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Federal Income Taxes and Noncitizens: Frequently Asked Questions

(name redacted)

Legislative Attorney

(name redacted)

Analyst in Public Finance

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Summary

This report answers frequently asked questions about noncitizens and federal income taxes. Noncitizens may be subject to U.S. income taxes when, for example, they work in the United States or they live abroad but have U.S. source income. Noncitizens who may be subject to U.S. income taxes include

- legal permanent residents (LPRs or green card holders) who are authorized to live and work in the United States permanently;
- aliens who are authorized to stay in the United States temporarily, and may or may not be authorized to work;
- aliens who are not authorized to be in the United States (called unlawfully present aliens for purposes of this report); and
- foreigners who are outside the United States but have U.S. tax obligations.

This report groups similar questions by category: questions concerning residency status for purposes of the Internal Revenue Code (IRC); questions related to individual taxpayer identification numbers (ITINs), which are ID numbers issued to noncitizens for tax-filing purposes; and questions regarding unlawfully present aliens and federal income taxes. The report also refutes a persistent rumor that there are special tax benefits for aliens starting businesses in the United States.

The report focuses on federal income taxes. Other taxes, such as payroll taxes, excise taxes, and estate and gift taxes, are outside the scope of this report. For information on aliens and the federal estate and gift taxes, see CRS Report R43576, *Estate and Gift Taxes for Nonresident Aliens*, by (name redacted).

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Questions Related to Residency Status

1. How are noncitizens categorized for federal income tax purposes?

Noncitizens in or outside the United States may be liable for U.S. income taxes. Under the Internal Revenue Code (IRC), a noncitizen is categorized as either a resident or nonresident alien, which determines the person's tax treatment.

In general, a noncitizen is a nonresident alien unless he or she meets the qualifications under either residency test:

- **Green card test:** the individual is a lawful permanent resident (LPR) of the United States at any time during the year.
- **Substantial presence test:** the individual is present in the United States for at least 31 days during the current year and at least 183 days during the current and previous two years (counting all the qualifying days in the current year, 1/3 of the days in the immediate preceding year, and 1/6 of the days in the earliest year).¹

Various exceptions apply. For example, an individual meeting the substantial presence test will be treated as a nonresident alien if he or she has a closer connection to a foreign country, maintains a tax home in that country, and is in the United States for fewer than 183 days during the year.²

Resident aliens are generally subject to the same federal income tax laws as U.S. citizens, which include being subject to tax on income earned in the United States and abroad. In contrast, nonresident aliens are subject to special rules, such as only being taxed on income from U.S. sources and facing restrictions on claiming certain tax benefits. For more information on the tax treatment of resident and nonresident aliens, see CRS Report RS21732, *Federal Taxation of Aliens Working in the United States*.

2. How does federal tax law interrelate with federal immigration law?

Under U.S. immigration law, noncitizens are admitted into the United States as immigrants to live permanently or as nonimmigrants to stay on a temporary basis.³ The terms “immigrant” and “nonimmigrant” are not used in the Internal Revenue Code. Instead, for federal tax purposes, a noncitizen is classified as a resident or nonresident alien, regardless of whether he or she is in the

¹ IRC §§7701(b)(1)(A), (b)(3). For more information, see CRS Report RS21732, *Federal Taxation of Aliens Working in the United States*, by (name redacted). A different residency standard applies for purposes of the federal estate and gift tax. See CRS Legal Sidebar WSLG729, *A Story In Inconsistency: The U.S. Tax Code's Definition of Resident Aliens*, by (name redacted) and (name redacted). For information on aliens and the federal estate and gift taxes, see CRS Report R43576, *Estate and Gift Taxes for Nonresident Aliens*, by (name redacted).

² IRC §7701(b)(3)(B).

³ For more information, see CRS Report RS20916, *Immigration and Naturalization Fundamentals*, by (name redacted).

United States as an immigrant or nonimmigrant, or is in the United States unlawfully. This classification is for federal tax purposes only and does not affect the individual's immigration status.

While an individual's status under immigration law is generally irrelevant in determining whether he or she is liable for federal income taxes or must comply with other IRC requirements, there are situations where it is important. For example, individuals with green cards are generally treated as resident aliens for tax purposes and special rules sometimes apply to individuals with F-, J-, M-, or Q-visas. For more information, see CRS Report RS21732, *Federal Taxation of Aliens Working in the United States*.

