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INTERNAL REVENUE SERVICE NATIONAL OFFICE TECHNICAL ASSISTANCE

MEMORANDUM FOR JAMES E. WALLACE
IRS TAXPAYER SERVICE SPECIALIST

FROM: M. Grace Fleeman
Assistant to the Branch Chief
CC:INTL:BR 1

SUBJECT: Resident Alien v. Nonresident Alien Status

This Technical Assistance responds to your memorandum dated March 11, 1999. Technical Assistance is not binding on Examination or Appeals and is not a final case determination. This document is not to be used or cited as precedent.

ISSUE:

Whether Portuguese citizens and residents who were at one time admitted to the United States as lawful permanent residents may elect to be treated as resident aliens for U.S. tax purposes so that the U.S. social security benefits they are receiving will be taxed under section 86 instead of section 871(a)(3).[1]

[1] All references to "section" are to sections of the Internal Revenue Code of 1986 ("Code"), as amended.

CONCLUSION:

Provided the taxpayers' status as lawful permanent residents has not been revoked or abandoned, they may be treated as resident aliens for purposes of section 86 if (i) they refrain from claiming any benefits under the U.S.-Portugal income tax treaty and (ii) they file U.S. tax returns as resident aliens and pay U.S. income tax on a net basis on their worldwide income. The determination of whether the taxpayers' status as lawful permanent residents has been revoked or abandoned must be made under the immigration laws of the United States, which are administered by the Immigration and Naturalization Service ("INS").

FACTS:

The taxpayers are Portuguese citizens and residents who were at one time admitted to the United States as lawful permanent residents ("green card" holders). When they left the United States, they did not relinquish their green cards.

The taxpayers are receiving U.S. social security benefits. They claim they should be treated as resident aliens for purposes of determining how their benefits are taxed by the United States. If the taxpayers are treated as resident aliens, section 86 will apply and a portion of their benefits (0, 50, or 85 percent, depending on their income level) will be taxed at graduated rates on a net basis. If, on the other hand, the taxpayers are treated as nonresident aliens, section 871(a)(3) will apply and 85 percent of the gross amount of their benefits will be subject to a 30 percent withholding tax.

The taxpayers rely on the last two sentences of the following paragraph in Publication 519, U.S. Tax Guide for Aliens:

> **Green Card Test**
>
> You are a resident for tax purposes if you are a lawful permanent resident of the United States ***at any time*** during the calendar year. (However, see *Dual Status Aliens*, later.) This is known as the "green card" test. You are a lawful permanent resident of the United States at any time if you have been given the privilege, according to the Immigration laws, of residing permanently in the United States as an immigrant. You generally have this status if the Immigration and Naturalization Service (INS) has issued you an alien registration card, also known as a "green card". You continue to have resident status under this test unless it is taken away from you or is administratively or judicially determined to have been abandoned.

LAW AND ANALYSIS:

Section 7701(b)(1)(A) provides, in relevant part, that an alien individual who is lawfully admitted for permanent residence at any time during a calendar year shall be treated as a resident of the United States with respect to that calendar year. Code §7701(b)(1)(A)(i). For purposes of section 7701(b), an individual is a lawful permanent resident of the United States at any time if--

> (A) such individual has the status of having been lawfully accorded the privilege of residing permanently in the United States as an immigrant in accordance with the immigration laws, and
>
> (B) such status has not been revoked (and has not been administratively or judicially determined to have been abandoned).

Code §7701(b)(6). An individual is a nonresident alien if such individual is neither a citizen of the United States nor a resident of the United States within the meaning of section 7701(b)(1)(A). Code §7701(b)(1)(B).

The determination of whether the status of the taxpayers in this case as lawful permanent residents has been revoked or abandoned must be made under the immigration laws of the United States, which are administered by the INS. For purposes of the remainder of this memorandum, we assume the INS will continue to treat the taxpayers as lawful permanent residents and that the taxpayers, therefore, will be resident aliens under the rules of section 7701(b).[2] However, section 7701(b) must be applied to the taxpayers with due regard to any treaty obligation of the United States that applies to the taxpayers. Code §894(a).

When Congress enacted section 7701(b), it recognized that an individual who would be treated as a resident alien under section 7701(b)(1)(A) might be treated as a nonresident alien under the so-called “tie-breaker” rules of the income tax treaties to which the United States is a party. The legislative history makes it clear that Congress did not intend for section 7701(b) to override any treaty obligations of the United States:

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[2] If the taxpayers’ status as lawful permanent residents has been revoked, or if there is an administrative or judicial determination that such status had been abandoned, the taxpayers will be nonresident aliens under section 7701(b)(1)(B) and their social security benefits must be taxed under section 871(a)(3).

