US (FEDERAL) TAX IMPLICATION ON GREEN CARD HOLDERS

An additional compliance requirement is put forth by The US Internal Revenue Service (IRS) in form of "Form 8938 – Statement of Specified Foreign Financial Assets", which has to be filed by US citizens and its residents along with their annual tax returns. These Tax payers are required to report their Foreign Financial Assets as specified by the IRS in Form 8938.

A brief attempt is made in this article to analyze the US – Federal Tax implication considering the above mentioned compliance requirement.

US Tax payers can be broadly divided into 2 Categories:

1. US Citizen / Resident Alien
2. Non- Resident Alien

We shall restrict our discussion here, to the category of Resident Alien and with specific focus on Green Card Holders only.

A person is considered as a Resident for US tax purpose if:

1. He/She is a Lawful Permanent Resident (LPR) of the United States at any time during the calendar year ("green card" test).
   A person generally acquires this status if the U.S. Citizenship and Immigration Service (USCIS) has issued an alien registration card, Form I-551, also known as a "green card" in name of the said person or

2. By passing the Substantial Presence Test. This test is a numerical formula which measures days of presence in the United States (further details are available on under mentioned link : http://www.irs.gov/businesses/small/international/article/0,,id=96352,00.html;) or

3. By making what is called the "First-Year Choice", it is again a numerical formula under which an alien may pass the Substantial Presence Test one year earlier than under the normal rules. (Refer to the discussion of "First-Year Choice" in Chapter 1 of Publication 519.)

Such a person continues to hold Resident status under the above mentioned test unless:

1. He/she voluntarily renounces and abandon this status in writing to the USCIS, or
2. A persons immigrant status is administratively terminated by the USCIS, or
3. A person's immigrant status is judicially terminated by a U.S. federal court.

Thus if a person is a Green Card Holder and spends at least one day in United States then that person shall be considered as a Resident Alien for US Tax Purposes

Such Resident Alien's shall be considered as a Tax Resident for US Tax purpose and will be subject to tax, in the same manner as US Citizens. Accordingly, they are required to report their worldwide income while filing their Tax

returns for a Particular Calendar/Tax Year.

Income earned in whatever form viz:

1. Interest,
2. Dividends,
3. Wages or
4. Any other compensation for services
5. Income from Rental property,
6. Royalties, or
7. Any Other type of Income.

From sources within and outside USA should be reported in the Federal Tax return filed by these Resident Aliens. It should also be noted here that, the U.S. income tax concept of world-wide taxation extends to foreign income and gains that accrued prior to the establishment of U.S. residency but which are realized as a U.S. resident.

Consequences:

Failure to report Worldwide Income earned/received by a Green Card Holder can lead to imposition of civil penalties, which shall be in addition to payment of tax & interest due on such Undisclosed Income.

In addition to this, IRS can also seek for Criminal prosecution against such tax defaulters. Based on a recent US Supreme Court decision in case of ***Kawashima ET UX v/s Holder, Attorney General***, it could also be concluded that if the IRS seeks Criminal prosecution then, it can lead to deportation of Green Card holder on account of aggravated tax fraud.

From the above it is clear that the Green Card Holders are required to disclose their global income in their federal tax returns. Now let us analyze whether they are also required to disclose their global assets?

Under Foreign Account Tax Compliance Act (FATCA) certain ***US taxpayers*** holding ***Financial assets*** outside USA with the aggregate value of $ 50,000/-*on the last day of the tax year or more than $ 75,000 at any time during the tax year, are required to disclose these assets to the IRS (*in a new form 8938 which should be attached to the annual tax return).* This Act was enacted in the year 2010 and applies to assets held in taxable years beginning after March 18, 2010.