3. How are unlawfully present aliens classified for tax purposes?

Noncitizens who are in the country unlawfully (called unlawfully present aliens for purposes of this report) generally do not have a special designation under the IRC.⁴ Rather, they are categorized in the same manner as all other noncitizens: as either a resident or nonresident alien (see Question 1). Hence, for example, an unlawfully present alien who resides in the United States for sufficient time to meet the substantial presence test would generally be considered a resident alien. This classification is for federal tax purposes only.

4. Does the resident alien classification confer immigration (legal) status?

Classification as a resident or nonresident alien is for federal tax purposes only. It does not affect a noncitizen's immigration status.

5. Is it better to be a resident or nonresident alien?

It is often assumed that one tax classification—resident or nonresident alien—is universally preferable over the other. However, which status is more preferable will depend on a taxpayer's particular circumstances. For example, while nonresident aliens—unlike resident aliens—are not taxed on foreign income, they are treated less favorably in other ways, such as being restricted in their ability to claim some tax benefits.

It is sometimes incorrectly believed that it is better to be a nonresident alien because their income is exempt from U.S. taxation. This is not true. While nonresident aliens are not subject to U.S. taxation on income earned abroad, all aliens—whether resident or nonresident and whether lawfully present or not—are generally subject to federal income taxes on their U.S.-source income (e.g., wages earned in the United States).

⁴ *But see* IRC §36B (premium assistance tax credit distinguishes between lawfully and unlawfully present aliens). For information on aliens and the §36B credit, see CRS Report R43561, *Treatment of Noncitizens Under the Affordable Care Act*, by (name redacted) and (name redacted).

Questions Related to Individual Taxpayer Identification Numbers (ITINs)

6. What are individual taxpayer identification numbers (ITINs) and who uses them?

By law, individuals must provide a unique identifying number when they file tax returns and other documents with the Internal Revenue Service (IRS).⁵ This means noncitizens must have a taxpayer identification number in order to file tax returns, pay taxes, and otherwise comply with federal tax law.

The general rule is that an individual's taxpayer identification number is his or her Social Security number (SSN).⁶ SSNs are issued by the Social Security Administration (SSA) to certain groups of noncitizens, specifically lawful permanent residents (green card holders); aliens admitted on a temporary basis who are authorized to work in the United States; and other aliens who are required by federal or state law to have an SSN in order to receive certain public benefits.⁷

Individuals who are not eligible to receive an SSN are required to use an individual taxpayer identification number (ITIN) when filing their tax returns and other documents with the IRS.⁸ ITINs are issued by the IRS and are for federal tax purposes only.

7. Does an ITIN confer immigration (legal) status?

Being assigned an ITIN does not affect an individual's immigration status. ITINs are supplied solely so that individuals are able to comply with federal tax law, which requires that taxpayers provide a taxpayer identification number in order to file returns and other documents. In fact, one reason for having the IRS be the agency responsible for distributing ITINs was to emphasize that there are no immigration consequences of being assigned one. As the IRS has explained,

Having the IRS as the sole issuer of ITINs will facilitate the general public's acceptance of the fact that the assignment of an ITIN creates no inference regarding the immigration status of an alien individual or the right of that individual to be legally employed in the United States.⁹

⁵ IRC §§6109, 7701(a)(41); Treas. Reg. §301.6109-1.

⁶ IRC §6109(a), (d); Treas. Reg. §§301.6109-1(a)(1)(ii)(A).

⁷ See 20 C.F.R. §422.104. For more information on eligibility for SSNs, see CRS Legal Sidebar WSLG723, *They've Got Your Number: Who Can Get A Social Security Card*, by (name redacted); CRS Legal Sidebar WSLG823, *Social Security Number or Individual Taxpayer Identification Number for Tax Credit? That is the Question*, by (name redacted), (name redacted), and (name redacted).

⁸ Treas. Reg. §301.6109-1(a)(1)(ii)(B).

⁹ Department of the Treasury, Internal Revenue Service, *Taxpayer Identifying Numbers (TINs)*, 61 Fed. Reg. 26788, 27689 (May 29, 1996) (final regulations).

