

Resident Aliens should fear the IRS more than ICE

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ABSTRACT

If a taxpayer is not a United States citizen, either by birth or naturalization, there is still an obligation with regards to U. S. taxation. To understand those obligations, it is crucial to know the difference between the definition of a resident alien and a nonresident alien. The status of an individual will indicate how the taxpayer will be taxed. As the United States uses a self-assessment procedure for reporting income taxes, it is the responsibility of the taxpayer to know if they are required to file a tax return and what kind of income is to be included. This paper explores the issue of a non-filed return that has no statute of limitations and will leave the resident alien exposed to a never-ending potential tax audit*.

*Any use of the term “illegal alien” in this paper is due to the legislation that uses the term.

Keywords: Resident Alien, Nonresident Alien, Taxation, Income Tax Returns and Statute of Limitations.



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Introduction

The United States taxes all residents even if they are noncitizens. When an individual resides in the United States for more than six (6) months, they are required to file a tax return on any United States income. As the noncitizen does not have a social security number, they are permitted to get a taxpayer identification number in order to file an income tax return. The conundrum for the resident is that failure to file a return subjects the income to no statute of limitations and the IRS may audit and assess a tax liability at any time. As there is no time limit, the resident exposes themselves, or their estate, to a tax liability that is years old. The IRS may audit any year where no return was filed. If no records are kept and no return was filed, the IRS could extrapolate the income that they believe has been earned and assess a tax even after death. The non-filed returns expose the taxpayer to years of liability that could grow from a misdemeanor to a felony. If the resident's non-filed return is determined to be a felony, this would be considered a basis for deportation.

Definition of a Resident Alien and Nonresident Alien.

The definition of resident alien and nonresident alien for income tax purposes can be found in the Internal Revenue Code, Section 7701(b) as follows:

(1) In general

(A) A resident alien. An alien individual who shall be treated as a resident of the United States with respect to any calendar year 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 list 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)).

(2) Special rules for first and last year of residency.

(A) First year of residency.

(i) In general. If an alien individual is a resident of the United States under paragraph (1)(A) with respect to any calendar year, but was not a resident of the United States at any time during the preceding calendar year, such alien individual shall be treated as a resident of the United States only for the portion of such calendar year which begins on the residency starting date.

(ii) Residency starting date for individuals lawfully admitted for permanent residence. In the case of any individual who is a lawfully permanent resident of the United States at any time during the calendar year, but does not meet the substantial presence test of paragraph (3), the residency starting date shall be the first day in such calendar year on which he was present in the United States while a lawful permanent resident of the United States.

(iii) Residency starting date for individuals meeting substantial presence test. In the case of an individual who meets the substantial presence test of paragraph (3) with

respect to any calendar year, the residency starting date shall be the first day during such calendar year on which the individual is present in the United States.

(iv) Residency starting date for individuals making first year election. In the case of an individual who makes the election provided by paragraph (4) with respect to any calendar year, the residency starting date shall be the 1st day during such calendar year on which the individual is treated as a resident of the United States under that paragraph.

(B) Last year of residency. An alien individual shall not be treated as a resident of the United States during a portion of any calendar year if –

(i) Such portion is after the last day in such calendar year on which the individual was present in the United States (or, in the case of any individual described in paragraph (1)(A)(i), the last day on which he was so described.

(ii) During such portion the individual has a closer connection to a foreign country than to the United States, and

(iii) The individual is not a resident of the United States at any time during the next calendar year.

(C) Certain nominal presence disregarded.

(i) In general. For purposes of subparagraphs (A)(iii) and (B), an individual shall not be treated as present in the United States during any period for which the individual establishes that he has a closer connection to a foreign country than to the United States.

(ii) Not more than 10 days disregarded. Clause (i) shall not apply to more than 10 days on which the individual is present in the United States.

(3) Substantial presence test.

(A) In general. Except as otherwise provided in this paragraph, an individual meets the Substantial presence test of this paragraph with respect to any calendar year (hereinafter in this section referred to as the “current year”) if –

(i) such individual was present in the United States on at least 31 days during the calendar year, and

(ii) the sum of the number of days on which such individual was present in the United States during the current year and the 2 preceding calendar years (when multiplied by the applicable multiplier determined under the following table) equals or exceeds 183 days:

In the case of days in:	The applicable multiplier
Current year	1
1st preceding year	1/3
2 nd preceding year	1/6

(B) Exception where individual is present in the United States during less than one-half Of current year and closer connection to foreign county is established. An individual shall not be treated as meeting the substantial presence test of this paragraph with respect to any current year if –

(i) such individual is present in the United States on few than 183 days during the current year, and

(ii) it is established that for the current year such induvial has a tax home (as defined in section 91 1(d)(3) without regard to the second sentence thereof) in a foreign

country and has a closer connection to such foreign country than to the United States.