> The conferees do not intend that the conference agreement override treaty obligations of the United States. For example, an alien who is a resident of the United States under the new statutory definition but who is a resident of a treaty partner of the United States (and not a resident of the United States) under a United States income tax treaty will be eligible for the benefits that the treaty extends to residents of the treaty partner.

H.R. Rep. No. 861, 98th Cong., 2d Sess. 967 (1984).

Consistent with the legislative intent, the regulations issued under section 7701(b) allow individuals who would be resident aliens under section 7701(b), but nonresident aliens under an income tax treaty, to claim benefits under the treaty as nonresident aliens. However, if such individuals elect to claim treaty benefits, they will be treated as nonresident aliens for purposes of computing their U.S. tax liability:

> §301.7701(b)-7. **Coordination with income tax treaties**.–(a) *Consistency requirement–(1) Application*. The application of this section shall be limited to an alien individual who is a dual resident taxpayer pursuant to a provision of a treaty that provides for resolution of conflicting claims of residence by the United States and its treaty partner. A "dual resident taxpayer" is an individual who is considered a resident of the United States pursuant to the internal laws of the United States and also a resident of a treaty country pursuant to the treaty partner's internal laws. If the alien individual determines that he or she is a resident of the foreign country for treaty purposes, and the alien individual claims a treaty benefit (as a nonresident of the United States) so as to reduce the individual's United States income tax liability with respect to any item of income covered by an applicable tax convention during a taxable year in which the individual was considered a dual resident taxpayer, then that individual shall be treated as a nonresident alien of the United States for purposes of computing that individual's income tax liability under the provisions of the Internal Revenue Code and the regulations thereunder (including the withholding provisions of section 1441 and the regulations under that section in cases in which the dual resident taxpayer is the recipient of income subject to withholding) with respect to that portion of the taxable year the individual was considered a dual resident taxpayer.

A dual resident taxpayer may elect not to claim treaty benefits and to file returns as a resident alien. See Treas. Reg. Section 301.7701(b)-7(e), Example 4.

We assume the taxpayers in this case would be treated as residents of Portugal under paragraph 2 of Article 4 (Residence) of the U.S.-Portugal income tax treaty ("Treaty"), which provides the following tie-breaker rule:

> 2. Where by reason of the provisions of paragraph 1, an individual is a resident of both Contracting States, then his status shall be determined as follows:
>
> (a) he shall be deemed to be a resident of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (center of vital interests);
>
> (b) if the State in which he has his center of vital interests cannot be determined, or if he does not have a permanent home available to him in either State, he shall be deemed to be a resident of the State in which he has an habitual abode;
>
> (c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident of the State of which he is a national;
>
> (d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

Assuming the taxpayers are both lawful permanent residents who would be treated as resident aliens under section 7701(b) and residents of Portugal who would be treated as nonresident aliens under Article 4 of the Treaty, it is necessary to determine with respect to each particular taxpayer whether he or she has claimed any benefits under the Treaty.

If a particular taxpayer has claimed benefits under the Treaty as a nonresident alien, he or she cannot elect to be treated as a resident alien for purposes of determining his or her tax liability under the Code. Article 20(1)(b) of the Treaty allows the United States to apply its domestic law to tax social security benefits paid to a resident of Portugal. Under the Code, the taxpayer's social security benefits will be subject to 30 percent withholding (on 85 percent of the gross amount of the benefits) under section 871(a)(3).

If, on the other hand, a particular taxpayer has not claimed benefits under the Treaty as a nonresident alien, such taxpayer will be treated as a resident alien if he or she files a U.S. tax return as a resident alien and pays U.S. tax on his or her worldwide income. In this case, the taxpayer's social security benefits will be taxable at graduated rates on a net basis under section 86. Depending on the total amount of the taxpayer's worldwide income and allowable deductions, there may be little or no U.S. tax actually due on the social security benefits.

If taxpayers who elect to be treated as resident aliens have not been filing U.S. tax returns as resident aliens, they may be liable for unpaid U.S. taxes on their worldwide income and may be subject to penalties for failure to file, as well as penalties and interest on their unpaid taxes.

If you have any further questions, please call (202) 622-3880

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