TAX RULES OF THE ROAD

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US tax rules are the most complex body of law and procedures in the world. The US federal tax rules consist of laws and income and estate tax treaties, plus regulations, rulings, notices, announcements, publications, forms and instructions issued by the Internal Revenue Service (IRS). The most complex and least well-defined tax rules are those that apply to transactions of foreign nationals. In all of its rulings and publications, the IRS fails to provide a framework so that taxpayers and their advisors can understand how to apply the tax rules to transactions of foreign nationals. The purpose of the "Tax Rules of the Road" is to provide you with that framework.

Rule One:
The general tax rule applies unless an exception is available, and the conditions for the exception, including procedural conditions, are met.

One general rule is that all compensation for employment services performed in the United States is subject to US social security and Medicare taxes (FICA). This is the case regardless of the location and currency of payment in most cases, because there is no blanket exception for employees paid outside the United States.

Rule Two:
The exception is not the general rule.

Tax laws typically include exceptions following the general rule. The exceptions may also have exceptions or conditions which can negate the exceptions.

One FICA exception is for nonresident aliens who are in F, J, M, or Q immigration status. Most individuals in such status assume that the general rule is that they are exempt from FICA, but that is not the general rule. The individual must meet all of the conditions of the exception in order to be exempt. For example, a J-2 dependent is not eligible for this exemption because the individual’s employment is not "consistent with the purpose that the individual entered the United States," which was to accompany the primary visa holder.

Rule Three:
The Rules of the Road depend on the "Tax Highway" that you are on.

There are many Tax Highways, each with its own Rules of the Road such as:

- Federal income taxes
- State income taxes
- Federal estate and gift taxes
- State estate taxes
- Social security and Medicare taxes (FICA)

Taxpayers and advisors must know the Tax Highway that they are on in order to apply the Rules of the Road. For example, federal income tax law includes rules for determining when an individual is a resident alien and taxed like a US citizen; or a nonresident alien and taxed under special rules. These residency rules are the "green card" test and the "substantial presence test." However, the State Income Tax Rules of the Road define a resident for state income tax purposes. The residency rule for federal estate taxes is based on the concept of "domicile," but the residency rules for trust grantors, trustees, and beneficiaries are based on the federal income tax residency rules.

Rule Four:
The Tax Highway may intersect with another Tax Highway with another set of Rules of the Road.

The FICA Rules of the Road include an exception for nonresident aliens in F, J, M, or Q status. However, the Federal Income Tax Rules of the Road define the term, "nonresident alien." An individual who meets either the "green card" or "substantial presence" test is a resident alien and, therefore, not eligible for the FICA exemption.

Rule Five:
A Treaty May Override the Rules of the Road

An individual may be entitled to use Rules of the Road provided by an income tax treaty. An estate executor may be able to use an estate tax treaty to reduce U.S. estate taxes.

Under an income tax treaty, a resident of the treaty country for income tax purposes may be exempt from federal income taxes on items of income covered by the treaty provided the treaty conditions are met and the individual follows the procedural rules required by the IRS for the exemption.

Treaties also include general rules with exceptions, and exceptions to exceptions. A good example is the "saving clause." Because the United States taxes its citizens and residents on worldwide income, tax treaties include an exception preserving the right of the United States to tax its citizens and residents as if the treaty did not come into effect. The saving clause includes exceptions for certain benefits, such as for students, trainees, teachers, and researchers. However, these exceptions are negated if the individual becomes a U.S. citizen or U.S. lawful permanent resident ("green card" holder).