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# Tax Guide for Individuals With Income From U.S. Possessions

For use in preparing  
**2005** Returns



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## What's New

**Bona fide residence.** For tax years beginning after October 22, 2004, you generally must be present in the possession for at least 183 days during the tax year or meet one of the alternatives to the 183-day test. You also must generally satisfy the tax home and closer connection tests. If you are a calendar year taxpayer, these tests apply to your tax returns for 2005 and later years. See chapter 1.

**Possession source income.** Generally, income earned after October 22, 2004, is not U.S. possession source income if it is treated as income from sources in the United States or if it is effectively connected to a U.S. trade or business. For more information, see chapter 2.

**Reporting a change in residence.** Beginning with tax year 2001, you may be required to file Form 8898, Statement for Individuals Who Begin or End Bona Fide Residence in a U.S. Possession. The penalty for failure to provide the required information is \$1,000. For details, see *Reporting a Change in Bona Fide Residence* in chapter 1.

## Reminders

**Third party designee.** You can check the "Yes" box in the "Third Party Designee" area of your return to authorize the IRS to discuss your return with a friend, family member, or any other person you choose. This allows the IRS to call the person you identified as your designee to answer any questions that may arise during the processing of your return. It also allows your

designee to perform certain actions. See your income tax package for details.

**IRS individual taxpayer identification numbers (ITINs) for aliens.** If you are a nonresident or resident alien and you do not have and are not eligible to get a social security number (SSN), you must apply for an ITIN. For details on how to do so, see Form W-7, Application for IRS Individual Taxpayer Identification Number, and its instructions. It usually takes 4–6 weeks to get an ITIN.

If you already have an ITIN, enter it wherever your SSN is requested on your tax return.



*An ITIN is for tax use only. It does not entitle you to social security benefits or change your employment or immigration status under U.S. law.*

**Earned income credit (EIC).** Generally, if you are a bona fide resident of a U.S. possession, you cannot claim the EIC on your U.S. tax return. However, certain U.S. possessions may allow bona fide residents to claim the EIC on their possession tax return. To claim the EIC on your U.S. tax return, your home (and your spouse's if filing a joint return) must have been in the United States for more than half the year. If you have a child, the child must have lived with you in the United States for more than half the year. For this purpose, the United States includes only the 50 states and the District of Columbia. Special rules apply to military personnel stationed outside the United States. For more information on this credit, see Publication 596, Earned Income Credit (EIC).

**Change of address.** If you change your mailing address, be sure to notify the Internal Revenue Service using Form 8822, Change of Address. Mail it to the Internal Revenue Service Center for your old address (addresses for the Service Centers are on the back of the form).

**Photographs of missing children.** The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling 1-800-THE-LOST (1-800-843-5678) if you recognize a child.

## Introduction

This publication discusses how to treat income received from the following U.S. possessions on your tax return(s).

- American Samoa.
- The Commonwealth of Puerto Rico (Puerto Rico).
- The Commonwealth of the Northern Mariana Islands (CNMI).
- Guam.
- The U.S. Virgin Islands (USVI).

Unless stated otherwise, when the term “possession” is used in this publication, it includes

the Commonwealths of Puerto Rico and the Northern Mariana Islands.

Chapter 1 discusses the requirements for being considered a bona fide resident of the listed possessions.

Chapter 2 gives the rules for determining if your income is from sources within, or effectively connected with a trade or business in, those possessions.

Next, chapter 3 looks at the rules for filing tax returns when you receive income from any of these possessions. You may have to file a U.S. tax return only, a possession tax return only, or both returns. This generally depends on whether you are a bona fide resident of the possession. In some cases, you may have to file a U.S. return, but will be able to exclude income earned in a possession from U.S. tax. You can find illustrated examples of some of the additional forms required in chapter 5.

If you are not a bona fide resident of one of the above possessions, or are otherwise required to file a U.S. income tax return, the information in chapter 4 will tell you how to file your U.S. tax return. This information also applies if you have income from U.S. insular areas other than the five possessions listed above because that income will not qualify for any of the exclusions or other benefits discussed in chapter 3. These other U.S. insular areas include:

- Baker Island,
- Howland Island,
- Jarvis Island,
- Johnston Island,
- Kingman Reef,
- Midway Islands,
- Palmyra Atoll, and
- Wake Island.



If you need additional information on U.S. taxation, write to:

Internal Revenue Service  
International Returns Section  
P.O. Box 920  
Bensalem, PA 19020-8518

If you need additional information on your tax obligations in a U.S. possession, write to the tax department of that possession. Their addresses are provided in chapter 3 under the individual headings for each possession.

**Comments and suggestions.** We welcome your comments about this publication and your suggestions for future editions.

You can write to us at the following address:

Internal Revenue Service  
Individual Forms and Publications Branch  
SE:W:CAR:MP:T:I  
1111 Constitution Ave. NW, IR-6406  
Washington, DC 20224

We respond to many letters by telephone. Therefore, it would be helpful if you would include your daytime phone number, including the area code, in your correspondence.

You can email us at [taxforms@irs.gov](mailto:taxforms@irs.gov). (The asterisk must be included in the address.) Please put “Publications Comment” on the subject line. Although we cannot respond individually to each email, we do appreciate your feedback and will consider your comments as we revise our tax products.

**Tax questions.** If you have a tax question, visit [www.irs.gov](http://www.irs.gov) or call 1-800-829-1040. We cannot answer tax questions at either of the addresses listed above.

**Ordering U.S. forms and publications.** Visit [www.irs.gov/formspubs](http://www.irs.gov/formspubs) to download U.S. forms and publications, call 1-800-829-3676, or write to the National Distribution Center at the address shown in chapter 6, How To Get Tax Help.

You can get the necessary possession tax forms at the tax office for the appropriate possession. The office addresses are given in chapter 3.

## Useful Items

You may want to see:

### Publication

- ❑ **54** Tax Guide for U.S. Citizens and Resident Aliens Abroad
- ❑ **514** Foreign Tax Credit for Individuals
- ❑ **519** U.S. Tax Guide for Aliens

### Form (and Instructions)

- ❑ **1040-PR** Planilla Para la Declaración de la Contribución Federal sobre el Trabajo por Cuenta Propia (Incluyendo el Crédito Tributario Adicional por Hijos para Residentes Bona Fide de Puerto Rico)
- ❑ **1040-SS** U.S. Self-Employment Tax Return (Including the Additional Child Tax Credit for Bona Fide Residents of Puerto Rico)
- ❑ **1116** Foreign Tax Credit
- ❑ **4563** Exclusion of Income for Bona Fide Residents of American Samoa
- ❑ **4868** Application for Automatic Extension of Time To File U.S. Individual Income Tax Return
- ❑ **5074** Allocation of Individual Income Tax to Guam or the Commonwealth of the Northern Mariana Islands (CNMI)
- ❑ **8689** Allocation of Individual Income Tax to the Virgin Islands
- ❑ **8898** Statement for Individuals Who Begin or End Bona Fide Residence in a U.S. Possession

# 1.

## Bona Fide Residence

In order to qualify for certain tax benefits (see chapter 3), you must be a bona fide resident of American Samoa, the CNMI, Guam, Puerto Rico, or the USVI for the entire tax year.

Generally, you are a bona fide resident of one of these possessions (the relevant possession) if, during the tax year, you:

- Meet the presence test,
- Do not have a tax home outside the relevant possession, and
- Do not have a closer connection to the United States or to a foreign country than to the relevant possession.

**New rules.** Recently issued temporary and final regulations define the requirements for meeting these three tests. Each regulation has a different effective date. The rules under the final regulation are mandatory for your 2006 return (for tax years ending after January 31, 2006). However, transition rules allow you to choose which set of requirements to apply to your 2004 and 2005 tax returns.

**2005 tax year—tax years beginning after October 22, 2004.** For 2005, you may choose to meet the three bona fide residence tests using either of the following.

- Final regulation: follow the rules discussed in this chapter.
- Temporary regulation: see Temporary Regulations section 1.937-1T on page 1039 of Internal Revenue Bulletin 2005-20, available at [www.irs.gov/pub/irs-irbs/irb05-20.pdf](http://www.irs.gov/pub/irs-irbs/irb05-20.pdf).



Generally, it will be to your advantage to use the rules discussed in this chapter rather than those in the temporary regulation.

**2004 tax year—tax years beginning before October 23, 2004, and ending after October 22, 2004.** For 2004, you may use either of the following to determine if you are a bona fide resident.

- Temporary regulation: see Temporary Regulations section 1.937-1T(b)(4) for requirements, which generally include the tax home and closer connection tests.
- Old rules (facts-and-circumstances test for U.S. citizens and resident aliens): see the rules in effect for tax years beginning before October 23, 2004, in the 2004 revision of Publication 570.

**Special rule for members of the U.S. Armed Forces.** If a member of the U.S. Armed Forces qualified as a bona fide resident of the relevant possession in an earlier tax year, his or her

absence from that possession during the current tax year in compliance with military orders will not affect the individual's status as a bona fide resident. Likewise, being in a possession solely in compliance with military orders will not qualify an individual for bona fide residency. Also see the special income source rule for members of the U.S. Armed Forces in chapter 2, under *Personal Services*.

## Presence Test



*If you became a bona fide resident before October 23, 2004, you must meet the new presence test for tax years beginning after October 22, 2004, in order to continue in that status. If you are a calendar year taxpayer, this applies to your tax returns for 2005 and later years.*

If you are a U.S. citizen or resident alien, you will satisfy the presence test for the entire tax year if you meet one of the following conditions.

1. You were present in the relevant possession for at least 183 days during the tax year.
2. You were present in the United States for no more than 90 days during the tax year.
3. You had earned income in the United States of no more than a total of \$3,000 and were present for more days in the relevant possession than in the United States during the tax year. Earned income is pay for personal services performed, such as wages, salaries, or professional fees.
4. You had no significant connection to the United States during the tax year.

**Special rule for nonresident aliens.** Conditions (1) through (4) above do not apply to nonresident aliens of the United States. Instead, nonresident aliens must meet the substantial presence test discussed in chapter 1 of Publication 519. In that discussion, substitute the name of the possession for "United States" and "U.S." wherever they appear. Also disregard the discussion in that chapter about a *Closer Connection to a Foreign Country*.

## Days of Presence in the United States or Relevant Possession

Generally, you are treated as being present in the United States or in the relevant possession on any day that you are physically present in that location at any time during the day.

**Days of presence in a possession.** You are considered to be present in the relevant possession on any of the following days.

1. Any day you are physically present in that possession at any time during the day,
2. Any day you are outside of the relevant possession in order to receive, or to accompany any of the following family members to receive, qualifying medical treatment (defined on the next page).

- a. Your parent.

- b. Your spouse.

- c. Your child, who is your son, daughter, stepson, stepdaughter, adopted child, or eligible foster child.

3. Any day you are outside the relevant possession because you leave or are unable to return to the relevant possession during any:

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

- b. Period for which a mandatory evacuation order is in effect for the geographic area in the relevant possession in which your main home is located.

If, during a single day, you are physically present:

- In the United States and in the relevant possession, that day is considered a day of presence in the relevant possession; and
- In two possessions, that day is considered a day of presence in the possession where your tax home is located (see *Tax Home*, later).

**Adopted child.** An adopted child is always treated as your own child. An adopted child includes a child lawfully placed with you for legal adoption.

**Eligible foster child.** An eligible foster child is any child placed with you by an authorized placement agency or by judgment, decree, or other order of any court of competent jurisdiction.

**Days of presence in the United States.** You are considered to be present in the United States on any day that you are physically present in the United States at any time during the day. However, do not count the following days as days of presence in the United States.

1. Any day you are temporarily present in the United States in order to receive, or to accompany a parent, spouse, or child who is receiving, qualifying medical treatment. "Child" is defined under item 2c in the previous column. "Qualifying medical treatment" is defined on the next page.
2. Any day you are in the United States for less than 24 hours when you are traveling between two places outside the United States.
3. Any day you are temporarily present in the United States as a professional athlete to compete in a charitable sports event (defined on the next page).
4. Any day you are temporarily in the United States as a student (defined on the next page).
5. Any day you are in the United States serving as an elected representative of the relevant possession, or serving full time as



an elected or appointed official or employee of the government of that possession (or any of its political subdivisions).

6. Any day you are temporarily present in the United States because you leave or are unable to return to the relevant possession during any:
  - a. 14-day period within which a major disaster occurs in the relevant possession for which a Federal Emergency Management Agency (FEMA) notice of a Presidential declaration of a major disaster is issued in the Federal Register, or
  - b. Period for which a mandatory evacuation order is in effect for the geographic area in the relevant possession in which your main home is located.

## Qualifying Medical Treatment

Such treatment is generally provided by (or under the supervision of) a physician for an illness, injury, impairment, or physical or mental condition. The treatment generally involves:

- Any period of inpatient care that requires an overnight stay in a hospital or hospice, and any period immediately before or after that inpatient care to the extent it is medically necessary, or
- Any temporary period of inpatient care in a residential medical care facility for medically necessary rehabilitation services.

With respect to each qualifying medical treatment, you must prepare (or obtain) and maintain documentation supporting your claim that such treatment meets the criteria to be considered days of presence in the relevant possession. You must keep the following documentation.

1. Records that provide:
  - a. The patient's name and relationship to you (if the medical treatment is provided to a person you accompany);
  - b. The name and address of the hospital, hospice, or residential medical care facility where the medical treatment was provided;
  - c. The name, address, and telephone number of the physician who provided the medical treatment;
  - d. The date(s) on which the medical treatment was provided; and
  - e. Receipt(s) of payment for the medical treatment.
2. Signed certification by the providing or supervising physician that the medical treatment met the requirements for being qualified medical treatment, and setting forth:
  - a. The patient's name,
  - b. A reasonably detailed description of the medical treatment provided by (or under the supervision of) the physician,

- c. The dates on which the medical treatment was provided, and
- d. The medical facts that support the physician's certification and determination that the treatment was medically necessary.

## Charitable Sports Event

A charitable sports event is one that meets all of the following conditions.

- The main purpose is to benefit a qualified charitable organization.
- The entire net proceeds go to charity.
- Volunteers perform substantially all the work.

In figuring the days of presence in the United States, you can exclude only the days on which you actually competed in the charitable sports event. You cannot exclude the days on which you were in the United States to practice for the event, to perform promotional or other activities related to the event, or to travel between events.

## Student

To qualify as a student, you must be, during some part of each of any 5 calendar months during the calendar year:

1. A full-time student at a school that has a regular teaching staff, course of study, and regularly enrolled body of students in attendance, or
2. A student taking a full-time, on-farm training course given by a school described in (1) above or by a state, county, or local government agency.

The 5 calendar months do not have to be consecutive.

**Full-time student.** A full-time student is a person who is enrolled for the number of hours or courses the school considers to be full-time attendance.

**School.** The term "school" includes elementary schools, junior and senior high schools, colleges, universities, and technical, trade, and mechanical schools. It does not include on-the-job training courses, correspondence schools, and Internet schools.

