

[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

[TD 9248]

RIN 1545-BC86

Residence Rules Involving U.S. Possessions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations, temporary regulations, and removal of temporary regulations.

SUMMARY: This document contains final regulations that provide rules for determining bona fide residency in the following U.S. possessions: American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, and the United States Virgin Islands under sections 937(a) and 881(b) of the Internal Revenue Code (Code).

DATES: Effective Date: These regulations are effective January 31, 2006.

Applicability Dates: For dates of applicability, see §§1.881-5(f)(8) and 1.937-1(i).

FOR FURTHER INFORMATION CONTACT: J. David Varley, (202) 435-5262 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in these final regulations have been reviewed and approved by the **Office of Management and Budget** in

accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545-1930.

The collections of information in these final regulations are in §1.937-1. The collection of information required by §1.937-1(h) is to ensure that individuals claiming to become, or cease to be, residents of a U.S. possession file notice of such a claim with the Internal Revenue Service in accordance with section 937(c) of the Code. Individuals subject to this reporting requirement must retain information to establish their residency as required by section 937(c) of the Code and §1.937-1. An additional collection of information in these final regulations is in §1.937-1(c)(4)(iii). This information is required to satisfy the documentation and production requirements for individuals who come within an exception to the presence test of §1.937-1(c) as a consequence of receiving (or accompanying certain family members who receive) qualifying medical treatment.

The collections of information are mandatory and will be used for audit and examination purposes. The likely respondents are individuals who become (or cease to be) bona fide residents of a U.S. possession and individuals who, in satisfying the presence test requirement for bona fide residence in a possession, exclude days in the U.S. or include days in a relevant possession because they receive (or accompany certain family members who receive) qualifying medical treatment.

Estimated total annual reporting and/or recordkeeping burden: 300,000 hours.

Estimated average annual burden hours per respondent: 4 hours.

Estimated number of respondents: 75,000.

Estimated annual frequency of responses: annually.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be directed to the **Office of Management and Budget**, Attn: Desk Officer for the Department of Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224.

Books or records relating to a collection of information must be retained as long as their contents might become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

The American Jobs Creation Act of 2004 (Public Law 108-357) was enacted on October 22, 2004. Section 809 of the Act added section 937 to the Code, relating to residence, source, and effectively connected income with respect to the U.S. possessions. On April 11, 2005, the IRS and Treasury published in the **Federal Register** temporary regulations (TD 9194, 70 FR 18920, as corrected at 70 FR 32589-01), which provided rules to implement section 937 and to conform existing regulations to other legislative changes with

respect to U.S. possessions. A notice of proposed rulemaking (REG-159243-03, 70 FR 18949) cross-referencing the temporary regulations was published in the **Federal Register** on the same day. Written comments were received in response to the notice of proposed rulemaking and a public hearing on the proposed regulations was held on July 21, 2005. The proposed regulations relating to the residence rules (specifically, §§1.937-1 and 1.881-5T(f)(4)) are adopted as amended by this Treasury decision, and the corresponding temporary regulations are removed. The revisions are discussed below. The remainder of the proposed and temporary regulations, relating to source and effectively connected income with respect to U.S. possessions, will be finalized together with the other conforming changes in a forthcoming Treasury decision.

Explanation of Provisions and Summary of Comments

The proposed and temporary regulations under Code section 937(a) provide rules for determining whether an individual is a “bona fide resident” of a U.S. possession. Generally, §1.937-1T provides that an individual is a bona fide resident of a possession if the individual meets a presence test, a tax home test and a closer connection test. The IRS received comments relating to each of the three tests.

I. Presence Test

A. General rule

Under section 937(a)(1), in order to satisfy the presence test, a person must be present in the possession for at least 183 days during the taxable year (the 183-day rule). The proposed and temporary regulations provide several

alternatives to the 183-day rule for purposes of satisfying the presence test. Thus, an individual who does not satisfy the 183-day rule nevertheless meets the presence test under the proposed and temporary regulations if the individual spends no more than 90 days in the United States during the taxable year; the individual spends more days in the possession than in the United States and has no earned income in the United States; or the individual has no permanent connection to the United States.

The proposed and temporary regulations also provide a special rule for nonresident aliens in lieu of the 183-day rule and its alternatives. This special rule reflects the intention of the IRS and Treasury to adopt, to the extent possible, the generally applicable rules of residence with respect to nonresident aliens. Thus, the special rule requires nonresident aliens to satisfy a mirrored version of the substantial presence test of section 7701(b) in order to meet the presence test of section 937(a)(1).

A number of commentators suggested that the IRS and Treasury should also allow U.S. citizens and residents to satisfy the 183-day rule of section 937(a)(1) by satisfying a mirrored version of the substantial presence test of section 7701(b). These comments generally argued that the 183-day rule fails to provide the flexibility necessary to reflect the realities of island life. The comments also stated that the proposed and temporary regulations subject U.S. citizens and residents to a higher presence requirement than nonresident aliens.

The final regulations do not incorporate the rules of section 7701(b) as an alternative to the 183-day rule of section 937(a)(1) for U.S. citizens and

residents. Congress considered but specifically rejected adopting section 7701(b) as the general rule for determining residency in a possession. See H.R. Conf. Rep. No. 108-755, at 791-795 (2004). Instead, Congress adopted the 183-day rule and gave the Service authority to adopt appropriate exceptions to the rule to provide sufficient flexibility. The proposed and temporary regulations follow that approach and provide alternatives to the 183-day rule intended to address the necessity of off-island travel. The IRS and Treasury do not believe it is appropriate to adopt a section 7701(b) rule by regulations when Congress expressly rejected this view. Accordingly, the IRS and Treasury generally retain the approach of the proposed and temporary regulations in the final regulations but also provide additional flexibility in the application of the 183-day rule and its alternatives to meet the needs of island residents and offset differences between the rules applicable to U.S. citizens and residents and the rules applicable to nonresident aliens.

Commentators also suggested that the 183-day rule should serve as a safe harbor whereby individuals who were present in the possession for at least 183 days would not need also to satisfy the tax home and closer connection tests. The IRS and Treasury believe that this type of safe-harbor rule is inconsistent with the three-part test provided by Congress under section 937(a), which requires individuals to pass an objective presence test as well as the more subjective tax home and closer connection tests. In addition, the IRS and Treasury believe that applying the presence test in combination with the tax and

closer connection tests is the most reliable method of determining whether an individual is a bona fide resident of a possession.

