

§ 1.871-13

(2) *Tax on nontreaty income.* For purposes of subparagraph (1) of this paragraph, compute a partial tax (determined without the allowance of any credit) upon only the nontreaty income in accordance with § 1.871-7 or § 1.871-8, or with § 1.881-2 or § 1.882-1, whichever applies, as though the tax convention had not come into effect. To the extent allowed by paragraph (d) of § 1.871-8, or paragraph (c) of § 1.882-1, the credits allowed by sections 33, 35, 38, and 40 shall then be allowed, without taking into account any item included in the treaty income, against the tax determined under this subparagraph.

(3) *Tax on treaty income.* For purposes of subparagraph (1) of this paragraph, compute a tax upon the gross amount, determined without the allowance of any deduction, of each separate item of treaty income at the reduced rate applicable to that item under the tax convention. No credits shall be allowed against the tax determined under this subparagraph.

(d) *Illustration.* The application of this section may be illustrated by the following example:

Example. (a) A nonresident alien individual who is a resident of a foreign country with which the United States has entered into a tax convention receives during the taxable year 1967 from sources within the United States total gross income of \$22,000, consisting of the following items:

Compensation for personal services the tax on which is not limited by the tax convention (effectively connected income under § 1.864-4(c)(6)(ii))	\$20,000
Oil royalties the tax on which is limited by the tax convention to 15 percent of the gross amount thereof (effectively connected income by reason of election under § 1.871-10)	2,000
Total gross income	22,000

(b) The taxpayer is engaged in business in the United States during the taxable year but does not have a permanent establishment therein. There are no allowable deductions, other than the deductions allowed by sections 613 and 873(b)(3).

(c) The tax liability for the taxable year is \$6,100, determined as follows:

Nontreaty gross income	\$20,000
Less: Deduction for personal exemption	600
Nontreaty taxable income	19,400
Tax under section 1 of the Code on nontreaty taxable income (\$5,170 plus 45 percent of \$1,400)	5,800
Plus: Tax on treaty income (Gross oil royalties) (\$2,000×15 percent)	300

Total tax (determined as provided in paragraph (c) (2) and (3) of this section)	6,100
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(d) If the tax had been determined under paragraph (b)(2) of § 1.871-8 as though the tax liability would have been \$6,478, determined as follows and by taking into account the election under § 1.871-10:

Total gross income	\$22,000
Less: Deduction under section 613 for percentage depletion (\$2000×27½ percent)	\$550
Deduction for personal exemption ...	600
Taxable income	20,850

Tax under section 1 of the Code on taxable income (\$6,070 plus 48 percent of \$850)	6,478
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(e) *Effective date.* This section shall apply for taxable years beginning after December 31, 1966. For corresponding rules applicable to taxable years beginning before January 1, 1967, see 26 CFR 1.871-7(e) (Revised as of January 1, 1971).

[T.D. 7332, 39 FR 44225, Dec. 23, 1974; as amended at T.D. 8657, 61 FR 9338, Mar. 8, 1996]

§ 1.871-13 Taxation of individuals for taxable year of change of U.S. citizenship or residence.

(a) *In general.* (1) An individual who is a citizen or resident of the United States at the beginning of the taxable year but a nonresident alien at the end of the taxable year, or a nonresident alien at the beginning of the taxable year but a citizen or resident of the United States at the end of the taxable year, is taxable for such year as though his taxable year were comprised of two separate periods, one consisting of the time during which he is a citizen or resident of the United States and the other consisting of the time during which he is not a citizen or resident of the United States. Thus, for example, the income tax liability of an alien individual under chapter 1 of the Code for the taxable year in which he changes his residence will be computed under two different sets of rules, one relating to resident aliens for the period of residence and the other relating to nonresident aliens for the period of nonresidence. However, in determining the taxable income for such year which is subject to the graduated rate of tax imposed by section 1 or 1201 of the Code,

all income for the period of U.S. citizenship or residence must be aggregated with the income for the period of nonresidence which is effectively connected for such year with the conduct of a trade or business in the United States. This section does not apply to alien individuals treated as residents for the entire taxable year under section 6013 (g) or (h). These individuals are taxed under the rules in § 1.1-1(b).

(2) For purposes of this section, an individual is deemed to be a citizen or resident of the United States for the day on which he becomes a citizen or resident of the United States, a non-resident of the United States for the day on which he abandons his U.S. residence, and an alien for the day on which he gives up his U.S. citizenship.

(b) *Acquisition of U.S. citizenship or residence.* Income from sources without the United States which is not effectively connected with the conduct by the taxpayer of a trade or business in the United States is not taxable if received by an alien individual while he is not a resident of the United States even though he becomes a citizen or resident of the United States after its receipt and before the close of the taxable year. However, income from sources without the United States which is not effectively connected with the conduct by the taxpayer of a trade or business in the United States is taxable if received by an individual while he is a citizen or resident of the United States, even though he earns the income earlier in the taxable year while he is neither a citizen nor resident of the United States.

(c) *Abandonment of U.S. citizenship or residence.* Income from sources without the United States which is not effectively connected with the conduct by the taxpayer of a trade or business in the United States is not taxable if received by an alien individual while he is not a resident of the United States, even though he earns the income earlier in the taxable year while he is a citizen or resident of the United States. However, income from sources without the United States which is not effectively connected with the conduct by the taxpayer of a trade or business in the United States is taxable if received by an individual while he is a

citizen or resident of the United States, even though he abandons his U.S. citizenship or residence after its receipt and before the close of the taxable year.

(d) *Special rules—(1) Method of accounting.* Paragraphs (b) and (c) of this section may not apply to an individual who for the taxable year uses an accrual method of accounting.

