

Comments

THE SUBSTANTIAL PRESENCE TEST EXCEPTIONS: TAXING PROBLEMS FOR THE ALIEN

Aliens present in the United States may be subject to federal income taxation. The first step in determining potential tax liability is the classification of an alien as either a resident or nonresident. In the 1984 Deficit Reduction Act, Congress created two tests in an attempt to make the classification simple and objective. The "green card" test accomplishes this congressional goal. The "substantial presence" test, however, is complicated and its exceptions depend on subjective criteria. Therefore, residency determination under the substantial presence test will be unpredictable and will likely result in much litigation. This Comment concludes that this unpredictability is likely to continue until Congress amends the test.

INTRODUCTION

An alien may incur income tax liability because of his presence in, or connections with, the United States. Depending on various factors, an alien's income tax liability may range from no liability¹ to a tax on all income from whatever source derived.² The major factor in determining potential income tax liability is the classification of the alien as either a resident or a nonresident.³ A nonresident alien is taxed only on United States income.⁴ A resident alien is taxed on

1. For example, the United States has income tax treaties with 40 countries. IRS PUB. NO. 519 at 31 (1985). One of the goals of these treaties is the avoidance of international double taxation. This goal is generally accomplished by the agreement of each treaty partner to limit its right to tax income earned in its territory by residents of the taxing country. *Id.* In this manner, an alien may have no United States tax liability.

2. Resident aliens are taxed in the same manner as United States citizens. IRS PUB. NO. 519 at 1. Therefore, resident aliens are subject to the broad language of I.R.C. § 61(a): "Except as otherwise provided in this subtitle, gross income means all income from whatever source derived." I.R.C. § 61(a) (West Supp. 1987).

3. IRS PUB. NO. 519 at 1.

4. I.R.C. §§ 871-879 (West Supp. 1987).

world-wide income.⁵

The Deficit Reduction Act of 1984⁶ (DRA) provides two tests for determining residency status.⁷ The purpose of these tests is to add objective clarity and certainty to a previously confusing area.⁸ The first test, the "green card" test, is truly objective and generally easy to apply. Congressional goals appear to have been successful concerning this test.

The second test, however, the "substantial presence" test, is objective and straightforward only in its initial application. This test provides two exceptions which allow an individual that would otherwise be classified as a resident to be classified as a nonresident. These exceptions are subjective and uncertain in their application and are a breeding ground for future litigation.⁹ Congress not only failed in its attempt to provide objectivity via the "substantial presence" test, but also complicated the determination of an alien's status.

This Comment discusses the pre-1985 determination of an alien's tax status, the impact of the DRA, and the mechanics of the DRA's "green card" and "substantial presence" tests. Then, the Comment analyzes the problems of the "substantial presence" test exceptions. Finally, the Comment proposes changes to alleviate the problems one of these exceptions presents.

HISTORY PRIOR TO THE DRA

Prior to the DRA, the tax status of an alien was determined on a case-by-case basis.¹⁰ No statutory definitions existed for the terms "resident" and "non-resident."¹¹ The income tax regulations provided the only guidelines for the determination. The regulations stated that if an individual was present in the United States and not a "mere transient or sojourner [with a] mere floating intention, indefinite as to time, to return to another country,"¹² the individual

5. IRS PUB. No. 519 at 1.

6. Pub. L. No. 98-369, 98 Stat. 494 (1984).

7. The Tax Reform Act of 1986, enacted while this Comment was being prepared for publication, added a third definition of resident and nonresident aliens. This new definition is not a test. It allows aliens who are nonresidents under the "green card" or "substantial presence" tests in the current year to elect resident status for income tax purposes, provided certain requirements are met. Those requirements are spelled out in amended section 7701(b)(4). Tax Reform Act of 1986, Pub. L. No. 99-514, § 1810(l), 100 Stat. 2085, ____ (1986) (to be codified at 26 U.S.C. § 7701(b)(1)(A)(iii), (4)). Inclusion of the "first year election" provision does not affect this Comment's analysis of the two tests of section 7701(b)(1).

8. See *infra* notes 9-33 and accompanying text.

9. No cases involving the "green card" or "substantial presence" tests have been reported as of March 12, 1987.

10. *Park v. Commissioner*, 79 T.C. 252, 286 (1982).

11. See H.R. REP. NO. 432, 98th Cong., 2d Sess., pt. 2, at 1523-24 (1984) [hereinafter No. 432].

12. Treas. Reg. § 1.871-2(b) (1986).

was a resident for purposes of federal income tax.¹³ One who had a definite purpose for his or her presence and did not stay for an extended period was a nonresident.¹⁴ Further, the regulations provided a presumption that an alien, "by reason of his alienage,"¹⁵ was a nonresident.¹⁶ This presumption could be rebutted by proof of an alien's intentions to remain in the United States or proof of the alien's close ties with the United States.¹⁷

These subjective criteria were uncertain, unwieldy, and required in-depth factfinding.¹⁸ Moreover, the courts were inconsistent in applying these criteria. Some courts emphasized intent; others emphasized the number of days of presence in the United States.¹⁹

The Tax Court's treatment of two representative cases exemplifies this inconsistency. In *Jellinek v. Commissioner*,²⁰ an alien filed a declaration of intent to become a United States citizen. The Tax Court stated that intent alone was not enough and required "some degree of permanent attachment for the country of which he is an alien."²¹ The Tax Court held that Jellinek's three month stay in the United States in 1951, coupled with his total absence from the United States in subsequent years, was insufficient to make him a resident for income tax purposes.²²