## Significant Connection

One way in which you can meet the presence test is to have no significant connection to the United States during the tax year. This section looks at the factors that determine if a significant connection exists.

You are treated as having a significant connection to the United States if you:

1. Have a permanent home in the United States,
2. Are currently registered to vote in any political subdivision of the United States, or
3. Have a spouse or child (see item 2c under *Days of presence in a possession*, earlier)

who is under age 18 whose main home is in the United States, other than:

- a. A child who is in the United States because he or she is the child of divorced or legally separated parents and who is living with a custodial parent under a custodial decree or multiple support agreement, or
- b. A child who is in the United States as a student.

For the purpose of determining if you have a significant connection to the United States, the term "spouse" does not include a spouse from whom you are legally separated under a decree of divorce or separate maintenance.

**Permanent home.** A permanent home generally includes an accommodation such as a house, an apartment, or a furnished room that is either owned or rented by you or your spouse. The dwelling unit must be available at all times, continuously, not only for short stays.

**Exception for rental property.** If you or your spouse own the dwelling unit and at any time during the tax year it is rented to someone else at fair rental value, it will be considered a permanent home only if you or your spouse uses that property for personal purposes for more than the greater of:

- 14 days, or
- 10% of the number of days during that tax year that the property is rented to others at a fair rental value.

You are treated as using rental property for personal purposes on any day the property is not being rented to someone else at fair rental value for the entire day.

A day of personal use of a dwelling unit is any day that the unit is used by any of the following persons.

- You or any other person who has an interest in it, unless you rent it to another owner as his or her main home under a shared equity financing agreement.
- A member of your family or a member of the family of any other person who has an interest in it, unless the family member uses the dwelling unit as his or her main home and pays a fair rental price. Family includes only brothers and sisters, half-brothers and half-sisters, spouses, ancestors (parents, grandparents, etc.) and lineal descendants (children, grandchildren, etc.).
- Anyone under an arrangement that lets you use some other dwelling unit.
- Anyone at less than a fair rental price.

However, any day you spend working substantially full time repairing and maintaining (not improving) your property is not counted as a day of personal use. Whether your property is used mainly for this purpose is determined in light of all the facts and circumstances, such as:

- The amount of time you devote to repair and maintenance work,

- How often during the tax year you perform repair and maintenance work on this property, and
- The presence and activities of companions.

See Publication 527, Residential Rental Property, for more information about personal use of a dwelling unit.

**Example—significant connection.** Ann Green, a U.S. citizen, is a sales representative for a company based in Guam. Ann lives with her husband and young children in their house in Guam, where she is also registered to vote. Her business travel requires her to spend 120 days in the United States and another 120 days in foreign countries. When traveling on business, Ann generally stays at hotels but sometimes stays with her brother, who lives in the United States. Ann's stays are always of short duration and she asks her brother's permission to stay with him. Her brother's house is not her permanent home, nor does she have any other accommodations in the United States that would be considered her permanent home. Ann satisfies the presence test because she has no significant connection to the United States.

**Example—presence test.** Eric and Wanda Brown live for part of the year in a condominium, which they own, in the CNMI. They also own a house in Maine where they live for 120 days every year to be near their grown children and grandchildren. The Browns are retired and their only income is from pension payments, dividends, interest, and social security benefits. In 2005, they spent only 175 days in the CNMI because of a 70-day vacation to Europe and Asia.

Thus, in 2005, the Browns were not present in the CNMI for at least 183 days, were present in the United States for more than 90 days, and had a significant connection to the United States because of their permanent home. However, the Browns still satisfied the presence test with respect to the CNMI because they had no earned income in the United States and were physically present for more days in the CNMI than in the United States.

## Tax Home

You will have met the tax home test if you did not have a tax home outside the relevant possession during any part of the tax year.

Your tax home is your regular or main place of business, employment, or post of duty regardless of where you maintain your family home. If you do not have a regular or main place of business because of the nature of your work, then your tax home is the place where you regularly live. If you do not fit either of these categories, you are considered an itinerant and your tax home is wherever you work.

## Exceptions

There are some special rules that provide exceptions to the general rule stated above. You will be considered to have met the tax home test if any of the following situations apply.

## Students and Government Officials

Disregard the following days when determining whether you have a tax home outside the relevant possession.

- Days you were temporarily in the United States as a student (see *Student* under *Days of Presence in the United States or Relevant Possession*).
- Days you were in the United States serving as an elected representative of the relevant possession, or serving full time as an elected or appointed official or employee of the government of that possession (or any of its political subdivisions).

## Seafarers

You will not be considered to have a tax home outside the relevant possession solely because you are employed 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 tax year, the total amount of time it is used in international waters and in the waters within three miles of the relevant possession exceeds the total amount of time it is used in the territorial waters of the United States, another possession, or any foreign country.

**Example.** In 2005, Sean Silverman, a U.S. citizen, was employed by a fishery and spent 250 days at sea on a fishing vessel. When not at sea, Sean lived with his wife at a house they own in American Samoa. The fishing vessel on which Sean works departs and arrives at various ports in American Samoa, other possessions, and foreign countries, but was in international or American Samoa's local waters for 225 days. For purposes of determining bona fide residency of American Samoa, Sean will not be considered to have a tax home outside that possession solely because of his employment on board the fishing vessel.

## Year of Move

If you are moving to or from a possession during the year, you may still be able to meet the tax home test for that year. See *Special Rules in the Year of a Move*, later in this chapter.

## Closer Connection

You will have met the closer connection test if, during any part of the tax year, you do not have a closer connection to the United States or a foreign country than to the relevant U.S. possession.

You will be considered to have a closer connection to a possession than to the United States or to a foreign country if you have maintained more significant contacts with the possession(s) than with the United States or foreign country. In determining if you have maintained more significant contacts with the relevant possession, the facts and circumstances to be considered include, but are not limited to, the following.

- The location of your permanent home.
- The location of your family.
- The location of personal belongings, such as automobiles, furniture, clothing, and jewelry owned by you and your family.
- The location of social, political, cultural, or religious organizations with which you have a current relationship.
- The location where you conduct your routine personal banking activities.
- The location where you conduct business activities (other than those that go into determining your tax home).
- The location of the jurisdiction in which you hold a driver's license.
- The location of the jurisdiction in which you vote.
- The country of residence you designate on forms and documents.
- The types of official forms and documents you file, such as Form W-8BEN, Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding, or Form W-9, Request for Taxpayer Identification Number and Certification.

Your connections to the relevant possession will be compared to the total of your connections with the United States and foreign countries. Your answers to the questions on Form 8898, Part III, will help establish the jurisdiction to which you have a closer connection.

**Example—closer connection to the United States.** Marcos Reyes, a U.S. citizen, moved to Puerto Rico in 2005 to start an investment consulting and venture capital business. His wife and two teenage children remained in California to allow the children to complete high school. He traveled back to the United States regularly to see his wife and children, to engage in business activities, and to take vacations. Marcos had an apartment available for his full-time use in Puerto Rico, but remained a joint owner of the residence in California where his wife and children lived. Marcos and his family had automobiles and personal belongings such as furniture, clothing, and jewelry located at both residences. Although Marcos was a member of the Puerto Rico Chamber of Commerce, he also belonged to and had current relationships with social, political, cultural, and religious organizations in California. Marcos received mail in California, including bank and brokerage statements and credit card bills. He conducted his personal banking activities in California. He held a California driver's license and was also registered to vote there. Based on all of the particular facts and circumstances pertaining to Marcos, he was not a bona fide resident of Puerto Rico in 2005 because he had a closer connection to the United States than to Puerto Rico.

**Closer connection to another possession.** Generally, possessions are not treated as foreign countries. Therefore, a closer connection to a possession other than the relevant possession will not be treated as a closer connection to a foreign country.

**Example—tax home and closer connection to possession.** Pearl Blackmon, a U.S. citizen, is a permanent employee of a hotel in Guam, but works only during the tourist season. For the remainder of each year, Pearl lives with her husband and children in the CNMI, where she has no outside employment. Most of Pearl's personal belongings, including her automobile, are located in the CNMI. She is registered to vote in, and has a driver's license issued by, the CNMI. She does her personal banking in the CNMI and routinely lists her CNMI address as her permanent address on forms and documents. Pearl satisfies the presence test with respect to both Guam and the CNMI. She satisfies the tax home test with respect to Guam, because her regular place of business is in Guam. Pearl satisfies the closer connection test with respect to both Guam and the CNMI, because she does not have a closer connection to the United States or to any foreign country. Pearl is considered a bona fide resident of Guam, the location of her tax home.

## Exception for Year of Move

If you are moving to or from a possession during the year, you may still be able to meet the closer connection test for that year. See *Special Rules in the Year of a Move*, next.

## Special Rules in the Year of a Move

If you are moving to or from a possession during the year, you may still be able to meet the tax home and closer connection tests for that year.

## Year of Moving to a Possession

You will satisfy the tax home and closer connection tests in the tax year of changing your residence to the relevant possession if you meet all of the following.

- You have not been a bona fide resident of the relevant possession in any of the 3 tax years immediately preceding your move.
- You do 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 during any of the last 183 days of the tax year.
- You are a bona fide resident of the relevant possession for each of the 3 tax years immediately following your move.

**Example.** Dwight Wood, a U.S. citizen, files returns on a calendar year basis. He lived in the United States from January 2000 through May 2005. In June 2005, he moved to the USVI, purchased a house, and accepted a permanent job with a local employer. From July 1 through December 31, 2005 (more than 183 days), Dwight's principal place of business was in the USVI and, during that time, he did not have a closer connection to the United States or a foreign country than to the USVI. If he continues to live and work in the USVI during all of 2006

through 2008, and maintains a closer connection to the USVI than to the United States or any foreign country, he will satisfy the tax home and closer connection tests for 2005. If Dwight also satisfies the presence test in 2005, he will be considered a bona fide resident for the entire 2005 tax year.

## Year of Moving From a Possession

In the year you cease to be a bona fide resident of American Samoa, the CNMI, Guam, or the USVI, you will satisfy the tax home and closer connection tests with respect to the relevant possession if you meet all of the following.

- You have been a bona fide resident of the relevant possession for each of the 3 tax years immediately preceding your change of residence.
- You do 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 during any of the first 183 days of the tax year.
- You are not a bona fide resident of the relevant possession for any of the 3 tax years immediately following your move.

**Example.** Jean Aspen, a U.S. citizen, files returns on a calendar year basis. From January 2002 through December 2004, Jean was a bona fide resident of American Samoa. Jean continued to live there until September 6, 2005, when she accepted new employment and moved to Hawaii. Jean's principal place of business from January 1 through September 5, 2005 (more than 183 days), was in American Samoa, and during that period Jean did not have a closer connection to the United States or a foreign country than to American Samoa. If Jean continues to live and work in Hawaii for the rest of 2005 and throughout years 2006 through 2008, she will satisfy the tax home and closer connection tests for 2005 with respect to American Samoa. If Jean also satisfies the presence test in 2005, she will be considered a bona fide resident for the entire 2005 tax year.

## Puerto Rico

You will be considered a bona fide resident of Puerto Rico for the part of the tax year preceding the date on which you move if you:

- Are a U.S. citizen,
- Are a bona fide resident of Puerto Rico for at least 2 tax years immediately preceding the tax year of the move,
- Cease to be a bona fide resident of Puerto Rico during the tax year,
- Cease to have a tax home in Puerto Rico during the tax year, and
- Have a closer connection to Puerto Rico than to the United States or a foreign country throughout the part of the tax year preceding the date on which you cease to have a tax home in Puerto Rico.

**Example.** Randy White, a U.S. citizen, files returns on a calendar year basis. For all of 2003 and 2004, Randy was a bona fide resident of Puerto Rico. From January through April 2005, Randy continued to reside and maintain his principal place of business in and closer connection to Puerto Rico. On May 5, 2005, Randy moved and changed his tax home to Nevada. Later that year he established a closer connection to the United States than to Puerto Rico. Randy did not satisfy the presence test for 2005 with respect to Puerto Rico, nor the tax home or closer connection tests. However, because Randy was a bona fide resident of Puerto Rico for at least 2 tax years before he moved to Nevada in 2005, he was a bona fide resident of Puerto Rico from January 1 through May 4, 2005.

## Reporting a Change in Bona Fide Residence

Beginning with tax year 2001, if you became or ceased to be a bona fide resident of certain possessions, you may need to file Form 8898, Statement for Individuals Who Begin or End Bona Fide Residence in a U.S. Possession. For this purpose, the following are considered U.S. possessions: American Samoa, the CNMI, Guam, Puerto Rico, and the USVI.

## Who Must File

You must file Form 8898 for the tax year (beginning with tax year 2001) in which you meet both of the following conditions.

1. Your worldwide gross income (defined below) in that tax year is more than \$75,000.
2. You meet one of the following.
  - a. You take a position for U.S. tax purposes that you became a bona fide resident of a U.S. possession after a tax year for which you filed a U.S. income tax return as a citizen or resident alien of the United States but not as a bona fide resident of the possession.
  - b. You are a citizen or resident alien of the United States who takes the position for U.S. tax purposes that you ceased to be a bona fide resident of a U.S. possession after a tax year for which you filed an income tax return as a bona fide resident of the possession.
  - c. You take the position for U.S. tax purposes that you became a bona fide resident of Puerto Rico or American Samoa after a tax year for which you were required to file an income tax return as a bona fide resident of the CNMI, Guam, or the USVI.

**Worldwide gross income.** Worldwide gross income means all income you received in the form of money, goods, property, and services, including any income from sources outside the United States (even if you can exclude part or all of it) and before any deductions, credits, or rebates.



**Example.** You are a U.S. citizen who moved to the CNMI in December 2002, but did not become a bona fide resident of that possession until the 2003 tax year. You must file Form 8898 for the 2003 tax year if your worldwide gross income for that year is more than \$75,000.

## Penalty for Not Filing Form 8898

If you are required to file Form 8898 for any tax year and you fail to file it, you may owe a penalty of \$1,000. You may also owe this penalty if you do not include all the information required by the form or the form includes incorrect information. In either case, you will not owe this penalty if you can show that such failure is due to reasonable cause and not willful neglect. This is in addition to any criminal penalty that may be imposed.

## 2.

# Possession Source Income

In order to determine where to file your return and which form(s) you need to complete, you must determine the source of each item of income you received during the tax year. Income you received from sources within, or that was effectively connected with the conduct of a trade or business in, the relevant possession must be identified separately from U.S. or foreign source income.

This chapter discusses the rules for determining if the source of your income is:

- American Samoa,
- The Commonwealth of the Northern Mariana Islands (CNMI),
- The Commonwealth of Puerto Rico (Puerto Rico),
- Guam, or
- The U.S. Virgin Islands (USVI).

Generally, the same rules that apply for determining U.S. source income also apply for determining possession source income. However, there are some important exceptions to these rules. Both the general rules and the exceptions are discussed in this chapter.

The rules for determining possession source income are generally effective for income earned after December 31, 2004. The basis of these rules is the “U.S. income rule.”