(C) Subparagraph (B) not to apply in certain cases. Subparagraph (B) shall not apply to any individual with respect to any current year if at any time during such year—

(i) such individual had an application for adjustment of status pending, or

(ii) such individual took other steps to apply for status as a lawful permanent resident of the United States.

(D) Exception for exempt individuals or for certain medical conditions. An individual shall not be treated as being present in the United States on any day if –

(i) such individual is an exempt individual for such day, or

(ii) such individual was unable to leave the United States on such day because of a medical condition which arose while such individual was present in the United States.¹

U. S. Taxation of a Resident Alien.

An individual is required to file income tax returns if the individual is considered a resident alien as specified above by the Internal Revenue Code (herein referred to as IRC). The definition of a United States resident for income tax purposes conflicts with its definition under the U. S. Immigration Laws. To the United States Citizenship and Immigration Services, a Permanent Resident alien is defined as:

“An alien admitted to the United States as a lawful permanent resident
Permanent residents are also commonly referred to as immigrants; however, the Immigration and Nationality Act (INA) broadly defines an immigrant as any alien in the United States, except one legally admitted under specific nonimmigrant categories [INA section 101(a)(15)]. An illegal alien who entered the United States without inspection, for example, would be strictly defined as an immigrant under the INA but is not a permanent resident alien. Lawful permanent residents are legally accorded the privilege of residing permanently in the United States. They may be issued immigrant visas by the Department of State overseas or adjusted to permanent resident status by U. S. Citizenship and Immigration Services in the United States”²

Meeting the substantial presence test under the IRC does not make the individual a Permanent Resident Alien under immigration law. Those individuals not lawfully admitted for permanent residence are required to file income tax returns. If they meet the substantial presence test and

¹ Internal Revenue Code 26 U.S.C. 7701

² U. S. Citizenship and Immigration Services. www.usimmigration.org/glossary/permanent-resident-alien

are here illegally, although not permitted to work in the United States, they must still file a tax return.

Why do Resident Aliens not file Income Tax Returns?

There is a distinction between paying taxes and filing income tax returns. A majority of immigrants pay some kind of taxes, either by buying consumer goods and paying the sales tax or by paycheck withholdings. Although the paycheck withholdings are done most of the time through the use of a fabricated social security number, it is still a tax paid to the government from immigrants that probably do not file income tax returns. It is obvious that if all resident aliens in the United States filed their income tax returns, the contributions would be much greater than what presently exists. Therefore, why do resident aliens not file income tax returns?

Many American citizens look at the resident aliens as a significant liability for the United States. The majority of resident aliens would prefer to legalize their status, follow the law and even pay taxes. However, because immigration laws are so strict and there is no easy way to legalize their status, they live here without documentation. For many it is not preferable to be undocumented, but that is more desirable than to return to their home countries and endure little opportunity and poor conditions.

The primary reason that most undocumented immigrants do not file income tax returns is because the current immigration laws will subject them to deportation if they are located. Under the current laws, “illegals” are not permitted to work in the United States; and if employed, filing would incriminate them. While their status is illegal, most do not realize that under tax law, there is still a requirement to file income tax returns. In fact, immigration laws and tax laws contradict one another to some extent. This makes it difficult for these people to understand their responsibility. As many of these undocumented immigrants do not have adequate education, they fail to understand that ignorance of the law in American is no excuse and can result in serious penalties.

Some undocumented immigrants simply take advantage of being under the government’s radar. The benefits of tax-free earnings without regard to the tax laws are enticing. Many fail to understand that failure to file income tax returns, regardless of your status, may result in civil penalties and even prosecution under criminal provisions. Additionally, many of the hard-working undocumented immigrants have knowledge of the income tax return requirement, but they consider it to be unfair and do not file. They have the perception that the system is only fair to those who would receive benefits from their contribution. As they are presently not allowed the same benefits as that of a legal resident or citizen, they may believe that it is to their disadvantage to contribute. The undocumented immigrant would not be entitled to receive social security and Medicare benefits at retirement, despite any payroll withholding. Therefore, they may elect to not file income tax returns.

Social Security Number versus ITIN Number.