In *Marsh v. Commissioner*,²³ however, the alien's intent, not her length of stay in the United States, was a crucial factor to the Tax Court. In *Marsh*, the alien declared her intent to become a United States citizen in 1962. In 1966, she left the United States to live in

13. *Id.*

14. *Id.*

15. Treas. Reg. § 1.871-4(b).

16. *Id.*

17. Treas. Reg. §§ 1.871-4(2)(i), (ii), (iii) provide three methods of rebutting the nonresident presumption:

(i) That the alien has filed a declaration of his intention to become a citizen of the United States under the naturalization laws; or

(ii) That the alien has filed Form 1078 or its equivalent; or

(iii) Of acts and statements of the alien showing a definite intention to acquire residence in the United States or showing that his stay in the United States has been of such an extended nature as to constitute him a resident.

18. This subjectivity was epitomized in *Park v. Commissioner*, 79 T.C. 252 (1982). There, the Tax Court discussed its findings of fact for 34 pages including separate sections on the taxpayer's bank accounts, living accommodations, religious and social activities, and automobiles.

19. No. 432, *supra* note 11 at 1523.

20. 36 T.C. 826 (1961).

21. *Id.* at 834.

22. *Id.* at 835.

23. 68 T.C. 68 (1977).

Japan for an indefinite period. During the next four years, Marsh returned only once to the United States. For this brief visit, immigration officials required Marsh to obtain a nonimmigrant visa, which was inconsistent with her status as one intending to become a United States citizen.²⁴ In 1970, Marsh resumed living in the United States because her husband was unable to find work in Hong Kong. The Tax Court held that Marsh was a resident for income tax purposes for the years she was absent from the United States. The Tax Court ignored the issuance of the nonimmigrant visa and Marsh's four-year absence from the United States.²⁵ Instead, the Tax Court emphasized Marsh's declaration of intent to become a United States citizen and her subsequent return to the United States. Accordingly, Marsh was taxed as a United States resident for each of the four years she resided in Japan.²⁶

As *Jellinek* and *Marsh* indicate, the Tax Court inconsistently emphasized either an individual's intent or the length of presence in the United States. To further complicate matters, the Tax Court has often considered the resident or nonresident status of aliens in years subsequent to the actual tax year in question. One may reasonably assume that had Mr. Jellinek returned to the United States, he could have been taxed as a resident for the years he was absent. Alternatively, had Mrs. Marsh remained in Japan, the Tax Court could have considered her a nonresident from the time she left the United States.

Because each case requires a factual determination, courts are unable to rely on prior cases for strong guidance.²⁷ Some parameters, however, have developed. The Tax Court has generally held that abandonment of a residence in another country was not a prerequisite to being a resident in the United States;²⁸ that an individual could be a resident of more than one country;²⁹ and that some permanence of living within a country's borders was necessary to establish residence.³⁰

Congress soon recognized the problems inherent in this subjective

24. The IRS and the INS consider lawful permanent resident status to be inconsistent with claiming tax benefits as a nonresident. See IRS PUB. NO. 519 (1985).

25. 68 T.C. at 73.

26. *Id.*

27. *Park*, 79 T.C. at 286. The Tax Court was rarely overturned in cases concerning residence status. In affirming *de la Begassiere v. Commissioner*, 31 T.C. 1031 (1959), the Fifth Circuit Court of Appeals stated: "In this case, where the issue is primarily one of fact, it does not appear that the findings of the Tax Court are clearly erroneous." 272 F.2d 709 (5th Cir. 1959).

28. *Adams v. Commissioner*, 46 T.C. 352, 358, 362-63 (1966).

29. *Marsh v. Commissioner*, 68 T.C. 68 (1977), *aff'd per order*, 588 F.2d 1350 (4th Cir. 1978).

30. *de la Begassiere*, 31 T.C. at 1036, *aff'd per curiam*, 272 F.2d 709 (5th Cir. 1959).

determination of residence status. A 1984 House Ways and Means Committee Report stated, "the Committee believes that the tax law should provide a more objective definition of residence for income tax purposes. The Committee believes that present law does not provide adequate guidance with respect to residence status."³¹ To effectuate these goals, Congress passed the Deficit Reduction Act of 1984.

CONGRESS' RESPONSE — INTERNAL REVENUE CODE SECTION
7701(b)

Congress attempted to remedy problems such as those encountered in *Jellinek* and *Marsh*, and attempted to add some predictability to the area, by enacting I.R.C. section 7701(b) as part of the Act. In doing so, Congress chose not to adopt the subjective terms "transient" and "sojourner" of the treasury regulations.³² Instead, Congress added objective definitions for the terms "resident alien" and "non-resident alien." These terms are defined on the basis of two tests.

Sections 7701(b)(1)(A)(i) and (ii) provide two tests to be used in determining residence status. These tests — the "green card" test and the "substantial presence" test — are both purportedly objective.³³ If an alien meets the requirements of either test, the alien is considered a resident for income tax purposes. Conversely, if an alien does not meet the requirements of both tests, the alien is a nonresident for income tax purposes.³⁴

31. No. 432, *supra* note 11 at 1523.

32. These terms are still viable for purposes of I.R.C. section 911 concerning "citizens or residents of the United States living abroad."