8. When did the IRS begin issuing ITINs?

The IRS began issuing ITINs in 1996. Previously, most aliens with U.S. tax obligations had been able to obtain a nonwork SSN from the SSA.¹⁰ For those aliens without nonwork SSNs, the IRS had issued temporary, one-time identification numbers that were assigned to the return rather than the taxpayer.¹¹

In 1995 and after discussions with SSA, the State Department, and the Immigration and Naturalization Service,¹² the IRS issued a notice of proposed rulemaking to issue permanent ITINs to aliens who were ineligible for SSNs.¹³ The purpose of the new ITIN system was to improve tax compliance and administration for individuals without SSNs.¹⁴ The regulations were finalized in 1996, and the IRS began issuing ITINs that year. The SSA, meanwhile, began the process of restricting who was eligible for nonwork SSNs, apparently due to concerns about the growth in the number of nonwork SSNs that could not be associated with a wage earner.¹⁵ As part of this, and in light of the new ITIN system, SSA stopped providing aliens nonwork SSNs solely so they could file their taxes. Thus, since SSA has stopped issuing SSNs for tax filing purposes and since aliens must have a taxpayer identification number in order to comply with U.S. tax law, the ITIN is used.

9. Does the IRS have the authority to issue ITINs?

It appears the IRS's authority to issue ITINs comes from IRC Sections 6109 and 7805. Section 6109 does three things:

- it provides that “[w]hen required by regulations prescribed by the [Treasury] Secretary,” a person required to file a tax return or document must include an “identifying number as may be prescribed for securing proper identification of such person”;
- it states that an individual’s identifying number is the SSN, “except as shall otherwise be specified under regulations of the Secretary”; and
- it expressly authorizes the Treasury Secretary “to require such information as may be necessary to assign an identifying number to a person.”¹⁶

Section 7805, meanwhile, provides the Treasury Secretary with the general authority to “prescribe all needful rules and regulations for the enforcement of” the IRC. As discussed above, taxpayer

¹⁰ See 68 Fed. Reg. 14563-14564 (SSA notice of proposed rulemaking to restrict the issuance of SSNs for nonwork purposes, which discusses the various nonwork purposes for which SSNs had historically been issued).

¹¹ See, e.g., Rev. Rul. 85-61, 1985-1 C.B. 355 (addressing the need for taxpayer identification numbers by a partnership’s partners who lived outside the United States).

¹² In 2003, the Immigration and Naturalization Service was abolished and its functions placed under three agencies within the Department of Homeland Security.

¹³ See Dept. of the Treasury, Internal Revenue Service, *Taxpayer Identifying Numbers (TIN)*, 60 Fed. Reg. 30211, 30212 (June 8, 1995) (notice of proposed rulemaking).

¹⁴ See *id.*

¹⁵ See U.S. General Accounting Office, *Individual Taxpayer Identification Numbers Can Be Improperly Obtained and Used*, GAO-04-529T, at 5 (March 10, 2004), <http://www.gao.gov/products/GAO-04-529T>.

¹⁶ IRC §6109(a),(c),(d).

identification numbers permit noncitizens to comply with their federal tax law obligations. Looking at these provisions in concert, they appear to authorize the Treasury Secretary, through the IRS, to issue taxpayer identification numbers such as ITINs.

10. How many ITIN filers are there?

In 2011, the most recent year for which a complete count is available, the IRS reported that 4,135,379 individual income tax returns were filed using an ITIN.¹⁷ This includes returns where an ITIN was used as a primary, secondary, or dependent's taxpayer identification number. (The IRS does not currently provide a more detailed breakdown of this number. For example, the IRS does not currently provide data on the number of tax returns where the ITIN was associated with a dependent child as opposed to the number of returns where it was associated with the primary taxpayer or his or her spouse.) Hence, a married couple filing jointly in which one taxpayer has an SSN and the other uses an ITIN would be counted as a return filed using an ITIN.

11. Are all individuals with ITINs unlawfully present aliens? Do all unlawfully present aliens working in the United States file using an ITIN?

