The Substantial Presence Test Requirements

Excerpt from: South of 49 by Philip McKernan, Dan Sampson, and Mike Cunning

You will be considered a US resident for tax purposes if you meet the substantial presence test for the calendar year. To meet this test, you must be physically present in the United States on at least:

1. 31 days during the current year, and
2. 183 days during the 3-year period that includes the current year and the 2 years immediately before that, counting:
    - All the days you were present in the current year and
    - 1/3 of the days you were present in the first year before the current year, and
    - 1/6 of the days you were present in the second year before the current year

For instance, to determine whether you met the substantial presence test for 2008, calculate the number of days you were present in the US during 2008, 2007 and 2006. The days do not have to be consecutive, and you are treated as being present in the US on any day you were there for part or all of the day. Each day:

- In 2008 counts as a full day
- In 2007 counts as one-third of a day; and
- In 2006 counts as one-sixth of a day

If your total is at least 183 days, you have met the substantial presence test and you are considered a resident alien for 2008. If your total is less than 183 days, you are considered a non-resident alien for 2008.

EXAMPLE

Florence and Henry are residents of Canada and own a trailer home in Florida, where they spend each winter. Although they have no US source income, they need to determine their US residency status. To do this, they have to determine how many days they were in the US during 2008, 2007, and 2006.

- 2008: They were in the US from Jan 1 – Apr 10, and from Nov 13 – Dec 31 (150 days).
- 2007: They were in the US from Jan 1 – Mar 31, and from Nov 14 – Dec 31 (138 days).
- 2006: They were in the US from Jan 1 – Apr 5, and from Nov 1 – Dec 31 (156 days).

Each Day they were in the US during 2008 counts as a full day (150). Each day they were in the US during 2007 counts as 1/3 of a day (138 multiplied by 1/3 = 46). Each day they were in the US during 2006 counts as 1/6 of a day (156 multiplied by 1/6 = 26)

They add the subtotals: 150 + 46 + 26 = 222. Since this total is at least 183 days during the 3-year period, they meet the substantial presence test and are considered resident aliens by the US for 2008.

Exceptions to the Substantial Presence Test

For Canadians snared by the substantial presence test, all is not lost. There are three exceptions to the test, which allow a Canadian to still be taxed as a non resident: the closer-connection-to-a-foreign-country exception, the exempt individual exception and the treaty tiebreaker provisions.

Exception 1: Closer Connection

An individual who, despite meeting the substantial presence test, maintains a closer connection to a foreign country will not be treated as meeting the test for the current year if:

- The individual is present in the US fewer than 183 days during the current year;
- The individual maintains a tax home (e.g., a main place of business or employment; or, if an individual has no such place, then the place where he/she regularly lives) in a foreign country during the current year; and
- The individual has a closer connection during the current year to a single foreign country in which he/she maintains a tax home than to the US.

An individual may generally establish that his/her tax home is in a foreign country but showing that his/her principal place of business or employment and/or abode is located in such foreign country. The tax home must be in existence for the entire taxable year and must be in the foreign country to which the individual claims a closer connection. Thus, the closer-connection exception generally will not apply to the year an individual moves to the US.

The determination of whether an individual has a closer connection to such foreign country will generally be made by weighing the individual's contacts with the US against those with the foreign country. Such contracts include the location of one's:

1. Regular or principal permanent home
2. Family
3. Automobiles
4. Personal belongings
5. Social, cultural, religious and political organizations
6. Banks with which an individual conducts routine personal banking activities
7. Registration to vote
8. Investments

Both the tax-home and closer-connection determinations are factual in nature and therefore subject to some degree of uncertainty. Therefore, a Canadian should generally rely on the closer-connection-to-a-foreign-country exception only as a last resort. Furthermore, this exception will not apply for any year during which the individual has an application pending for adjustment to permanent resident status or has taken other affirmative steps to apply for status as a lawful permanent resident of the US.

In order to qualify for the closer connection exception, an individual must file a form with the IRS.

Exception 2: Exempt Individual

Under the exempt-individual exception, an individual generally will not be treated as being present in the US on any day in which he/she is temporarily present in the US as a foreign government-related individual, a teacher or trainee who holds a J visa, a student holding either an F, J or M visa, or a professional athlete temporarily in the US to compete in a charitable sports event.

Exempt individuals are required to file a form with the IRS stating why they are exempt from US taxation.

Exception 3: Treaty Tie-Breaker Provisions

It is possible that a Canadian will be considered to be a resident of both Canada and the US pursuant to the tax laws in each country. The Canada-United State Income Tax Convention (the Treaty) provides relief from being considered a resident of both locations as follows:

1. An Individual shall be deemed to be a resident solely of the country in which he/she has a permanent home available;
2. If a permanent home is available in both countries, or if a permanent home is not available in either country, the individual will be deemed to be a resident solely in the country with which his/her personal and economic relations are the closer (center of vital interests).
3. If the center of vital interests cannot be determined, he/she will be deemed to be a resident of the country in which he/she has a habitual abode;
4. If a habitual abode is available in both countries or in neither country, he/she will be deemed to be a resident of the country of which he/she is a citizen;
5. If he/she is a citizen of both countries, or of neither, the competent authorities of the countries will settle the question by mutual agreement.

Although an individual who holds a US permanent resident visa may claim to be a non-resident of the US pursuant to the Treaty, it is advisable that the individual consult with his/her immigration attorney before claiming non-resident status. The US Income Tax Regulations provide that claiming non-resident status may affect the determination by the Immigration and Naturalization Service as to whether the individual qualifies to maintain a residency permit.

A tax return must be filed in a timely fashion to claim the Treaty Tie-Breaker Provisions. Failure to file within the time limits may result in significant penalties.