under Rev. Proc. 2020-20 should retain evidence of the individual's presence in the U.S. during the individual's claimed COVID-19 Emergency Period. Examples include:
  - Customs and Border Protection Form I-94 showing the individual's entries into the United States. Note this may be available at <https://i94.cbp.dhs.gov/I94/>
  - Hotel receipts, or travel reservations, including confirmation of changes or cancellations



# May 27 FAQs for Sick or Infected Individuals

- May 27 FAQs also addressed individuals claiming the general Medical Condition Exception in 2020
- FAQ1 removes need to obtain physician's signature on Form 8840 for actual illnesses of 30 days or less
- Instead, FAQ 2 instructs alien individuals claiming the 30-Day Medical Condition to retain documentary evidence that substantiates their medical condition, their inability to leave due to the medical condition, and the period of the medical condition such as:
  - evidence of consultations with a health care provider,
  - receipts related to healthcare purchases,
  - evidence of canceled or changed travel reservations,
  - official medical records, and/or
  - written healthcare correspondence received (e.g., automated responses instructing an individual to self-isolate)
- FAQs 3 and 4 provide additional guidance on how to complete Form 8843, including when an individual wishes to claim multiple Medical Condition Exceptions

# The Personal Services Problem

- Nonresident individuals may have to render services while stranded in the United States
  - Those services may be related to the business for which they came to the United States or they may be related to their home country business but can be performed remotely
- Under IRC §§ 861(a)(3) and 864(b), compensation for services performed in the United States has a U.S. source and is treated as effectively connected with a U.S. trade or business (with a *de minimis* exception)
  - Such individuals may therefore be taxed on other compensation for services they continue to render while stranded

# The USTB/PE Problem

- Nonresident individuals (as well as U.S. citizens normally residing abroad) rendering services while stranded in the United States may create U.S. tax issues for their employers and principals
  - May cause employer or principal to be engaged in a U.S. trade or business (USTB)
  - May create a U.S. office or fixed place of business for purposes of IRC § 864(c)(4)(B) or a permanent establishment (PE) under a relevant treaty
- The Tax Residence and Coronavirus Working Group and Florida Bar Tax Section pointed out these USTB/PE issues to the government
- The IRS responded by issuing two FAQs on April 21

# April 21 USTB/PE FAQs (1)

- FAQ 1: Will a nonresident alien or foreign corporation not otherwise engaged in a USTB be treated as engaged in a USTB as a result of services or other activities conducted by one or more individuals temporarily present in the United States if, but for COVID-19 Emergency Travel Disruptions, those services or other activities would not have been conducted in the United States?
- Answer: Foreign persons or a partnership in which a foreign person is a partner ("Affected Person") may choose a 60-day period beginning between February 1 and April 1 during which services of nonresidents will not be taken into account in determining whether the Affected Person is engaged in a USTB
  - Services to be disregarded must have been performed by persons temporarily present and would not have been performed in the U.S. but for the COVID-19 Emergency Travel Disruptions
  - Can include services of U.S. citizens and green card holders who had foreign tax home in 2019 and reasonably expect to have foreign tax home in 2020

# April 21 USTB/PE FAQs (2)

- FAQ 2: If a foreign person is engaged in a USTB (taking into account FAQ1) but otherwise does not carry on such USTB through a PE under an applicable income tax treaty, will the foreign person be treated as conducting business through a PE due to services or other activities conducted by individuals temporarily present in the United States that would not have been conducted in the United States but for COVID-19 Emergency Travel Disruptions?
- Answer: During an Affected Person's COVID-19 Emergency Period, services or other activities performed by individuals temporarily present in the United States will not be taken into account to determine whether the Affected Person has a PE, provided that the services or other activities would not have occurred in the United States but for COVID-19 Emergency Travel Disruptions