33. See generally H.R. REP. NO. 432, 98th Cong., 2d Sess., pt. 2, at 1523 (1984).

34. I.R.C. § 7701(b)(1) (West Supp. 1987) states:

(b) *Definition of resident alien and nonresident alien* —

(1) *In general* — For purposes of this title (other than subtitle B) —

(A) *Resident alien* — An alien individual shall be treated as a resident of the United States with respect to any calendar years if (and only if) such individual meets the requirements of clause (i), (ii), or (iii):

(i) *Lawfully admitted for permanent residence* — Such individual is a lawful permanent resident of the United States at any time during such calendar year.

(ii) *Substantial presence test* — Such individual meets the substantial presence test of paragraph (3).

(iii) *First year election*. Such individual makes the election provided in paragraph (4).

(B) *Nonresident alien* — An individual is a nonresident alien if such individual is neither a citizen of the United States nor a resident of the United States (within the meaning of subparagraph (A)). See also *supra* note 7 (explaining

The "Green Card" Test

Section 7701(b)(1)(A)(i), the "green card"³⁵ test, provides that individuals are residents for income tax purposes if they are lawfully admitted for permanent residence to the United States at any time during the calendar year.³⁶ The section defines "lawful permanent resident" as anyone given the privilege, according to the immigration laws, of residing permanently in the United States as an immigrant, provided such status has not been revoked or administratively or judicially determined to have been abandoned.³⁷

Such an objective test, however, may yield harsh results. For example, application of the "green card" test would have changed the result the Tax Court reached in *Jellinek*.³⁸ Mr. Jellinek was present in the United States for three months in 1953 as a lawful permanent resident. The "green card" test provides that if an alien is present as a lawful permanent resident at any time during the year, then the alien is a resident for tax purposes.³⁹ Therefore, Mr. Jellinek would have been a resident for the year in which he was in the United States for a short time with the intention of leaving the United States permanently.⁴⁰

Congress realized the possibility of these harsh results in the first and last years of an individual's residency. Accordingly, section 7701(b)(2) provides special rules for these years. These rules allow an alien to partition the first or last tax year into resident and non-resident segments. Under these rules, Mr. Jellinek would have been a resident for the first three months of 1953 and a nonresident for the remainder of the year.

The "green card" test is truly objective. It provides the certainty Congress intended and is simple to apply. If an individual has a "green card," he is a resident for income tax purposes. The House Ways and Means Committee justified this blanket application in

sections 7701(b)(1)(A)(iii)).

35. A green card (which is no longer green) is a permanent residence card, Form I-551. It is issued to all immigrants admitted to the United States for permanent residence. J. WASSERMAN, *IMMIGRATION LAW AND PRACTICE* 120 (3d ed. 1979).

36. I.R.C. § 7701(b)(6). See also *infra* note 39.

37. *Id.*

38. See *supra* notes 20-22 and accompanying text.

39. The "substantial presence" test will never tax an alien as a resident unless the alien is present for at least 32 days in the current year. However, presence is unimportant under the "green card" test. An alien may be absent for an entire year and still be taxed as a resident if the alien is a lawful permanent resident I.R.C. §§ 7701(b)(1)(A)(i), (b)(3)(A)(i); see also No. 432, *supra* note 11 at 1523, 1524.

40. I.R.C. § 7701(b)(6) states that an alien is a lawful permanent resident and, therefore, a resident for income tax purposes as long as: "(B) such status has not been revoked (and has not been administratively or judicially determined to have been abandoned)." For information concerning the problems of abandoning lawful permanent resident status, see Mailman, *How Immigration Law Concepts Clarify, Mesh With the Code's 'Resident Alien' Definition*, 65 J. TAX'N 26 (1986).

stating: "[Resident aliens] have rights that are similar to those afforded citizens (including the right to enter the United States at will); equity demands that they contribute to the cost of running the government as much as citizens."⁴¹

It is apparent from section 7701(b) that Congress realized that many aliens cannot or do not wish to obtain a "green card." Focusing on these individuals, Congress provided the "substantial presence" test of section 7701(b)(1)(A)(ii). This test provides the second definition for the resident/nonresident determination. Unfortunately, Congress did not instill the simplicity and objectivity of the "green card" test in the "substantial presence" test and its exceptions.

The "Substantial Presence" Test

For those aliens who do not have or do not want a "green card," section 7701(b)(3) provides that aliens who are "substantially present" in the United States are residents for income tax purposes. This test consists of counting the number of days of physical presence within the United States.⁴² Days of presence are counted for the current year and the two preceding years. Each day in the present year is counted as one. Each day in the first preceding year is counted as one-third. Each day in the second preceding year is counted as one-sixth. If an alien is present in the current year for more than thirty-one days and the three year total of days present is more than 182, the alien is considered a resident for the current tax year.⁴³

Congress justified this formula, stating: "Almost all individuals present in the United States for more than half a year should be taxable as U.S. residents."⁴⁴ But the formula also provides for taxation as a resident when an individual is present for far less than six months if the individual has been present a large number of days in the past two years. Congress stated that "an average of 122 days of

41. No. 432, *supra* note 11 at 1523, 1524.

42. An alien is present in the United States "on any day if such individual is physically present in the United States at any time during such day." I.R.C. § 7701(b)(7)(A).