The fact someone has an ITIN does not mean he or she is unlawfully present in the United States. As discussed in Question 6, ITINs are provided to those individuals who need a taxpayer identification number and are not eligible for an SSN.¹⁸ These include

- noncitizens who are lawfully present on a temporary basis in the United States but are SSN-ineligible because they are unauthorized to work;
- individuals who are outside the United States but still have federal tax obligations (e.g., because they have U.S.-source investment income); and
- unlawfully present aliens.

Nonetheless, IRS and the Treasury Inspector General for Tax Administration (TIGTA) reportedly believe that a large proportion of ITIN filers are unlawfully present aliens working in the United States.¹⁹

While many taxpayers using ITINs may be living and working in the country unlawfully, not all aliens who are unlawfully present and/or unauthorized to work file their taxes using an ITIN. For example, some may file using an SSN they lawfully received at one time (e.g., the individual may have been lawfully present and authorized to work but has overstayed his or her visa²⁰); a made-

¹⁷ Data was provided in an email dated April 16, 2013, by the Internal Revenue Service's Senior Librarian for Legislative Affairs and is available upon request.

¹⁸ For information on who is eligible for SSNs, see CRS Legal Sidebar WSLG723, *They've Got Your Number: Who Can Get A Social Security Card*, by (name redacted); CRS Legal Sidebar WSLG823, *Social Security Number or Individual Taxpayer Identification Number for Tax Credit? That is the Question*, by (name redacted), (name redacted), and (name redacted).

¹⁹ U.S. General Accounting Office, *Individual Taxpayer Identification Numbers Can Be Improperly Obtained and Used*, GAO-04-529T, March 10, 2004, p. 14, <http://www.gao.gov/products/GAO-04-529T>.

²⁰ See CRS Report RS22446, *Nonimmigrant Overstays: Brief Synthesis of the Issue*, by (name redacted).

up nine-digit number; or another individual's SSN, with or without that person's name. Additionally, some aliens who are not lawfully present and/or authorized to work may work for cash and not file an income tax return at all.²¹

12. What tax benefits can taxpayers using ITINs claim under the IRC?

Individuals using ITINs are generally eligible for tax benefits under the IRC. However, Congress has occasionally included express statutory requirements that taxpayers provide their SSNs when claiming certain tax benefits, which means that taxpayers using ITINs would be ineligible to claim them. Currently, with respect to credits and deductions, only the earned income tax credit (EITC) includes a statutory provision requiring that taxpayers provide their SSNs, along with those of their spouses (if filing a joint return) and any qualifying children.²²

Other provisions of tax law may indirectly limit which benefits individuals using ITINs may claim. For example, the child tax credit requires the qualifying child be a U.S. citizen, national, or resident.²³ This may affect the ability of taxpayers using an ITIN (e.g., a foreign taxpayer) to claim the credit—not because of the ITIN, but because of the status of their children. Another example is that nonresident aliens are restricted in their ability to claim certain tax benefits, and therefore any ITIN filer who is a nonresident alien would be subject to those restrictions.

Questions Related to Unlawfully Present Aliens and Federal Income Taxes

13. Do unlawfully present aliens have to pay federal income taxes?

Unlawfully present aliens are subject to the same tax rules as everyone else. For federal tax purposes, these individuals are treated like any other noncitizen and classified as either a resident or nonresident alien (see Questions 1 and 3).

14. What tax benefits can unlawfully present aliens claim?

There is no general rule in the IRC that prohibits unlawfully present aliens from claiming tax benefits.²⁴ Rather, the limitations that exist are done on a benefit-by-benefit basis, with the specific statute that provides the benefit containing an express restriction. Examples include the following:

²¹ Requirements of employer verification are outside the scope of this report.

²² IRC §32(c)(1)(D), (m).

²³ IRC §24(c).

²⁴ It might be asked whether another federal law, the Personal Responsibility and Work Opportunity Reconciliation Act of 1996, restricts the ability of unlawfully present aliens to claim at least some refundable credits. For analysis, see CRS Report R42628, *Ability of Unauthorized Aliens to Claim Refundable Tax Credits*, by (name redacted) et al.