B. Counting days of presence

A number of commentators suggested that certain days an individual is not physically present in the possession nevertheless should be considered days during which the individual is present in the possession. Specifically, commentators suggested that days spent outside of the possession for medical treatment of the individual or a family member or because of a natural disaster in the possession, a family emergency, charitable pursuits, or business travel should be counted as days of presence in the possession for purposes of applying the 183-day rule. Similarly, commentators suggested that days spent in the United States for such purposes should not count as days spent in the United States under the alternatives to the 183-day rule.

In response to these comments, the final regulations liberalize the rules on counting days of presence. Consistent with the legislative history of section 937(a), the IRS and Treasury believe that it is desirable to allow for situations in which an individual's presence outside the possession is unlikely to be attributable to a tax avoidance purpose. See H.R. Conf. Rep. No. 108-755, at 791-795 (2004). Accordingly, the final regulations provide additional flexibility for certain situations involving medical conditions and natural disasters.

The proposed and temporary regulations provide that any day that an individual is prevented from leaving the United States because of a medical condition that arose while the individual was present in the United States is not

treated as a day of presence in the United States for purposes of the alternatives to the 183-day rule. In response to the comments received, the final regulations provide additional flexibility for medical treatment. Under the final regulations, a temporary stay in the United States for certain documented medical treatment of the individual, or a parent, spouse or child whom the individual accompanies to the treatment, will not count as days spent in the United States for purposes of the alternatives to the 183-day rule, irrespective of where the medical condition arose. Further, such a temporary stay outside of the possession, whether in the United States, another possession or a foreign country, also will count as days of presence in the possession. Qualifying medical treatment generally involves any period of inpatient care in a hospital or hospice in the United States, and any temporary period of time spent in the United States for medically necessary inpatient care in a residential medical care facility. The final regulations focus on the place of treatment and the formal credentials of the health care provider as an objective proxy for a determination that a medical condition is serious enough to entail periods of treatment that may not be readily covered by other alternatives to the 183-day rule.

With respect to disasters, the final regulations provide that if an individual leaves, or is unable to return to, a relevant possession during (1) a two-week period within which an officially declared major disaster in the relevant possession occurs, or (2) the period in which a mandatory evacuation order applies, then the individual will not count any day during either period as a day of presence in the United States, even though the individual has evacuated to or is

otherwise present in the United States. The Federal Emergency Management Agency lists officially declared major disasters on its website at www.fema.gov/news/disasters.fema. Furthermore, the individual may count that day (whether the individual's temporary presence was in the United States or in some other location outside the relevant possession) as a day of presence in the relevant possession even though the major disaster or mandatory evacuation order prevented the individual from being physically present in the relevant possession.

The final regulations do not adopt commentators' suggestion that days spent outside of a possession for nonmedical family emergencies, charitable pursuits or business travel should count as days spent in the possession and outside the United States. These additional exceptions would have been administratively difficult to implement and monitor. The IRS and Treasury believe that in these situations, and in medical situations not otherwise provided for in the final regulations, the 183-day rule in combination with the alternatives to that rule, as liberalized in these final regulations, provide sufficient flexibility to accommodate absences from the possession to pursue a range of activities.

C. Permanent connection

Under the proposed and temporary regulations, an individual may satisfy the presence test if the individual has "no permanent connection" to the United States during the taxable year. The proposed and temporary regulations provide a nonexclusive list of three items each of which constitutes a permanent connection. The enumerated items are a "permanent home" in the United

States, a spouse or dependent having a principal place of abode in the United States, and current registration to vote in any political subdivision of the United States.

The IRS and Treasury believe that the term significant connection is more precise and accurate than the term permanent connection. As a result, the final regulations use the term significant connection rather than permanent connection. In addition, the IRS and Treasury have concluded that the rules of the proposed and temporary regulations should be amended in several respects.

The IRS and Treasury believe that it is not appropriate for the listing of items constituting a significant connection to be a nonexclusive list that leaves open the possibility that undefined or unspecified factors could result in a determination that an individual has a significant connection to the United States in a particular case. The significant connection test is an alternative under the presence test, which itself is fundamentally an objective standard. Section 937(a) and the regulations already provide a more subjective, facts-and-circumstances standard in the form of the closer connection test. With respect to the significant connection test, the IRS and Treasury believe that the regulations should provide certainty and that the three items enumerated in the proposed and temporary regulations are the critical significant connections. Accordingly, the final regulations adopt these items as the exclusive list of significant connections to the United States.

The proposed and temporary regulations define permanent home by general reference to §301.7701(b)-2(d)(2). Commentators asserted that this

definition does not provide adequate guidance as to the application of the significant connection test in the common situation of individuals who own several homes, including vacation homes. In response to these comments, the final regulations provide an exception for rental property.

With respect to a spouse or dependent whose principal place of abode is in the United States, commentators requested that an estranged spouse and a child of a noncustodial parent not be treated as a significant connection. These commentators observed that the noncustodial parent may not have any control over the place where the child resides and that a finding of significant connection in such circumstances would be inappropriate. The IRS and Treasury agree, and the final regulations exclude such children from the definition of significant connection. In addition, the final regulations provide that only minor children are the type of dependent that constitutes a significant connection. Further, the final regulations do not treat as a significant connection a minor child who resides in the United States as a student, or a spouse from whom the individual is legally separated.

D. Earned income

The proposed and temporary regulations provide that an individual may satisfy the presence test if the individual spends more days in the possession than in the United States and has no earned income in the United States. Commentators suggested that the regulations should permit an individual to qualify under this alternative even with some de minimis amount of earned income in the United States. In addition, commentators suggested that income

earned on any day excluded for purposes of counting days of presence in the United States under the presence test (for example, for certain medical treatment) should be excluded from earned income.

The IRS and Treasury agree that from the standpoint of practicality, fairness and administrability, de minimis amounts of U.S.-earned income should not render unavailable this alternative to the 183-day rule. In establishing a permitted amount of earned income for this purpose, the IRS and Treasury believe it appropriate to look to existing de minimis provisions of the Code involving compensation for services. In this regard, the final regulations cross-reference the maximum amount (\$3,000 under current law) of compensation for labor or personal services performed in the United States that is not deemed to be income from sources within the United States under section 861(a)(3). The final regulations do not incorporate the suggestion that income earned on days excluded for purposes of counting days of presence should be excluded from earned income. The IRS and Treasury believe that this type of exclusion from earned income would be difficult to administer and could lead to abuse of this alternative, particularly given the additional flexibility provided in the final regulations with respect to days that can be excluded for purposes of counting days of presence.