43. I.R.C. § 7701(b)(3)(A). This formula is expressed more simply in algebraic terms:

where: x = days present in the current year.
 y = days present in the first preceding year.
 z = days present in the second preceding year.

If $x > 31$

and $x + 1/3 y + 1/6 z > 182$, then the alien is a resident under § 7701(b)(3)(A).

44. No. 432, *supra* note 11 at 1523, 1524.

presence over a three-year period is a significant amount of time for the purpose of imposing U.S. tax in such circumstances.”⁴⁵

Applying the “substantial presence” test to the current tax year is simple and objective.⁴⁶ At this level, the test effectuates congressional reform goals. However, counting days present in the two preceding years is complicated and may often lead to unfair results.

For example, if alien *A* is present in the United States every day for two years, the “substantial presence” test would cause *A* to be taxed as a resident for those two years. If *A* concluded business operations on December 31 of the second year and left the United States, *A* would already have the maximum number of allowable days present (182)⁴⁷ for the third year. Thus, if a medical emergency⁴⁸ or some other exigency arose requiring *A* to return to the United States, the “substantial presence” formula would consider *A* a resident after only thirty-two days of presence.⁴⁹ The reason for *A*’s presence would be irrelevant.

Congress recognized that the “substantial presence” test, like the “green card” test, may render harsh results. Therefore, Congress provided exceptions to the “substantial presence” test for certain classes of individuals,⁵⁰ and a limited exception for aliens with a close affiliation to a foreign country.⁵¹ Unfortunately, these exceptions do not contain the objectivity of the “green card” test, nor do they remedy all harsh results such as the example given above.

THE “SUBSTANTIAL PRESENCE” TEST EXCEPTIONS

Congress recognized that objective definitions may spawn harsh results. Therefore, five exceptions were included in I.R.C. section 7701(b).⁵² Two of the exceptions are minor and guard against ludicrous results that would rarely occur but would be intolerable if they

45. *Id.*

46. For a single year, if an alien is present less than 183 days, the alien will be taxed as a nonresident. I.R.C. § 7701(b)(3)(A).

47. $365 \times 1/6 = 60.8$

$365 \times 1/3 = 121.6$
182.4

48. I.R.C. § 7701(b)(3)(D)(ii) provides that an individual is not considered present for days the “individual was unable to leave the United States . . . because of a medical condition which arose while such individual was present in the United States.” Someone entering the United States for medical treatment would be considered present. *Id.*

49. I.R.C. § 7701(b)(3)(A) allows up to 31 days of presence regardless of the number of days present in the past two years.

50. *See infra* notes 56-83 and accompanying text.

51. *See infra* notes 84-126 and accompanying text.

52. I.R.C. § 7701(b)(3)(B)(ii) (closer affiliation to a foreign country); I.R.C. § 7701(b)(3)(D)(i) (exempt individuals); I.R.C. § 7701(b)(3)(D)(ii) (medical conditions; *see supra* note 49); I.R.C. § 7701(b)(7)(B) (commuters from Canada or Mexico); I.R.C. § 7701(b)(7)(C) (West Supp. 1987) (alien in transit between two foreign points).

did.⁵³ A third slightly more expansive exception exempts commuters from Canada and Mexico employed in the United States.⁵⁴

This Comment focuses primarily on the "exempt individual" exception and the "foreign country affiliation" exception. The "exempt individual" exception allows aliens to be taxed as nonresidents "because of the reason for the alien's stay."⁵⁵ The "foreign country affiliation" exception allows an individual to remain in the United States for 182 days in any year, disregarding presence in past years. An alien must meet two requirements to benefit from this exception: (1) the alien must have a "tax home" in a foreign country; and (2) the alien must have a closer connection to that country than to the United States.

Exempt Individuals

Section 7701(b)(4) provides that aliens need not count any days present in the United States while they are "exempt individuals."⁵⁶ An exempt individual is defined as a foreign government-related individual, a teacher or trainee,⁵⁷ or a student.⁵⁸

The "foreign government-related individual" definition is expanded in section 7701(b)(4)(B) to include any individual temporarily present by reason of diplomatic status⁵⁹ or possession of a visa which represents diplomatic or consular status,⁶⁰ by being a full-time employee of an international organization,⁶¹ or by being in the immediate family of these individuals.⁶² The terms "teacher," "trainee," and "student" are expanded in sections 7701(b)(4)(C) and (D), but in the process they take on broader meanings. Subsections (C) and (D) state in relevant part:

(C) Teacher or Trainee. — The term 'teacher or trainee' means any indi-

53. See I.R.C. §§ 7701(b)(3)(D)(ii), (b)(6)(C). Without these exceptions, an alien could be regarded as a resident because a medical condition prevented him from leaving the country or because his plane made a fuel stop in the United States.

54. See I.R.C. § 7701(b)(7)(B) (West Supp. 1987).

55. No. 432, *supra* note 11 at 1523, 1524 (1984).

56. I.R.C. § 7701(b)(5)(A)(i).

57. I.R.C. § 7701(b)(5)(A)(ii).

58. I.R.C. § 7701(b)(5)(A)(iii). The Tax Reform Act of 1986 also exempts professional athletes temporarily present in the United States to compete in charitable sports events. I.R.C. § 7701(b)(5)(A)(iv).

