

Cross-Border Tax-Related COVID-19 Relief

On April 21, 2020, the IRS released a much-awaited package of guidance in the cross-border tax space that provides relief to those impacted by the COVID-19 pandemic. The guidance relates to (1) day-counting for both tax residency purposes and certain treaty positions, (2) the ability of taxpayers to claim the foreign-earned income exclusion, and (3) carrying on a U.S. trade or business. The summary below provides an overview of this guidance, which has been issued in a combination of IRS Revenue Procedures and a "Q&A" available on the IRS website.

(1) Substantial Presence Test and Certain Treaty Benefits

As travelers around the world remain on lockdown, several countries have issued guidance related to residence rules or day-count tests for purposes of determining an individual's tax residency, which can often turn on the number of days spent in a country. The IRS issued Revenue Procedure 2020-20, which provides rules for exempting certain days from an individual's day-count in the United States for purposes of the "substantial presence test" to become a U.S. tax resident under Internal Revenue Code Section 7701(b)(3).

This guidance recognizes that the COVID-19 pandemic may have caused individuals to spend additional days in the United States, whether due to shelter-in-place and quarantine orders, infection, travel disruptions, border closures, or other obstacles, including feeling unsafe to travel in light of social distancing recommendations. In the absence of relief, such individuals' longer-than-anticipated stays in the United States could cause their day-counts to be high enough to trigger U.S. tax residency or to affect their ability to claim certain treaty benefits. Therefore, the IRS provided guidance on how to claim a "COVID-19 Medical Condition Travel Exception" to avoid counting certain days present in the United States.

The relief available in relation to tax residency applies only to individuals who would otherwise become U.S. tax residents under the "substantial presence test." Under this test, an alien individual is considered a U.S. tax resident for a calendar year if:

1. the individual is present in the United States for at least 31 days in that calendar year; and
2. the sum of:
 - (i) the number of days of presence in that calendar year,
 - (ii) one-third of the number of days of presence in the preceding calendar year, and
 - (iii) one-sixth of the number of days in the second preceding calendar year totals 183 or more.

For purposes of U.S. tax treaties, the number of days spent in the United States can also be relevant to whether income from employment income is taxable by the United States. A number of tax treaties exempt such income from U.S. taxation if the individual was present in the United States for 183 days or less in any 12-month period that begins or ends in the relevant tax year.

Both for purposes of the substantial presence test and day-counting under tax treaties, there are exceptions available if an individual is forced to remain in the United States on account of a medical condition.¹ The new guidance expands this concept to provide relief to individuals impacted by the COVID-19 pandemic, as described below.

¹ See Section 7701(b)(3)(D)(ii) and Treasury Regulation Section 301.7701(b)-3(c).

In the case of an individual seeking to exclude days of presence for purposes of the substantial presence test, the COVID-19-related relief is available only if that individual: (1) was not a U.S. tax resident at the close of the 2019 tax year; (2) is not a green card holder at any point in 2020; (3) is present in the United States on each day of a period of up to 60 days of that individual's choosing (which meets certain requirements, described below), called the "COVID-19 Emergency Period"; and (4) does not become a U.S. tax resident in 2020 due to days spent in the United States outside of that "COVID-19 Emergency Period."

Individuals that meet the above requirements can exclude the days comprising their "COVID-19 Emergency Period" from their substantial presence test calculations.² An individual's "COVID-19 Emergency Period" is a period of up to 60 consecutive calendar days selected by that individual beginning on or after February 1, 2020, and on or before April 1, 2020, during which the individual is physically present in the United States on each day. For example, an individual might choose the 60-day period beginning February 15, which would continue through April 14. Alternatively, an individual might choose a period beginning on March 18 that continues through May 16. Similarly, individuals seeking to claim treaty benefits for certain employment income may exclude any days during their "COVID-19 Emergency Period" in determining their eligibility for such benefits. In general, individuals will be presumed to have been unable to leave the United States on any day during their "COVID-19 Emergency Period" for both U.S. tax residency and treaty eligibility purposes.

To claim this COVID-19 relief for purposes of the substantial presence test, an individual who is otherwise required to file a nonresident income tax return (IRS Form 1040-NR) must attach an IRS Form 8843, *Statement for Exempt Individuals and Individuals with a Medical Condition* to their return. Individuals who are not required to file a Form 1040-NR do not need to file Form 8843 but should retain records related to the individual's reliance on Revenue Procedure 2020-20. The IRS does not specify the records to be retained, but in the absence of more detail regarding any record-keeping requirements, we believe it would be prudent to retain information such as details related to the lockdown orders and flight cancellation communications from airlines, to name just a couple of examples. Note that international travelers can access their records of admission into the United States through the U.S. Customs and Border Protection I-94 website.³ Individuals seeking to claim this COVID-19 relief to qualify for treaty benefits related to employment income must file Form 8233, *Exemption From Withholding on Compensation for Independent (and Certain Dependent) Personal Services of a Nonresident Alien Individual* according to the instructions in Revenue Procedure 2020-20.

(2) Foreign Earned Income Exclusion

The IRS also released Revenue Procedure 2020-27, which relaxes the time requirements for U.S. citizens or residents to claim the foreign earned income exclusion found in Internal Revenue Code Section 911. This relief applies in cases where an individual reasonably expected to meet the eligibility requirements for this exclusion, but failed to do so due to certain COVID-19-related circumstances. In order to exclude certain foreign earned income or amounts related to housing from their calculation of gross income, individuals must have a tax home in a foreign country and satisfy certain residency or presence requirements in a foreign country.⁴ Existing rules provide that an individual will be treated as satisfying these requirements even though the individual left the foreign country in cases where the Secretary of the Treasury has determined that individuals were required to leave because of war, civil unrest,

² Revenue Procedure 2020-20 also notes that other exceptions to the "substantial presence test" will continue to apply – such as the exclusion of days of presence for exempt individuals (such as students), exclusion of days under the medical condition exception, the closer connection exception, and relief available to certain treaty country residents.

