



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
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Dear \_\_\_\_\_ :

This letter responds to a series of questions regarding social security payments and withholding taxes that your office sent to us on April 10, 2009.

Q1: How is "the United States" defined for purposes of the IRC?

A1: Unless otherwise specified, section 7701(a)(9) provides the general definition of "the United States" for purposes of the IRC. Under this definition, the United States includes only the 50 States and the District of Columbia. However, for the limited purpose of determining the taxes imposed by Chapter 21 (Federal Insurance Contribution Act) of the IRC, section 3121(e)(2) defines the term "United States" when used in a geographical sense as including the Commonwealth of Puerto Rico, the Virgin Islands, Guam, and American Samoa (collectively referred to as "U.S. possessions" or "U.S. territories"). It is important to remember that the section 3121(e)(2) expansion of this definition to include the U.S. possessions is confined to Chapter 21 taxes and does not apply for purposes of income tax withholding on SSA benefits.

Q2: Is the Northern Mariana Islands (CNMI) included in the definition of the United States for purposes of section 3121(e)(2)?

A2: Although Congress did not amend the text of section 3121(e)(2) of the IRC to include the Northern Mariana Islands (CNMI) in the definition of the United States, section 601(c) of the Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America (CNMI Covenant) provides: "References in the Internal Revenue Code to Guam will be deemed also to refer to the Northern Mariana Islands, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof or of this Covenant." See P.L. 94-241, 48 U.S.C.

§1801. Accordingly, for purposes of social security taxation, the United States includes the CNMI. Additionally, by Presidential Proclamation, on November 4, 1986, the provisions in the CNMI Covenant that grant U.S. citizenship to persons domiciled in the CNMI were made effective.

Q3: How does an individual's status as a bona fide resident of a U.S. possession impact the Social Security Administration's process for administering benefits?

A3: Under the IRC there are special tax provisions that may apply to an individual who is a bona fide resident of a U.S. possession under section 937. However, these special tax rules do not affect how the Social Security Administration should withhold on social security payments made to these individuals. The individual's status as a U.S. resident or nonresident alien is used to determine whether the individual is subject to NRA withholding tax on social security payments. Also, because U.S. possessions are not included in the definition of "United States" for most purposes of the IRC, including section 7701(b) [see Treas. Reg. § 301.7701(b)-1(c)(2)(ii)], time spent in a U.S. possession does not count as days of physical presence in the United States for purposes of determining U.S. residence status under the "substantial presence test" of section 7701(b)(3). On the other hand, an individual who is a lawful permanent resident (i.e., a green card holder) is a "U.S. resident" even if the individual resides in a U.S. possession. See Publication 570, Tax Guide for Individuals with Income from U.S. Possessions, for more information about the tax consequences to individuals with income from a U.S. possession. The publication is available online at: <http://www.irs.gov/pub/irs-pdf/p570.pdf> .

Q4: What is the test for determining whether an individual is a bona fide resident of a U.S. possession?

A4: An individual, including a U.S. citizen, qualifies as a bona fide resident of a U.S. possession if all of the following tests are met:

- (1) The individual is present in a U.S. possession for 183 days during a tax year,
- (2) Has no tax home outside the U.S. possession, and
- (3) Has no closer connection to the United States or a foreign country than to the U.S. possession.

In lieu of meeting the first test (183 days), an individual may still qualify as a bona fide resident if any one of the four alternative tests is met:

- (1) Present in the relevant possession for at least 549 days during the three-year period consisting of the taxable year and the two immediately preceding taxable years, provided that the individual was also present in the relevant possession for at least 60 days during each taxable year of the period;
- (2) Present in the United States for no more than 90 days during the taxable year;

- (3) During the taxable year had earned income (as defined in § 1.911-3(b)) in the United States, if any, not exceeding in the aggregate the amount specified in section 861(a)(3)(B) [\$3,000] and was present for more days in the relevant possession than in the United States; or
- (4) No significant connection to the United States during the taxable year.

See Treas. Reg. § 1.937-1(c). Publication 570 includes detailed information on how to determine whether an individual is a bona fide resident of a U.S. possession.