**U.S. income rule.** This rule states that income is not possession source income if, under the rules of Internal Revenue Code sections 861–865, it is treated as income:

- From sources in the United States, or
- Effectively connected with the conduct of a trade or business in the United States.

Table 2-1 shows the general rules for determining whether income is from sources within the United States.

## Types of Income

This section looks at the most common types of income received by individuals, and the rules for determining the source of the income. Generally, the same rules shown in Table 2-1 are used to determine if you have possession source income.

### Personal Services

Personal service income includes wages, salaries, commissions, fees, per diem allowances, and employee allowances and bonuses. It also includes income earned by sole proprietors and general partners from providing personal services in the course of their trade or business.

#### Wages, salaries, and other compensation.

Generally, all pay you receive for services performed in a relevant possession is considered to be from sources within that possession. However, there is an exception for income earned as a member of the U.S. Armed Forces.

**U.S. Armed Forces.** If you are a bona fide resident of a relevant possession, your military service pay will be sourced in that possession even if you perform the services in the United States or another possession. However, if you are not a bona fide resident of a possession, your military service pay will be income from the United States even if you perform services in a possession.

**Pensions.** Pension income is sourced according to where services were performed that earned the pension. For example, if your entire working career was spent in the United States and then you retired to the USVI, your pension

would be considered U.S. source income because all services were performed in the United States.

### Investment Income

This category includes such income as interest, dividends, rents, and royalties.

**Interest income.** The source of interest income is generally determined by the residence of the payer. Interest paid by corporations created or organized in a relevant possession (possession corporation) or by individuals who are bona fide residents of a relevant possession is considered income from sources within that possession.

However, there is an exception to this rule if you are a bona fide resident of a relevant possession, receive interest from a corporation created or organized in that possession, and are a shareholder of that corporation who owns, directly or indirectly, at least 10% of the total voting stock of the corporation. See Temporary Regulations section 1.937-2T(i) for more information.

**Dividends.** Generally, dividends paid by a corporation created or organized in a relevant possession will be considered income from sources within that possession. There are additional rules for bona fide residents of a relevant possession who receive dividend income from possession corporations, and who own, directly or indirectly, at least 10% of the voting stock of the corporation. For more information, see Temporary Regulations section 1.937-2T(g).

**Rental income.** Rents from property located in a relevant possession are treated as income from sources within that possession.

**Royalties.** Royalties from natural resources located in a relevant possession are considered income from sources within that possession.

Also considered possession source income are royalties received for the use of, or for the

Table 2-1. General Rules for Determining U.S. Source of Income

Item of Income	Factor Determining Source
Salaries, wages, other compensation	Where services performed
Business income: Personal services Sale of inventory—purchased Sale of inventory—produced	Where services performed Where sold Allocation
Interest	Residence of payer
Dividends	Where corporation created or organized
Rents	Location of property
Royalties: Natural resources Patent, copyrights, etc.	Location of property Where property is used
Sale of real property	Location of property
Sale of personal property	Seller's tax home (but see <i>Sales or exchanges of certain personal property</i> , later, for exceptions)
Sale of natural resources	Allocation based on fair market value of product at export terminal. For more information, see section 1.863-1(b) of the Regulations.
Pensions	Where services were performed that earned the pension

privilege of using, in a relevant possession, patents, copyrights, secret processes and formulas, goodwill, trademarks, trade brands, franchises, and other like property.

## Sales or Other Dispositions of Property

The source rules for sales or other dispositions of property are varied. The most common situations are discussed below.

**Real property.** Real property includes land and buildings, and generally anything built on, growing on, or attached to land. The location of the property generally determines the source of income from the sale. For example, if you are a bona fide resident of Guam and sell your home that is located in Guam, the gain on the sale is sourced in Guam. If, however, the home you sold was located in the United States, the gain is U.S. source income. However, for exceptions, see *Special rules for gains from disposition of certain property* on this page.

**Personal property.** The term “personal property” refers to property that is not real property, such as machinery, equipment, or furniture. Generally, gain or loss from the sale or other disposition is sourced according to the seller’s tax home. If personal property is sold by a bona fide resident of a relevant possession, the gain or loss from the sale is treated as sourced within that possession.

This rule does not apply to the sale of inventory, intangible property, depreciable personal property, or property sold through a foreign office or fixed place of business. The rules applying to sales of inventory are discussed below. For information on sales of the other types of property mentioned, see Internal Revenue Code section 865.

**Inventory.** Your inventory is personal property that is stock in trade or that is held primarily for sale to customers in the ordinary course of your trade or business. The source of income from the sale of inventory depends on whether the inventory was purchased or produced.

**Purchased.** Income from the sale of inventory that you purchased is sourced where you sell the property. Generally, this is where title to the property passes to the buyer.

**Produced.** Income from the sale of inventory that you produced in a relevant possession and sold outside that possession (or vice versa) is sourced based on an allocation. For information on making the allocation, see Regulations section 1.863-3(f).

**Special rules for gains from dispositions of certain property.** There are special rules for gains from dispositions of certain investment property (for example, stocks, bonds, debt instruments, diamonds, and gold) owned by a U.S. citizen or resident alien prior to becoming a bona fide resident of a possession. You are subject to these special rules if you meet both of the following conditions.

- For the tax year for which the source of the gain must be determined, you are a bona fide resident of the relevant possession.

- For any of the 10 years preceding that year, you were a citizen or resident alien of the United States (other than a bona fide resident of the relevant possession).

If you meet these conditions, gains from the disposition of this property will not be treated as income from sources within the relevant possession for purposes of the Internal Revenue Code. Accordingly, bona fide residents of American Samoa and Puerto Rico, for example, may not exclude the gain on their U.S. tax return. (See chapter 3 for additional information on filing requirements.) With respect to the CNMI, Guam, and the USVI, the gain from the disposition of this property will not meet the requirements for certain tax rules that may allow bona fide residents of those possessions to reduce or obtain a rebate of taxes on income from sources within the relevant possessions.

These rules apply to dispositions after April 11, 2005. For details, see Temporary Regulations section 1.937-2T(f)(1) and Example 2 of section 1.937-2T(k).

**Example.** In 2000, Cheryl Jones, a U.S. citizen, lives in the United States and buys 100 shares of stock in the Rose Corporation, a U.S. corporation. In 2003, she moves to Puerto Rico. In 2006, while a bona fide resident of Puerto Rico, Cheryl sells the Rose Corporation stock at a gain. For income tax purposes, this gain is not treated as income from sources within Puerto Rico.



*The new source rules discussed in the preceding paragraphs supplement, and may apply in conjunction with, an existing special rule. This existing special rule applies if you are a U.S. citizen or resident alien who becomes a bona fide resident of American Samoa, the CNMI, or Guam, and who has gain from the disposition of certain U.S. assets during the 10-year period beginning when you became a bona fide resident. The gain is U.S. source income that generally is subject to U.S. tax if the property is either (1) located in the United States; (2) stock issued by a U.S. corporation or a debt obligation of a U.S. person or of the United States, a state (or political subdivision), or the District of Columbia; or (3) property that has a basis in whole or in part by reference to property described in (1) or (2). See chapter 3 for filing requirements.*

## Scholarships, Fellowships, Grants, Prizes, and Awards

The source of these types of income is generally the residence of the payer, regardless of who actually disburses the funds. Therefore, in order to be possession source income, the payer must be a resident of the relevant possession, such as an individual who is a bona fide resident or a corporation created or organized in that possession.



*These rules do not apply to amounts paid as salary or other compensation for services. See Wages, salaries, and other compensation, earlier in this chapter, for the source rules that apply.*

## Effectively Connected Income

In limited circumstances, some kinds of income from sources outside the relevant possession must be treated as effectively connected with a trade or business in that possession. These circumstances are listed below.

- You have an office or other fixed place of business in the relevant possession to which the income can be attributed.
- That office or place of business is a material factor in producing the income.
- The income is produced in the ordinary course of the trade or business carried on through that office or other fixed place of business.

An office or other fixed place of business is a material factor if it significantly contributes to, and is an essential economic element in, the earning of the income.

The three kinds of income from sources outside the relevant possession to which these rules apply are the following.

1. Rents and royalties for the use of, or for the privilege of using, intangible personal property located outside the relevant possession or from any interest in such property. Included are rents or royalties for the use of, or for the privilege of using, outside the relevant possession, patents, copyrights, secret processes and formulas, goodwill, trademarks, trade brands, franchises, and similar properties if the rents or royalties are from the active conduct of a trade or business in the relevant possession.
2. Dividends or interest from the active conduct of a banking, financing, or similar business in the relevant possession.
3. Income, gain, or loss from the sale or exchange outside the relevant possession, through the office or other fixed place of business in the relevant possession, of:
  - a. Stock in trade,
  - b. Property that would be included in inventory if on hand at the end of the tax year, or
  - c. Property held primarily for sale to customers in the ordinary course of business.

Item (3) will not apply if you sold the property for use, consumption, or disposition outside the relevant possession and an office or other fixed place of business in a foreign country was a material factor in the sale.

For tax years beginning after October 22, 2004 (beginning with tax year 2005 if a calendar year taxpayer), any income from a source outside the relevant possession that is equivalent to any item of income described in (1)–(3) above is treated as effectively connected with a trade or business in the relevant possession.



**Example.** Marcy Jackson is a bona fide resident of American Samoa. Her business, which she conducts from an office in American Samoa, is developing and selling specialized computer software. A software purchaser will frequently pay Marcy an additional amount to install the software on the purchaser's operating system and to ensure that the software is functioning properly. Marcy installs the software at the purchaser's place of business, which may be in American Samoa, in the United States, or in another country. The income from selling the software is effectively connected with the conduct of Marcy's business in American Samoa, even though the product's destination may be outside the possession. However, the compensation she receives for installing the software (personal services) outside of American Samoa is not effectively connected with the conduct of her business in the possession—the income is sourced where she performs the services.

### 3.

## Filing Requirements for Individuals in Certain U.S. Possessions

If you have income from American Samoa, the CNMI, Guam, Puerto Rico, or the USVI, you may have to file a tax return with the tax department of that possession. Or, you may have to file two annual tax returns, one with the possession's tax department and the other with the U.S. Internal Revenue Service. This chapter covers the general rules for filing returns in the five possessions.

You must first determine if you are a bona fide resident of the relevant possession. See chapter 1 for a discussion of the requirements you must meet.

You should ask for forms and advice about the filing of possession tax returns from that possession's tax department, not the Internal Revenue Service. Contact information is listed in this chapter under the heading for each possession.

### American Samoa

American Samoa has its own separate and independent tax system. Although its tax laws are modeled on the U.S. Internal Revenue Code, there are certain differences.

## Where To Get Forms and Information



Requests for advice about matters connected with Samoan taxation should be sent to:

Tax Division  
Government of American Samoa  
Pago Pago, American Samoa 96799



The phone number is 684-633-4181.  
The fax number is 684-633-1513.



You can access the Samoan website at [www.asg-gov.net/tax\\_index.htm](http://www.asg-gov.net/tax_index.htm).

**Caution.** The addresses and phone numbers listed above are subject to change.

## Which Returns To File

Your residency status and your source of income with regard to American Samoa determine whether you file your return and pay your tax to American Samoa, to the United States, or to both.

In addition to the information below that is categorized by residency status, the *Special Rules* section contains important information for determining the correct forms to file.

### Bona Fide Resident of American Samoa

Bona fide residents of American Samoa are generally exempt from U.S. tax on their American Samoa source income.

**U.S. citizen or resident alien.** If you are a U.S. citizen or resident alien and a bona fide resident of American Samoa during the entire tax year, you generally must file the following returns.

- An American Samoa tax return reporting your gross income from worldwide sources. If you report non-American Samoa source income on your American Samoa tax return, you can claim a credit against your American Samoa tax liability for income taxes paid on that income to the United States, a foreign country, or another possession.
- A U.S. tax return reporting income from worldwide sources, but excluding income from sources within American Samoa. However, amounts received for services performed as an employee of the United States or any of its agencies cannot be excluded (see *U.S. Government employees* on the next page).

To exclude American Samoa source income, attach a completed Form 4563 to your U.S. tax return (see *Form 4563*, on this page, for more information). If you are excluding American Samoa source income on your U.S. tax return, you will not be allowed any deductions or credits from gross income that are directly or indirectly allocable to the exempt income. For more

information, see *Special Rules for Completing Your U.S. Tax Return* in chapter 4.

**Nonresident alien.** If you are a bona fide resident of American Samoa during the entire tax year, but a nonresident alien of the United States, you generally must file the following returns.

- An American Samoa tax return reporting worldwide income.
- A U.S. tax return (Form 1040) reporting income from worldwide sources, but excluding American Samoa source income other than amounts for services performed as an employee of the United States or any of its agencies. For more information, see *U.S. Government employees* on the next page. To exclude income from sources within American Samoa, attach a completed Form 4563 to your U.S. tax return (see *Form 4563*, on this page, for more information).

For all other tax purposes, however, you will be treated as a nonresident alien individual. For example, you are not allowed the standard deduction, you cannot file a joint return, and you are not allowed a deduction for a dependent unless that person is a citizen or national of the United States. There are also limitations on what deductions and credits are allowed. See Publication 519, *U.S. Tax Guide for Aliens*, for more information.

**Form 4563.** If you must file a U.S. income tax return and you qualify to exclude any of your income from American Samoa, claim the exclusion by completing Form 4563 and attaching it to your Form 1040. Form 4563 cannot be filed by itself. There is an example of a filled-in Form 4563 in chapter 5.

### Not a Bona Fide Resident of American Samoa

An individual who is not a bona fide resident of American Samoa for the tax year generally files both U.S. and American Samoa tax returns, and claims a foreign tax credit on the U.S. return for taxes paid to American Samoa.

**U.S. citizen or resident alien.** If you are a U.S. citizen or resident alien but not a bona fide resident of American Samoa during the entire tax year, you generally must file the following returns.

- An American Samoa tax return reporting only your income from sources within American Samoa.
- A U.S. tax return reporting your income from worldwide sources. You can take a credit against your U.S. tax liability if you paid income taxes to American Samoa (or other possession or foreign country) and reported income from those sources on your U.S. tax return.

**Nonresident alien.** If you are a nonresident alien of the United States who does not qualify as a bona fide resident of American Samoa for

the entire tax year, you generally must file the following returns.

- An American Samoa tax return reporting only your income from sources within American Samoa. In this situation, wages for services performed in American Samoa for the U.S. Government or for private employers is income from sources within American Samoa.
- A U.S. tax return (Form 1040NR) reporting U.S. source income according to the rules for a nonresident alien. See the instructions for Form 1040NR, U.S. Nonresident Alien Income Tax Return.

## Special Rules

Some special rules apply to certain types of income and employment.

**U.S. Armed Forces.** Bona fide residents of American Samoa include military personnel whose official home of record is American Samoa.

**U.S. Government employees.** If you are employed in American Samoa by either the U.S. Government or any of its agencies, or by the Government of American Samoa, you are subject to tax by American Samoa on your pay from either government. Whether you are subject to tax by American Samoa on your non-American Samoa source income depends on your status in American Samoa as a bona fide resident.

