

Death and Taxes —

A monthly column on tax issues and estate planning

Marjorie Rawls Roberts, Esq., P.C.

Meeting the “Closer Connection Test” — A Must for USVI Residency

A “bona fide resident” of the U.S. Virgin Islands (USVI) must file a tax return with and pay all taxes due to the Virgin Islands Bureau of Internal Revenue (BIR). In contrast, persons who are not bona fide residents of the USVI but who have USVI income are required to file their Form 1040 with the IRS and the BIR and allocate taxes between the USVI and the United States.

The American Jobs Creation Act, enacted in October 2004, and subsequently issued Treasury regulations, changed the definition of what constitutes a bona fide resident of the USVI for purposes of filing resident income tax returns with the BIR from a “facts and circumstances” test to a three-part determination. USVI “bona fide residents” must meet a “closer connection test” and a “tax home test” — as well as a “physical presence test” — in lieu of the “facts and circumstances” test in place before 2005. The January 2007 column of “Death and Taxes” discussed the physical presence test requirements.

The “closer connection test” requires that a taxpayer be able to demonstrate that he or she does not have a “closer connection” to the United States or a foreign country than to the USVI (or another possession if relevant). The applicable regulations list ten factors to be considered in determining whether a “closer connection” exists and an individual should look at each factor to determine whether he or she meets the factor only for the USVI (such as voting), for the USVI and other locations (such as location of personal belongings or personal bank accounts), or just for another location.

The “closer connection” factors are (1) location of the individual’s permanent home; (2) location of the individual’s family; (3) location of personal belongings, such as automobiles, furniture, clothing, and jewelry owned by the individual and family members; (4) location of social, political,

cultural or religious organizations in which the individual has a current relationship; (5) location of the individual’s personal bank accounts; (6) location where the individual conducts business activities other than those that constitute the individual’s principal business; (7) type of driver’s license held by the individual; (8) country of residence designated by the individual on forms and documents; (9) types of official forms and documents filed by the individual; and (10) where the individual votes.

After the IRS issued regulations regarding the “closer connection test” in April 2005, a number of people suggested via written comments to the IRS that the final regulations designate certain factors as primary and others as secondary, or that the final regulations indicate that an individual who meets a majority of the factors for the USVI automatically establishes a closer connection to the USVI. However, in issuing final regulations in January, 2006, the IRS indicated that “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.”

The IRS also indicated that since the list was not exclusive, other factors could be considered in a determination of “closer connection” and specifically mentioned as relevant whether an individual was born and raised in the possession. The IRS also responded to concerns that people expressed that the IRS seemed to consider the location of the individual’s family as singularly determinative of a closer connection as demonstrated in an example that it had included in the April 2005 regulations. It stated that although the location of an 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.”



Marjorie Rawls Roberts

The IRS distinguished the closer connection test from the “no significant connection” test discussed in last month’s column whereby a person without a residence, spouse, or dependents in the United States and who is not registered to vote in the United States does not have to “count days” in order to meet the physical presence test. A person who meets the “no significant connection” with regard to the United States would usually meet the “closer connection test” for the USVI unless the person has a closer connection to one or more foreign countries than to the USVI. Specifically, the IRS made it clear 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 connections in the USVI (or another possession). Thus, for example, a person could have a closer connection to the USVI than to any other single location but still not have a closer connection to the USVI for purposes of the bona fide residency test if he or she has multiple homes in the United States or a foreign country and connections with each home that must be aggregated.

Subsequent columns will cover such topics as, the requirements of the “tax home test” and like-kind exchanges involving USVI real estate. If you would like to suggest topics for future columns please email:
AskJorie@TradewindsHouseandHome.com

The information provided in this column is not legal advice. Readers should consult with their professional advisors to determine how this information may apply to their specific circumstances.