An illegal immigrant is not allowed to officially secure a social security number and use of a fraudulent number may result in a penalty. An illegal immigrant that passes the substantial presence test is required to file an income tax return. To do so without a social security number, Michael Salzman in *IRS Practice and Procedures* states that an IRS issued TIN is a:

“...number the Service issues to an alien individual who is ineligible to obtain a Social Security number but is required to furnish a TIN with filing obligations imposed by the Code.”³

To be clear, the ITIN number may only be used for income tax purposes; it does not grant any immigration status to the taxpayer. The assigned number also does not authorize the individual to work in the United States. Once a taxpayer is eligible to have a legitimate social security number, the ITIN number may no longer be used. Taxpayers interested in applying for the ITIN number is to use IRS Form W-7. The process usually take approximately six (6) to ten (10) weeks to be processed.

While the ITIN does not legalize the individual under immigration law, it is a lawful way in which to file an income tax return without the use of a fraudulent document that could result in criminal prosecution. The individual may also furnish the ITIN to an employer. The employer may use the number to complete 1099 forms for independent contractors. Although the undocumented immigrant is not permitted work in the United States, the ITIN is the most legitimate way for the individual to file an income tax return.

IRS and Immigration Services.

A question may arise as to whether the IRS will notify the U. S. Immigration Service that an undocumented immigrant is working without authorization and then furnish the agency with information to locate them. In a 2016 Forbes article, the IRS does not have any intention in doing so.⁴ Under the IRC Section 6103 *Confidentiality and disclosure of returns and return information*, the IRS is not allowed to disclose any information from the filed income tax returns. The protected information from the income tax returns includes taxpayer identity, mailing address, identifying number or any other information contained in the return. It is not in the interest of the IRS to report undocumented immigrants that are filing income tax returns and paying their taxes. The objective of the IRS is to collect the most revenue for the U S. Government as is legally permitted. If the IRS took an alternative position, it would result in noncompliance by undocumented immigrants. Therefore, the IRS turns a blind eye to the returns filed under an ITIN number and often, to returns filed under fraudulent social security numbers.

Why File an Income Tax Return?

Contrary to what many understand, the undocumented and the resident aliens must follow the same tax laws as that of U. S. citizens.⁵ After three (3) years of failing to file income tax returns, the act is presumed to be criminal. There is also no statute of limitations when the taxpayer fails to file a return. Therefore, the IRS may review any years for which a return is not filed making it extremely important for taxpayers to file enough of a return to start the statute of limitations.

³ Saltzman, Michael I., *IRS Practice and Procedure*, Revised Second Edition,(Valhalla, NY), Thompson Reuters Checkpoint 2014), 4-32.

⁴ Wood, Robert W. "IRS Admits It Encourages Illegals to Steal SSNs, Plus 13 More Sobering Tax Facts", www.forbes.com, April 12, 2016.

⁵ IRC § 6501 (c)(3)

If the IRS does not agree with the amount self-assessed by the taxpayer, they have three (3) years [Section 6501(A)] to audit them. If a return is never filed, the IRS has no limit on assessing and collecting taxes [IRC 6501 (c)(3)]. By doing what is required by law, the illegal immigrant will

also be protected against conviction of a misdemeanor, fines and even imprisonment. The Internal Revenue Code Section 7203 *Willful failure to file return, supply information, or pay tax*, clarifies the punishments as follows:

“Any person required under this title to pay any estimated tax or taxes, or required by this title or by regulations made under authority thereof to make a return, keep any records or supply any information, at the time or times required by law or regulations, shall, in addition to other penalties provided be guilty of a misdemeanor and, upon conviction thereof, shall be fined not more than \$25,000 (\$100,000 in the case of a corporation), or imprisoned not more than 1 year, or both, together with the costs of prosecution. In the case of any person with respect to whom there is a failure to pay any estimated tax, this section shall not apply to such person with respect to such failure if there is no addition to tax under section 6654 or 6655 with respect to such failure. In the case of a willful violation of any provision of section 6501, the first sentence of this section shall be applied by substituting “felony” for “misdemeanor” and “5 years” for “1 year”.