Wages and salaries paid to U.S. citizens by the Governments of the United States and American Samoa are also subject to U.S. federal income tax. These payments do not qualify for the exclusion of income from sources within American Samoa, discussed earlier.

If you report government wages on both your U.S. and American Samoa tax returns, you can take a credit on your U.S. tax return for income taxes paid or accrued to American Samoa. Figure the credit on Form 1116, and attach that form to your U.S. tax return, Form 1040. Show your wages paid for services performed in American Samoa on Form 1116, line 1, as income from sources in a possession.

**Moving expense deduction.** Generally, expenses of a move to American Samoa are directly attributable to American Samoa wages, salaries, and other earned income. Likewise, the expenses of a move back to the United States are generally attributable to U.S. earned income.

If your move was to American Samoa, report your deduction for moving expenses as follows.

- If you are a bona fide resident in the tax year of your move, enter your deductible expenses on your American Samoa tax return.
- If you are not a bona fide resident, enter your deductible expenses on both your American Samoa and U.S. tax returns. Also, for purposes of a tax credit against your U.S. tax liability, reduce your American Samoa "general limitation income" on Form 1116, line 2, by the deductible moving expenses.

If your move was to the United States, complete Form 3903, Moving Expenses, and enter the deductible amount on Form 1040, line 26.

**Self-employment tax.** If you are not required to file a U.S. tax return but have income that is effectively connected with a trade or business in American Samoa, you must file Form 1040-SS with the United States. On this form you will report your self-employment income to the United States and, if necessary, pay self-employment tax on that income.

## Double Taxation

A mutual agreement procedure exists to settle cases of double taxation between the United States and American Samoa. See *Double Taxation* in chapter 4.

## The Commonwealth of Puerto Rico

The Commonwealth of Puerto Rico has its own separate and independent tax system. Although it is modeled after the U.S. system, there are differences in law and tax rates.

## Where To Get Forms and Information



Requests for information about the filing of Puerto Rican tax returns should be addressed to:

Departamento de Hacienda  
Negociado de Asistencia  
Contributiva y Consultas Especializadas  
P.O. Box 9024140  
San Juan, Puerto Rico 00902-4140



The phone number is 787-721-2020, extension 3611.

To obtain Puerto Rican tax forms, contact the Forms and Publications Division Office at the above address or call 787-721-2020, extensions 2645 or 2646.



You can access the Puerto Rican website at [www.hacienda.gobierno.pr](http://www.hacienda.gobierno.pr).

**Caution.** The addresses and phone numbers listed above are subject to change.

## Which Returns To File

Generally, you will file returns with both Puerto Rico and the United States. The income reported on each return depends on your residency status in Puerto Rico. To determine if you are a bona fide resident of Puerto Rico, see the information in chapter 1.

## Bona Fide Resident of Puerto Rico

Bona fide residents of Puerto Rico will generally pay tax to Puerto Rico on their worldwide income.

**U.S. citizen or resident alien.** If you are a U.S. citizen or resident alien and also a bona fide resident of Puerto Rico during the entire tax year, you generally must file the following returns.

- A Puerto Rican tax return reporting income from worldwide sources. If you report U.S. source income on your Puerto Rican tax return, you can claim a credit against your Puerto Rican tax, up to the amount allowable, for income taxes paid to the United States.
- A U.S. tax return reporting income from worldwide sources, but excluding Puerto Rico source income. However, see *U.S. Government employees*, on the next page, for an exception.

If you are excluding Puerto Rican income on your U.S. tax return, you will not be allowed any deductions or credits that are directly or indirectly allocable to exempt income. For more information, see *Special Rules for Completing Your U.S. Tax Return* in chapter 4.

If all of your income is from Puerto Rican sources, you are not required to file a U.S. tax return. However, if you have self-employment income, see *Self-employment tax* on the next page.

**U.S. citizen only.** If you are a U.S. citizen, you may also qualify under these rules if you have been a bona fide resident of Puerto Rico for at least 2 years before moving from Puerto Rico. In this case, you can exclude your income derived from sources within Puerto Rico that you earned before the date you changed your residence. For more information, see *Puerto Rico* under *Special Rules in the Year of a Move* in chapter 1.

**Nonresident alien.** If you are a bona fide resident of Puerto Rico during the entire tax year, but a nonresident alien of the United States, you generally must file the following returns.

- A Puerto Rican tax return reporting income from worldwide sources. If you report U.S. source income on your Puerto Rican tax return, you can claim a credit against your Puerto Rican tax, up to the amount allowable, for income taxes paid to the United States.
- A U.S. tax return (Form 1040) reporting income from worldwide sources, but excluding Puerto Rican source income (other than amounts for services performed as an employee of the United States or any of its agencies). For tax purposes other than reporting income, however, you will be treated as a nonresident alien individual. For example, you are not allowed the standard deduction, you cannot file a joint return, and you are not allowed a deduction for a dependent unless that person is a citizen or national of the United States. There are also limitations on what deductions and credits are allowed. See Publication 519 for more information.

## Not a Bona Fide Resident of Puerto Rico

An individual who is not a bona fide resident of Puerto Rico for the tax year generally files tax returns with both Puerto Rico and the United States.

**U.S. citizen or resident alien.** If you are a U.S. citizen or resident alien but not a bona fide resident of Puerto Rico during the entire tax year, you generally must file the following returns.

- A Puerto Rican tax return reporting only your income from Puerto Rican sources. Wages for services performed in Puerto Rico for the U.S. Government or for private employers is income from Puerto Rican sources.
- A U.S. tax return reporting income from worldwide sources. Generally, you can claim a foreign tax credit for income taxes paid to Puerto Rico on the Puerto Rican income that is not exempt from U.S. taxes (see chapter 4 for more information).

**Nonresident alien.** If you are a nonresident alien of the United States who does not qualify as a bona fide resident of Puerto Rico for the entire tax year, you generally must file the following returns.

- A Puerto Rican tax return reporting only your income from Puerto Rican sources. Wages for services performed in Puerto Rico for the U.S. Government or for private employers is income from Puerto Rican sources.
- A U.S. tax return (Form 1040NR) according to the rules for a nonresident alien. See the instructions for Form 1040NR.

## Special Rules

In addition to the above general rules for filing U.S. and Puerto Rican tax returns, there are some special rules that apply to certain individuals and types of income.

**U.S. Government employees.** Wages and cost-of-living allowances paid by the U.S. Government (or one of its agencies) for working in Puerto Rico are subject to Puerto Rican tax. However, the cost-of-living allowances are excluded from Puerto Rican gross income up to the amount exempt from U.S. tax. In order to claim this exclusion, you must:

- Include with your Puerto Rican tax return evidence to show the amount received during the year, and
- Be in full compliance with your Puerto Rican tax responsibilities.

These wages are also subject to U.S. tax, but the cost-of-living allowances are excludable. A foreign tax credit is available in order to avoid double taxation.

**Income from sources outside Puerto Rico and the United States.** If you are a U.S. citizen and bona fide resident of Puerto Rico and you have income from sources outside both Puerto Rico and the United States, that income

is treated as foreign source income under both tax systems. In addition to your Puerto Rican and U.S. tax returns, you may also have to file a return with the country or possession from which your outside income was derived. To avoid double taxation, a foreign tax credit is generally available for either the U.S. or Puerto Rican return.

**Example.** Thomas Red is a bona fide resident of Puerto Rico and a U.S. citizen. He traveled to the Dominican Republic and worked in the construction industry for one month. His wages were \$20,000. Because the wages were earned outside Puerto Rico and outside the United States, Thomas must file a tax return with Puerto Rico and the United States. He may also have to file a tax return with the Dominican Republic.

**Moving expense deduction.** Generally, expenses of a move to Puerto Rico are directly attributable to wages, salaries, and other earned income from Puerto Rico. Likewise, the expenses of a move back to the United States are generally attributable to U.S. earned income.

If your move was to Puerto Rico, report your deduction for moving expenses as follows.

- If you are a bona fide resident in the tax year of your move, enter your deductible expenses on your Puerto Rican tax return.
- If you are not a bona fide resident, enter your deductible expenses on both your Puerto Rican and U.S. tax returns. Also, for purposes of a tax credit against your U.S. tax liability, reduce your Puerto Rican "general limitation income" on Form 1116, line 2, by the deductible moving expenses.

If your move was to the United States, complete Form 3903 and enter the deductible amount on Form 1040, line 26.

**Additional child tax credit.** If you are not required to file a U.S. income tax return, this credit is available only if you meet all three of the following conditions.

- You were a bona fide resident of Puerto Rico during the entire tax year.
- Social security and Medicare taxes were withheld from your wages or you paid self-employment tax.
- You had three or more qualifying children. (For the definition of a qualifying child, see the instructions for Form 1040-PR or Form 1040-SS.)

If your income exceeds certain levels, you may be disqualified from receiving this credit. Use Form 1040-PR or Form 1040-SS to claim this credit.



*Advice about possible tax benefits under the Puerto Rican investment incentive programs is available from the Puerto Rican tax authorities.*

**Self-employment tax.** If you have no U.S. filing requirement but have income that is effectively connected with a trade or business in Puerto Rico, you must file Form 1040-SS or Form 1040-PR with the United States to report your self-employment income and, if necessary, pay self-employment tax.

## Double Taxation

A mutual agreement procedure exists to settle cases of double taxation between the United States and the Commonwealth of Puerto Rico. See *Double Taxation* in chapter 4.

## The Commonwealth of the Northern Mariana Islands

The Commonwealth of the Northern Mariana Islands (CNMI) has its own tax system based partly on the same tax laws and tax rates that apply to the United States and partly on local taxes imposed by the CNMI government.

## Where To Get Forms and Information



Requests for advice about CNMI residency and tax matters should be addressed to:

Department of Revenue and Taxation  
Commonwealth of the Northern  
Mariana Islands  
P.O. Box 5234, CHRBP  
Saipan, MP 96950



The phone number is 670-664-1000.  
The fax number is 670-664-1015.

**Caution.** The address and phone numbers listed above are subject to change.

## Which Return To File

In general, all individuals with income from the CNMI will file only one return, either to the CNMI or to the United States. Your residency status with regard to the CNMI determines which return you will file. Be sure to check the *Special Rules* section on the next page for additional information about filing your tax return.

## Bona Fide Resident of the CNMI

If you are a U.S. citizen, resident alien, or nonresident alien and a bona fide resident of the CNMI during the entire tax year, file your income tax return with the CNMI.

- Include income from worldwide sources on your CNMI return. In determining your tax, include all income tax withheld by either the CNMI or the United States, any credit for an overpayment of income tax to either the CNMI or the United States, and any payments of estimated tax to either the CNMI or the United States. Pay any balance of tax due with your tax return.
- Generally, if you properly file your return with, and fully pay your income tax to, the CNMI, then you are not liable for filing an income tax return with, or for paying tax to, the United States for the tax year. How-



ever, if you were self-employed in 2005, see *Self-employment tax* on this page.

**Example.** David Gold was a bona fide resident of the CNMI for 2005. He received wages of \$30,000 paid by a private employer in the CNMI and dividends of \$4,000 from U.S. corporations that carry on business mainly in the United States. He must file a 2005 income tax return with the CNMI Department of Revenue and Taxation. He reports his total income of \$34,000 on the CNMI return.

**Where to file.** If you are a bona fide resident of the CNMI for the entire tax year, send your return to the Department of Revenue and Taxation at the address given earlier.

## U.S. Citizen or Resident Alien (Other Than a Bona Fide Resident of the CNMI)

If you have income from sources within the CNMI and are a U.S. citizen or resident alien, but you are not a bona fide resident of the CNMI during the entire tax year, file your income tax return with the United States.

- Include income from worldwide sources on your U.S. return. In determining your tax, include all income tax withheld by either the United States or CNMI, any credit for an overpayment of income tax to either the United States or CNMI, and any payments of estimated tax to either the United States or CNMI. Pay any balance of tax due with your tax return.
- You are not liable for filing an income tax return with, or for paying tax to, the CNMI for the tax year.

You may also need to complete Form 5074.

**Form 5074.** If you file a U.S. income tax return, attach a completed Form 5074 if you (and your spouse if filing a joint return) have:

- Adjusted gross income of \$50,000 or more for the tax year, and
- Gross income of \$5,000 or more from sources within the CNMI.

The information on this form is used by the United States and the CNMI to divide the net income taxes collected on these individuals.

There is an example of a filled-in Form 5074 in chapter 5.

**Where to file.** If you are a citizen or resident alien of the United States but not a bona fide resident of the CNMI during the entire tax year, send your return to:

Internal Revenue Service  
Philadelphia, PA 19255-0215

## Citizen of the CNMI

If you are a citizen of the CNMI but not otherwise a U.S. citizen (meaning that you were born or naturalized in the CNMI) or a U.S. resident alien during the tax year, file your income tax return with the CNMI. Include income from worldwide

sources on your CNMI return. Take into account tax withheld by both jurisdictions in determining if there is tax due or an overpayment. Pay any balance of tax due with your tax return.

## Special Rules

Special rules apply to certain types of income, employment, and filing status.

**Joint return.** If you file a joint return, you should file your return (and pay the tax) with the jurisdiction where the spouse who has the greater adjusted gross income would have to file if you were filing separately. If the spouse with the greater adjusted gross income is a bona fide resident of the CNMI during the entire tax year, file the joint return with the CNMI. If the spouse with the greater adjusted gross income is a U.S. citizen or resident alien but not a bona fide resident of the CNMI during the entire tax year, file your joint return with the United States. For this purpose, income is determined without regard to community property laws.

**Example.** Marsha Blue, a U.S. citizen, was a resident of the United States, and her husband, a citizen of the CNMI, was a bona fide resident of the CNMI during the entire tax year. Marsha earned \$65,000 as a computer programmer in the United States. Her husband earned \$20,000 as an artist in the CNMI. Mr. and Mrs. Blue will file a joint return. Because Marsha has the greater adjusted gross income, the Blues must file their return with the United States and report the entire \$85,000 on that return.

**U.S. Armed Forces.** If you are a member of the U.S. Armed Forces who qualified as a bona fide resident of the CNMI in a prior tax year, your absence from the CNMI solely in compliance with military orders will not change your bona fide residency. If you did not qualify as a bona fide resident of the CNMI in a prior tax year, your presence in the CNMI solely in compliance with military orders will not qualify you as a bona fide resident of the CNMI.

**Moving expense deduction.** Generally, expenses of a move to the CNMI are directly attributable to wages, salaries, and other earned income from the CNMI. Likewise, the expenses of a move back to the United States are generally attributable to U.S. earned income.

If your move was to the CNMI, report your deduction for moving expenses as follows.

- If you are a bona fide resident in the tax year of your move, enter your deductible expenses on your CNMI tax return.
- If you are not a bona fide resident, enter your deductible expenses on Form 3903 and enter the deductible amount on Form 1040, line 26, and on Form 5074, line 20.

If your move was to the United States, complete Form 3903 and enter the deductible amount on Form 1040, line 26.

