



LB&I International Practice Service Concept Unit

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Unit Name	Identification of a U.S. Trade or Business of a Nonresident Alien
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Table of Contents

(View this PowerPoint in "Presentation View" to click on the links below)

[General Overview](#)

[Detailed Explanation of the Concept](#)

[Training and Additional Resources](#)

[Glossary of Terms and Acronyms](#)

[Index of Related Issues](#)

General Overview

Identification of a U.S. Trade or Business of a Nonresident Alien

- If a nonresident alien (NRA) is engaged in a trade or business within the United States (USTB) during the year, U.S. tax is imposed on all taxable income that is effectively connected with the conduct of the USTB. A NRA is an individual who is not a citizen of the United States, a lawful permanent resident of the United States, does not meet the substantial presence test and has not made a first-year election. For more information on determining the residency status of an individual, see the IIC Jurisdiction to Tax IPN.
- Although most effectively connected income is derived from domestic sources, it may also include certain foreign source income connected with a USTB provided that the taxpayer has an office or other “fixed place of business” within the United States and the income is attributable to that office.
- In determining taxable income, gross income includes only gross income which is effectively connected with the conduct of the USTB, and deductions are generally limited to those that are connected with the effectively connected income. A NRA must file a return in order to receive the benefit of allowable deductions and credits. See IRC 873 and 874. Tax is imposed at graduated rates under IRC 1.
- A NRA reports their U.S. source income on Form 1040NR. Income from the performance of dependent personal services is generally reported on Line 8 (wages, salaries, tips, etc.) on the Form 1040NR. If the income is from the performance of independent personal services or some other type of business activity, the income (and expenses) is generally reported on a Schedule C attached to the Form 1040NR.

General Overview (cont'd)

Identification of a U.S. Trade or Business of a Nonresident Alien

- If a NRA does not have a USTB, his or her U.S. source income may still be taxable as FDAP (fixed or determinable, annual or periodical) income at a flat rate of 30%, unless otherwise reduced or exempted by an applicable income tax treaty.
- This practice unit provides an overview of how to determine whether a NRA is engaged in a USTB. It does not discuss the determination of income which is effectively connected with the conduct of a NRA's USTB, which is addressed in a separate practice unit.

 **CONSULTATION:** The determination of whether a NRA is engaged in a USTB usually arises in the context of personal services performed in the United States or, in certain cases, investment activities in the United States. Examiners who encounter a NRA with a potential trade or business other than the performance of personal services or investment type activities should consult with the Jurisdiction to Tax IPN under the business inbound face of the international matrix.

 **TREATY IMPLICATION:** This unit assumes that the NRA is resident of a non-treaty jurisdiction. Other practice units will address situations where the NRA is resident in a jurisdiction having an income tax treaty with the United States and may be eligible to use the Permanent Establishment and Business Profits articles of the treaty to override domestic tax provisions discussed in this unit.

Detailed Explanation of the Concept

Identification of a U.S. Trade or Business of a Nonresident Alien

Analysis	Resources
<ul style="list-style-type: none"> ▪ The term “trade or business within the United States” is not fully defined in the Code or Treasury regulations, and the IRS will not provide an advanced ruling on whether a taxpayer is engaged in a USTB. ▪ Generally, whether or not a person is engaged in a USTB shall be determined on the basis of the facts and circumstances of each case. A NRA can have a USTB through a dependent agent. ▪ To be engaged in a trade or business, a taxpayer (either directly or through a dependent agent) must be involved in an activity that is considerable, continuous and regular, and the taxpayer’s primary purpose for engaging in the activity must be for income or profit. A sporadic activity does not qualify. ▪ Once it is determined that a NRA has a USTB, the NRA may be able to deduct expenses under IRC 162 (business expenses) and IRC 212 (expenses of producing nonbusiness income). 	<ul style="list-style-type: none"> ▪ Rev. Proc. 2014-7 ▪ Treas. Reg. 1.864-2(e) ▪ IRC 864(c)(5) ▪ <i>Commissioner v. Spermacet Whaling & Shipping Co.</i>, 281 F.2d 646 (6th Cir. 1960) ▪ <i>Amalgamated Dental Co. v. Commissioner</i>, 6 T.C. 1009 (1946)

Detailed Explanation of the Concept (cont'd)