Commentators also suggested that the no-U.S.-earned-income alternative to the 183-day rule should be applied by treating each state or other defined geographic area as a separate location so that the United States is not treated as a single location for purposes of determining if an individual was present for more

days in the possession than in the United States under this alternative. The IRS and Treasury believe that this type of rule could be easily manipulated and difficult to administer. Further, with respect to residency determinations, the Code typically treats the United States as a single location. Therefore, the final regulations do not adopt this suggestion.

II. Tax Home Test

Sections 931, 932, 933 and 935 generally apply to an individual who is considered a bona fide resident of the respective possession under Code section 937(a) for the entire taxable year. The proposed and temporary regulations treat an individual as a bona fide resident of a possession for the entire taxable year only if the individual satisfies the presence, tax home, and closer connection tests for the taxable year.

Commentators suggested that it may be difficult for an individual moving to a possession during a taxable year to satisfy the tax home test if the individual had a regular or principal place of business in the United States or a closer connection to the United States for the portion of the year prior to the date of the move to the possession. These commentators suggested that individuals should be able to prorate their income for the taxable year of the move in accordance with the portion of the year for which they satisfy the tax home test.

The IRS and Treasury agree that special rules are appropriate for the year of a move to a possession and believe that similar rules are appropriate for the year of a move out of a possession. However, the IRS and Treasury do not believe that general statutory authority exists for the proration of a taxpayer's

income for the taxable year in this context. Only in the case of Puerto Rico does the Code expressly allow for prorating income according to periods of residency, and then only when an individual moves out of Puerto Rico. See section 933(2). Sections 931, 932 and 935 contain no analogous proration provisions. As a result, except for a special rule applicable to certain individuals who move from Puerto Rico, the final regulations do not provide proration rules.

Instead, the final regulations adopt a standard whereby an individual moving to a possession during the taxable year generally will satisfy the tax home test if the individual does not have a tax home outside that possession during any part of the last 183 days of that taxable year. To prevent abuse of this special rule, the regulations further require in order to use the rule that the individual not have been a bona fide resident of the relevant possession during the three taxable years before the move and that the individual continue to qualify as a bona fide resident of the possession for the three taxable years following the year of the move. Corresponding rules will apply to the taxable year in which an individual moves from a possession. However, reflecting that section 933(2) provides for proration of a U.S. citizen's income with respect to bona fide residents who move from Puerto Rico, the final regulations provide a special rule that allows qualifying individuals to be treated as bona fide residents for the part of the year before they move from Puerto Rico.

Under the tax home test, the proposed and temporary regulations provide a special rule applicable to seafarers. The special rule prevents an individual from being considered to have a tax home outside a particular possession solely

by reason of employment on a ship or other seafaring vessel that is used predominantly in local and international waters. As set forth in the proposed and temporary regulations, the special rule does not specify how to treat time that the ship spends in waters of another possession. The final regulations clarify that time spent in the waters of another possession is treated the same as time spent in the waters of the United States or a foreign country. Thus, under the final regulations, a ship is considered to be used predominantly in local or international waters if the total time it is used in local and international waters during a taxable year exceeds the total time it is used in the territorial waters of the United States, another possession, and any foreign country.

See section V of this preamble for an explanation of the transition rule concerning the effective date of the tax home test.

III. Closer Connection Test

Under section 937(a)(2), in order to be a bona fide resident of a possession, a person must not have a closer connection (determined under the principles of section 7701(b)(3)(B)(ii)) to the United States or a foreign country than to the relevant possession. The regulations under section 7701(b)(3)(B)(ii) provide a facts-and-circumstances test to determine whether an individual has a closer connection with the United States or with a foreign country. This facts-and-circumstances test provides a nonexclusive list of factors to be taken into consideration. See §301.7701(b)-2(d). The proposed and temporary regulations under section 937 apply the principles of and factors provided in §301.7701(b)-

2(d) in determining whether an individual meets the closer connection test of section 937.

Commentators suggested that the final regulations designate certain factors as primary and others as secondary, thereby indicating the relative weight of the factors listed in §301.7701(b)-2(d). Alternatively, commentators requested that the final regulations indicate that an individual who meets a majority of factors establishes a closer connection. Some commentators criticized Example 6 under §1.937-1T(f) (the closer connection example) for failing to take into account all factors listed in §301.7701(b)-2(d) and for not providing an analysis of how the example concludes that the individual fails to satisfy the closer connection test. These commentators appeared to believe that the closer connection example suggests that the location of an individual's spouse and children is more important than other factors or even is determinative of whether the individual has a closer connection to the United States or the possession. Some commentators also seemed to confuse these factors with the permanent connection alternative to the presence test and believed that the closer connection test requires an individual's spouse and dependent children also to reside in the possession. Commentators noted that if it applied, this requirement would apparently conflict with the joint filing rule of section 932(d).

The closer connection test is a facts-and-circumstances test. The very nature of the test does not allow for weighting of factors because a factor with respect to one set of facts and circumstances may be less important than with respect to another set of facts and circumstances. Because the test must be

applied to a wide variety of individual situations, the final regulations do not designate specific factors as primary, adopt a weighting of factors, or adopt a rule that counts a majority of the factors to determine closer connection. Further, because the list in §301.7701(b)-2(d) is not exclusive, other factors, including, for example, whether the individual was born and raised in the relevant possession, may be considered in the determination. The final regulations amend Example 6 to demonstrate that all factors (including any factors important in a particular case but not on the nonexclusive list) must be considered in determining an individual's closer connection.

Although the location of the individual's family is often a very important factor, it is one of many factors to be evaluated qualitatively under the facts-and-circumstances test, and in a particular case it may not be an important or overriding factor. Thus, unlike the no-significant-connection alternative (previously the no-permanent-connection alternative) to the presence test, the closer connection test can be satisfied, depending on an individual's particular facts and circumstances, even if, for example, the individual's spouse resides in the United States. In addition, Congress provided in section 937(a) that individuals must satisfy the closer connection test to establish bona fide residency in a possession notwithstanding the statutory joint filing rule provided in section 932(d). For these reasons, the regulations under section 937 do not conflict with section 932(d).

The proposed and temporary regulations require that an individual satisfy the closer connection test for the entire taxable year in order to be considered a

bona fide resident of a relevant possession. Commentators noted that, as with the tax home test, it may be difficult for an individual moving into a possession during a taxable year to satisfy the closer connection test for the entire taxable year. Accordingly, the final regulations provide special year-of-move rules under the closer connection test similar to those described in section II of this preamble (relating to the tax home test).