**Self-employment tax.** If you have no U.S. filing requirement, but have income that is effectively connected with a trade or business in the CNMI, you must file Form 1040-SS with the United States to report your self-employment income and, if necessary, pay self-employment tax.

**Payment of estimated tax.** If you must pay estimated tax, make your payment to the jurisdiction where you would file your income tax return if your tax year were to end on the date your estimated tax payment is first due. Generally, you should make your quarterly payments of estimated tax to the jurisdiction where you made your first payment of estimated tax. However, estimated tax payments to either jurisdiction will be treated as payments to the jurisdiction with which you file the tax return.

If you make a joint payment of estimated tax, make your payment to the jurisdiction where the spouse who has the greater estimated adjusted gross income would have to pay (if a separate payment were made). For this purpose, income is determined without regard to community property laws.

**Early payment.** If you make your first payment of estimated tax early, follow the rules above to determine where to send it. If you send it to the wrong jurisdiction, make all later payments to the jurisdiction to which the first payment should have been sent.

## Double Taxation

A mutual agreement procedure exists to settle cases of double taxation between the United States and the CNMI. See *Double Taxation* in chapter 4.

## Guam

Guam has its own tax system based on the same tax laws and tax rates that apply in the United States.

## Where To Get Forms and Information



Requests for advice about Guam residency and tax matters should be addressed to:

Department of Revenue and Taxation  
Government of Guam  
P.O. Box 23607  
GMF, GU 96921



The phone number is 671-475-1840 or 671-475-1842. The fax number is 671-472-2643.



You can access the Guam Department of Revenue and Taxation website at [www.guamtax.com](http://www.guamtax.com).

**Caution.** The addresses and phone numbers listed above are subject to change.

## Which Return To File

Bona fide residents of Guam are subject to special U.S. tax rules. In general, all individuals with income from Guam will file only one return—either to Guam or the United States.

## Bona fide resident of Guam

If you are a bona fide resident of Guam during the entire tax year, file your return with Guam. This applies to all bona fide residents who are citizens, resident aliens, or nonresident aliens of the United States.

- Include income from worldwide sources on your Guam return. In determining your tax, you will include all income tax withheld by either Guam or the United States, any credit for an overpayment of income tax to either Guam or the United States, and any payments of estimated tax to either Guam or the United States. Pay any balance of tax due with your tax return.
- Generally, if you properly file your return with, and fully pay your income tax to, Guam, then you are not liable for filing an income tax return with, or for paying tax to, the United States. However, if you were self-employed in 2005, see *Self-employment tax* on this page.

**Example.** Gary Barker was a bona fide resident of Guam for 2005. He received wages of \$25,000 paid by a private employer and dividends of \$2,000 from U.S. corporations that carry on business mainly in the United States. He must file a 2005 income tax return with the Government of Guam. He reports his total income of \$27,000 on the Guam return.

**Where to file.** If you are a bona fide resident of Guam for the entire tax year, file your return with the Department of Revenue and Taxation at the address given earlier.

## U.S. Citizen or Resident Alien (Other Than a Bona Fide Resident of Guam)

If you have income from sources within Guam and are a U.S. citizen or resident alien, but you are not a bona fide resident of Guam during the entire tax year, file your income tax return with the United States.

- Include income from worldwide sources on your U.S. return. In determining your tax, include all income tax withheld by either the United States or Guam, any credit for an overpayment of income tax to either the United States or Guam, and any payments of estimated tax to either the United States or Guam. Pay any balance of tax due with your tax return.
- You are not liable for filing an income tax return with, or for paying tax to, Guam for the tax year.

You may also need to complete Form 5074.

**Form 5074.** If you file a U.S. income tax return, attach a completed Form 5074 if you (and your spouse if filing a joint return) have:

- Adjusted gross income of \$50,000 or more for the tax year, and
- Gross income of \$5,000 or more from sources within Guam.

The information on this form is used by the United States and Guam to divide the net income taxes collected on these individuals.

There is an example of a filled-in Form 5074 in chapter 5.

**Where to file.** If you are a citizen or resident alien of the United States but not a bona fide resident of Guam during the entire tax year, send your return to:

Internal Revenue Service  
Philadelphia, PA 19255-0215

## Citizen of Guam

If you are a citizen of Guam but not otherwise a U.S. citizen (meaning that you were born or naturalized in Guam) or U.S. resident alien during the tax year, file your income tax return with Guam. Include income from worldwide sources on your Guam return. Take into account tax withheld by both jurisdictions in determining if there is tax due or an overpayment. Pay any balance of tax due with your tax return.

## Special Rules

Special rules apply to certain types of income, employment, and filing status.

**Joint return.** If you file a joint return, you should file your return (and pay the tax) with the jurisdiction where the spouse who has the greater adjusted gross income would have to file if you were filing separately. If the spouse with the greater adjusted gross income is a bona fide resident of Guam during the entire tax year, file the joint return with Guam. If the spouse with the greater adjusted gross income is a U.S. citizen or resident alien but not a bona fide resident of Guam during the entire tax year, file the joint return with the United States. For this purpose, income is determined without regard to community property laws.

**Example.** Bill Whiting, a U.S. citizen, was a resident of the United States, and his wife, a citizen of Guam, was a bona fide resident of Guam during the entire tax year. Bill earned \$45,000 as an engineer in the United States. His wife earned \$15,000 as a teacher in Guam. Mr. and Mrs. Whiting will file a joint return. Because Bill has the greater adjusted gross income, the Whitings must file their return with the United States and report the entire \$60,000 on that return.

**U.S. Armed Forces.** If you are a member of the U.S. Armed Forces who qualified as a bona fide resident of Guam in a prior tax year, your absence from Guam solely in compliance with military orders will not change your bona fide residency. If you did not qualify as a bona fide resident of Guam in a prior tax year, your presence in Guam solely in compliance with military orders will not qualify you as a bona fide resident of Guam.

**Moving expense deduction.** Generally, expenses of a move to Guam are directly attributable to wages, salaries, and other earned income from Guam. Likewise, the expenses of a move back to the United States are generally attributable to U.S. earned income.

If your move was to Guam, report your deduction for moving expenses as follows.

- If you are a bona fide resident in the tax year of your move, enter your deductible expenses on your Guam tax return.
- If you are not a bona fide resident, enter your deductible expenses on Form 3903 and enter the deductible amount on Form 1040, line 26, and on Form 5074, line 20.

If your move was to the United States, complete Form 3903 and enter the deductible amount on Form 1040, line 26.

**Self-employment tax.** If you have no U.S. filing requirement, but have income that is effectively connected with a trade or business in Guam, you must file Form 1040-SS with the United States to report your self-employment income and, if necessary, pay self-employment tax.

**Payment of estimated tax.** If you must pay estimated tax, make your payment to the jurisdiction where you would file your income tax return if your tax year were to end on the date your estimated tax payment is first due. Generally, you should make your quarterly payments of estimated tax to the jurisdiction where you made your first payment of estimated tax. However, estimated tax payments to either jurisdiction will be treated as payments to the jurisdiction with which you file the tax return.

If you make a joint payment of estimated tax, make your payment to the jurisdiction where the spouse who has the greater estimated adjusted gross income would have to pay (if a separate payment were made). For this purpose, income is determined without regard to community property laws.

**Early payment.** If you make your first payment of estimated tax early, follow the rules above to determine where to send it. If you send it to the wrong jurisdiction, make all later payments to the jurisdiction to which the first payment should have been sent.

## Double Taxation

A mutual agreement procedure exists to settle cases of double taxation between the United States and Guam. See *Double Taxation* in chapter 4.

## The U.S. Virgin Islands

An important factor in USVI taxation is whether, during the entire tax year, you are a bona fide resident of the USVI.

## Where To Get Forms and Information



For information about filing your Virgin Islands tax return or about Form 1040INFO, contact:

Virgin Islands Bureau of Internal Revenue  
9601 Estate Thomas  
Charlotte Amalie  
St. Thomas, VI 00802



The phone number is 340-774-5865. The fax numbers are 340-714-9341 and 340-714-9345.

**Caution.** The address and phone numbers listed above are subject to change.

## Which Return To File

In general, bona fide residents of the USVI pay taxes only to the USVI. U.S. citizens or resident aliens (but not bona fide residents of the USVI) with USVI source income pay a portion of the tax to each jurisdiction.

### Bona Fide Resident of the USVI

File your tax return with the USVI if you are a U.S. citizen, resident alien, or nonresident alien and a bona fide resident of the USVI during the entire tax year.

- Include your worldwide income on your USVI return. In determining your tax, take into account all income tax withheld by either the USVI or the United States, any credit for an overpayment of income tax to either the USVI or the United States, and any payments of estimated tax to either the USVI or the United States. Pay any balance of tax due with your tax return.
- You do not have to file with the United States for any tax year in which you are a bona fide resident of the USVI during the entire tax year, provided you report and pay tax on your income from all sources to the USVI and identify the source(s) of the income on the return. However, if you have self-employment income, you may be required to file Form 1040-SS with the United States. For more information, see *Self-employment tax* under *Special Rules* on this page.

**Form 1040INFO.** If you are a bona fide resident of the USVI and have non-USVI source income, you must also file Virgin Islands Form 1040INFO, Non-Virgin Islands Source Income of Virgin Islands Residents, with the Virgin Islands Bureau of Internal Revenue. You can get Form 1040INFO by contacting the address given earlier.

**Where to file.** If you are a bona fide resident of the USVI for the entire tax year, file your return with the Virgin Islands Bureau of Internal Revenue at the address given earlier.

### U.S. Citizen or Resident Alien (Other Than a Bona Fide Resident of the USVI)

If you are a U.S. citizen or resident alien but not a bona fide resident of the Virgin Islands during the entire tax year, you must file identical tax returns with the United States and the Virgin Islands if you have:

- Income from sources in the USVI, or
- Income effectively connected with the conduct of a trade or business in the USVI.

File the original return with the United States and file a copy of the U.S. return (including all attachments, forms, and schedules) with the Virgin Islands Bureau of Internal Revenue by the due date for filing Form 1040. Use Form 8689 to figure the amount of tax you must pay to the USVI.

**Form 8689.** Complete this form and attach it to both the return you file with the United States and the copy you file with the USVI. Figure the amount of tax you must pay to the Virgin Islands as follows:

$$\begin{array}{l} \text{Total tax on} \\ \text{U.S. return} \\ \text{(after certain} \\ \text{adjustments)} \end{array} \times \frac{\text{USVI AGI}}{\text{Worldwide AGI}}$$

Pay any tax due to the USVI when you file your return with the Virgin Islands Bureau of Internal Revenue. To receive credit for taxes paid to the USVI, include the amounts on Form 8689, lines 40 and 44, in the total on Form 1040, line 71. On the dotted line next to line 71, enter "Form 8689" and show the amounts.

See the illustrated example in chapter 5.

**Where to file.** If you are not a bona fide resident of the USVI during the entire tax year, but you have USVI source income, file Form 1040 and all attachments with the Internal Revenue Service Center, Philadelphia, PA 19255-0215, and with the Virgin Islands Bureau of Internal Revenue at the address given earlier.

## Special Rules

There are some special rules for certain types of income, employment, and filing status.

**Joint return.** If you file a joint return, you should file your return (and pay the tax) with the jurisdiction where the spouse who has the greater adjusted gross income would have to file if you were filing separately. If the spouse with the greater adjusted gross income is a bona fide resident of the USVI during the entire tax year, file the joint return with the USVI. If the spouse with the greater adjusted gross income is a U.S. citizen or resident alien of the United States but not a bona fide resident of the USVI during the entire tax year, file the joint return with the United States. For this purpose, income is determined without regard to community property laws.

**Example.** Marge Birch, a U.S. citizen, was a resident of the United States, and her husband, a citizen of the USVI, was a bona fide resident of the USVI during the entire tax year. Marge earned \$55,000 as an architect in the United States. Her husband earned \$15,000 as a libra-

rian in the USVI. Mr. and Mrs. Birch will file a joint return. Because Marge has the greater adjusted gross income, the Birches must file their return with the United States and report the entire \$70,000 on that return.

**Moving expense deduction.** Generally, expenses of a move to the USVI are directly attributable to wages, salaries, and other earned income from the USVI. Likewise, the expenses of a move back to the United States are generally attributable to U.S. earned income.

If your move was to the USVI, report your deduction for moving expenses as follows.

- If you are a bona fide resident in the tax year of your move, enter your deductible expenses on your USVI tax return.
- If you are not a bona fide resident, enter your deductible expenses on Form 3903 and enter the deductible amount on Form 1040, line 26, and on Form 8689, line 20.

If your move was to the United States, complete Form 3903 and enter the deductible amount on Form 1040, line 26.

**Self-employment tax.** If you have no U.S. filing requirement, but have income that is effectively connected with a trade or business in the USVI, you must file Form 1040-SS with the United States to report your self-employment income and, if necessary, pay self-employment tax.

**Extensions of time to file.** You can get an automatic 6-month extension of time to file your tax return. See *Extensions of Time To File* in chapter 4. Bona fide residents of the USVI during the entire tax year must file a paper Form 4868 with the Virgin Islands Bureau of Internal Revenue. Nonresidents of the USVI should file separate extension requests with the IRS and the Virgin Islands Bureau of Internal Revenue and make any payments due to the respective jurisdictions. However, the Virgin Islands Bureau of Internal Revenue will honor an extension request that is timely filed with the IRS.

## Double Taxation

A mutual agreement procedure exists to settle cases of double taxation between the United States and the U.S. Virgin Islands. See *Double Taxation* in chapter 4.

# 4.

## Filing U.S. Tax Returns

The information in chapter 3 will tell you if a U.S. income tax return is required for your situation. If a U.S. return is required, your next step is to see if you meet the filing requirements. If you do meet the filing requirements, the information presented in this chapter will help you under-



stand the special procedures involved. This chapter discusses:

- Filing requirements,
- When to file your return,
- Where to send your return,
- How to adjust your deductions and credits if you are excluding income from American Samoa or Puerto Rico,
- How to make estimated tax payments and pay self-employment tax, and
- How to request assistance in resolving instances of double taxation.

## Who Must File

If you are not required to file a possession tax return that includes your worldwide income, you must generally file a U.S. income tax return if your gross income is at least the amount shown in Table 4-1 for your filing status and age.

If you were a bona fide resident of American Samoa or Puerto Rico and are able to exclude your possession income from your U.S. tax return, your filing requirement may be less than the amount in Table 4-1. For details, see the information below under *Filing Requirement if Possession Income Is Excluded*.

Some individuals (such as those who can be claimed as a dependent on another person's return or who owe certain taxes, such as self-employment tax) must file a tax return even though the gross income is less than the amount shown in Table 4-1 for their filing status and age. For more information, see the Form 1040 instructions.

## Filing Requirement if Possession Income Is Excluded

If you were a bona fide resident of American Samoa or Puerto Rico and qualify to exclude your possession income on your U.S. tax return, you must determine your adjusted filing requirement. Generally, your filing requirement is based on the total of your personal exemption(s) plus your standard deduction.

