Relocation to the US: Individual Tax Considerations

Income Tax Liability

- U.S. residents are subject to tax on their worldwide income. A resident alien is subject to income tax on worldwide income under the same rules that apply to U.S. citizens
- Nonresidents are taxed only on U.S. source income and on income received, accruing or arising in U.S. A nonresident alien is subject to U.S. tax on income that is effectively connected with a U.S. trade or business and on U.S.-source fixed or determinable, annual or periodic gains, profits and income

Test of Residency

- Residency, for US tax purposes, is generally not related to the individual's immigration status: It is possible, and quite common, for a foreign national to be a nonresident for legal or immigration purposes and yet be a resident for tax purposes. Following are two tests used that determine whether a foreign national is a U.S. tax resident. If the foreign national meets the requirements of either of these two tests, he/she will be treated as a U.S. tax resident.
- **The Substantial Presence Test –** this test looks at the number of days of actual physical presence over a three-year period-of-time. If the number of days of U.S. presence equals or exceeds 183 days in the current tax year or 183 "equivalent days" during a three-year period, the foreign national is treated as a U.S. tax resident. An "equivalent" day is defined as:
  - ✓ For the current year, each day of actual presence constitutes one full "equivalent" day.
  - ✓ For the first year preceding the current year, each day of presence counts as one-third of an "equivalent" day.
  - ✓ Each day of presence in the second preceding year counts as one-sixth of an "equivalent" day.
- **The lawful Permanent Resident Test –** a foreign national is considered a U.S. resident taxpayer if he/she has been issued the official privilege of residing permanently in the U.S. This occurs when the foreign national receives an Alien Registration Card ("Green Card").
- **Beginning of Tax Residency Period** - if the foreign national is qualify under the Substantial Presence Test in the current year and was not qualified in the prior year, his residency begins on the first day that he/she physically present in the U.S.
- **End of Tax Residency Period** - the tax residency of a foreign national is terminated on the last day that he/she is present in the U.S. in the year that he/she transfers from the U.S. and establishes a tax home (principal place of work or employment) in another country.

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Income Subject to Tax

- In general, gross income must be segregated into three separate baskets as follows:
  - ✓ **Earned income**: generally salary and earnings from active trades or businesses.
  - ✓ **Portfolio income**: generally investment income, including interest, dividends, certain royalties and gains from the disposition of investment property.
  - ✓ **Passive income**: generally income from traditional tax-shelter investments including real estate.

Employment Income

- In addition to cash payments, taxable salary generally includes all employer-paid items, except qualifying moving expenses and medical insurance premiums and pension contributions to a qualified plan and
- In general, a nonresident alien who performs personal services as an employee in the U.S. at any time during the tax year is considered to be engaged in a U.S. trade or business. An exception to this rule applies to a nonresident alien performing services in the U.S. if all of the following conditions apply:
  - ✓ The services are performed for a foreign employer.
  - ✓ The employee is present no more than 90 days during the tax year.
  - ✓ Compensation for the services does not exceed $3,000.
- These conditions are similar to those contained in the income tax treaty between Israel and the US (as described in the paragraph of 'Double Tax Treaties between Israel and the US' below) expands the time limit to 183 days.
- If an Israeli employee does not fall under the above statutory exception or under the income tax treaty between Israel and the U.S. all U.S.-source compensation received in that year is considered effectively connected income. This income includes wages, bonuses and reimbursements for certain living expenses paid to, or on behalf of, the employee.
- Compensation is considered to be from a U.S. source if it is paid for services performed in the U.S. The place where the income is paid or received is irrelevant in determining its source.
- If income is paid for services performed partly in the U.S. and partly in a foreign country, and if the amount of income attributable to services performed in the U.S. cannot be accurately determined, the U.S. portion is determined on a workday ratio basis.

Deductions/Personal Exemptions

- Certain types of deductions, including amounts related to producing gross income, are subtracted to arrive at adjusted gross income. Such deductions are qualifying employer reimbursed moving expenses and alimony payments.
- After adjusted gross income is determined, a citizen or resident alien is entitled to

claim the greater of itemized deductions or a standard deduction. The amount of the standard deduction varies, depending on the taxpayer's filing status ($11,900 for married individuals filing a joint return and $5,800 for a single (not married) individual and for a married taxpayer filing a separate return.

- Itemized deductions include the following items:
  - ✓ Un-reimbursed medical expenses to the extent that they exceed 7.5% of adjusted gross income.
  - ✓ Income and property taxes of states and localities.
  - ✓ Foreign income taxes paid if a foreign tax credit is not elected.
  - ✓ Certain interest expense, generally home mortgage interest and investment interest expense.
  - ✓ Casualty and theft losses to the extent that they exceed 10% of adjusted gross income.
  - ✓ Charitable contributions made to qualified U.S. charities.
  - ✓ Un-reimbursed employee business expenses.
- A nonresident alien may not use the standard deduction instead of actual itemized deductions. Also, the types of itemized deductions a nonresident alien may claim are limited to casualty losses, charitable contributions made to qualified U.S. charities, certain miscellaneous deductions, and state and local taxes imposed on effectively connected income.
- Individuals who are not dependents of other taxpayers are entitled to deduct a personal exemption in arriving at taxable income. Each personal exemption is currently equals $3,800.
- Self-employed individuals are entitled to the same deductions as employees, except that they may also deduct directly related ordinary and necessary business expenses.

Temporary Assignment

- A temporary assignment is defined as an assignment where the tax home does not change. If the intent of the assignment is to return to the original work location within one year, the assignment is considered a Temporary Assignment.
- In case the intent of the assignment was to return to the original work location within one year but due to un-expected reasons it was extended the foreign national is still entitled for a Temporary Assignment status for the first year of tax residency in the U.S. However, in the following years his assignment will be defined as Non-Temporary Assignment.
- The tax advantage of a Temporary Assignment is that employer-provided benefits such as accommodation, meals, travel, and certain other items related to the assignment are not considered taxable wages to the employee. In the case of a Non-Temporary Assignment, these are typically considered taxable wages.

Dual-Status Taxpayers

- A Dual-Status occurs when a foreign national is defined as a U.S. resident and a nonresident in the same tax year. This occurs in the year that a foreign national moves to the U.S. and in the year that he/she departs the U.S. to resume residency in another country.
- A Dual-Status taxpayer is treated as a nonresident for one portion of the tax year and as a resident for the other portion of the year. Accordingly, he/she will be taxed on the worldwide income he/she received in the period of residency while only his/her U.S. source income will be taxed in the period of nonresidency.

Social Security Tax

- Under the Federal Insurance Contributions Act (FICA), social security tax is imposed on wages or salaries received by individual employees to fund retirement benefits paid by the federal government. The social security tax level is 13.3%, which includes a 2.9% Medicare tax, imposed on the first $110,100 of annual employment income. However, no limit applies to the amount of wages subject to the Medicare portion of the social security tax. 5.65% of the tax is withheld from the employee’s wages and 7.65% by the employer.
- FICA tax is imposed on compensation for services performed in the U.S., regardless of the citizenship or residence of the employee or employer. Consequently, absent an exception, nonresident alien employees who perform services in the U.S. are subject to FICA tax, even though they may be exempt from U.S. income tax under a statutory rule or the Israel-US income tax treaty.