The final regulations make clarifying amendments to the closer connection test. Section 1.937-1T(e)(2) of the proposed and temporary regulations specifies that another possession is not considered a foreign country for purposes of the closer connection test. The final regulations do not specify this because a special rule distinguishing possessions from foreign countries is unnecessary and potentially confusing. In the absence of an explicit provision, possessions are not treated as foreign countries under the Code or Treasury Regulations. The final regulations also clarify that an individual's connections to the United States and foreign countries are considered in the aggregate, rather than on a country-by-country basis, when comparing those connections with the individual's connections to the relevant possession.

See section V of this preamble for an explanation of the transition rule concerning the effective date of the closer connection test.

IV. Withholding Tax Exceptions for Certain Possessions Corporations

Section 881(b) provides exemptions from, or reductions of, withholding tax and branch profits tax on certain U.S.-source income received by corporations organized in U.S. possessions. As one of the conditions for such treatment in

certain cases, section 881(b)(1)(C) sets forth a “base-erosion” test requiring that no substantial part of the possessions corporation’s income be used to satisfy obligations to “persons” who are not bona fide residents of such a possession or of the United States. Section 937(a) provides in relevant part that for purposes of section 881(b), except as provided in regulations, a “person” is a bona fide resident if the person satisfies the requirements of section 937(a). For purposes of the base-erosion test, §1.881-5T(f)(4)(i) defines a bona fide resident of a possession by reference to §1.937-1T, which provides that only a natural person, rather than a juridical person, may qualify as a bona fide resident of a possession. Similarly, §1.881-5T(f)(4)(ii) defines bona fide residents of the United States for purposes of the base-erosion test as including only certain individuals who are citizens or residents of the United States.

Commentators observed that the interaction of these rules in the proposed and temporary regulations could result in disqualifying income from the withholding tax exceptions in any situation where the possessions corporation makes payments to satisfy obligations to persons other than individuals. These commentators further noted that many common business arrangements would run afoul of the base-erosion test if corporations cannot constitute bona fide residents.

The IRS and Treasury agree that such results would be undesirable and unintended. In the context of section 881(b), the IRS and Treasury believe that the statutory terms persons and bona fide residents should not be interpreted as limited to individuals. Accordingly, the final regulations additionally provide that a

corporation, or a business association that is treated as a corporation for tax purposes, may qualify as a bona fide resident of a relevant possession or the United States for purposes of the base-erosion test if it is created or organized in that jurisdiction. The final regulations reflect that section 937(a) and the regulations under that section are intended to apply only to individuals in determining whether a person is a bona fide resident of a possession within the meaning of section 881(b)(1)(C).

Note that the IRS and Treasury believe that the words “direct or indirect” in section 881(b)(1)(C) (and §1.881-5(c)(3)) would authorize an anti-abuse rule that prohibits payments to possessions corporations that are a part of back-to-back loan arrangements or other base erosion schemes. Accordingly, the IRS and Treasury are strongly considering including such an anti-abuse rule when finalizing the remaining proposed and temporary regulations under section 881(b). It is expected that any such anti-abuse rule would be retroactive to January 31, 2006.

Commentators also proposed that the final regulations adopt a special rule whereby publicly traded corporations may qualify for favorable tax treatment without regard to the conditions under section 881(b)(1), including the base-erosion test. A similar rule is provided under section 884(e)(4)(B) and §1.884-5(d) under the branch profits tax. However, the final regulations do not adopt such a special rule in this context. The IRS and Treasury note that section 881(b) does not grant authority to depart from the statutory conditions of section 881(b)(1), including the base-erosion test.

V. Effective Date

The proposed and temporary regulations are generally effective for tax years ending after October 22, 2004. Consistent with the effective date of section 937(a), the proposed and temporary regulations provide a transition rule that delays the effective date of the presence test until tax years beginning after October 22, 2004 (tax year 2005 for calendar year taxpayers). A number of commentators suggested that the final regulations should provide a similar transition rule with respect to the effective date of the tax home and closer connection tests so that the prior-law, facts-and-circumstances test continues to apply through tax years beginning on or before October 22, 2004.

The IRS and Treasury believe that it is appropriate to provide a transition rule with respect to the tax home and closer connection tests consistent with the effective date of the presence test. The effective date of the final regulations reflects the fact that most taxpayers already will have filed their income tax returns for taxable year 2004. As a result, this transition rule is elective so that taxpayers may apply at their option the prior-law test for determining residency.

Under section 937(a), an individual's tax home outside the relevant possession conclusively forecloses bona fide residency in the possession, rather than being one of a number of facts and circumstances that are considered under the prior-law test. However, in most instances the outcome of the residency determination under prior law should be the same as with the application of the section 937(a) tax home and closer connection tests because individuals are required to demonstrate similar factors to support claims that they

are bona fide residents of a particular possession. See, e.g., Sochurek v. Commissioner, 300 F.2d 34, 38 (7th Cir. 1962) (enumerating representative factors), and Bergersen v. Commissioner, 109 F.3d 56, 61-62 (1st Cir. 1997), aff'g T.C. Memo 1995-424 (applying prior-law facts-and-circumstances test in same way closer connection test is applied by "taking account of all of the [taxpayers'] ties to both places" to determine residency under principles of §§1.871-2 through 1.871-5). The optional effective date for the tax home and closer connection tests is intended to create symmetry with the effective date of the presence test. No inference is intended or may be drawn from this transition rule as to the result under prior law.

VI. Miscellaneous Changes

Consistent with section 937(a), the final regulations specify that the residency rules apply for purposes of the income tax and certain other enumerated provisions of the Code. With respect to the estate and gift taxes, see §§20.2209-1 and 25.2501-1(d).

The final regulations also reflect various nonsubstantive stylistic edits to the proposed and temporary regulations to enhance clarity and readability.

VII. Mutual Agreement Procedures

In the application of the operative provisions of the Code relating to possessions, for example sections 931 through 935, section 937(a) and the final regulations govern whether an individual is a bona fide resident of a particular possession. A commentator observed that there is a possibility that the IRS and the taxing authority of a particular possession might reach different conclusions

with respect to certain determinations, including residency, when administering their respective income tax laws. In such cases, taxpayers are advised that mutual agreement procedures are available. For procedures to request the assistance of the IRS when a taxpayer is or may be subject to inconsistent tax treatment by the IRS and a possession tax agency, see Revenue Procedure 89-8 (1989-1 C.B. 778).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is J. David Varley, Office of the Associate Chief Counsel (International), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1 -- INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.931-1T also issued under 26 U.S.C. 7654(e).
Section 1.932-1T also issued under 26 U.S.C. 7654(e).
Section 1.935-1T also issued under 26 U.S.C. 7654(e). * * *
Section 1.937-1 also issued under 26 U.S.C. 937(a). * * *

Par. 2. Section 1.881-5 is added to read as follows:

§1.881-5 Exception for certain possessions corporations.