Of course, as mentioned in A3, the determination of whether an individual is a bona fide resident of a U.S. possession does not affect how the Social Security Administration should withhold income tax on social security payments.

Q5: How do you determine where a retired person has a tax home for purposes of the IRC?

A5: As described in A3, A8, and A10, the special tax rules for bona fide residents of a U.S. possession do not affect how the Social Security Administration withholds on social security payments made to these individuals. Therefore, the determination of whether an individual living in a U.S. possession has a tax home outside that U.S. possession—for purposes of the bona fide residence test described in A4—is irrelevant for withholding tax purposes. In general, for purposes of income tax withholding on SSA benefits, the relevant inquiry is whether the individual is subject to withholding as a nonresident alien. The definition of nonresident alien under section 7701(b)(1)(B) excludes U.S. citizens and U.S. residents. An alien (non-U.S. citizen) individual is a U.S. resident only if that individual (i) is lawfully admitted for permanent residence to the United States at any time during the calendar year (i.e., meets the green card test), (ii) meets the substantial presence test of section 7701(b)(3), or (iii) makes a first-year election under section 7701(b)(4). See I.R.C. § 7701(b)(1)(A). An individual's tax home is relevant only for purposes of determining whether an individual who already meets the substantial presence test (i.e., is a U.S. resident) can claim to be treated as a nonresident under the "closer connection exception" of section 7701(b)(3)(B). Among the requirements that must be satisfied to claim the closer connection exception is that the individual must maintain a tax home in a foreign country during the tax year. Treas. Reg. § 301-7701(b)-2(c)(1) provides that the term "tax home" for purposes of section 7701(b) has the same meaning as it has for purposes of IRC § 162(a)(2) [relating to deduction of travel expenses while away from home]. Although the meaning of the term "tax home," in the context of section 162(a), is inextricably bound up with the idea of the taxpayer's employment or engaging in a trade or business, or engaging in an activity for which deductions are allowed, the regulations under section 7701(b) recognize that many individuals may not have a "tax home" in the section 162(a) sense because they are retired, unemployed, or independently wealthy. Treas. Reg. § 301-7701(b)-2(c)(1) provides that if the individual is not engaged in carrying on any trade or business within the meaning of section 162(a), then the individual's tax home is the individual's regular place of abode in a real and substantial sense. The concept of "abode" has been described by the Tax Court as follows.

"Abode" has been variously defined as one's home, habitation, residence, domicile, or place of dwelling. Black's Law Dictionary 7 (5th ed. 1979). While an exact definition of "abode" depends upon the context in which the word is used, it clearly does not mean one's principal place of business. Thus, "abode" has a domestic rather than vocational meaning, and stands in contrast to "tax home" as defined for purposes of § 162(a)(2).

Bujol v. Comr., T.C. Memo 1987-230, aff'd without written opinion, 842 F.2d 328 (5th Cir.1988).

The location of a taxpayer's abode often will depend on where he or she maintains his or her economic, family, and personal ties. If the facts reveal the retired person has a regular place of living (abode) in a real and substantial sense, the retired person will be considered to have a tax home for purposes of section 7701(b).

Q6: For tax treaty purposes, can a resident of a tax treaty country reside in the United States for three months or longer and still qualify as a resident of that tax treaty country?

A6: Yes. Under some U.S. income tax treaties, an individual who becomes a U.S. resident under domestic law may still be eligible for treaty benefits (these exceptions apply primarily to individuals claiming benefits under the teachers, researchers, students, and trainees provisions). In addition, tax treaties include a so-called "tie breaker" provision, normally located in the Residence article, that provides a set of rules to determine of which treaty country an individual will be considered a resident for treaty purposes. Depending upon the facts and circumstances, an individual who is a resident of the United States and of a treaty partner jurisdiction may be able to apply the tie-breaker rules in favor of residence in the tax treaty country. Individuals should consult the text of the specific treaty to determine whether the tie-breaker provision may be applicable. The text of most U.S. income tax treaties in force may be found on the IRS website at <http://www.irs.treas.gov/businesses/international/article/0,,id=96739,00.html>. Individuals may also find it helpful to review IRS Publication 901, U.S. Tax Treaties, or Publication 519, U.S. Tax Guide for Aliens, both available on the IRS website at <http://www.irs.gov/app/picklist/list/publicationsNoticesPdf.html>, for additional information about tax treaty benefits. See also the answer to Q12 below.