**Personal exemption.** When figuring your filing requirement, your personal exemption is allowed in full. Do not reduce it for this purpose. Do not include exemptions for your dependents.

**Allowable standard deduction.** Unless your filing status is married filing separately, the minimum income level at which you must file a return is based, in part, on the standard deduction for your filing status and age. Because the standard deduction applies to all types of income, it must be divided between your excluded income and income from other sources. Multiply the regular standard deduction for your filing status and age (this is zero if you are married filing a separate return; all others, see Form 1040 instructions) by the following fraction:

$$\frac{\text{Gross income subject to U.S. tax}}{\text{Gross income from all sources (including excluded possession income)}}$$

**Example.** Barbara Spruce, a U.S. citizen, is single, under 65, and a bona fide resident of American Samoa. During 2005, she received \$20,000 of income from American Samoa sources and \$8,000 of income from sources outside the possession. Her allowable standard deduction for 2005 is figured as follows:

$$\frac{\$8,000}{\$28,000} \times \frac{\$5,000}{\text{(standard deduction)}} = \$1,429$$

**Adjusted filing requirement.** Figure your adjusted filing requirement by adding the amount of your allowable standard deduction to the amount of your personal exemption. You must file a U.S. income tax return if your gross income is at least the amount shown on line 3 of the following worksheet.

1. Enter the allowable standard deduction you figured earlier under *Allowable standard deduction*. If your filing status is married filing separately, enter -0- . . . . . \_\_\_\_\_
2. Personal exemption. If your filing status is married filing jointly, enter \$6,400; if someone can claim you as a dependent, enter -0-; otherwise, enter \$3,200 . . . . . \_\_\_\_\_
3. Add lines 1 and 2. You must file a U.S. income tax return if your gross income from sources outside the relevant possession is at least this amount . . . . . \_\_\_\_\_

**Example 1.** James and Joan Thompson, one over 65, are U.S. citizens and bona fide residents of Puerto Rico during the entire tax year. They file a joint income tax return. During 2005, they received \$35,000 of income from Puerto Rican sources and \$6,000 of income from sources outside Puerto Rico. They do not itemize their deductions. Their allowable standard deduction for 2005 is figured as follows:

$$\frac{\$6,000}{\$41,000} \times \frac{\$11,000}{\text{(standard deduction)}} = \$1,610$$

The Thompsons do not have to file a U.S. income tax return because their gross income (\$6,000) is less than their allowable standard deduction plus their personal exemptions (\$1,610 + \$6,400 = \$8,010).

**Example 2.** Barbara Spruce (see *Example* under *Allowable standard deduction*), however, must file a U.S. income tax return because her gross income subject to U.S. tax (\$8,000) is more than her allowable standard deduction plus her personal exemption (\$1,429 + \$3,200 = \$4,629).



*If you must file a U.S. income tax return, you may be able to file a paperless return using IRS e-file. See your form instructions or visit our website at www.irs.gov.*

## When To File

If you file on a calendar year basis, the due date for filing your U.S. income tax return is April 15 following the end of your tax year. If you use a fiscal year (a year ending on the last day of a month other than December), the due date is the 15th day of the 4th month after the end of your fiscal year. If any due date falls on a Saturday, Sunday, or legal holiday, your tax return is due on the next business day.

For this purpose, "legal holiday" means a legal holiday in the District of Columbia or in the state where the return is required to be filed. It does not include a legal holiday in a foreign country, unless it is also a legal holiday described in the previous sentence.

If you mail your federal tax return, it is considered timely if it bears an official postmark dated on or before the due date, including any extensions. If you use a private delivery service desig-

Table 4-1. 2005 Filing Requirements Chart for Most Taxpayers

IF your filing status is...	AND at the end of 2005 you were*...	THEN file a return if your gross income** was at least...
single	under 65	\$ 8,200
	65 or older	\$ 9,450
married filing jointly***	under 65 (both spouses)	\$16,400
	65 or older (one spouse)	\$17,400
	65 or older (both spouses)	\$18,400
married filing separately	any age	\$ 3,200
head of household	under 65	\$10,500
	65 or older	\$11,750
qualifying widow(er) with dependent child	under 65	\$13,200
	65 or older	\$14,200

\* If you were born on January 1, 1941, you are considered to be age 65 at the end of 2005.

\*\* Gross income means all income you received in the form of money, goods, property, and services that is not exempt from tax, including any income from sources outside the United States (even if you may exclude part or all of it). Do not include social security benefits unless you are married filing a separate return and you lived with your spouse at any time in 2005.

\*\*\* If you did not live with your spouse at the end of 2005 (or on the date your spouse died) and your gross income was at least \$3,200, you must file a return regardless of your age.

nated by the IRS, generally the postmark date is the date the private delivery service records in its database or marks on the mailing label. See your form instructions for a list of designated private delivery services.

## Extensions of Time To File

You can get an extension of time to file your return. Special rules apply for those living outside the United States.

### Automatic 6-Month Extension

If you cannot file your 2005 return by the due date, you can get an automatic 6-month extension of time to file.

**Example.** If your return must be filed by April 17, 2006, you will have until October 16, 2006, to file.



*Although you are not required to make a payment of the tax you estimate as due, Form 4868 does not extend the time to pay taxes. If you do not pay the amount due by the regular due date (generally, April 15), you will owe interest on any unpaid tax from the original due date to the date you pay the tax. You may also be charged penalties (see the instructions for Form 4868).*

**How to get the automatic extension.** You can get the automatic 6-month extension if you do one of the following by the due date for filing your return.

- E-file Form 4868 using your personal computer or a tax professional.
- E-file and pay by credit card. You may pay by phone or over the Internet. You do not file Form 4868.
- File a paper Form 4868. If you are a fiscal year taxpayer, you must file a paper Form 4868.

See Form 4868 for information on getting an extension using these options.

**When to file.** You must request the automatic extension by the due date for your return. You can file your return any time before the 6-month extension period ends.

**When you file your return.** Enter any payment you made related to the extension of time to file on Form 1040, line 69. If you file Form 1040A or Form 1040EZ, include that payment in your total payments on Form 1040A, line 43, or Form 1040EZ, line 10. Also print "Form 4868" and the amount paid in the space to the left of line 43 or line 10.



*You cannot ask the Internal Revenue Service to figure your tax if you use the extension of time to file.*

### Individuals Outside the United States

You are allowed an automatic 2-month extension (until June 15, 2006, if you use the calendar year) to file your 2005 return and pay any federal income tax due if:

1. You are a U.S. citizen or resident, and
2. On the due date of your return:
  - a. You are living outside of the United States and Puerto Rico, and your main place of business or post of duty is outside the United States and Puerto Rico, or
  - b. You are in military or naval service on duty outside the United States and Puerto Rico.

However, if you pay the tax due after the regular due date (generally April 15), interest will be charged from that date until the date the tax is paid.

If you served in a combat zone or qualified hazardous duty area, you may be eligible for a longer extension of time to file. For more information, see Publication 3, Armed Forces Tax Guide.

**Married taxpayers.** If you file a joint return, only one spouse has to qualify for this automatic extension. If you and your spouse file separate returns, this automatic extension applies only to the spouse who qualifies.

**How to get the extension.** To use this special automatic extension, you must attach a statement to your return explaining what situation qualified you for the extension. (See the situations listed under (2), above.)

**Extensions beyond 2 months.** If you cannot file your return within the automatic 2-month extension period, you can get an additional 4-month extension, for a total of 6 months. File Form 4868 by the end of the automatic extension period (usually June 15). Be sure to check the box on line 8 of Form 4868.

In addition to this 6-month extension, taxpayers who are out of the country (as defined in the Form 4868 instructions) can request a discretionary 2-month additional extension of time to file their returns (to December 15 for calendar year taxpayers).

To request this extension, you must send the IRS a letter explaining the reasons why you need the additional 2 months. Send the letter by the extended due date (October 15 for calendar year taxpayers) to:

Internal Revenue Service Center  
Austin, TX 73301-0215

You will not receive any notification from the IRS unless your request is denied for being untimely.

## Where To File

If you have to file Form 1040 with the United States, send your return to:

Internal Revenue Service Center  
Philadelphia, PA 19255-0215

If you do not qualify to exclude possession income on your U.S. return, mail your return to the address shown in the Form 1040 instructions for the possession or state in which you reside.

## Special Rules for Completing Your U.S. Tax Return

If you are not excluding possession income from your U.S. tax return, follow the instructions for the specific forms you file.

However, if you are excluding income from American Samoa or Puerto Rico, you will not be allowed to take deductions and credits that apply to the excluded income. This section contains the additional information you need.

### Deductions

Deductions that specifically apply to your excluded possession income, such as employee business expenses, are not allowable on your U.S. income tax return.

Deductions that do not specifically apply to any particular type of income must be divided between your excluded income from sources in the relevant possession and income from all other sources to find the part that you can deduct on your U.S. tax return. Examples of such deductions are alimony payments, the standard deduction, and certain itemized deductions (such as medical expenses, charitable contributions, real estate taxes, and mortgage interest on your home).

**Figuring the deduction.** To find the part of a deduction that is allowable, multiply the deduction by the following fraction.

$$\frac{\text{Gross income subject to U.S. tax}}{\text{Gross income from all sources (including excluded possession income)}}$$

### Adjustments to Income

Your adjusted gross income equals your gross income minus certain deductions (adjustments).

**Moving expense deduction.** Generally, expenses of a move to a possession are directly attributable to wages, salaries, and other earned income from that possession. Likewise, the expenses of a move back to the United States are generally attributable to U.S. earned income.

If you are claiming expenses for a move to a relevant possession, how and where you will deduct the expenses depends on your status as a bona fide resident and if any of your possession income is excluded on your U.S. tax return. For more information, see *Moving expense deduction* in chapter 3 under the name of the relevant possession.

If you are claiming expenses for a move from a U.S. possession to the United States, use Form 3903 to figure your deductible expenses and enter the amount on Form 1040, line 26. For purposes of deducting moving expenses, the possessions are considered part of the United States. See Publication 521, Moving Expenses, for more information.

**Self-employment tax deduction.** Generally, if you are reporting self-employment income on your U.S. return, you can deduct one-half of your self-employment tax on Form 1040, line 27. This

is an income tax deduction only; it is not a deduction in figuring net earnings from self-employment (for self-employment tax).

However, if you are a bona fide resident of American Samoa or Puerto Rico and you exclude all of your self-employment income from gross income, you cannot take the deduction on Form 1040, line 27, because the deduction is related to excluded income.

If only part of your self-employment income is excluded, the part of the deduction that is based on the nonexcluded income is allowed. This would happen if, for instance, you have two businesses and only the income from one of them is excludable.

Figure the self-employment tax on the nonexcluded income by multiplying your total self-employment tax (from Schedule SE) by the following fraction.

$$\frac{\text{Self-employment income subject to U.S. tax}}{\text{Total self-employment income (including excluded possession income)}}$$

The result is your self-employment tax on nonexcluded income. Deduct one-half of this amount on Form 1040, line 27.

**Individual retirement arrangement (IRA) deduction.** Do not take excluded income into account when figuring your deductible IRA contribution.

## Standard Deduction

The standard deduction and the additional standard deduction for taxpayers who are blind or age 65 or over do not apply to any particular type of income. To find the amount you can claim on Form 1040, line 40, multiply your standard deduction by the fraction given earlier in this chapter under *Figuring the deduction*. Also, see the *Example* under *Allowable standard deduction*, near the beginning of this chapter. In the space above line 40, print "Standard deduction modified due to income excluded under section 931 (if American Samoa) or 933 (if Puerto Rico)."



*Make this computation before you determine if you must file a U.S. tax return, because the minimum income level at which you must file a return is based, in part, on the standard deduction for your filing status. See Filing Requirement if Possession Income Is Excluded, near the beginning of this chapter.*

## Itemized Deductions

Most itemized deductions do not apply to a particular type of income. However, itemized deductions can be divided into three categories.

- Those that apply specifically to excluded income, such as employee business expenses, are not deductible.

- Those that apply specifically to income subject to U.S. income tax, which might also be employee business expenses, are fully allowable under the instructions for Schedule A (Form 1040).
- Those that do not apply to specific income must be allocated between your gross income subject to U.S. tax and your total gross income from all sources.

The example below shows how to figure the deductible part of each type of expense that is not related to specific income.

**Example.** In 2005, you and your spouse are both under 65 and U.S. citizens who are bona fide residents of Puerto Rico during the entire tax year. You file a joint income tax return. During 2005, you earned \$15,000 from Puerto Rican sources and your spouse earned \$45,000 from the U.S. Government. You have \$16,000 of itemized deductions that do not apply to any specific type of income. These are medical expenses of \$4,000, real estate taxes of \$5,000, home mortgage interest of \$6,000, and charitable contributions of \$1,000 (cash contributions). You determine the amount of each deduction that you can claim on your Schedule A (Form 1040), by multiplying the deduction by the fraction shown under *Figuring the deduction*, earlier.

### Medical Expenses

$$\frac{\$45,000}{\$60,000} \times \$4,000 = \frac{\$3,000}{\text{(enter on line 1 of Schedule A)}}$$

### Real Estate Taxes

$$\frac{\$45,000}{\$60,000} \times \$5,000 = \frac{\$3,750}{\text{(enter on line 6 of Schedule A)}}$$

### Home Mortgage Interest

$$\frac{\$45,000}{\$60,000} \times \$6,000 = \frac{\$4,500}{\text{(enter on line 10 or 11 of Schedule A)}}$$

### Charitable Contributions (cash contributions)

$$\frac{\$45,000}{\$60,000} \times \$1,000 = \frac{\$750}{\text{(enter on line 15a or 15b of Schedule A)}}$$

Enter on Schedule A (Form 1040) only the allowable portion of each deduction.

## Personal Exemptions

Personal exemptions are allowed in full even if you are excluding possession income. However, depending upon your adjusted gross income and filing status, the amount you can deduct may be reduced (phased out). See the instructions for Form 1040.

## Credits

In this section you will find information on two credits that may be affected by your residency in one of these five possessions.

- The earned income credit is available only under certain circumstances.
- To determine the foreign tax credit, your foreign (possession) taxes paid or accrued must be reduced by taxes allocable to excluded income.

## Earned Income Credit

Even if you maintain a household in one of these possessions that is your main home and the home of your qualifying child, you cannot claim the earned income credit on your U.S. tax return. This credit is available only if you maintain the household in the United States or you are serving on extended active duty in the U.S. Armed Forces.

**U.S. Armed Forces.** U.S. military personnel stationed outside the United States on extended active duty are considered to live in the United States during that duty period for purposes of the EIC. Extended active duty means you are called or ordered to duty for an indefinite period or for a period of more than 90 days. Once you begin serving your extended active duty, you are still considered to have been on extended active duty even if you do not serve more than 90 days.

## Foreign Tax Credit

If you must report possession source income on your U.S. tax return, you can claim a foreign tax credit for income taxes paid to the possession on that income. You cannot claim a foreign tax credit for taxes paid on excluded possession income. The foreign tax credit is generally figured on Form 1116.