(2) *Deductions for personal exemptions.* An alien individual to whom this section applies is entitled to deduct one personal exemption for the taxable year under section 151. In addition, he is entitled to such additional exemptions as are allowed as a deduction under section 151 but only to the extent the amount of such additional exemptions do not exceed his taxable income (determined without regard to any deduction for personal exemptions) for the period in the taxable year during which he is a citizen or resident of the United States. This subparagraph does not apply to the extent it is inconsistent with section 873, and the regulations thereunder, or with the provisions of an income tax convention to which the United States is a party.

(3) *Exclusion of dividends received.* In determining the \$100 exclusion for the taxable year provided by section 116 in respect of certain dividends, only those dividends for the period during which the individual is neither a citizen nor resident of the United States may be taken into account as are effectively connected for the taxable year with the conduct of a trade or business in the United States. See § 1.116-1(e)(1).

(e) *Illustrations.* The application of this section may be illustrated by the following examples:

Example 1. A, a married alien individual who uses the calendar year as the taxable year and the cash receipts and disbursements method of accounting, becomes a resident of the United States on June 1, 1971. During the period of nonresidence from January 1, 1971, to May 31, 1971, inclusive, A receives \$15,000 income from sources without the United States which is not effectively connected with the conduct of a trade or business in the United States. During the period of residence from June 1, 1971, to December 31, 1971, A receives wages of \$10,000, dividends of \$200 from a foreign corporation, and dividends of \$75 from a domestic corporation qualifying under section 116(a). Of the amount of wages so received, \$2,000 is for services performed

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by A outside the United States during the period of nonresidence. Total allowable deductions (other than for personal exemptions) amount to \$700, none of which are deductible under section 62 in computing adjusted gross income. For 1971 A's spouse has no gross income and is not the dependent of another taxpayer. For 1971, A's taxable income is \$8,200, all of which is subject to tax under section 1, as follows:

Wages	\$10,000	
Dividends from foreign corporation	200	
Dividends from domestic corporation (\$75 less \$75 exclusion)	0	
Adjusted gross income	10,200	
Less deductions:		
Personal exemptions (2×\$650)	\$1,300	
Other allowable deductions	700	2,000
Taxable income	8,200	

Example 2. The facts are the same as in example 1 except that during the period of nonresidence from January 1, 1971, to May 31, 1971, A receives from sources within the United States income of \$1,850 which is effectively connected with the conduct by A of a business in the United States and \$350 in dividends from domestic corporations qualifying under section 116(a). Only \$50 of these dividends are effectively connected with the conduct by A of a business in the United States. The assumption is made that there are no allowable deductions connected with such effectively connected income. For 1971, A has taxable income of \$10,075 subject to tax under section 1 and \$300 income subject to tax under section 871(a)(1)(A), as follows:

Wages	\$10,000	
Business income	1,850	
Dividends from foreign corporation	200	
Dividends from domestic corporation (\$125 less \$100 exclusion)	25	
Adjusted gross income	12,075	
Less deductions:		
Personal exemptions (2×\$650)	\$1,300	
Other allowable deductions	700	2,000
Taxable income subject to tax under section 1	10,075	
Income subject to tax under section 871(a)(1)(A) ...	300	

Example 3. A, a married alien individual with three children, uses the calendar year as the taxable year and the cash receipts and disbursements method of accounting. On October 1, 1971, A and his family become residents of the United States. During the period of nonresidence from January 1, 1971, to September 30, 1971, A receives income of \$18,000 from sources without the United States which is not effectively connected with the conduct of a trade or business in the United States and of \$2,500 from sources within the United States which is effectively connected with the conduct of a business in the United States. It is assumed there are no allowable

deductions connected with such effectively connected income. During the period of residence from October 1, 1971, to December 31, 1971, A receives wages of \$2,000, of which \$400 is for services performed outside the United States during the period of nonresidence. Total allowable deductions (other than for personal exemptions) amount to \$250, none of which are deductible under section 62 in computing adjusted gross income. Neither the spouse nor any of the children has any gross income for 1971, and the spouse is not the dependent of another taxpayer for such year. For 1971, A's taxable income is \$1,850, all of which is subject to tax under section 1, as follows:

Wages (residence period)	\$2,000	
Less: Allowable deductions	250	
Taxable income (without deduction for personal exemptions) (residence period)	\$1,750	
Business income (nonresidence period)	2,500	
Total taxable income (without deduction for personal exemptions)	4,250	
Less deduction for personal exemptions:		
Taxpayer	650	
Wife and 3 children (4×\$650, but not to exceed \$1,750)	1,750	2,400
Taxable income	1,850	

(f) *Effective date.* This section shall apply for taxable years beginning after December 31, 1966. There are no corresponding rules in this part for taxable years beginning before January 1, 1967.

[T.D. 7332, 39 FR 44226, Dec. 23, 1974, as amended by T.D. 7670, 45 FR 6928, Jan. 31, 1980]

§ 1.871-14 Rules relating to repeal of tax on interest of nonresident alien individuals and foreign corporations received from certain portfolio debt investments.

(a) *General rule.* No tax shall be imposed under section 871(a)(1)(A), 871(a)(1)(C), 881(a)(1) or 881(a)(3) on any portfolio interest as defined in sections 871(h)(2) and 881(c)(2) received by a foreign person. But see section 871(b) or 882(a) if such interest is effectively connected with the conduct of a trade or business within the United States.

(b) *Rules concerning obligations in bearer form—(1) In general.* Interest (including original issue discount) with respect to an obligation in bearer form is portfolio interest within the meaning of section 871(h)(2)(A) or 881(c)(2)(A) only if it is paid with respect to an obligation issued after July 18, 1984, that