Identification of a U.S. Trade or Business of a Nonresident Alien

Analysis	Resources
<ul style="list-style-type: none">▪ The term “trade or business within the United States” generally includes the performance of personal services within the United States at any time within the taxable year. For some examples of the performance of personal services which were treated as a USTB, see:<ul style="list-style-type: none">• <i>Goosen v. Commissioner</i>, 136 T.C. 547 (2011). A foreign golfer was engaged in a USTB of playing golf and as a result, a portion of his on-course endorsement contract income was considered ECI.• <i>Santos v. Commissioner</i>, 135 T.C. 447 (2010). A foreign teacher participating in an exchange program in the United States was engaged in a USTB.	<ul style="list-style-type: none">▪ IRC 864(b)▪ Treas. Reg. 1.864-2(a)

Detailed Explanation of the Concept (cont'd)

Identification of a U.S. Trade or Business of a Nonresident Alien

Analysis	Resources
<ul style="list-style-type: none">▪ See also:<ul style="list-style-type: none">▪ <i>Lewenhaupt v. Commissioner</i>, 20 T.C. 151 (1953)▪ <i>De Amodio v. Commissioner</i>, 34 T.C. 894 (1960)▪ <i>Pinchot v. Commissioner</i>, 113 F.2d 718 (2d Cir. 1940) ▪ In these cases the court held that a nonresident alien was engaged in business in the United States through his activities connected with the ownership of real property in the United States and the management of such property through a resident agent. ▪ <i>United States v. Balanovski</i>, 236 F.2d 298 (2d Cir. 1956). An Argentine partnership was engaged in a USTB based on the activities its majority partner. As a result, the partners were taxable on their share of the partnership's profits from sources within the United States.	

Detailed Explanation of the Concept (cont'd)

Identification of a U.S. Trade or Business of a Nonresident Alien

Analysis	Resources
<ul style="list-style-type: none">▪ <u>Foreign employer</u>. There is a limited exception for personal services provided for a foreign employer. The exception applies if the following requirements are met:<ul style="list-style-type: none">▪ <u>Foreign employer</u>: The employer is a NRA, foreign partnership, or foreign corporation not engaged in a USTB, or foreign office of a U.S. person;▪ <u>Temporary presence</u>: The services are performed while the NRA is temporarily present in the United States for no more than 90 days during the taxable year. A “day” means any calendar day if the NRA is present in the United States during any portion of the day; and	<ul style="list-style-type: none">▪ IRC 864(b)(1)▪ IRC 7701(a)(5) and 7701(b)(1)(B)▪ Treas. Reg. 1.864-2(b)(2)(i)

Detailed Explanation of the Concept (cont'd)

Identification of a U.S. Trade or Business of a Nonresident Alien

Analysis	Resources
<ul style="list-style-type: none">▪ <u>Compensation</u>: Compensation for the services performed in the United States does not exceed in the aggregate \$3,000. The \$3,000 limitation does not include pensions and retirement pay attributable to personal services performed in the United States and travel advances or reimbursements if the NRA is required to account to his or her employer for the expenses.▪ The exception applies whether the NRA performs the services as an employee or as an independent contractor.▪ This exception does not apply if the NRA works for a U.S. employer or if the foreign employer has a USTB or permanent establishment in the United States.	<ul style="list-style-type: none">▪ Treas. Reg. 1.864-2(b)(2)(iv) ▪ Treas. Reg. 1.864-2(b)(2)(iii)

Detailed Explanation of the Concept (cont'd)

Identification of a U.S. Trade or Business of a Nonresident Alien

Analysis	Resources
<ul style="list-style-type: none">▪ The Treasury regulations provide the following examples:▪ During 1967, A, a nonresident alien individual, is employed by the London office of a domestic partnership. A, who uses the calendar year as his taxable year, is temporarily present in the United States during 1967 for 60 days performing personal services in the United States for the London office of the partnership and is paid by that office a total gross salary of \$2,600 for such services. During 1967, A is not engaged in trade or business in the United States solely by reason of his performing such personal services for the London office of the domestic partnership.▪ The facts are the same as in example (1), except that A's total gross salary for the services performed in the United States during 1967 amounts to \$3,500, of which \$2,625 is received in 1967 and \$875 is received in 1968. During 1967, A is engaged in trade or business in the United States by reason of his performance of personal services in the United States.	<ul style="list-style-type: none">▪ Treas. Reg. 1.864-2(b)(3) Example (1)▪ Treas. Reg. 1.864-2(b)(3) Example (2)

Detailed Explanation of the Concept (cont'd)

Identification of a U.S. Trade or Business of a Nonresident Alien

Analysis	Resources
 CAUTION: Note that the exception for personal services provided for a foreign employer operates in tandem with a nearly identical exception in IRC 861(a)(3) that prevents the compensation from being treated as income from sources within the United States. The net effect is that if the NRA meets the three tests discussed on the previous slide, he or she will not be considered to be engaged in a USTB and his or her compensation will be foreign-source income.	