- “unlawfully present aliens,” as defined by regulation,²⁵ are ineligible for the health insurance premium assistance credit enacted by the Affordable Care Act,²⁶
- the EITC requires taxpayers to provide SSNs that were issued for work purposes for themselves, their spouses if married filing jointly, and any qualifying children,²⁷ thus denying the credit to individuals without such SSNs; and
- certain benefits are disallowed to nonresident aliens (see Question 1), which means any unlawfully present alien who is a nonresident alien is ineligible for these benefits.²⁸

15. Can unlawfully present aliens claim tax benefits based on earnings?

Several provisions in the IRC are based on earnings. Two prominent examples are the EITC and the additional child tax credit (ACTC), both of which are refundable tax credits. It might be argued that the earnings of an unlawfully present alien should not be considered when calculating these credits if that person is not legally authorized to work in the United States.

The EITC restricts the ability of individuals with earnings from unauthorized work to claim the credit by requiring that taxpayers provide SSNs issued for work purposes for themselves, their spouses (if married filing jointly), and any qualifying children. Some aliens who are currently in the country unlawfully may have once received work-authorized SSNs, but have since overstayed their visa.²⁹ While they might attempt to claim the credit using those SSNs, it appears Congress intended to limit the EITC to those individuals whose work authorization was still valid.³⁰

The ACTC, on the other hand, does not have an SSN requirement, and nothing else in the tax code requires the earnings be earned while authorized to work in the United States. Therefore, it appears that unlawfully present aliens working in the United States can legally claim the credit under the IRC.³¹ In 2011, TIGTA reported that individuals not authorized to work in the United States whose tax returns were processed in 2010 claimed \$4.2 billion worth of the ACTC, increasing from \$924 million for returns processed in 2005 and \$2.1 billion for returns processed in 2008.³²

²⁵ Treas. Reg. § 1.36B-1(g) (using the definition found in 45 C.F.R. § 155.2).

²⁶ IRC § 36B(e). For more information, see CRS Report R43561, *Treatment of Noncitizens Under the Affordable Care Act*, by (name redacted) and (name redacted).

²⁷ IRC § 32(m).

²⁸ See, e.g., IRC § 31(c)(1)(D) (EITC); § 25A(g)(7) (American Opportunity Tax Credit).

²⁹ See CRS Report RS22446, *Nonimmigrant Overstays: Brief Synthesis of the Issue*, by (name redacted).

³⁰ See P.L. 104-193, § 451 (header reads “Earned income credit denied to individuals not authorized to be employed in the United States”); H.Rept. 104-651, at 1457 (“The Committee does not believe that individuals who are not authorized to work in the United States should be able to claim the [EITC]”).

³¹ It might be asked whether another federal law, the Personal Responsibility and Work Opportunity Reconciliation Act of 1996, restricts the ability of unlawfully present aliens to claim at least some refundable credits. For analysis, see CRS Report R42628, *Ability of Unauthorized Aliens to Claim Refundable Tax Credits*, by (name redacted) et al.

³² TIGTA, *Individuals Who Are Not Authorized to Work in the United States Were Paid \$4.2 Billion in Refundable Credits*, 2011-41-061, July 7, 2011. These figures do not necessarily represent the annual revenue losses associated with ITIN filers claiming the ACTC. For example, the TIGTA report detailed that for returns processed in 2010, approximately 11% of claimants submitted tax returns for multiple years, claiming a little more than \$1 billion in the (continued...)

16. How much do unlawfully present aliens pay in federal income taxes? How much do they claim in tax benefits?

Currently, the IRS does not have estimates on the federal income taxes paid by unlawfully present aliens working in the United States³³ or the amount of tax benefits they claim. Income tax returns do not provide information as to whether the taxpayer is lawfully present. Furthermore, as discussed in Question 11, while unlawfully present aliens use ITINs, not all ITIN filers are unlawfully present, and some unlawfully present aliens file using an SSN, rather than an ITIN.

17. How will individuals covered by the Obama Administration's recent immigration initiative be treated for federal tax purposes?

On November 20, 2014, President Obama announced the commencement of a multi-pronged immigration initiative which would, among other things, (1) expand the scope of aliens eligible for grants of relief under the Deferred Action for Childhood Arrivals (DACA) initiative that was announced in 2012 and (2) establish a new DACA-like initiative for unlawfully present alien parents of U.S. citizens and LPRs.³⁴ Both categories of individuals would generally be subject to the same tax rules as other noncitizens (see Questions 1 and 13).