Note: ** A higher asset threshold will be applicable to U.S. taxpayers who file a joint return or who reside abroad. In the present case we assume that a couple is residing in US and is filing a joint US federal tax return then, for* ***Married taxpayers filing a joint income tax return and living in the US:*** *The total value of their specified foreign financial assets should be more than $100,000 on the last day of the tax year or more than $150,000 at any time during the tax year.*

In addition to this, FATCA will also require foreign financial institutions ("FFIs") to report directly to the IRS certain information about financial accounts held by U.S. taxpayers, or by foreign entities in which U.S. taxpayers hold a substantial ownership interest

Source:

http://www.irs.gov/businesses/corporations/article/0,,id=236664,00.html

http://www.irs.gov/businesses/corporations/article/0,,id=251217,00.html

Now let us understand the meaning of Specified Financial assets. Specified Financial Assets are defined in IRC 6038D (b) *and generally includes*

1. Ownership of any financial account maintained by a foreign financial institution,
2. Any stock or security issued by a non-U.S. person/entity,
3. Any financial interest or contract held for investment that has a non-U.S. issuer or counterparty,
4. A capital or profits interest in a foreign partnership,
5. An interest in a foreign trust or foreign estate,
6. A note, bond, debenture, or other form of indebtedness issued by a foreign person and
7. Any interest in a foreign entity.

From the above one can also conclude that, where foreign real property is held directly by the tax payer, it would not be required to be reported under FATCA as a foreign investment. However, if foreign real property is held through a foreign entity, reporting of the entity would be required.

It should be noted that, this reporting is in addition to current disclosure requirements for filing Form 90-22.1 – Report of the Foreign Bank and Financial Accounts ("FBAR") when foreign financial assets owned equal to or exceed an aggregate value of $10,000. (FBAR reporting requirements: *Any United States person who has a financial interest in or signature authority or other authority over any financial account in a foreign country, if the aggregate value of these accounts exceeds $10,000 at any time during the calendar year are required to disclose these details to the IRS.)*

So many of the assets included under the definition of specified foreign financial asset are also included in the FBAR definition of foreign financial account, creating duplicative reporting requirements.

Minimum reporting requirements are:

1. the names and addresses of financial institutions and account numbers for financial accounts,
2. name and address of the issuer of any stock or contract as well as such information necessary to appropriately identify the actual stock or contract owned, and
3. The name, address and type of foreign entity when an interest in the same is owned as well as the value of the related assets.

To identify whether the US taxpayer as exceeded the threshold limit (of $ 50,000/$ 100,000 as the case may be), specified for filing Form 8938, these specified Foreign Financial Assets must be valued in the manner specified in the instruction to Form 8938 viz.:

1. The Value of these Assets held during the tax year or at the last day of the tax year = Cost or Fair Market Value whichever is higher.

2. The value so determined shall be in foreign currency hence this Value should to be converted into US dollars.

3. Conversion rate must the one that is reported on the U.S. Treasury Department's Financial Management Service _ foreign currency exchange rate, for purchasing U.S. dollars. (http://www.fms.treas.gov/intn.html).

   If the said conversion rate is not available, only then a person is allowed to use any other publicly available rate.

4. Currency Determination date shall be last date of the tax year or the any a date during the tax year to determine whether the threshold limit for reporting requirement has exceeded. If however this asset is sold or otherwise disposed off during the tax year. The date of sale or disposal should be used to determine the reporting requirements

(Source: Instruction to form 8938)

Further to this, Reporting requirements are also increased for Passive Foreign Investment Companies (PFIC) but a detail analysis of the same is not captured in this article.

Consequences:

Failure to report foreign financial assets on Form 8938 will result in a penalty of $10,000 (and a penalty up to $50,000 for continued failure after IRS notification). Further, underpayments of tax attributable to non-disclosed foreign financial assets will be subject to an additional substantial understatement penalty of 40 percent.

The impact of this reporting requirement in Form 8938 needs to be seen particularly in case of tax payers who had held such foreign financial assets in prior years and have missed to report the same earlier in *Form 90-22.1 – Report of the Foreign Bank and Financial Accounts ("FBAR").*

Note: US Tax implications of a Non-resident Alien type of Tax Payer are not captured in this Article and neither are US State Tax implications discussed in this Article.