Detailed Explanation of the Concept (cont'd)

Identification of a U.S. Trade or Business of a Nonresident Alien

Analysis	Resources
<ul style="list-style-type: none"> ▪ <u>Trading in derivatives</u>. If a foreign person is not a dealer, a trade or business within the United States does not include effecting transactions in derivatives for the taxpayer's own account, including hedging transactions. ▪ <u>Investing</u>. Investing, including the active management of one's own investments, however extensive, does not constitute a trade or business. ▪ <u>Ministerial and ancillary activities</u>. A taxpayer does not have a USTB if only routine clerical functions are performed in the United States. ▪ The volume of transactions shall not be taken into consideration in determining whether the NRA is engaged in a USTB. 	<ul style="list-style-type: none"> ▪ <i>Higgins v. Commissioner</i>, 312 U.S. 212 (1941) ▪ <i>Scottish American Investment Co. v. Commissioner</i>, 12 T.C. 49, 59 (1949) ▪ Treas. Reg. 1.864-2(c)(1) and (d)(1)

Detailed Explanation of the Concept (cont'd)

Identification of a U.S. Trade or Business of a Nonresident Alien

Analysis	Resources
<ul style="list-style-type: none"> ▪ <u>NRA students, teachers or trainees</u> ▪ There is a special rule for NRA students, teachers, and trainees who are not otherwise engaged in a USTB. NRAs who are temporarily present in the United States on a F, J, M or Q visa (relating to the admission of students, teachers, trainees, specialists, etc. into the United States) are deemed to be engaged in a USTB during the taxable year. ▪ <u>Partner in a partnership</u> ▪ A NRA who is a member of a domestic or foreign partnership is deemed engaged in a USTB if the partnership is engaged in a USTB. Thus, the determination of whether a foreign partner is engaged in a USTB is made at the partnership level. 	<ul style="list-style-type: none"> ▪ IRC 871(c) ▪ IRC 875(1) ▪ <i>United States v. Balanovski</i>, 236 F.2d 298 (2d Cir. 1956). ▪ <i>Donroy Ltd v. United States</i>, 196 F. Supp 54 (1961) ▪ Prop. Reg. 1.875-1

Detailed Explanation of the Concept (cont'd)

Identification of a U.S. Trade or Business of a Nonresident Alien

Analysis	Resources
<ul style="list-style-type: none">▪ The effect of this rule is that a foreign partner's distributive share of a partnership's effectively connected income is treated as income effectively connected with a USTB of the partner. The opposite issue of whether a partnership is engaged in a USTB by virtue of a partner's activities depends on whether the partner is acting as an agent for the firm or on his or her behalf. <p> CAUTION: Note that the IRS has ruled that if a foreign partner sells or exchanges an interest in a partnership that carries on a USTB through an office or other fixed place of business in the U.S., then at least part of the gain or loss on the disposition is effectively connected income or loss.</p>	<ul style="list-style-type: none">▪ Rev. Rul. 91-32

Detailed Explanation of the Concept (cont'd)

Identification of a U.S. Trade or Business of a Nonresident Alien

Analysis	Resources
<ul style="list-style-type: none"> ▪ <u>Beneficiary of an estate or trust</u> ▪ A NRA which is a beneficiary of an estate or trust which is engaged in a USTB shall be treated as being engaged in such USTB. Unlike a partnership, a trust or estate is a taxable entity and is subject to the effectively connected income tax if it is foreign and is engaged in a USTB. However, the taxable income of a trust or estate is determined with a deduction for amounts that can be distributed or are distributed to beneficiaries. The deductible amounts are taxed to the beneficiaries, who must treat them as having the same character as they do to the trust or estate. The effectively connected income tax is therefore imposed on amounts distributable or distributed to a beneficiary from a trust's or estate's effectively connected income. ▪ <u>Real property investments</u> ▪ Investments in real property in the United States may or may not be a USTB. It can be difficult to differentiate between passive investments, which are not a trade or business, and investments that are a trade or business. 	<ul style="list-style-type: none"> ▪ IRC 875(2) ▪ IRC 652(b) ▪ IRC 662(b) ▪ IRC 871(d)

Detailed Explanation of the Concept (cont'd)

Identification of a U.S. Trade or Business of a Nonresident Alien

Analysis	Resources
<ul style="list-style-type: none">▪ NRAs can elect to treat income from U.S. real property as trade or business income, regardless of whether or not the NRA is actually engaged in a trade or business. The purpose of this election is to allow real property income to be taxed on a net basis and allow related deductions to be taken into account. After making the election for any taxable year, the election remains in force for subsequent years unless the IRS consents to its revocation.▪ Under the Foreign Investment in Real Property Tax Act (FIRPTA), gain or loss from the disposition of a U.S. real property interest is treated as if the NRA were engaged in a USTB and as if the gain or loss were effectively connected with the conduct of the USTB. For more information on FIRPTA, refer to the IIC Withholding IPN.	<ul style="list-style-type: none">▪ IRC 897(a)