59. I.R.C. § 7701(b)(5)(B)(i).

60. *Id.* Though not explicitly set forth, the section refers to A and G class visas. See A. GELLMANN, K. COHEN & J. GRASSMICK, UNITED STATES IMMIGRATION FOR BUSINESSES, INVESTORS AND WORKERS 2 (1981).

61. I.R.C. § 7701(b)(5)(B)(ii).

62. I.R.C. § 7701(b)(5)(B)(iii).

vidual —

(i) who is temporarily present in the United States under subparagraph (J) of section 101(15) of the Immigration and Nationality Act (other than as a student). . .

(D) Student. — The term 'student' means any individual —

(i) who is temporarily present in the United States —

(I) under subparagraph (F) of section 101(15) of the Immigration and Nationality Act, or

(II) as a student under subparagraph (J) of such sections 101(15).⁶³

Using the INA subparagraphs for defining these terms and using the terms "any individual" broadens the definition of "teacher," "trainee," and "student." Anyone with a J or F visa is an exempt individual under the "substantial presence" test. A J visa can be obtained by scholars, trainees, teachers, professors, research assistants, specialists, "leaders in their fields" and the spouses and children of J visa holders. An F visa can be obtained by one attending a college, university, seminary, conservatory, academic high school, elementary school, a language training program, or any other academic institution, and includes the F visa holders' spouse and children.⁶⁴

As a result of this broad definition of the terms "teacher," "trainee," and "student," individuals whom Congress did not intend to benefit from this exception may be benefited. To insure that aliens would not obtain an F or J visa merely to avoid resident tax status, section 7701(b) stipulates that individuals must "substantially

63. Immigration and Nationality Act, §§ 101(15)(F),(J), 8 U.S.C. §§ 1101(15)(F),(J) (1982) [hereinafter INA] state:

(F)(i) an alien having a residence in a foreign country which he has no intention of abandoning, who is a bona fide student qualified to pursue a full course of study and who seeks to enter the United States temporarily and solely for the purpose of pursuing such a course of study at an established college, university, seminary, conservatory, academic high school, elementary school, or other academic institution or in a language training program in the United States, particularly designated by him and approved by the Attorney General after consultation with the Secretary of Education, which institution or place of study shall have agreed to report to the Attorney General the termination of attendance of each nonimmigrant student, and if any such institution of learning or place of study fails to make reports promptly the approval shall be withdrawn, and (ii) the alien spouse and minor children of any such alien if accompanying him or following to join him;

(J) an alien having a residence in a foreign country which he has no intention of abandoning who is a bona fide student, scholar, trainee, teacher, professor, research assistant, specialist, or leader in a field of specialized knowledge or skill, or other person of similar description, who is coming temporarily to the United States as a participant in a program designated by the Director of the United States Information Agency, for the purpose of teaching, instructing or lecturing, studying, observing, conducting research, consulting demonstrating special skills, or receiving training and who, if he is coming to the United States to participate in a program under which he will receive graduate medical education or training, also meets the requirements of section 1182(j) of this title, and the alien spouse and minor children of any such alien if accompanying him or following to join him

64. *Id.*

compl[y]" with the requirements of the visas.⁶⁵

To comply with the requirements of an F visa, an alien must be a bona fide student qualified to pursue a full course of study, must have a residence in a foreign country of which he has no intent to abandon, and must intend to enter the United States temporarily and solely to pursue a full course of study.⁶⁶ Once an alien enters the United States with an F visa, however, a determination of continued compliance with the requirements of the visa is often difficult. The INS has only one procedural method available for this purpose. This procedure requires all institutions who have F visa students in attendance to report to the Attorney General if the F visa holder fails to carry a full course of study, fails to attend classes to the extent normally required, or terminates attendance at the institution.⁶⁷ However, the INS has found that such institutions do not always comply with the requirement of reporting F visa violations.⁶⁸

The consequences to an individual who does not comply with the F visa requirements are deportation⁶⁹ and determination as a resident for tax purposes. The consequence to an institution which fails to report violations is loss of INS approval necessary for accepting F visa students. These results, however, are rare because institutions are often unaware of violations or fail to report them. Thus, the INS and IRS may remain uninformed of any noncompliance.

The "substantial presence" test allows an F visa holder to remain an exempt individual for five years or more.⁷⁰ As a result, an alien may stay in the United States for an extended period without being taxed as a resident and, perhaps, without complying with the terms of the visa.⁷¹

65. I.R.C. §§ 7701(b)(5)(C)(ii) and (D)(ii).

66. See *supra* note 63.

67. 8 C.F.R. §§ 214.3(g) (1986).

68. In *Blackwell College of Business v. Attorney General*, 454 F.2d 928 (D.C. Cir. 1971), the INS reported that F visa holders do not always comply with the requirements of the F visa and that institutions do not always comply with the reporting requirement. A letter from the INS to the institution in *Blackwell College* stated:

Recent visits to your school by an officer of this Service . . . revealed that classroom attendance by such aliens is minimal, and that the majority of these students have never actually attended class at all, and that less than 10% of them attend classes regularly. There is no evidence of record that this Service has been kept informed of this lack of attendance.