(a) through (f)(3) [Reserved]. For more information, see §1.881-5T(a) through (f)(3).

(f)(4) Bona fide resident--

(i) With respect to a particular possession, means--

(A) An individual who is a bona resident of the possession as defined in §1.937-1; or

(B) A business entity organized under the laws of the possession and taxable as a corporation in the possession; and

(ii) With respect to the United States, means--

(A) An individual who is a citizen or resident of the United States (as defined under section 7701(b)(1)(A)); or

(B) A business entity organized under the laws of the United States or any State that is classified as a corporation for federal tax purposes under §301.7701-2(b) of this chapter.

(5) through (7) [Reserved]. For more information, see §1.881-5T(f)(5) through (7).

(8) Effective date. This section applies to payments made after January 31, 2006. However, taxpayers may choose to apply this section to all payments made after October 22, 2004 for which the statute of limitations under section 6511 is open.

(g) through (i) [Reserved]. For more information, see §1.881-5T(g) through (i).

Par. 3. In §1.881-5T, paragraph (f)(4) is revised to read as follows:

§1.881-5T Exception for certain possessions corporations (temporary).

* * * * *

(f)(4) [Reserved]. For more information, see §1.881-5(f)(4).

* * * * *

§1.931-1T [Amended]

Par. 4. In §1.931-1T, paragraph (a)(2) is amended by removing and reserving the Example.

§1.932-1T [Amended]

Par. 5. In §1.932-1T, paragraph (i) is amended by removing and reserving Example 2.

§1.933-1T [Amended]

Par. 6. In §1.933-1T, paragraph (a)(2) is amended by removing and reserving the Example.

§1.935-1T [Amended]

Par. 7. In §1.935-1T, paragraph (f) is amended by removing and reserving Examples 1 and 2.

Par. 8. Section 1.937-1 is added to read as follows:

§1.937-1 Bona fide residency in a possession.

(a) Scope-- (1) In general. Section 937(a) and this section set forth the rules for determining whether an individual qualifies as a bona fide resident of a particular possession (the relevant possession) for purposes of Subpart D, Part III, Subchapter N, Chapter 1 of the Internal Revenue Code as well as section 865(g)(3), section 876, section 881(b), paragraphs (2) and (3) of section 901(b), section 957(c), section 3401(a)(8)(C), and section 7654(a).

(2) Definitions. For purposes of this section and §§1.937-2 and 1.937-3--

(i) Possession means one of the following United States possessions: American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, or the Virgin Islands. When used in a geographical sense, the term comprises only the territory of each such possession (without application of sections 932(c)(3) and 935(c)(2) (as in effect before the effective date of its repeal)).

(ii) United States, when used in a geographical sense, is defined in section 7701(a)(9), and without application of sections 932(a)(3) and 935(c)(1) (as in effect before the effective date of its repeal).

(b) Bona fide resident-- (1) General rule. An individual qualifies as a bona fide resident of the relevant possession if such individual satisfies the requirements of paragraphs (c) through (e) of this section with respect to such possession.

(2) Special rule for members of the Armed Forces. A member of the Armed Forces of the United States who qualified as a bona fide resident of the relevant possession in a prior taxable year is deemed to have satisfied the requirements of paragraphs (c) through (e) of this section for a subsequent taxable year if such individual otherwise is unable to satisfy such requirements by reason of being absent from such possession or present in the United States during such year solely in compliance with military orders. Conversely, a member of the Armed Forces of the United States who did not qualify as a bona fide resident of the relevant possession in a prior taxable year is not considered to have satisfied the requirements of paragraphs (c) through (e) of this section for a subsequent taxable year by reason of being present in such possession solely in compliance with military orders. Armed Forces of the United States is defined (and members of the Armed Forces are described) in section 7701(a)(15).

(3) Juridical persons. Except as provided in §1.881-5(f):

(i) Only natural persons may qualify as bona fide residents of a possession; and

(ii) The rules governing the tax treatment of bona fide residents of a possession do not apply to juridical persons (including corporations, partnerships, trusts, and estates).

(4) Transition rule. For taxable years beginning before October 23, 2004, and ending after October 22, 2004, an individual is considered to qualify as a bona fide resident of the relevant possession if that individual would be a bona fide resident of the relevant possession by applying the principles of §§1.871-2 through 1.871-5.

(5) Special rule for cessation of bona fide residence in Puerto Rico. See paragraph (f)(2)(ii) of this section for a special rule applicable to a citizen of the United States who ceases to be a bona fide resident of Puerto Rico during a taxable year.

(c) Presence test-- (1) In general. A United States citizen or resident alien individual (as defined in section 7701(b)(1)(A)) satisfies the requirements of this paragraph (c) for a taxable year if during that taxable year that individual--

(i) Was present in the relevant possession for at least 183 days;

(ii) Was present in the United States for no more than 90 days;

(iii) Had earned income (as defined in §1.911-3(b)) in the United States, if any, not exceeding in the aggregate the amount specified in section 861(a)(3)(B) and was present for more days in the relevant possession than in the United States; or

(iv) Had no significant connection to the United States. See paragraph (c)(5) of this section.

(2) Special rule for alien individuals. A nonresident alien individual (as defined in section 7701(b)(1)(B)) satisfies the requirements of this paragraph (c) for a taxable year if during that taxable year that individual satisfies the substantial presence test of §301.7701(b)-1(c) of this chapter (except for the substitution of the name of the relevant possession for the term United States where appropriate).

(3) Days of presence. For purposes of paragraph (c)(1) of this section--

(i) An individual is considered to be present in the relevant possession on:

(A) Any day that the individual is physically present in that possession at any time during the day;

(B) Any day that an individual is outside of the relevant possession to receive, or to accompany on a full-time basis a parent, spouse, or child (as defined in section 152(f)(1)) who is receiving, qualifying medical treatment as defined in paragraph (c)(4) of this section; and

(C) Any day that an individual is outside the relevant possession because the individual leaves or is unable to return to the relevant possession during any--

(1) 14-day period within which a major disaster occurs in the relevant possession for which a Federal Emergency Management Agency Notice of a Presidential declaration of a major disaster is issued in the Federal Register; or

(2) Period for which a mandatory evacuation order is in effect for the geographic area in the relevant possession in which the individual's place of abode is located.