The reasons to file income tax returns go beyond avoiding penalties. There are also benefits for a resident alien to file. Any illegal immigrant who wants to become a permanent resident under immigration laws will have to be prepared to show the last three years of income tax returns. It is also one of the requirements to be a naturalized U. S. citizen. If an illegal immigrant has any hope of one day becoming a lawful resident under immigration law, it is essential that they keep all returns current. For undocumented immigrants that do not see any possible legal way to become a lawful resident, it is still advisable to file. Immigration reform can be changed by Congress to grant amnesty to undocumented immigrants and filed income tax returns will surely be one of the requirements to apply for legal status

As stated earlier, many illegal aliens often file false returns using a social security number that is not legally obtained. The Supreme Court has now spoken on the law of filing false tax returns. Resident aliens Akio and Fasako Kawashim⁶ were ordered to be removed from the United States. The issue was whether a conviction for filing a false tax return under 26 U.S.C. §7206(1) and aiding and assisting in the preparation of a false tax return under 26 U.S.C. §7206(2) qualified as crimes involving fraud or deceit under 8 U.S.C. §1101(a)(43)(M)(i) [clause (i)] and thus were aggravated felonies for which they could be deported. The Supreme Court held that the actions were an “aggravated felony”. While the code sections 7206(1) and 7206(2) deal with felonies, failure to file is a misdemeanor.⁷ The issue, in these code sections, revolves around the length of time before failure to file becomes willful. If the return is required under 26 U.S.C. §§6001 and 6102, at some point in time the failure becomes willful. This paper does not address the prosecutorial

⁶ *Kawashima v. Holder*, 615 F.3d 1043

⁷ 26 U.S.C. §§6001, 6012

discretion as to when a failure to file becomes criminal. Logic, however, suggests that a period beyond three (3) years (the normal statute of limitations for the audit of a file return) would be

reasonable. If the argument can be made that the failure to file is *willful*, then the misdemeanor could become a felony.

Taxation of Resident Aliens.

Like U.S. citizens, a resident alien is taxed on worldwide income. A resident alien is also allowed to claim the same deductions as a U. S. citizen in order to calculate taxable income. The gross income includes all interest, dividends, wages or other compensation for services, income from rental property or royalties. All income must be included in the total whether it was earned in the U.S. or elsewhere. The taxpayer may claim all itemized deductions or standard deduction, and tax credits as a citizen. The resident alien uses the same form (Form 1040) which is due annually on April 15.⁸

Taxation of Nonresident Aliens Not Engaged in a U. S. Trade or Business.

U.S. source income that is not related to trade or business is taxed at a flat 30 percent rate and no deductions are permitted. According to Section 1441, the person or business in charge of such payment to a nonresident alien shall withhold the tax in order to ensure compliance of tax payment by the nonresident. Income taxed at the 30 percent rate includes dividends, specific interest, rents, royalties, specific compensations, premiums, annuities and other fixed or determinable annual periodical gains, profits and income. A 14 percent tax shall be withheld from U. S. income earned by the nonresident when they are temporarily present in the U.S. as specified in code Section 1441.⁸ There are certain interest from debt investments as well as interest from bank deposits and capital gains that are exempt from taxation insofar as they are not connected with the conduct of U. S. trade or business and the individual has not been in the United States for more than 183 days.

Nonresident Aliens Engaged in a U. S. Trade or Business.

When a nonresident alien is engaged in U. S. trade or business, such income is taxed in much the same way as any other business in the U. S. The same tax rates apply, and the business-related expenses may be claimed against business income. The IRC does not describe what constitutes a U. S. trade or business, but there are a few things that point to that direction. The location of production activities, management, distribution activities and other business functions

⁸https://apps.irs.gov/app/vita/content/globalmedia/nonresident_alien_or_resident_alien_decision_tree_4012.pdf.

⁹ U. S. Const. art XXVI, §1441, Accessed December 4, 2022. <https://checkpoint.riag.com/app/main/doc?usid=413f8as628a0&docID=i099b27fa19d811dcb1a9c7f8eaa77&collFilterId=T0toc080&collId=T0toc080&docTid=T0tos080&feature-tcheckpoint&lastCpReqId-5126790&ods=CODE&pinpnt=1441&searchHandle-i0ad6ada600000158cbe06d8edb044ca3&d-#1441>

that are carried at regular substantial and in a continuous basis are among those items that point to what constitutes trade or business in the U. S.¹⁰

In an article by CPA firm KPMG, *U. S. Taxation of Foreign Citizens*, “Nonresident aliens are generally entitled to the same credits against income tax as U. S. citizens and residents.¹⁰ However, foreign tax credits are allowed only if the foreign tax is related to foreign source income that comes from U. S. trade of business, which is unusual.”¹¹

Exceptions to the Filing of Income Tax Returns by Nonresident Aliens.