454 F.2d 928, 937 (Robb, J., dissenting).

69. See, e.g., *In re Sancho* 13, I & N Dec. 641 (BIA 1970).

70. I.R.C. § 7701(b)(5)(E)(ii).

71. Generally the only way an F visa holder can be deported is if the alien has been convicted of a crime. See, e.g., *In re Mehta*, 14 I & N Dec. 451 (BIA 1973).

The compliance issue concerning J visa holders is different than that for F visas. A J visa alien must enter the United States under the auspices of a program sponsor,⁷² either the United States government or a foreign government.⁷³ Therefore, a J visa holder's activities while in the United States are subject to fairly close scrutiny. Accordingly, compliance with the requirements of the J visa is often easier to determine than compliance with the F visa.

The main issue concerning the J visa is the availability of a number of different classes of visas for aliens with the same qualifications. Two aliens present in the United States for the same reasons may be taxed differently merely because of the classification of their visas. The J visa holder will be taxed as a nonresident despite the length of stay in the United States.⁷⁴ The non-J visa holder will be taxed as a resident if found to be "substantially present" in the United States.⁷⁵

An alien who qualifies for a J visa is also eligible for a B, H-1 or H-3 visa. Often the converse is also true: an alien who qualifies for a B, H-1 or H-3 visa may also be eligible for a J visa. B visas are for business visitors,⁷⁶ H-1 visas are for aliens of distinguished merit or ability,⁷⁷ and H-3 visas are for trainees in various types of industry and professions.⁷⁸ Why Congress singled out J visas for special treatment is unclear. The House and Ways and Means Committee stated that this preference would allow "the United States to maintain its paramount position in the field of education."⁷⁹ But often J visa holders are not connected with education, while an H-1 holder may have such a connection and yet not be afforded special tax treatment.

Prior to the DRA, B, H-1 and H-3 visas were accorded the same status as J visas.⁸⁰ All four visas allowed the alien holder to be a nonresident "absent exceptional circumstances."⁸¹ All but the J visa lost this favored status under the DRA. The DRA initially balanced its unequal treatment of the four classes by providing a two-year cap on the J visa exception.⁸² But the Tax Reform Act of 1986 extended this limit to four years.⁸³ Now, in many instances, the only difference

72. See B. HING, *HANDLING IMMIGRATION CASES* 36 (1985).

73. *Id.*

74. I.R.C. § 7701(b)(5).

75. I.R.C. § 7701(b)(3).

76. INA § 101(15)(B), 8 U.S.C. § 1101(15)(B).

77. INA § 101(15)(H)(i), 8 U.S.C. § 1101(15)(H)(i).

78. INA § 101(15)(H)(iii), 8 U.S.C. § 1101(15)(H)(iii).

79. No. 432, *supra* note 11 at 1524 (1984).

80. Treas. Reg. § 1.871-2(b).

81. *Id.*

82. I.R.C. § 7701(b)(5)(E)(i).

83. Tax Reform Act of 1986, Pub. L. No. 99-514, § 1810(l)(1), 100 Stat. 2085, _____ (1986) (to be codified at I.R.C. § 7701(b)(5)(E)(i)).

between a J visa and the other three classes may be the tax treatment accorded their holders.

This arbitrary result can be tempered by proper planning before obtaining a visa. If tax status is a concern, then an alien should apply for a J visa. But if an alien is uninformed of the possible tax ramifications of a visa classification, then this area could become a trap for the unwary.

The "exempt individual" exception is somewhat arbitrary and may produce problems in its application. However, although it is not as simple or objective as the "green card" test, the "exempt individual" exception still successfully effectuates congressional reform goals in the determination of an alien's residence.

Affiliation With a Foreign Country

Whereas the "exempt individual" exception allows only certain classes of individuals to remain in the United States without incurring residence status, a second exception to the "substantial presence" test is available to any alien.⁸⁴ Under the second exception, if an alien is more closely affiliated with a foreign country than with the United States, the alien is considered a nonresident. This exception, however, allows only 182 days of presence in any tax year. Because of the 182 day limit, this exception addresses the problems of aliens who are present in the current year for less than 183 days but, because of their presence in the two preceding years, would still be residents under the "substantial presence" formula.⁸⁵

The foreign affiliation exception allows an alien to remain in the United States as a nonresident for up to 182 days in any year if the alien has a tax home in a foreign country and has a closer connection to that foreign country.⁸⁶ Unfortunately, the objectivity Congress attempted to instill in the tests of section 7701(b) is replaced in this exception with subjective standards. The objectivity is lost because the terms "tax home" and "closer connection" are not defined in the Internal Revenue Code. One seeking to determine residency status under the exception must resort to judicial interpretation of these terms. Unfortunately, the courts have not agreed on an interpretation of "tax home"⁸⁷ or "closer connection."⁸⁸

84. I.R.C. § 7701(b)(3)(B).

85. *Id.*

86. *Id.*

87. *Markey v. Commissioner*, 490 F.2d 1249, 1254 (6th Cir. 1974). *See also infra* notes 89-110 and accompanying text.

88. *See generally Park*, 79 T.C. 252 (1982).