(ii) An individual is considered to be present in the United States on any day that the individual is physically present in the United States at any time during the day. Notwithstanding the preceding sentence, the following days will not count as days of presence in the United States:

(A) Any day that an individual is temporarily present in the United States under circumstances described in paragraph (c)(3)(i)(B) or (C) of this section;

(B) Any day that an individual is in transit between two points outside the United States (as described in §301.7701(b)-3(d) of this chapter), and is physically present in the United States for fewer than 24 hours;

(C) Any day that an individual is temporarily present in the United States as a professional athlete to compete in a charitable sports event (as described in §301.7701(b)-3(b)(5) of this chapter);

(D) Any day that an individual is temporarily present in the United States as a student (as defined in section 152(f)(2)); and

(E) In the case of an individual who is an elected representative of the relevant possession, or who serves full time as an elected or appointed official or employee of the government of the relevant possession (or any political subdivision thereof), any day spent serving the relevant possession in that role.

(iii) If, during a single day, an individual is physically present--

(A) In the United States and in the relevant possession, that day is considered a day of presence in the relevant possession;

(B) In two possessions, that day is considered a day of presence in the possession where the individual's tax home is located (applying the rules of paragraph (d) of this section).

(4) Qualifying medical treatment--(i) In general. The term qualifying medical treatment means medical treatment provided by (or under the supervision of) a physician (as defined in section 213(d)(4)) for an illness, injury, impairment, or physical or mental condition that satisfies the documentation and production requirements of paragraph (c)(4)(iii) of this section and that involves--

(A) Any period of inpatient care in a hospital or hospice and any period immediately before or after that inpatient care to the extent it is medically necessary; or

(B) Any temporary period of inpatient care in a residential medical care facility for medically necessary rehabilitation services;

(ii) Inpatient care. The term inpatient care means care requiring an overnight stay in a hospital, hospice, or residential medical care facility, as the case may be.

(iii) Documentation and production requirements. In order to satisfy the documentation and production requirements of this paragraph, an individual must, with respect to each qualifying medical treatment, prepare (or obtain), maintain, and, upon a request by the Commissioner (or the person responsible for tax administration in the relevant possession), make available within 30 days of such request:

(A) Records that provide--

(1) The patient's name and relationship to the individual (if the medical treatment is provided to a person other than the individual);

(2) The name and address of the hospital, hospice, or residential medical care facility where the medical treatment was provided;

(3) The name, address, and telephone number of the physician who provided the medical treatment;

(4) The date(s) on which the medical treatment was provided; and

(5) Receipt(s) of payment for the medical treatment;

(B) Signed certification by the providing or supervising physician that the medical treatment was qualified medical treatment within the meaning of paragraph (c)(4)(i) of this section, and setting forth--

(1) The patient's name;

(2) A reasonably detailed description of the medical treatment provided by (or under the supervision of) the physician;

(3) The dates on which the medical treatment was provided; and

(4) The medical facts that support the physician's certification and determination that the treatment was medically necessary; and

(C) Such other information as the Commissioner may prescribe by notice, form, instructions, or other publication (see §601.601(d)(2) of this chapter).

(5) Significant connection. For purposes of paragraph (c)(1)(iv) of this section--

(i) The term significant connection to the United States means--

(A) A permanent home in the United States;

(B) Current registration to vote in any political subdivision of the United States; or

(C) A spouse or child (as defined in section 152(f)(1)) who has not attained the age of 18 whose principal place of abode is in the United States other than--

(1) A child who is in the United States because the child is living with a custodial parent under a custodial decree or multiple support agreement; or

(2) A child who is in the United States as a student (as defined in section 152(f)(2)).

(ii) Permanent home-- (A) General rule. For purposes of paragraph (c)(5)(i)(A) of this section, except as provided in paragraph (c)(5)(ii)(B) of this section, the term permanent home has the same meaning as in §301.7701(b)-2(d)(2) of this chapter.

(B) Exception for rental property. If an individual or the individual's spouse owns property and rents it to another person at any time during the taxable year, then notwithstanding that the rental property may constitute a permanent home under §301.7701(b)-2(d)(2) of this chapter, it is not a permanent home under this paragraph (c)(5)(ii) unless the taxpayer uses any portion of it as a residence during the taxable year under the principles of section 280A(d). In applying the principles of section 280A(d) for this purpose, an individual is treated as using the rental property for personal purposes on any day determined under the principles of section 280A(d)(2) or on any day that the rental property (or any portion of it) is not rented to another person at fair rental for the entire day. The rental property

is not used for personal purposes on any day on which the principal purpose of the use of the rental property is to perform repair or maintenance work on the property. Whether the principal purpose of the use of the rental property is to perform repair or maintenance work is determined in light of all the facts and circumstances including, but not limited to, the following: the amount of time devoted to repair and maintenance work, the frequency of the use for repair and maintenance purposes during a taxable year, and the presence and activities of companions.

(iii) For purposes of this paragraph (c)(5), the term spouse does not include a spouse from whom the individual is legally separated under a decree of divorce or separate maintenance.

(d) Tax home test-- (1) General rule. Except as provided in paragraph (d)(2) of this section, an individual satisfies the requirements of this paragraph (d) for a taxable year if that individual did not have a tax home outside the relevant possession during any part of the taxable year. For purposes of section 937 and this section, an individual's tax home is determined under the principles of section 911(d)(3) without regard to the second sentence thereof. Thus, under section 937, an individual's tax home is considered to be located at the individual's regular or principal (if more than one regular) place of business. If the individual has no regular or principal place of business because of the nature of the business, or because the individual is not engaged in carrying on any trade or business within the meaning of section 162(a), then the individual's tax home is the individual's regular place of abode in a real and substantial sense.

(2) Exceptions-- (i) Year of move. See paragraph (f) of this section for a special rule applicable to an individual who becomes or ceases to be a bona fide resident of the relevant possession during a taxable year.

(ii) Special rule for seafarers. For purposes of section 937 and this section, an individual is not considered to have a tax home outside the relevant possession solely by reason of employment on a ship or other seafaring vessel that is predominantly used in local and international waters. For this purpose, a vessel is considered to be predominantly used in local and international waters if, during the taxable year, the aggregate amount of time it is used in international waters and in the waters within three miles of the relevant possession exceeds the aggregate amount of time it is used in the territorial waters of the United States, another possession, and a foreign country.