Detailed Explanation of the Concept (cont'd)

Identification of a U.S. Trade or Business of a Nonresident Alien

Analysis	Resources
<p>T TREATY IMPLICATION: The provisions of the Code discussed above must be applied to a NRA with due regard to any treaty obligations of the United States that apply to the NRA. For example, a treaty may affect the taxation of a NRA's compensation from the performance of personal services by allocating the taxing rights between the treaty countries. In this respect, a tax treaty might override a provision in the Code that would normally allow the United States to tax the income. It is therefore important that examiners consider income tax treaties in every examination of a NRA.</p>	

Detailed Explanation of the Concept (cont'd)

Identification of a U.S. Trade or Business of a Nonresident Alien

Analysis	Resources
<ul style="list-style-type: none">▪ Treaty articles that may affect various types of income earned by NRAs engaged in a USTB include:<ul style="list-style-type: none">▪ Income from Employment;▪ Directors' Fees;▪ Entertainers and Sportsmen;▪ Pensions, Social Security, Annuities, Alimony and Child Support;▪ Government Service;▪ Students and Trainees; and▪ Business Profits and Permanent Establishment. If a NRA of a treaty country carries on business in the United States through a permanent establishment, the United States may impose tax at the statutory rates on any business profits that are attributable to the permanent establishment.	<ul style="list-style-type: none">▪ 2006 U.S. Model Income Tax Treaty

Training and Additional Resources

Identification of a U.S. Trade or Business of a Nonresident Alien

Type of Resource	Description(s) and/or Instructions for Accessing	References
Issue Toolkits	<ul style="list-style-type: none">Treaty / Visa Tool. Access from the U.S. Business Activities IPN homepage.	
Reference Materials – Treaties	<ul style="list-style-type: none">BNA 907-3rd: U.S. Income Taxation of Nonresident Alien IndividualsBittker & Lokken: Federal Taxation of Income, Estates and Gifts – Chapter 67	<ul style="list-style-type: none">These resources are available in Westlaw.

Glossary of Terms and Acronyms

Term/Acronym	Definition
FDAP	Fixed or Determinable Annual or Periodical
FIRPTA	Foreign Investment in Real Property Tax Act
NRA	Nonresident Alien
USTB	United States Trade or Business

Index of Related Issues

Issue	Associated UIL(s)	References
Creation of a Permanent Establishment (PE) through the Activities of a Dependent Agent in the United States	<ul style="list-style-type: none"> ▪ 9421.01-03 ▪ 9441.04 ▪ 9450.06 	<ul style="list-style-type: none"> ▪ DCN: TRE/9450.06_01(2013)
Substantial Presence Test	<ul style="list-style-type: none"> ▪ 9431.01-01 	<ul style="list-style-type: none"> ▪ DCN: JTO/9431.01_03(2013)
Determining Tax Residency Status of Lawful Permanent Residents	<ul style="list-style-type: none"> ▪ 9431.01-02 	<ul style="list-style-type: none"> ▪ DCN: JTO/9431.01_02(2013)
First Year Election Under IRC 7701(b)(4)	<ul style="list-style-type: none"> ▪ 9431.02-05 	<ul style="list-style-type: none"> ▪ DCN: JTO/9431.02_11(2014)
Effectively Connected Income	<ul style="list-style-type: none"> ▪ 9441.02-01 	<ul style="list-style-type: none"> ▪ Unit in process
Allocation and Apportionment of Expenses	<ul style="list-style-type: none"> ▪ 9441.02-02 	<ul style="list-style-type: none"> ▪ Unit in process
Determination of Permanent Establishment through the Activities of Seconded Employees in the United States	<ul style="list-style-type: none"> ▪ 9441.01-03 ▪ 9450.06-01 	<ul style="list-style-type: none"> ▪ DCN: TRE/9450.06_02(2013)

Index of Related Issues (cont'd)

Issue	Associated UIL(s)	References
Gross Effectively Connected Income (ECI) of a Foreign Corporation (Non-Treaty)	▪ 9422.01-01	▪ DCN: ISI/9422.01_01(2013)
Preparatory and Auxiliary Treaty Exception to Permanent Establishment Status	▪ 9450.06	▪ DCN: TRE/9450.06_03(2013)