Note: U.S. income tax treaties do not include the U.S. territories within the meaning of the United States for treaty purposes.

Q7: What type of immigration document would be considered for a person who is claiming substantial presence in the United States?

A7: USCIS Form I-94 (Arrival-Departure Record) would be an example. This document lists the person's arrival and departure dates from the United States.

Q8: Does section 937, residence and source rules involving possessions, apply to social security beneficiaries who live in a U.S. possession?

A8: Yes, the rules of section 937 can apply to any individual for purposes of certain possession residence and source determinations, but an individual's status as a bona fide resident of a U.S. possession under section 937(a) does not affect how the Social Security Administration should withhold the gross-basis income tax on social security payments under section 1441. The withholding rules look to the general rules of section 7701(b) for classification of an individual as a U.S. resident or a nonresident alien. Payments of U.S. source income to nonresident aliens are generally subject to withholding. Social security benefits, as defined in section 86(d), are U.S. source income under section 861(a)(8). Moreover, under section 937(b)(2), U.S. source income cannot be possession source income, so any special filing or other rules that potentially could apply to possession source income will not apply to social security benefits.

Q9: How are individuals born in American Samoa, Guam, the Northern Mariana Islands, Puerto Rico and the U.S. Virgin Islands treated for purposes of the nonresident alien withholding tax under Chapter 3 of the IRC?

A9: Individuals born in American Samoa, Guam, the CNMI, Puerto Rico, and the U.S. Virgin Islands are generally considered U.S. citizens (or U.S. nationals in some cases) according to the Immigration and Nationality Act. For federal income tax purposes, social security payments made to a U.S. citizen are subject to tax under section 86, pursuant to the net-basis tax imposed by section 1. Therefore, social security payments made to U.S. citizens are not subject to the gross-basis withholding tax imposed under section 871 on nonresident alien individuals or to the withholding mechanism prescribed under section 1441 for collecting such tax liabilities. The Social Security Administration may want to inform U.S. citizens or U.S. residents (for example, lawful permanent residents) with a mailing address in a U.S. possession to provide a Form W-9 to confirm their status as a U.S. person to avoid application of the nonresident withholding rules to their social security payments. If tax has been withheld in error, a U.S. citizen may request a refund of the over-withheld amount. As a withholding agent, the Social Security Administration should have information about the U.S. or foreign status of their payees (or social security beneficiaries) in its account records.

Note: The withholding rules applicable to U.S. citizens are also applicable to U.S. residents (for example, lawful permanent residents).

Q10: How is a nonresident alien individual (not a U.S. citizen or resident) who is a bona fide resident of American Samoa, Guam, the Northern Mariana Islands or Puerto Rico treated for purposes of the nonresident alien withholding tax under Chapter 3 of the IRC?

A10: Although the substantive U.S. federal income tax liability of nonresident alien individuals who are bona fide residents of American Samoa, Puerto Rico, Guam, CNMI, or the U.S. Virgin Islands may differ depending upon the specific possession involved (see generally section 876), the withholding tax consequences are the same for all nonresident alien individuals who are bona fide residents of a U.S. possession. For purposes of section 1441, nonresident alien individuals, including those who are bona fide residents of a U.S. possession, are subject to gross-basis withholding of 30% on U.S. source fixed, determinable, annual or period income (FDAP). In accordance with sections 871(a)(3) and 1441, 30% withholding on 85% of the social security benefits paid to the nonresident alien individual should be collected by SSA. If an amount has been over-withheld because an individual's substantive tax liability is affected by a special tax provision applicable to bona fide residents of a U.S. possession, such individual may request a refund of the over-withheld amount.

Q11: How does the Visa Waiver Program affect "exempt individuals" described in IRC section 7701(b)(5) for purposes of the substantial presence test?

A11: It has no effect. The visa waiver program permits citizens of certain foreign countries to travel to the United States for stays of 90 days or less for tourism or business purposes without obtaining a visa. Individuals who are physically present in the United States for tourism (B-2) or business purposes (B-1) are not among the "exempt individual" categories described in section 7701(b)(5). Each day such an individual is physically present in the United States would count as a day of physical presence for purposes of the substantial presence test. See the Note in A13 below.