If you have income, such as U.S. Government wages, that is not excludable, and you also have possession source income that is excludable, you must figure the credit by reducing your foreign taxes paid or accrued by the taxes based on the excluded income. You make this reduction for each separate income category. To find the amount of this reduction, use the following formula for each income category.

$$\frac{\text{Excluded income from possession sources less deductible expenses based on that income}}{\text{Total income subject to possession tax less deductible expenses based on that income}} \times \frac{\text{Tax paid or accrued to the possession}}{\text{Reduction in foreign taxes}}$$

Enter the amount of the reduction on Form 1116, line 12.

For more information on the foreign tax credit, see Publication 514.



**Example.** Jason and Lynn Reddy are U.S. citizens who were bona fide residents of Puerto Rico during all of 2005. They file a joint tax return. The following table shows their excludable and taxable income for U.S. federal income tax purposes.

	Taxable	Excludable
Jason's wages from U.S. Government . . .	\$25,000	
Lynn's wages from Puerto Rican corp. . . . .		\$15,000
Dividend from Puerto Rican corp. doing business in Puerto Rico . . . . .		200
Dividend from U.S. corp. doing business in U.S.* . . . . .	1,000	
<b>Totals . . . . .</b>	<b>\$26,000</b>	<b>\$15,200</b>

\* Income from sources outside Puerto Rico is taxable.

Jason and Lynn must file 2005 income tax returns with both Puerto Rico and the United States. They have gross income of \$26,000 for U.S. tax purposes. They paid taxes to Puerto Rico of \$4,000. The tax on their wages is \$3,980 and the tax on the dividend from the Puerto Rican corporation is \$20. They figure their foreign tax credit on two Forms 1116, which they must attach to their U.S. return. They fill out one Form 1116 for wages and one Form 1116 for the dividend. Jason and Lynn figure the Puerto Rican taxes on excluded income as follows.

Wages:  $(\$15,000 \div \$40,000) \times \$3,980 = \$1,493$   
 Dividend:  $(\$200 \div \$200) \times \$20 = \$20$

They enter \$1,493 on Form 1116, line 12, for wages and \$20 on the second Form 1116, line 12, for the dividend.

## Paying Your Taxes

You may find that not all of your income tax has been paid through withholding by either the United States or the possession. This is often true if you have income that is not subject to withholding, such as self-employment, interest, or rental income. In this situation, you may need to make estimated tax payments.

### Estimated Tax

If your estimated income tax obligation is to the United States, use the worksheet in the Form 1040-ES package to figure your estimated tax, including self-employment tax. If you are paying by check or money order, use the payment vouchers in the Form 1040-ES package. Or, you can make your payments electronically and not have to file any paper forms. See the Form 1040-ES instructions for information on making payments.

### Self-Employment Tax

Self-employment tax includes both social security and Medicare taxes for individuals who are self-employed.

A U.S. citizen or resident alien who is self-employed must pay self-employment tax on net self-employment earnings of \$400 or more. This rule applies whether or not the earnings are excludable from gross income (or whether or not a U.S. income tax return must otherwise be filed). Bona fide residents of the possessions discussed in this publication are considered U.S. residents for this purpose and are subject to the self-employment tax.

If you must file Form 1040 with the United States, figure your self-employment tax on Schedule SE (Form 1040) and attach it to your Form 1040.

If you are a bona fide resident of American Samoa, the CNMI, Guam, Puerto Rico, or the USVI who has net self-employment income, and you do not have to file Form 1040 with the United States, use Form 1040-SS to figure your self-employment tax.



*If you are a resident of Puerto Rico, you can file Form 1040-PR instead of Form 1040-SS. Form 1040-PR is the Spanish-language version of Form 1040-SS.*

## Double Taxation

A mutual agreement procedure exists to settle issues where there is inconsistent tax treatment between the IRS and the taxing authorities of the following possessions.

- American Samoa.
- The Commonwealth of Puerto Rico.
- The Commonwealth of the Northern Mariana Islands.
- Guam.
- The U.S. Virgin Islands.

These issues usually involve allocations of income, deductions, credits, or allowances between related persons; determinations of residency; and determinations of the source of income and related expenses.



Send your written request for assistance under this procedure to:

Internal Revenue Service  
 Director, International  
 Attn: Office of Tax Treaty  
 SE:LM:IN:T  
 1111 Constitution Avenue, N.W.,  
 MA3-322D  
 Washington, DC 20224

Your request must contain a statement that assistance is requested under the mutual agreement procedure with the possession. It must also contain all the facts and circumstances relating to your particular case. You must sign and date it. To avoid unnecessary delays, make sure you include all of the following information.

- Your name, address, and social security number.

- The name, address, and social security number of the related person in the possession (if one is involved).
- The tax year(s) in question and the Internal Revenue Service Center where your return was filed. If no return was filed, include a statement to that effect.
- If income tax is involved, the type of income (such as salary, dividends, or interest), a description of the transaction, activities, or other pertinent circumstances, and the positions taken by you and the possession tax agency.
- The amount of the item (income, deduction, or credit) involved and the amount of tax the possession assessed or proposed to assess.
- A description of the control and business relationships between you and the related person in the possession, if that applies.
- The status of your tax liability for the year(s) in question and, if it applies, the status of the tax liability of the related person in the possession.
- Whether you or the related person, if one is involved, is entitled to any possession tax incentive or subsidy program benefits for the year(s) in question.
- Copies of any correspondence received from the possession tax agency and copies of any material you provided to them.
- Copy of the possession tax return(s) for the year(s) in question.
- Whether a foreign tax credit was claimed on your federal tax return for all or part of the possession tax paid or accrued on the item in question.
- Whether your federal return or the return of the related person, if there is one, was examined, or is being examined.
- A separate document signed and dated by you that you consent to the disclosure to the designated possession tax official of any or all of the items of information set forth in, or enclosed with, the request for assistance under this procedure.

## Credit or Refund

In addition to the tax assistance request, if you seek a credit or refund of any overpayment of U.S. tax paid on the income in question, you should file a claim on Form 1040X, Amended U.S. Individual Income Tax Return. Indicate on the form that a request for assistance under the mutual agreement procedure with the possession has been filed. Attach a copy of the request to the form.

You should take whatever steps must be taken under the possession tax code to prevent the expiration of the statutory period for filing a claim for credit or refund of a possession tax.

## 5.

# Illustrated Examples

Use the following examples to help you complete the correct attachment to your Form 1040. The completed form for each example is shown on the pages that follow.

## Illustrated Example of Form 4563

John Black is a U.S. citizen and was a bona fide resident of American Samoa during all of 2005. He must file Form 1040 because his gross income from sources outside the possessions (\$10,000 of dividends from U.S. corporations) is more than the filing requirement for single filers. (See Table 4-1 in chapter 4.) Because he must file Form 1040 (not illustrated), he fills out Form 4563 to determine the amount of possession income he can exclude.

**Completing Form 4563.** John enters his name and social security number at the top of the form.

**Line 1.** On Form 4563 (shown later in this chapter), John enters the date his bona fide residence began in American Samoa, June 2, 2004. Because he is still a bona fide resident, he prints "not ended" in the second blank space.

**Line 2.** He checks the box labeled "Rented house or apartment" to describe his type of living quarters in American Samoa.

**Lines 3a and 3b.** He checks "No" on line 3a because no family members lived with him. He leaves line 3b blank.

**Lines 4a and 4b.** He checks "No" on line 4a because he did not maintain a home outside American Samoa. He leaves line 4b blank.

**Line 5.** He enters the name and address of his employer, Samoa Products Co. It is a private American Samoa corporation.

**Line 6.** He enters the dates of his 2-week vacation to New Zealand from November 11 to November 25. That was his only trip outside American Samoa during the year.

**Line 7.** He enters the \$24,000 in wages he received from Samoa Products Co.

**Line 9.** He received \$220 in dividends from an American Samoa corporation, which he enters here. He also received \$10,000 of dividends

from a U.S. corporation, but he will enter that amount only on his Form 1040 because the U.S. dividends do not qualify for the possession exclusion.

**Line 15.** John totals the amounts on lines 7 and 9 to get the amount he can exclude from his gross income in 2005. He will not enter his excluded income on Form 1040. However, he will attach his completed Form 4563 to his Form 1040.

## Illustrated Example of Form 5074

Tracy Grey is a U.S. citizen, who is a self-employed fisheries consultant with a tax home in New York. Her only income for 2005 was net self-employment income of \$80,000. Of the \$80,000, \$20,000 was from consulting work in Guam and the rest was earned in the United States. Thinking she would owe tax to Guam on the \$20,000, Tracy made estimated tax payments of \$1,409 to Guam. She was not a bona fide resident of Guam during 2005.

Tracy completes Form 1040 (not illustrated), reporting her worldwide income. Because she earned more than \$50,000 and at least \$5,000 of her gross income is from Guam, Tracy must file Form 5074 with her Form 1040. All amounts reported on Form 5074 are also reported on her Form 1040.

**Completing Form 5074.** Tracy enters her name and social security number at the top of the form.

**Part I.** On Form 5074 (shown later in this chapter), Tracy enters her self-employment income from Guam (\$20,000) on line 6. She has no other income, so the total on line 16 is \$20,000.

**Part II.** Tracy's only adjustment in Part II is the deduction for one-half of the self-employment tax on her net income earned in Guam. She enters \$1,413 on line 21 and line 29. Her adjusted gross income on line 30 is \$18,587.

**Part III.** Tracy made estimated tax payments of \$1,409. She enters this amount on line 31, and again on line 35 as the total payments.

## Illustrated Example of Form 8689

Gerald and Lily Smith live and work in the United States. In 2005, they received \$14,400 in income from the rental of a condominium they own in the Virgin Islands. The rental income was deposited in a bank in the Virgin Islands and they received \$500 of interest on this income.

They were not bona fide residents of the Virgin Islands during the entire tax year.

The Smiths complete Form 1040 (not illustrated), reporting their income from all sources. They report their wages, interest income, and the income and expenses from their Virgin Islands rental property on Schedule E (Form 1040).

The Smiths also complete Form 8689 to determine how much of their U.S. tax shown on Form 1040, line 63 (with certain adjustments), is due to the Virgin Islands. This is the amount the Smiths must pay to the Virgin Islands.

The Smiths file their Form 1040, attaching Form 8689 and all other schedules, with the Internal Revenue Service.

At the same time, they send a copy of their Form 1040 with all schedules, including Form 8689, to the Virgin Islands Bureau of Internal Revenue. This copy will be processed as their original Virgin Islands return.

**Completing Form 8689.** Gerald and Lily enter their names and Gerald's social security number at the top of the form.

**Part I.** The Smiths enter their income from the Virgin Islands in Part I. The interest income is entered on line 2 and the net rental income of \$6,200 (\$14,400 of rental income minus \$8,200 of rental expenses) is entered on line 11. The Smiths' total Virgin Islands income of \$6,700 is entered on line 16.

**Part II.** The Smiths have no adjustments to their Virgin Islands income, so they enter zero (-0-) on line 28, and \$6,700 on line 29. Their Virgin Islands adjusted gross income is \$6,700.

**Part III.** On line 30, the Smiths enter the amount from Form 1040, line 63 (\$5,199). They leave line 31 blank and put this same amount on line 32.

The Smiths enter their worldwide adjusted gross income, \$54,901 (Form 1040, line 37), on line 33. They divide their Virgin Islands adjusted gross income, \$6,700 (from line 29), by line 33. They multiply the amount on line 33 by this decimal, 0.122, to find the amount of tax allocated to the Virgin Islands (line 35).

**Part IV.** Part IV is used to show payments of income tax to the Virgin Islands only. The Smiths had no tax withheld by the Virgin Islands, but made estimated tax payments to the Virgin Islands of \$600, which are shown on lines 37 and 39. The Smiths include this amount (\$600) in the total on Form 1040, line 71. On the dotted line next to line 71, they print "Form 8689" and show the amount. The Smiths do not complete Form 1116. The income tax the Smiths owe to the Virgin Islands (\$34) is shown on Form 8689, line 44. The Smiths include this additional amount (\$34) in the total on Form 1040, line 71. They must pay their Virgin Islands tax at the same time they file the copy of their return with the Virgin Islands.

## Exclusion of Income for Bona Fide Residents of American Samoa

OMB No. 1545-0074

▶ **Attach to Form 1040.** ▶ **See instructions below and on back.**

Attachment  
Sequence No. **68**

Name(s) shown on Form 1040

John Black

Your social security number

111 : 00 : 1111

### Part I General Information

- 1 Date bona fide residence began ▶ 6-2-04 , and ended ▶ not ended
- 2 Type of living quarters in American Samoa
 

<input type="checkbox"/> Rented room	<input checked="" type="checkbox"/> Rented house or apartment
<input type="checkbox"/> Quarters furnished by employer	<input type="checkbox"/> Purchased home
- 3a Did any of your family live with you in American Samoa during any part of the tax year? . . . . .  Yes  No
- b If "Yes," who and for what period? ▶ .....
- 4a Did you maintain any home(s) outside American Samoa? . . . . .  Yes  No
- b If "Yes," show address of your home(s), whether it was rented, the name of each occupant, and his or her relationship to you. ▶ .....
- 5 Name and address of employer (state if self-employed) ▶ Samoa Products Co., Pago Pago, American Samoa
- 6 Complete columns (a) through (d) below for days absent from American Samoa during the tax year.

(a) Date left	(b) Date returned	(c) Number of days absent	(d) Reason for absence
11-11-05	11-25-05	14	Vacation to New Zealand

### Part II Figure Your Exclusion. Include **only** income that qualifies for the exclusion. See instructions.

7 Wages, salaries, tips, etc. . . . .	<b>7</b>	24,000	
8 Taxable interest . . . . .	<b>8</b>		
9 Ordinary dividends . . . . .	<b>9</b>	220	
10 Business income . . . . .	<b>10</b>		
11 Capital gain . . . . .	<b>11</b>		
12 Rental real estate, royalties, etc. . . . .	<b>12</b>		
13 Farm income . . . . .	<b>13</b>		
14 Other income. List type and amount ▶ .....	<b>14</b>		
15 Add lines 7 through 14. This is the amount you may exclude from your gross income this tax year . . . . .	<b>15</b>	24,220	

### Instructions

Section references are to the Internal Revenue Code.

#### What's New

- The rules for determining whether you are a bona fide resident of American Samoa have changed. See *Bona Fide Residence Test* on this page.
- If, in tax year 2001 or later, you become or ceased to be a bona fide resident of a U.S. possession, you may be required to file Form 8898, Statement for Individuals Who Begin or End Bona Fide Residence in a U.S. Possession. The penalty for failure to provide the required information is \$1,000. For details, see the Instructions for Form 8898.

#### Purpose of Form

If you qualify, use Form 4563 to figure the amount of income you may exclude from your gross income.

#### Who Qualifies

You qualify for the exclusion if you were a bona fide resident of American Samoa for the entire tax year. See *Bona Fide Residence Test* on this page.