If the only earnings received by a nonresident alien were from personal services to not exceed \$3,000 in compensation, under the commercial traveler exception, there is no requirement to file a U. S. income tax return. In addition, there is no filing requirement if services were performed on behalf of a foreign person or business that is not engaged in U. S. trade or business and the nonresident alien was only in the United States for 90 days or less.¹⁰ Nonresident aliens that are temporarily present in the U. S. under visas F, J, M and Q as a teacher, student or trainee and do not have income that is subject to U. S. taxation, are not required to file an income tax return.

There is no requirement to file an income tax return for those nonresidents that receive U. S. wages that are less than the personal exemption amount. It is best, however, to file the return and be protected against the IRS asserting years later that deficiencies exist because the filer received more than the personal exemption amount. Once a return is filed, the statute of limitation starts and the IRS has only three years to assess deficiencies. If the statute of limitations expires, there is nothing else the IRS can pursue, unless the return is fraudulent.

U. S. Taxation of Dual Status Alien.

A dual-status alien is someone who during part of the year was a nonresident alien and later moves to the U. S. and becomes a U. S. resident, or vice versa. In this scenario, the taxpayer must file Form 1040 for the portion of the year in which they were a resident and a Form 1040NR for the remainder of the year in which they were a nonresident alien. The forms should be attached to one another with the form for the last portion of the year on top. The taxpayer will be taxed on worldwide income for the period in which they were a resident alien and taxed only on the U. S. income source for the time they were considered to be a nonresident alien. This dual status will only apply in the year in which the taxpayer either moves in or out of the United States and has met the substantial presence test or has been lawfully admitted as a resident.

¹⁰William H. Hoffman, Jr. et al, eds, *South-Western Federal Taxation: Corporations, Partnerships, Estates & Taxes*, 2016 ed. (Boston, MA: Cengage Learning, 2015), 9-31.

¹¹KPMG, “US. Taxation of Foreign Citizens,” www.kpmg.com, last modified 2022, [chrome-extension://oemmnadbldboiebnladdacbfmadadm/https://www.kpmg.com/US/en/IssuesAndInsights/ArticlesPublications/Document/us.5](https://www.kpmg.com/US/en/IssuesAndInsights/ArticlesPublications/Document/us.5)

Departing Alien.

Whenever a resident alien leaves the country, it is advisable to have all taxes paid prior to departure. Travelers who carry large amounts of cash may be subject to jeopardy or termination assessments by the IRS agent located at the airport. Under Code sections 6851 and 6861, the IRS has the authority to terminate a taxpayer's taxable year and assess the tax due, or immediately assess a tax already due and demand payment if the agent suspects the departure to another country is to conceal assets.¹² In order to prevent that occurrence, the taxpayer should file either Form 2063 or Form 104-C with the IRS prior to their departure and obtain a certificate that proves that the taxpayer's tax obligations have been met. Under Section 6851, *Termination Assessments of Income Tax*, "No alien shall depart from the United States unless he first procures from the Secretary a certificate that he has complied with all the obligations imposed upon him by the income tax laws". This certificate is also called a sailing permit or departure permit and it allows the taxpayer to leave the country with no further issue.

Tax Treaties.

Before a resident alien or nonresident alien starts to file a U. S. income tax return, it is best to research the issue of a tax treaty with the taxpayer's country of nationality. Tax treaties are meant to alleviate the tax burden of individuals covered under the treaty. When an individual resides in one country and receives income from another country, that person may be subject to two income taxes. In most cases, the tax treaty will require one of the countries to impose the tax and grant the taxpayer a credit for taxes paid in the other country. As an example, Jamaica has a tax treaty with the United States to avoid double taxation and to prevent fiscal evasion with respect to taxes on income. Many other countries have similar types of tax treaties with the U. S. It is important to review those to determine if the taxpayer has any benefit covered under a treaty.

Conclusion

This paper has touched on but a few subjects related to the taxation of resident aliens, nonresident aliens, and illegal aliens. The Internal Revenue Code has many sections that contain information related to these defined taxpayers and in different situations. The tax laws for dealing with this issue is enormous and there are many applicable exceptions. It is always best to seek the advice of a tax professional when in doubt. The U. S. tax laws and immigration laws are extremely complex to citizens and more so to taxpayers or illegal aliens from different countries with different tax laws and procedures.

¹² Camilla E. Watson, *Tax Procedure and Tax Fraud in a Nutshell*, 6th ed. (LEG, Inc. d/b/a West Academic, St. Paul, MN, Thomson West, 2022), 131.