# Issues with the USTB/PE FAQs (1)

- It was pointed out to the government that income excluded from USTB/PE treatment under the FAQs would arguably constitute U.S. source FDAP income, taxable at 30%
  - On June 12, the government responded by adding: An Affected Person's income earned during the COVID-19 Emergency Period will not be subject to the 30% gross basis tax imposed under section 871(a) or section 881(a) solely because the Affected Person is not treated as having a USTB or PE under these FAQs
- It is not clear what happens if a foreign person is found to be engaged in a USTB because their stay in the United States exceeds 60 days. To date, the government has chosen not to lengthen the 60-day period despite ongoing pandemic travel disruptions and related concerns

# Issues with the USTB/PE FAQs (2)

## Employers and Withholding Agents

- Employers and service recipients whose employees and contractors were unable to leave the United States as a result of COVID-19 Emergency Travel Disruptions may have or may have had wage and Chapter 3 withholding obligations, both for compensation paid before the issuance of the FAQs and for compensation with respect to periods outside the Emergency Period (which may not even have been determined at the time of payment)
- The IRS has not taken up recommendations to clarify the position or obligations of such employers or service recipients

# Issues with the USTB/PE FAQs (3)

## Procedure

- The USTB/PE FAQs do not explain how to claim the COVID-19 Emergency Period relief provided
  - The FAQs instruct Affected Persons to retain contemporaneous documentation to establish the chosen Emergency Period and to substantiate that the activities would not have been conducted in the United States but for COVID-19 Emergency Travel Disruptions
  - The FAQs also permit foreign persons to make protective tax return filings
- FAQs are unofficial guidance that can be changed or removed at any time. Taxpayers who hope to avoid being engaged in a USTB or having a PE based on the FAQs should be very cautious, especially if they have activities outside the COVID-19 Emergency Period



# What's Next?

- In the April 21 USTB/PE FAQs, the IRS states that it "will continue to monitor the evolving effects of the COVID-19 Emergency on nonresident alien individuals and foreign corporations and may update these FAQs as appropriate."
- As the impact of the pandemic and governmental responses persist (or re-emerge) in the U.S. and other countries, the IRS should consider additional guidance, such as:
  - Extending the 60-day period generally or for specific categories of aliens (though as of late June, the IRS said it had no plans to do so)
  - Revisit the uncertainties of the medical condition exception, including whether it applies to dependents
- The U.S. and other countries may also consider further guidance to address longer-term or more permanent changes in how business is or must be conducted for the duration of the pandemic and beyond

# Other Responses

- The OECD believes that the extraordinary and temporary conditions of COVID-19 should not change residency and PE determinations under most current treaties. For example, the OECD believes that generally:
  - Working from home or concluding contracts from employee/agent's home should not create a new PE (as home should not be considered to be "at the disposal" of the foreign enterprise)
  - Temporary cessation in work at construction site should not terminate PE.
  - Subsidized income payments to temporarily displaced employees should not create PE
  - Temporary changes in location of officers or executives should not trigger change of "place of effective management" for corporate residency purposes (which should be based on "usual" or "ordinary" circumstances)
  - [https://read.oecd-ilibrary.org/view/?ref=127\\_127237-vsdagpp2t3&title=OECD-Secretariat-analysis-of-tax-treaties-and-the-impact-of-the-COVID-19-Crisis](https://read.oecd-ilibrary.org/view/?ref=127_127237-vsdagpp2t3&title=OECD-Secretariat-analysis-of-tax-treaties-and-the-impact-of-the-COVID-19-Crisis)
- Many other countries have published their own responses and in some cases, bordering countries have entered into bilateral or multilateral agreements

# State Residency Considerations

- Each state may have its own definition of “resident” – not just relevant to aliens
- States also adopt their own sourcing rules for determining income situs, in taxing nonresidents
- AICPA survey of 50 states response to COVID-19 on residency and related issues

<https://www.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/coronavirus-state-filing-relief.pdf> (current version updated through 9/11/2020)

# Questions?

Attendees can submit questions via the Q&A feature on the webinar interface.