These aliens' eligibility for two tax benefits may be affected by the President's initiative: the EITC and the ACA premium assistance credit. Aliens covered by the initiative who are given an SSN for work authorization purposes may then also be eligible for the EITC. With respect to the ACA premium tax credit, their eligibility will depend on whether they meet the credit's definition of "lawfully present." Regulations define the term "lawfully present" to include aliens granted deferred action, with the exception of those granted deferred action through the 2012 DACA initiative.³⁵ It is unclear whether this exception would also apply to aliens granted deferred action through the 2014 expansion of DACA (i.e., group (1) above). The other 2014 deferred action beneficiaries (i.e., group (2) above) would appear to qualify for the credit under the existing regulation. However, the Obama Administration reportedly may take action to exclude them.³⁶

(...continued)

ACTC.

³³ The Office of the Chief Actuary of the Social Security Administration has estimated that in 2010 unlawfully present individuals working in the United States paid approximately \$16 billion in payroll (FICA) taxes, of which \$13 billion was from Social Security taxes and \$3 billion was from Medicare hospital insurance (HI) trust fund taxes. These estimates are for calendar year 2010 and reflect the taxes assessed on both employers and employees (a combined 2.9% Medicare HI tax rate, and 12.4% Social Security tax rate on wages).

³⁴ For information on the Administration's announcement, see CRS Report WSLG1125, *The Obama Administration's Announced Immigration Initiative: A Primer*, by (name redacted); CRS Report R43798, *The Obama Administration's November 2014 Immigration Initiatives: Questions and Answers*, by (name redacted). For the announcement, see <http://www.whitehouse.gov/the-press-office/2014/11/20/remarks-president-address-nation-immigration>.

³⁵ 45 C.F.R. §152.2(4)(vii), (8); 26 C.F.R. §1.36B-1(g). See also CRS Report R43561, *Treatment of Noncitizens Under the Affordable Care Act*, by (name redacted) and (name redacted).

³⁶ See Jason Millman & Juliet Eilperin, *Obama's Order Won't Extend Obamacare to Undocumented Immigrants*, WASH. POST (Nov. 19, 2014), <http://www.washingtonpost.com/blogs/wonkblog/wp/2014/11/19/obamas-order-wont-extend-obamacare-to-undocumented-immigrants/>.

Miscellaneous Issues

18. Are there special tax benefits for aliens starting businesses in the United States?

There is a persistent rumor that noncitizens who own businesses in the United States are exempt from federal income taxes for a certain period of years (typically five or seven).³⁷ In some versions of the rumor, the individual is then able to transfer the business to another alien, thus ensuring a continuous exemption from taxation. This rumor is false.

As discussed in Question 1, for federal tax purposes, a noncitizen is classified as either a resident or nonresident alien. Resident aliens are generally taxed in the same manner as U.S. citizens.³⁸ Thus, just like U.S. citizens, resident aliens are subject to tax on income earned from performing services or conducting a business in the United States.

Nonresident aliens are subject to a different set of tax rules; however, none would exempt these individuals from tax under the circumstances described. Nonresident aliens, just like U.S. citizens and resident aliens, are generally subject to tax on income earned while performing services or conducting business in the United States.³⁹ While there are limited exceptions, none would allow an individual to avoid paying income tax under the situation presented in the rumor.

Finally, a noncitizen cannot incorporate a business in his or her home country and operate that business tax-free in the United States. Foreign corporations are generally subject to U.S. taxation on income from conducting a trade or business in the United States.⁴⁰ Thus, a noncitizen could not set up a foreign corporation to avoid taxation in the manner described in the rumor.

Author Contact Information

(name redacted)
Legislative Attorney
[redacted]@crs.loc.gov, 7-....

(name redacted)
Analyst in Public Finance
[redacted]@crs.loc.gov, 7-....

³⁷ See, e.g., Snopes.com, *Tax Holiday For Immigrants*, <http://www.snopes.com/business/taxes/immigrants.asp>.

³⁸ Treas. Reg. §1.1-1(a).

³⁹ IRC §§871, 872.

⁴⁰ IRC §§881, 882.

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