“Tax Home”

Section 7701(b)⁸⁹ provides that the term “tax home” in section 7701(b) is to have the same meaning as it does in the first sentence of section 911(d)(3).⁹⁰ Section 911(d)(3) provides: “The term ‘tax home’ means, with respect to any individual, such individual’s home for purposes of section 162(a)(2) (relating to traveling expenses while away from home).”⁹¹ I.R.C. sections 162(a) and 162(a)(2) state:

There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including — (2) traveling expenses (including amounts expended for meals and lodging . . .) while away from home in the pursuit of a trade or business.⁹²

This definition of “tax home” is inadequate for a number of reasons: it is inherently subjective;⁹³ its interpretation has not been judicially agreed upon;⁹⁴ and it is defined in section 162(a) in reference to a business deduction.⁹⁵ Clearly, Congress did not originally intend for section 162 to be used as a factor to determine nonresident status of foreign individuals.⁹⁶ Furthermore, case law has developed guidelines, albeit inconsistent ones, for the term “tax home” in determining business deductions.⁹⁷ But these guidelines may be unfair or meaningless in determining an alien’s tax home.

How courts will interpret the tax home definition in section 162 in relation to an alien’s tax home is uncertain. However, possible interpretations arise by analyzing the treatment courts have given the term in the business deduction context and then applying this analysis to situations involving aliens.

Courts that have addressed the interpretation of “tax home” for business deduction purposes have disagreed on the factors relevant to the determination. In finding the location of a tax home, courts have alternatively emphasized the location of a business, location of a residence, the number of days of presence, and the location of income

89. I.R.C. § 7701(b)(3)(B)(ii).

90. I.R.C. § 911(d)(3) (West Supp. 1987). Section 911 of the Code addresses the issue of United States taxation on United States citizens’ or residents’ foreign earned income. Section 911(d)(3) is the only place in the Code where aliens’ and U.S. citizens’ taxation directly cross paths. *Id.*

91. I.R.C. § 911(d)(3).

92. I.R.C. § 162(a) (West Supp. 1987).

93. *Michel v. Commissioner*, 629 F.2d 1071 (5th Cir. 1980).

94. *Id.* at 1073.

95. Section 911(a) provides an exclusion of foreign earned income from gross income for U.S. residents living abroad. I.R.C. § 911(a).

96. Section 162 predates section 7701(b). Therefore, one may assume that section 162 was not intended to address residency issues concerning aliens. I.R.C. §§ 162, 7701(b).

97. *See infra* notes 99-112 and accompanying text.

production.⁹⁸

If a taxpayer's business and residence are in the same location, all courts agree that the taxpayer's tax home is in that location.⁹⁹ However, when the business and residence are in different locations, most courts of appeal have held that the tax home is where the business is located.¹⁰⁰ At least two circuit courts, however, have held that the tax home is the residence's location.¹⁰¹

In determining an alien's tax home, if an alien has both a business and a residence in a foreign country, the alien's tax home is in that country. However, if the alien has only a business or a residence in the foreign country, the result is unclear. The outcome may ultimately depend on which circuit has jurisdiction over the case. The overall result seems arbitrary, yet an individual alien could predict the probable results in a particular case. This predictability, however, may provide little consolation to the alien who will be considered a resident, and pay more tax than an alien fortunate enough to live in a different circuit.

The outcome may be less predictable in other situations. For example, when a taxpayer has two business locations, the courts must look at criteria other than the business location to determine the taxpayer's tax home. In *Markey v. Commissioner*¹⁰² the taxpayer had business in two locations. In determining which location was the taxpayer's tax home, the court looked at the time spent at each location, the degree of business activity at each location, and the income derived from each location.¹⁰³ The determination in *Markey* was relatively simple because the taxpayer's presence and income were substantially greater at one of the locations.¹⁰⁴ However, if these factors are split between the locations, courts have alternately emphasized "time spent" and "income derived."¹⁰⁵

The IRS has consistently emphasized that the time spent at each location should be the deciding factor in determining which business

98. *Id.*

99. *Six v. United States*, 450 F.2d 66 (2d Cir.) *rem'g* 322 F. Supp. 547 (S.D.N.Y. 1971).

100. *Id.*

101. *See, e.g., Harvey v. Commissioner*, 283 F.2d 491 (9th Cir. 1960), *rev'g* and *rem'g* 32 T.C. 1368 (1959); *Six v. United States*, 450 F.2d 66 (2d Cir.), *rem'g* 322 F. Supp. 547 (S.D.N.Y. 1971).

102. 490 F.2d 1249 (6th Cir. 1974).

103. *Id.* at 1252.

104. *Id.* at 1255.

105. *Hicks v. Commissioner*, 47 T.C. 71 (1966).

location is the tax home.¹⁰⁶ But to use the time factor alone would be unfair in deciding an alien's tax home. If an alien is present for the allowable 182 days under this "substantial presence" test exception the alien would have to spend every day for the rest of the year at the business location in the foreign country. Fortunately, the courts have not always agreed with the IRS. Some courts have held that the location which produces the most income is the tax home regardless of the time spent at that location.¹⁰⁷

Two more possible results further demonstrate the inadequacy of using the section 162 tax home definition to determine an alien's tax home. First, if an alien does not have a business in either the United States or a foreign country, the alien could automatically lose the benefits of the closer affiliation exception. Under section 162(a)(2), the location of a tax home is a moot point when a business deduction for traveling expenses is not being sought.¹⁰⁸ Therefore, an alien may be precluded from this exception merely because the alien does not have a business in a foreign country. This result would arise without consideration of the alien's activities in the United States.