³ <https://i94.cbp.dhs.gov/I94/#/home>

⁴ Under Internal Revenue Code Section 911(d)(4), an individual must be either: (a) a U.S. citizen and a *bona fide* resident of a foreign country for an uninterrupted period that includes an entire taxable year, or (B) a U.S. citizen or resident who, during any period of 12 consecutive months, is present in a foreign country during at least 330 full days.

or similar adverse conditions that precluded the normal conduct of business. In such a case, individuals must establish that but for those conditions, they could reasonably have been expected to meet the residency or presence requirements for claiming the exclusions for foreign earned income and/or housing amounts.

Revenue Procedure 2020-27 provides that, for purposes of the foreign residency or presence requirements noted above, the COVID-19 emergency is an adverse condition in the 2019 and 2020 tax years that has precluded the normal conduct of business (i) in the People's Republic of China, excluding Hong Kong and Macau, as of December 1, 2019; and (ii) globally, as of February 1, 2020. As of May 6, 2020, the period during which the COVID-19 emergency is deemed an adverse condition that would preclude the normal conduct of business lasts through July 15, 2020, but this may be extended through further guidance.

In order to claim this COVID-19 relief for foreign earned income purposes, the individual must have established foreign residency or presence prior to December 1, 2019, in the case of China, and prior to February 1, 2020, for everywhere else. Eligible individuals must claim the foreign earned income exclusion on a Form 2555, *Foreign Earned Income* and attaching it to their original or amended U.S. federal income tax returns.

(3) U.S. Trade or Business Issues for Nonresident Aliens and Foreign Businesses

In two relatively brief questions and answers on its website,⁵ the IRS has provided limited guidance to nonresident alien individuals and foreign businesses who, due to COVID-19-related disruptions, are conducting business activity from the United States. Similar to the day-counting relief described in part (1) above, a nonresident alien, foreign corporation or partnership in which either a nonresident alien or a foreign corporation is a partner may choose a COVID-19 Emergency Period consisting of an uninterrupted period of up to 60 calendar days, beginning on or after February 1, 2020, and on or before April 1, 2020, during which services or other activities conducted in the United States will not be taken into account for purposes of determining whether they are engaged in a U.S. trade or business. In order to benefit from this relief, the activities to be disregarded must have been performed by either a nonresident alien (taking into account the day-count relief available in Revenue Procedure 2020-20, described above), or a U.S. citizen or green card holder who had a tax home outside of the United States in 2019 and who reasonably expects to have a tax home outside the United States in 2020.

The Q&A also provides that the activities taking place during the COVID-19 Emergency Period noted above should not be taken into account in determining whether the nonresident alien or foreign business has a permanent establishment for purposes of a tax treaty analysis, assuming the business activity would not have occurred but for the COVID-19 disruptions.

Comments

Although the relief described above is welcome, it is somewhat limited. For example, suppose a foreign individual who regularly spends approximately 120 days or less in the U.S. annually is trying to avoid becoming a U.S. tax resident under the substantial presence test. She had arrived in New York in mid-February of 2020 and had been planning on returning to her home country in early March. Suppose further that the individual's home country had seen a spike in COVID-19 cases by early March, and the individual decided it would be too risky to travel home – or perhaps faced flight cancellations. Ultimately, that individual returns to her home country in early June of 2020.

⁵ <https://www.irs.gov/newsroom/information-for-nonresident-aliens-and-foreign-businesses-impacted-by-covid-19-travel-disruptions>

Assume further that this individual had planned to return to the United States for a longer stay or stays later in the year, and spends another three months total in the United States later in 2020. If the individual chose March 1 as her start date for her COVID-19 Emergency Period, that would only extend to April 29. Therefore, she would be left to deal with over 30 “extra” days in 2020 on account of COVID-19-related issues that are not exempted by Revenue Procedure 2020-20. As of May 6, 2020, thousands of flights remain canceled and much of the world continues to be in lockdown, so the 60-day period may come up short for others as well.

Under the substantial presence test, even after accounting for her COVID-19 Emergency Period, this individual is over the 183 day-count. She may be eligible to claim the closer connection exception. In order to do so, she would need to file Form 8843, *Statement for Exempt Individuals and Individuals with a Medical Condition* to claim the closer connection exception. Showing that closer connection in a case like this may be more difficult, however, depending on how much time was ultimately spent in the United States and countries other than the individual’s home country.

Given the relatively limited number of days in the United States that will not be counted for purposes of this guidance, foreign individuals should carefully consider their travel plans for the remainder of the year and be mindful of the possibility of having to file certain forms with the IRS. In all cases, individuals should take care to preserve all travel records and notifications of flight changes and cancelations. Furthermore, individuals should be mindful of state tax residency requirements, which do not always follow federal rules.

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Henry P. Bubel

212-336-2615

hpbubel@pbwt.com

Jenny L. Longman

212-336-2409

jlongman@pbwt.com

Tiffany N. Tam

212.336.2520

ttam@pbwt.com

To subscribe to any of our publications, call us at 212.336.2813, email info@pbwt.com or sign up on our website, <https://www.pbwt.com/subscribe/>.

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