Q12: IRC section 7701(b)(5) defines certain categories of "exempt individuals" where days of physical presence in the United States do not count for purposes of the substantial presence test. Are there any other examples of when a person can be living in the United States and not be a U.S. citizen or resident alien and subject to nonresident alien withholding tax?

A12: Yes. Under Treas. Reg. § 301.7701(b)-7(a), an individual who is a resident of the United States and of a treaty partner jurisdiction (i.e., a dual resident taxpayer) and who applies the treaty's tie-breaker rules in favor of residence in the other country will be treated as a nonresident of the United States solely for purposes of computing his or her U.S. income tax liability. The individual must file IRS Form 8833, Treaty-Based Return Position Disclosure under Section 6114 or 7701(b). See also, the answer to Q6 above.

Q13: What are the visa codes for the "exempt individual" categories described in IRC section 7701(b)(5)?

A13: The general visa types issued to each category of "exempt individual" under section 7701(b)(5) are as follows:

- **A foreign-government related individual temporarily present in the United States**

- by reason of a visa that represents full-time diplomatic or consular status-  
A-1, A-2, G-1, G-2, or G-3 visas, depending on the person's job position
- as a full-time employee of an international organization-  
G-4 visas
- as immediate family member traveling with a foreign-government related individual-  
same underlying visa class as the primary person (e.g., a family member of a G-1 employee receives a G-1 visa).
- **A teacher or trainee** (limited status--generally can't exclude days of physical presence if exempt as a teacher, trainee, or student for any part of two of six preceding calendar years)-  
J-1 or Q-1 visas (immediate family members receive J-2 and Q-2 visas, respectively)
- **A student** (limited status--can't exclude days of physical presence if exempt as a teacher, trainee, or student for any part of more than five calendar years without IRS approval)-  
F-1, F-3, M-1, M-3, J-1, or Q-1 visas (immediate family members receive F-2, M-2, J-2, and Q-2 visas, respectively)
- **A professional athlete temporarily in the U.S. to compete in a charitable event-**  
B-1 (business visitor) visas

Note: Although certain categories of "exempt individuals" described in section 7701(b)(5) contain references to specific visa types, the determination of whether a particular individual qualifies as an exempt individual is not necessarily governed by the type of visa he or she holds, but rather by whether the individual falls within one of the enumerated "exempt individual" categories set forth in section 7701(b)(5). For example, the professional athlete exempt individual category of section 7701(b)(5)(A)(iv) contains a reference to "B" class visas. Although it is true that professional athletes traveling to the United States for the purpose of competing in charitable sports events do enter the United States under "B-1" (business visitor) visas, not all persons entering the United States under B-1 visas are considered exempt individuals under section 7701(b)(5). B-1 class visas are issued to individuals traveling to the United States for a variety of purposes, including consulting with business associates, attending a scientific,

educational, professional or business convention, settling an estate, or negotiating a contract. See, <http://travel.state.gov/pdf/BusinessVisa.pdf> . Each day one of these other B-1 visa holders is physically present in the United States would count as a day of physical presence for purposes of the substantial presence test.

Q14: Are the IRS Forms 1001 and 5335 obsolete? If so, what has replaced them?

A14: Form 1001, Ownership, Exemption, or Reduced Rate Certificate, became obsolete in July 1998. It has been replaced by Form W-8BEN, which is provided by beneficial owners of certain income subject to withholding under section 1441 to a withholding agent to claim a reduced withholding rate or exemption from withholding under an income tax treaty. Form W-8BEN and its accompanying instructions may be found on the irs.gov website.

Form 5335, Income Subject to Withholding Under Chapter 3 Internal Revenue Code as Reported on Form 1042S, was obsolete in 1988. Currently, Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons, is filed by a withholding agent to report tax withheld on certain income of foreign persons, including nonresident alien individuals. Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, is used to report amounts withheld under Chapter 3 of the IRC (which includes nonresident alien withholding under section 1441).

If you have any additional questions, please contact \_\_\_\_\_ at \_\_\_\_\_

Sincerely,

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