(iii) Special rule for students and government officials. Any days described in paragraphs (c)(3)(ii)(D) and (E) of this section are disregarded for purposes of determining whether an individual has a tax home outside the relevant possession under paragraph (d)(1) of this section during any part of the taxable year.

(e) Closer connection test-- (1) General rule. Except as provided in paragraph (e)(2) of this section, an individual satisfies the requirements of this paragraph (e) for a taxable year if that individual did not have a closer connection to the United States or a foreign country than to the relevant possession during any part of the taxable year. For purposes of this paragraph (e)--

(i) The principles of section 7701(b)(3)(B)(ii) and §301.7701(b)-2(d) of this chapter apply (without regard to the final sentence of §301.7701(b)-2(b) of this chapter); and

(ii) An individual's connections to the relevant possession are compared to the aggregate of the individual's connections with the United States and foreign countries.

(2) Exception for year of move. See paragraph (f) of this section for a special rule applicable to an individual who becomes or ceases to be a bona fide resident of the relevant possession during a taxable year.

(f) Year of move-- (1) Move to a possession. For the taxable year in which an individual's residence changes to the relevant possession, the individual satisfies the requirements of paragraphs (d)(1) and (e)(1) of this section if--

(i) For each of the 3 taxable years immediately preceding the taxable year of the change of residence, the individual is not a bona fide resident of the relevant possession;

(ii) For each of the last 183 days of the taxable year of the change of residence, the individual does not have a tax home outside the relevant possession or a closer connection to the United States or a foreign country than to the relevant possession; and

(iii) For each of the 3 taxable years immediately following the taxable year of the change of residence, the individual is a bona fide resident of the relevant possession.

(2) Move from a possession-- (i) General rule. Except for a bona fide resident of Puerto Rico to whom §1.933-1(b) and paragraph (f)(2)(ii) of this section apply, for the taxable year in which an individual ceases to be a bona fide resident of the relevant possession, the individual satisfies the requirements of paragraphs (d)(1) and (e)(1) of this section if--

(A) For each of the 3 taxable years immediately preceding the taxable year of the change of residence, the individual is a bona fide resident of the relevant possession;

(B) For each of the first 183 days of the taxable year of the change of residence, the individual does not have a tax home outside the relevant possession or a closer connection to the United States or a foreign country than to the relevant possession; and

(C) For each of the 3 taxable years immediately following the taxable year of the change of residence, the individual is not a bona fide resident of the relevant possession.

(ii) Year of move from Puerto Rico. Notwithstanding an individual's failure to satisfy the presence, tax home, or closer connection test prescribed under paragraph (b)(1) of this section for the taxable year, the individual is a bona fide resident of Puerto Rico for that part of the taxable year described in paragraph (f)(2)(ii)(E) of this section if the individual--

(A) Is a citizen of the United States;

(B) Is a bona fide resident of Puerto Rico for a period of at least 2 taxable years immediately preceding the taxable year;

(C) Ceases to be a bona fide resident of Puerto Rico during the taxable year;

(D) Ceases to have a tax home in Puerto Rico during the taxable year; and

(E) Has a closer connection to Puerto Rico than to the United States or a foreign country throughout the part of the taxable year preceding the date on which the individual ceases to have a tax home in Puerto Rico.

(g) Examples. The principles of this section are illustrated by the following examples:

Example 1. Presence test. W, a U.S. citizen, lives for part of the taxable year in a condominium, which she owns, located in Possession P. W also owns a house in State N where she lives for 120 days every year to be near her grown children and grandchildren. W is retired and her income consists solely of pension payments, dividends, interest, and Social Security benefits. For 2006, W is only present in Possession P for a total of 175 days because of a 70 day vacation to Europe and Asia. Thus, for taxable year 2006, W is not present in Possession P for at least 183 days, is present in the United States for more than 90 days, and has a significant connection to the United States by reason of her permanent home. However, under paragraph (c)(1)(iii) of this section, W still satisfies the presence test of paragraph (c) of this section with respect to Possession P because she has no earned income in the United States and is present for more days in Possession P than in the United States.

Example 2. Presence test. T, a U.S. citizen, was born and raised in State A, where his mother still lives in the house in which T grew up. T is a sales representative for a company based in Possession V. T lives with his wife and minor children in their house in Possession V. T is registered to vote in Possession V and not in the United States. In 2006, T spends 120 days in State A and another 120 days in foreign countries. When traveling on business to State A, T often stays at his mother's house in the bedroom he used when he was a child. T's stays are always of short duration, and T asks for his mother's permission before visiting to make sure that no other guests are using the room and that she agrees to have him as a guest in her house at that time. Therefore, under paragraph (c)(5)(ii) of this section, T's mother's house is not a permanent home of T. Assuming that no other accommodations in the United States constitute a permanent home with respect to T, then under paragraphs (c)(1)(iv) and (c)(5) of this section, T has no significant connection to the United States.

Accordingly, T satisfies the presence test of paragraph (c) of this section for taxable year 2006.

Example 3. Alien resident of possession-- presence test. F is a citizen of Country G. F's tax home is in Possession C and F has no closer connection to the United States or a foreign country than to Possession C. F is present in Possession C for 123 days and in the United States for 110 days every year. Accordingly, F is a nonresident alien with respect to the United States under section 7701(b), and a bona fide resident of Possession C under paragraphs (b), (c)(2), (d), and (e) of this section.

Example 4. Seafarers-- tax home. S, a U.S. citizen, is employed by a fishery and spends 250 days at sea on a fishing vessel in 2006. When not at sea, S resides with his wife at a house they own in Possession G. The fishing vessel upon which S works departs and arrives at various ports in Possession G, other possessions, and foreign countries, but is in international and local waters (within the meaning of paragraph (d)(2) of this section) for 225 days in 2006. Under paragraph (d)(2) of this section, for taxable year 2006, S will not be considered to have a tax home outside Possession G for purposes of section 937 and this section solely by reason of S's employment on board the fishing vessel.

