US Tax Filing Obligations of Dual Residents

With the advent of enhanced scrutiny of “foreign” financial accounts and income by the US Internal Revenue Service (IRS), much confusion exists regarding the filing obligation, if any, of people born on United States (US) soil but citizens of other countries. This paper will explore the answers for a hypothetical Belgian national who was born while her Belgian father was seconded to a US subsidiary of a Belgian multinational corporation, but who now lives and works in Belgium. This analysis is valid only for nationals of a country which has an income tax treaty with the US that is similar to the Belgian Treaty[1].

First, we must define several terms:

Resident: A person treated as resident under the internal laws of the US. Under the Internal Revenue Code of 1986, as amended (the Code) an individual is resident if he or she is (a) a Citizen; (b) a lawful permanent resident (sometimes referred to as the Green Card Test); or (c) a resident pursuant to the Substantial Presence Test (present at least 183 days in one year, but subject to a three year rolling average formula). There are exceptions and qualifications to these requirements which are not relevant here. See Treasury Regulation § 301.7701(b) included in the appendix.

Dual Resident: A dual resident is an individual who is considered a resident of the US, as described above, and also a resident of a Treaty Country pursuant to that country's internal laws. We will assume for this article that our Belgian national accepted citizenship in Belgium and has been issued a Belgian passport.

US – Belgian Treaty Residence Test

Article 4, Section 1 of the US-Belgium Income Tax Treaty defines a resident as any person who,

1 A schedule of current in force US treaty partner countries and treaties can be found at https://www.irs.gov/businesses/international-businesses/united-states-income-tax-treaties-a-to-z

"is liable to tax therein by reason of his domicile, residence, citizenship…". Section 2 goes on to state that, in part,

> An individual who is a United States Citizen or an alien admitted to the United States for permanent residence (a "green card" holder) is a resident of the United States only if the individual has a substantial presence, permanent home or habitual abode in the United States and if that individual is not a resident of a State other than Belgium….

Section 4 of Article 4 deals with "tie breakers." Where an individual is deemed resident in both the US and Belgium, the Treaty looks first to the presence of a permanent home, second to personal and economic relations ("vital interests"), third to nationality and lastly throws up its hands. In such a case, there is a procedure for the fiscal authorities of both countries the "Competent Authority" to settle the question by mutual agreement.

Our Belgian national has no presence or abode in the US and so will not be a US resident under the Treaty.

Dual Resident Non-resident

Consistent with the purposes of Dual Tax Treaties, if a Dual Resident determines that she is a resident of a foreign country under that Country's Tax Treaty, and claims the benefit of that Treaty so as to reduce or eliminate US source taxable income, she will be treated as a Dual Resident Non-resident (DRNR). A Dual Resident electing to be treated as a DRNR will be non-resident for all tax purposes, including the withholding tax requirements on interest, dividends, rents, wages, royalties and other income not connected with a US business. Section 1441 of the Code governs withholding of income tax on non-residents and generally imposes a 30% withholding tax at source. Treasury Decision 9809 makes clear for purposes of Code §1441 that an individual will not be treated as a US person for a taxable year or any portion of a taxable year that the individual is a DRNR.

Effectively Connected Income

All income connected with the conduct of a US trade or business is effectively connected income. A US trade or business could be conducted as a sole proprietorship, partnership, trust, limited liability company or corporation. A trade or business is considered conducted in the US if it has a fixed place of business in the US or a US agent. A US agent is an agent with authority to conclude binding contracts.

Pursuant to the US-Belgian Treaty, a fixed place of business, through which the business of an enterprise is wholly or partly carried on includes a “place of management,” branch, office, factory, workshop, construction site or mine. In the case of a construction site or mine, the project must last for at least twelve months (counting from first shovel to final departure from the country of the constructor or Miner). Such a fixed place of business is referred to as a Permanent Establishment.

A US trade or business could have gross income, but no net income, or all foreign source income and no US source income. A US trade or business could also have income which is exempt from tax. In all cases, its income is effectively connected with its fixed place of business.

Filing Obligations of a Non-resident Alien

A US non-resident with reportable US income files a personal income tax return on Form 1040NR. The due date is the 15th day of the sixth month following the close of the taxable year.

A non-resident alien must file a US income tax return if she is engaged in a US trade or business whether or not the business has taxable income. She must also file form 1040NR if she received income from US sources not related to a US trade or business that was not subjected to the correct US income tax withholding rate under the Code or the relevant treaty. For this purpose, the withholding may have been too low or too high. Under the US-Beligum Tax Treaty, dividends, interest, royalties and wages can be subjected to a reduced rate of withholding. In the case of the later three, the rate may be zero. No return is required if there is no US trade or business and any tax due on other income was

fully paid at source.

Statement of Specified Foreign Financial Assets

The IRS requires “specified persons” to report foreign financial assets which exceed a threshold amount. This is done on Schedule B and on a Form 8938 attached to an income tax return. An individual treated as a DRNR is not a specified person. In addition, Form 8938 is not required to be filed if no income tax return is required. Accordingly, our Belgian national does not have to report foreign financial assets.

FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR)

US persons, including residents, as defined above, with foreign bank and financial accounts that meet the reporting threshold are required to file an annual report with the Bank Secrecy Act Financial Crimes Enforcement Network (BSA FinCEN)[2]. The threshold is a $10,000 aggregate balance at any one time in a calendar year. Reportable accounts include deposit and custodial accounts held in non-US banks or non-US branches of US banks, as well as stock or security accounts in non-US financial institutions.

Please see our related article on FBAR reporting. If you would like to discuss how these issues affect you, please contact your PARLEX advisor.

2 https://bsafiling.fincen.treas.gov/main.html