Second, if an alien does not have a principal place of business or a "regular place of abode in a real and substantial sense"¹⁰⁹ in the United States, the courts may still find that the alien has a tax home in the United States and consequently does not have a tax home in a foreign country. In *Hicks v. Commissioner*,¹¹⁰ an individual traveled around the United States in pursuit of business and pleasure. The Tax Court held that the taxpayer was an "itinerant" and disallowed a business deduction because the taxpayer's tax home followed him around the country.¹¹¹

For aliens, the result in *Hicks* may be unfavorable. If an alien travels around the United States in "pursuit of business and pleasure," the court may hold that the alien has a tax home in the United States despite the lack of any permanent abode or business location. As a result, a showing of a tax home in a foreign country may be precluded because an individual has only one tax home.¹¹²

Closer Connection

The second prong of the "foreign affiliation" exception requires an alien to further demonstrate a "closer connection" to a foreign coun-

106. Rev. Rul. 82, 1963-1 C.B. 33; Rev. Rul. 67, 1961-1, C.B. 25.

107. *Sherman v. Commissioner*, 16 T.C. 332 (1951).

108. *See supra* notes 91-92 and accompanying text.

109. Rev. Rul. 82, 1983-1 C.B. 45.

110. 47 T.C. 71 (1966).

111. *Id.* at 73.

112. No reported case of an individual having two tax homes exists.

try than to the United States.¹¹³ The connection must be to the same country in which the alien's tax home is located.¹¹⁴

Whereas the tax home inquiry requires a reading of both the revenue code and the cases interpreting the code, the "closer connection" requirement depends upon case law prior to the Act. Still, some duplication in the factors that would determine the location of a tax home and the existence of a closer connection to a foreign country apparently exists.¹¹⁵

Prior to the DRA, the Tax Court frequently examined three factors: (1) the location of the alien's family, whether marital or lineal;¹¹⁶ (2) whether the alien rents or owns a residence — in either the United States or the foreign country;¹¹⁷ and (3) whether the alien is considered a resident for income tax purposes in the foreign country.¹¹⁸ The court used these factors in addition to the location of a business or residence and the type of visa an alien held. One may conclude that these three factors will be at the core of the closer connection inquiry.¹¹⁹

In addition to these factors, courts may also consider other, somewhat minor, criteria that were occasionally emphasized in cases decided prior to the DRA. In *Park v. Commissioner*,¹²⁰ the Tax Court examined factors such as the number of days the alien was present in Korea,¹²¹ the number of days he was listed in a Washington, D.C. social directory,¹²² and the quality of his living conditions in Korea.¹²³ Although none of these factors alone was the basis for the court's decision, the cumulative effect of these and other factors was sufficient for the court to consider Park a resident.¹²⁴

Similarly, in *Escobar v. Commissioner*,¹²⁵ the Tax Court held that the aliens were residents, in part because they had bank accounts in the United States and Maryland drivers' licenses. The court also

113. I.R.C. § 7701(b)(3)(B)(ii).

114. *Id.*

115. Although the locations of a business and residence are the primary factors involved in the tax home inquiry, these factors would also seem to impact on the closer connection criteria.

116. Rev. Rul. 529, 1973-2 C.B. 37.

117. *Park v. Commissioner*, 79 T.C. 252 (1982).

118. *Id.*

119. See IRS PUB. No. 519 (1985).

120. 79 T.C. 252 (1982).

121. *Id.* at 296.

122. *Id.* at 289.

123. *Id.* at 281.

124. *Id.* at 297.

125. 68 T.C. 304 (1977).

noted that the aliens were active socially in Maryland.¹²⁶

This inquiry indicates that the foreign affiliation exception, consisting of the tax home and closer connection criteria, is a return to the subjectivity of the law prior to the DRA. This portion of section 7701(b) does not simplify the resident/nonresident determination, nor does it allow aliens to accurately predict their tax status.

CONCLUSION

Congress intended section 7701(b) to simplify and remove the subjectivity of the resident/nonresident determination. The “green card” test effectively carries out this intent. It is simple, objective, and predictable. Otherwise harsh results are ameliorated by the ability to partition the first and last years of presence into resident and nonresident segments. The “substantial presence” test is objective in its initial application. This initial objectively, however, is overshadowed by the test’s complexity and the potential unfairness in its use of prior years of presence.

The “exempt individual” exception to the “substantial presence” test is somewhat arbitrary in its treatment of J visas. Also, inability to check compliance with the F visa may present problems. Still, the “exempt individual” exception is an improvement over the prior law and is therefore acceptable.

However, the closer affiliation to a foreign country exception is neither simple nor objective. This exception is confusing and complicated and will not permit an alien to make any tax plans with certainty. The subjectivity that Congress intended to remove from the residence determination is pervasively present in this exception. The “closer affiliation” exception fails to effectuate the congressional intent of simplicity and predictability.

To remedy this situation, the closer affiliation to a foreign country exception should be deleted from section 7701(b). The “substantial presence” test should also be amended to allow an alien to be present for 152 days in any year before incurring resident income tax liability. This would simplify the “substantial presence” test by making it unnecessary to count fractions of days present in preceding years. The number 152 is a compromise between the average number of days (122) allowed for three years and the maximum number of days (182) for any one year. At the very least, these proposals would render predictable results and preclude the litigation that will arise under section 7701(b) as it now stands.

J. SCOTT KIRCHER

126. *Id.* at 309.