Example 5. Seasonal workers-- tax home and closer connection. P, a U.S. citizen, is a permanent employee of a hotel in Possession I, but works only during the tourist season. For the remainder of each year, P lives with her husband and children in Possession Q, where she has no outside employment. Most of P's personal belongings, including her automobile, are located in Possession Q. P is registered to vote in, and has a driver's license issued by, Possession Q. P does her personal banking in Possession Q and P routinely lists her address in Possession Q as her permanent address on forms and documents. P satisfies the presence test of paragraph (c) of this section with respect to both Possession Q and Possession I, because, among other reasons, under paragraph (c)(1)(ii) of this section she does not spend more than 90 days in the United States during the taxable year. P satisfies the tax home test of paragraph (d) of this section only with respect to Possession I, because her regular place of business is in Possession I. P satisfies the closer connection test of paragraph (e) of this section with respect to both Possession Q and Possession I, because she does not have a closer connection to the United States or to any foreign country (and possessions generally are not treated as foreign countries). Therefore, P is a bona fide resident of Possession I for purposes of the Internal Revenue Code.

Example 6. Closer connection to United States than to possession. Z, a U.S. citizen, relocates to Possession V in a prior taxable year to start an investment consulting and venture capital business. Z's wife and two teenage children remain in State C to allow the children to complete high school. Z travels back to the United States regularly to see his wife and children, to engage

in business activities, and to take vacations. He has an apartment available for his full-time use in Possession V, but he remains a joint owner of the residence in State C where his wife and children reside. Z and his family have automobiles and personal belongings such as furniture, clothing, and jewelry located at both residences. Although Z is a member of the Possession V Chamber of Commerce, Z also belongs to and has current relationships with social, political, cultural, and religious organizations in State C. Z receives mail in State C, including brokerage statements, credit card bills, and bank advices. Z conducts his personal banking activities in State C. Z holds a State C driver's license and is registered to vote in State C. Based on the totality of the particular facts and circumstances pertaining to Z, Z is not a bona fide resident of Possession V because he has a closer connection to the United States than to Possession V and therefore fails to satisfy the requirements of paragraphs (b)(1) and (e) of this section.

Example 7. Year of move to possession. D, a U.S. citizen, files returns on a calendar year basis. From January 2003 through May 2006, D resides in State R. In June 2006, D moves to Possession N, purchases a house, and accepts a permanent position with a local employer. D's principal place of business from July 1 through December 31, 2006 is in Possession N, and during that period (which totals at least 183 days) D does not have a closer connection to the United States or a foreign country than to Possession N. For the remainder of 2006, and throughout years 2007 through 2009, D continues to live and work in Possession N and maintains a closer connection to Possession N than to the United States or any foreign country. D satisfies the tax home and closer connection tests for 2006 under paragraphs (d)(2), (e)(2), and (f)(1) of this section. Accordingly, assuming that D also satisfies the presence test in paragraph (c) of this section, D is a bona fide resident of Possession N for all of taxable year 2006.

Example 8. Year of move from possession (other than Puerto Rico). J, a U.S. citizen, files returns on a calendar year basis. From January 2007 through December 2009, J is a bona fide resident of Possession C because she satisfies the requirements of paragraph (b)(1) of this section for each year. J continues to reside in Possession C until September 6, 2010, when she accepts new employment and moves to State H. J's principal place of business from January 1 through September 5, 2010 is in Possession C, and during that period (which totals at least 183 days) J does not have a closer connection to the United States or a foreign country than to Possession C. For the remainder of 2010 and throughout years 2011 through 2013, D continues to live and work in State H and is not a bona fide resident of Possession C. J satisfies the tax home and closer connection tests for 2010 with respect to Possession C under paragraphs (d)(2)(i), (e)(2), and (f)(2)(i) of this section. Accordingly, assuming that J also satisfies the presence test of paragraph (c) of this section, J is a bona fide resident of Possession C for all of taxable year 2010.

Example 9. Year of move from Puerto Rico. R, a U.S. citizen who files returns on a calendar year basis satisfies the requirements of paragraphs (b) through (e) of this section for years 2006 and 2007. From January through April 2008, R continues to reside and maintain his principal place of business in and closer connection to Puerto Rico. On May 5, 2008, R moves and changes his principal place of business (tax home) to State N and later that year establishes a closer connection to the United States than to Puerto Rico. R does not satisfy the presence test of paragraph (c) for 2008 with respect to Puerto Rico. Moreover, because R had a tax home outside of Puerto Rico and establishes a closer connection to the United States in 2008, R does not satisfy the requirements of paragraph (d)(1) or (e)(1) of this section for 2008. However, because R was a bona fide resident of Puerto Rico for at least two taxable years before his change of residence to State N in 2008, he is a bona fide resident of Puerto Rico from January 1 through May 4, 2008 under paragraphs (b)(5) and (f)(2)(ii) of this section. See section 933(2) and §1.933-1(b) for rules on attribution of income.

(h) Information reporting requirement. The following individuals are required to file notice of their new tax status in such time and manner as the Commissioner may prescribe by notice, form, instructions, or other publication (see §601.601(d)(2) of this chapter):

(1) Individuals who take the position for U.S. tax reporting purposes that they qualify as bona fide residents of a possession for a tax year subsequent to a tax year for which they were required to file Federal income tax returns as citizens or residents of the United States who did not so qualify.

(2) Citizens and residents of the United States who take the position for U.S. tax reporting purposes that they do not qualify as bona fide residents of a possession for a tax year subsequent to a tax year for which they were required to file income tax returns (with the Internal Revenue Service, the tax authorities of a possession, or both) as individuals who did so qualify.

(3) Bona fide residents of Puerto Rico or a section 931 possession (as defined in §1.931-1T(c)(1)) who take a position for U.S. tax reporting purposes

that they qualify as bona fide residents of that possession for a tax year subsequent to a tax year for which they were required to file income tax returns as bona fide residents of the United States Virgin Islands or a section 935 possession (as defined in §1.935-1T(a)(3)(i)).

(i) Effective date. Except as provided in this paragraph (i), this section applies to taxable years ending after January 31, 2006. Paragraph (h) of this section also applies to a taxpayer's 3 taxable years immediately preceding the taxpayer's first taxable year ending after October 22, 2004. Taxpayers also may choose to apply this section in its entirety to all taxable years ending after October 22, 2004 for which the statute of limitations under section 6511 is open.

§1.937-1T [Removed]

Par. 9. Section 1.937-1T is removed.

**PART 602 -- OMB CONTROL NUMBERS UNDER THE PAPERWORK
REDUCTION ACT**

Par. 10. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 11. In §602.101, paragraph (b) is amended by removing the entry for "1.937-1T" and adding a new entry for "1.937-1" in numerical order to the table to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * * 1.937-1..... * * * * *	1545-1930

Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

Approved: January 20, 2006.

Eric Solomon,
Acting Deputy Assistant Secretary of the Treasury (Tax Policy).