*In future years, bona fide residents of Guam and the Commonwealth of the Northern Mariana Islands (CNMI) may also qualify for the exclusion. They will not qualify, however, unless implementation agreements are in effect with the United States. At the time this form went to print, the CNMI had not entered into an implementation agreement. Also, the effective date of the agreement between the United States and Guam had not been determined.*

#### Bona Fide Residence Test

To qualify under this test, you must be a bona fide resident of American Samoa for the entire tax year (January 1 through December 31 if you file a calendar year return).

In general, for tax years beginning after October 22, 2004, you are a bona fide resident of American Samoa if, during the tax year, you:

- Are present in American Samoa for at least 183 days,
- Do not have a tax home outside of American Samoa, and
- Do not have a closer connection to the United States or a foreign country than to American Samoa.

For Paperwork Reduction Act Notice, see back of form.

Cat No. 12909U

Form **4563** (Rev. 12-2005)



Department of the Treasury  
Internal Revenue Service

▶ Attach to Form 1040.

Name(s) shown on Form 1040

Tracy Grey

Your social security number

111 ; 0 0 ; 2 2 2 2

**Part I Income From Guam or the CNMI Reported on Form 1040**

	Guam	CNMI
1 Wages, salaries, tips, etc. . . . .		
2 Taxable interest . . . . .		
3 Ordinary dividends . . . . .		
4 Taxable refunds, credits, or offsets of state and local income taxes . . . . .		
5 Alimony received . . . . .		
6 Business income or (loss) . . . . .	20,000	
7 Capital gain or (loss) . . . . .		
8 Other gains or (losses) . . . . .		
9 IRA distributions (taxable amount) . . . . .		
10 Pensions and annuities (taxable amount) . . . . .		
11 Rental real estate, royalties, partnerships, S corporations, trusts, etc. . . . .		
12 Farm income or (loss) . . . . .		
13 Unemployment compensation . . . . .		
14 Social security benefits (taxable amount) . . . . .		
15 Other income. List type and amount ▶ . . . . .		
16 <b>Total income.</b> Add lines 1 through 15. . . . . ▶	20,000	

**Part II Adjusted Gross Income From Guam or the CNMI Reported on Form 1040**

17 Educator expenses . . . . .		
18 Certain business expenses of reservists, performing artists, and fee-basis government officials . . . . .		
19 Health savings account deduction . . . . .		
20 Moving expenses . . . . .		
21 One-half of self-employment tax . . . . .	1,413	
22 Self-employed SEP, SIMPLE, and qualified plans . . . . .		
23 Self-employed health insurance deduction . . . . .		
24 Penalty on early withdrawal of savings . . . . .		
25 Alimony paid . . . . .		
26 IRA deduction . . . . .		
27 Student loan interest deduction . . . . .		
28 Tuition and fees deduction . . . . .		
29 Add lines 17 through 28 . . . . .	1,413	
30 <b>Adjusted gross income.</b> Subtract line 29 from line 16 . . . . . ▶	18,587	

**Part III Payments of Income Tax to Guam or the CNMI**

31 Payments on estimated tax return filed with Guam or the CNMI . . . . .	1,409	
32 Income tax withheld from your wages while employed by the U.S. Government as a civilian in Guam or the CNMI . . . . .		
33 Income tax withheld from your wages while employed as a member of the U.S. Armed Forces in Guam or the CNMI . . . . .		
34 Income tax withheld from your wages earned in Guam or the CNMI other than amounts on lines 31 through 33 . . . . .		
35 <b>Total payments.</b> Add lines 31 through 34 . . . . . ▶	1,409	

**Instructions**

Section references are to the Internal Revenue Code.

**What's New**

• For tax years ending after October 22, 2004, you generally file your income tax return with Guam or the CNMI only if you are a bona fide resident of the possession for the entire tax year. See *Where to file* on page 2. Also, the rules for determining bona fide residence have

changed. See Pub. 570 for information about these rules.

• If, in tax year 2001 or later, you become or ceased to be a bona fide resident of a U.S. possession, you may be required to file Form 8898, Statement for Individuals Who Begin or End Bona Fide Residence in a U.S. Possession. The penalty for failure to provide the required information is \$1,000. For details, see the Instructions for Form 8898.

(Continued on back)

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Cat. No. 42243X

Form **5074** (2005)

# Allocation of Individual Income Tax to the Virgin Islands

Department of the Treasury  
Internal Revenue Service

▶ Attach to Form 1040.

Name(s) shown on Form 1040

*Gerald and Lily Smith*

Your social security number

2 2 2 : 0 0 : 2 2 2 2

**Part I Income From the Virgin Islands**

1	Wages, salaries, tips, etc. . . . .	1	
2	Taxable interest . . . . .	2	500
3	Ordinary dividends . . . . .	3	
4	Taxable refunds, credits, or offsets of local Virgin Islands taxes . . . . .	4	
5	Alimony received . . . . .	5	
6	Business income or (loss) . . . . .	6	
7	Capital gain or (loss) . . . . .	7	
8	Other gains or (losses) . . . . .	8	
9	IRA distributions (taxable amount) . . . . .	9	
10	Pensions and annuities (taxable amount) . . . . .	10	
11	Rental real estate, royalties, partnerships, S corporations, trusts, etc. . . . .	11	6,200
12	Farm income or (loss) . . . . .	12	
13	Unemployment compensation . . . . .	13	
14	Social security benefits (taxable amount) . . . . .	14	
15	Other income. List type and amount. ▶ . . . . .	15	
16	Add lines 1 through 15. This is your <b>total income</b> . . . . . ▶	16	6,700

**Part II Adjusted Gross Income From the Virgin Islands**

17	Educator expenses . . . . .	17	
18	Certain business expenses of reservists, performing artists, and fee-basis government officials . . . . .	18	
19	Health savings account deduction . . . . .	19	
20	Moving expenses . . . . .	20	
21	One-half of self-employment tax . . . . .	21	
22	Self-employed SEP, SIMPLE, and qualified plans . . . . .	22	
23	Self-employed health insurance deduction . . . . .	23	
24	Penalty on early withdrawal of savings . . . . .	24	
25	IRA deduction . . . . .	25	
26	Student loan interest deduction . . . . .	26	
27	Tuition and fees deduction . . . . .	27	
28	Add lines 17 through 27 . . . . .	28	-0-
29	Subtract line 28 from line 16. This is your <b>adjusted gross income</b> . . . . . ▶	29	6,700

**Part III Allocation of Tax to the Virgin Islands**

30	Enter amount from Form 1040, line 63 . . . . .	30	5,199
31	Enter the total of the amounts from Form 1040, lines 58, 59, 62, 66a, and 68. Include any uncollected social security and Medicare or tier 1 RRTA tax, tax on golden parachute payments, or excise tax on insider stock compensation reported on line 63. Also include any amount from Form 5329, Parts III, IV, V, VI, VII, or VIII reported on line 60 . . . . .	31	
32	Subtract line 31 from line 30 . . . . .	32	5,199
33	Enter amount from Form 1040, line 38 . . . . .	33	54,901
34	Divide line 29 above by line 33. Enter the result as a decimal (rounded to at least 3 places). Do not enter more than 1.000. . . . .	34	× . 122
35	Multiply line 32 by line 34. This is your <b>tax allocated to the Virgin Islands</b> . . . . .	35	634

**Part IV Payments of Income Tax to the Virgin Islands**

36	Income tax withheld by the Virgin Islands . . . . .	36	
37	2005 estimated tax payments and amount applied from 2004 return . . . . .	37	600
38	Amount paid with Form 4868 (extension request) . . . . .	38	
39	Add lines 36 through 38. These are your <b>total payments</b> . . . . . ▶	39	600
40	Enter the smaller of line 35 or line 39. This is the amount in the total on Form 1040, line 71. On the dotted line next to line 71, enter "Form 8689" and show this amount . . . . .	40	600
41	<b>Overpayment</b> to the Virgin Islands. If line 39 is more than line 35, subtract line 35 from line 39 . . . . .	41	
42	Amount of line 41 you want <b>refunded to you</b> . . . . . ▶	42	
43	Amount of line 41 you want <b>applied to your 2006 estimated tax</b> . . . . . ▶	43	
44	<b>Amount you owe</b> to the Virgin Islands. Subtract line 39 from line 35. Enter the amount that you are paying here and on Form 1040, line 71. Next to line 71, enter "Form 8689" and the amount paid ▶	44	34

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## 6.

# How To Get Tax Help

You can get help with unresolved tax issues, order free publications and forms, ask tax questions, and get information from the IRS in several ways. By selecting the method that is best for you, you will have quick and easy access to tax help.

**Contacting your Taxpayer Advocate.** If you have attempted to deal with an IRS problem unsuccessfully, you should contact your Taxpayer Advocate.

The Taxpayer Advocate independently represents your interests and concerns within the IRS by protecting your rights and resolving problems that have not been fixed through normal channels. While Taxpayer Advocates cannot change the tax law or make a technical tax decision, they can clear up problems that resulted from previous contacts and ensure that your case is given a complete and impartial review.

To contact your Taxpayer Advocate:

- Call the Taxpayer Advocate toll free at 1-877-777-4778.
- Call, write, or fax the Taxpayer Advocate office in your area.
- Call 1-800-829-4059 if you are a TTY/TDD user.
- Visit [www.irs.gov/advocate](http://www.irs.gov/advocate).

For more information, see Publication 1546, How To Get Help With Unresolved Tax Problems (now available in Chinese, Korean, Russian, and Vietnamese, in addition to English and Spanish).

**Free tax services.** To find out what services are available, get Publication 910, IRS Guide to Free Tax Services. It contains a list of free tax publications and an index of tax topics. It also describes other free tax information services, including tax education and assistance programs and a list of TeleTax topics.



**Internet.** You can access the IRS website 24 hours a day, 7 days a week, at [www.irs.gov](http://www.irs.gov) to:

- *E-file* your return. Find out about commercial tax preparation and *e-file* services available free to eligible taxpayers.
- Check the status of your 2005 refund. Click on *Where's My Refund*. Be sure to wait at least 6 weeks from the date you filed your return (3 weeks if you filed electronically). Have your 2005 tax return available because you will need to know your social security number, your filing status, and the exact whole dollar amount of your refund.
- Download forms, instructions, and publications.
- Order IRS products online.

- Research your tax questions online.
- Search publications online by topic or keyword.
- View Internal Revenue Bulletins (IRBs) published in the last few years.
- Figure your withholding allowances using our Form W-4 calculator.
- Sign up to receive local and national tax news by email.
- Get information on starting and operating a small business.



**Phone.** Many services are available by phone.

- *Ordering forms, instructions, and publications.* Call 1-800-829-3676 to order current-year forms, instructions, and publications and prior-year forms and instructions. You should receive your order within 10 days.
- *Asking tax questions.* Call the IRS with your tax questions at 1-800-829-1040.
- *Solving problems.* You can get face-to-face help solving tax problems every business day in IRS Taxpayer Assistance Centers. An employee can explain IRS letters, request adjustments to your account, or help you set up a payment plan. Call your local Taxpayer Assistance Center for an appointment. To find the number, go to [www.irs.gov/localcontacts](http://www.irs.gov/localcontacts) or look in the phone book under *United States Government, Internal Revenue Service*.
- *TTY/TDD equipment.* If you have access to TTY/TDD equipment, call 1-800-829-4059 to ask tax questions or to order forms and publications.
- *TeleTax topics.* Call 1-800-829-4477 and press 2 to listen to pre-recorded messages covering various tax topics.
- *Refund information.* If you would like to check the status of your 2005 refund, call 1-800-829-4477 and press 1 for automated refund information or call 1-800-829-1954. Be sure to wait at least 6 weeks from the date you filed your return (3 weeks if you filed electronically). Have your 2005 tax return available because you will need to know your social security number, your filing status, and the exact whole dollar amount of your refund.

**Evaluating the quality of our telephone services.** To ensure that IRS representatives give accurate, courteous, and professional answers, we use several methods to evaluate the quality of our telephone services. One method is for a second IRS representative to sometimes listen in on or record telephone calls. Another is to ask some callers to complete a short survey at the end of the call.



**Walk-in.** Many products and services are available on a walk-in basis.

- *Products.* You can walk in to many post offices, libraries, and IRS offices to pick up certain forms, instructions, and publications. Some IRS offices, libraries, gro-

cery stores, copy centers, city and county government offices, credit unions, and office supply stores have a collection of products available to print from a CD-ROM or photocopy from reproducible proofs. Also, some IRS offices and libraries have the Internal Revenue Code, regulations, Internal Revenue Bulletins, and Cumulative Bulletins available for research purposes.

- *Services.* You can walk in to your local Taxpayer Assistance Center every business day for personal, face-to-face tax help. An employee can explain IRS letters, request adjustments to your tax account, or help you set up a payment plan. If you need to resolve a tax problem, have questions about how the tax law applies to your individual tax return, or you're more comfortable talking with someone in person, visit your local Taxpayer Assistance Center where you can spread out your records and talk with an IRS representative face-to-face. No appointment is necessary, but if you prefer, you can call your local Center and leave a message requesting an appointment to resolve a tax account issue. A representative will call you back within 2 business days to schedule an in-person appointment at your convenience. To find the number, go to [www.irs.gov/localcontacts](http://www.irs.gov/localcontacts) or look in the phone book under *United States Government, Internal Revenue Service*.



**Mail.** You can send your order for forms, instructions, and publications to the address below and receive a response within 10 business days after your request is received.

National Distribution Center  
P.O. Box 8903  
Bloomington, IL 61702-8903



**CD-ROM for tax products.** You can order Publication 1796, IRS Tax Products CD-ROM, and obtain:

- A CD that is released twice so you have the latest products. The first release ships in late December and the final release ships in late February.
- Current-year forms, instructions, and publications.
- Prior-year forms, instructions, and publications.
- Tax Map: an electronic research tool and finding aid.
- Tax law frequently asked questions (FAQs).
- Tax Topics from the IRS telephone response system.
- Fill-in, print, and save features for most tax forms.
- Internal Revenue Bulletins.
- Toll-free and email technical support.

Buy the CD-ROM from National Technical Information Service (NTIS) at [www.irs.gov/cdorders](http://www.irs.gov/cdorders) for \$25 (no handling fee) or call 1-877-233-6767 toll free to buy the CD-ROM for \$25 (plus a \$5 handling fee).





**CD-ROM for small businesses.**

Publication 3207, The Small Business Resource Guide CD-ROM for 2005,

has a new look and enhanced navigation features. This year's CD includes:

- Helpful information, such as how to prepare a business plan, find financing for your business, and much more.

- All the business tax forms, instructions, and publications needed to successfully manage a business.
- Tax law changes for 2005.
- IRS Tax Map to help you find forms, instructions, and publications by searching on a keyword or topic.

- Web links to various government agencies, business associations, and IRS organizations.
- “Rate the Product” survey—your opportunity to suggest changes for future editions.

An updated version of this CD is available each year in early April. You can get a free copy by calling 1-800-829-3676 or by visiting [www.irs.gov/smallbiz](http://www.irs.gov/smallbiz).



