

Foreign Tax Issues for US Citizens

Presented by
Monica Haven, EA, JD, LLM
mhaven@pobox.com
www.mhaven.net



In this seminar...

- World-wide tax regime
- Income & Housing Exclusions for wage-earners
- Housing Deduction for self-employed
- Foreign Tax Credit
- Forms 1116 & 2555
- Expatriation Tax
- Foreign Account Reporting



US Tax Policy

- US citizens and resident aliens must report world-wide income
- Even if income earned abroad is subject to foreign tax!
- Credits & exclusions may (?) be available to mitigate duplicative tax regimes



US Citizens Living Abroad

- Subject to same reporting requirements as citizens living in US
- Filing deadline automatically extended to June 15th
- Can extend to October 15th using Form 4868
- **Automatic extension until 15th day of 3rd month after release, if taken hostage**
- Report all income & expenses in US dollars
- Use prevailing exchange rate at time income was received or expense paid
- Currency converter available at <http://fms.treas.gov/intn.html> or <http://www.oanda.com/>



Taxable Income

- All foreign earned income subject to US tax unless eligible for:
 - Foreign Earned Income Exclusion
 - Foreign Housing Exclusion
 - Foreign Housing Deduction
- Amounts excluded must be added back when computing regular & AMT liabilities
→ bumps taxable income into higher marginal tax bracket

Taxpayer received \$80K foreign income & \$20K US-source income...

\$80K	<i>Foreign Earned Income</i>
+ <u>20K</u>	<i>Other Income</i>
\$100K	<i>Gross Income</i>
- <u>80K</u>	<i>Foreign Earned Income Exclusion</i>
\$20K	<i>Taxable Income</i>

BUT taxed at marginal bracket of \$100K!!!



Credit vs. Exclusion

- May receive Foreign Tax Credit only for income tax paid on income that is taxable in the United States
- Credit offers dollar-for-dollar reduction of tax liability
- Exclusion removes income from AGI → may benefit from deductions limited by AGI
- Credit is preferable if foreign tax rates > US tax rates or if taxpayer is ineligible to claim exclusion
- Choice to use credit or exclusion in first year is binding on all future years unless revoked by attaching statement to Form 1040
 - Cannot change again for 5 years without IRS consent

No credit for tax paid on excluded income!



Withholdings

- US employers must withhold US tax on wages paid to US citizens abroad
- Employer is exempt from US withholdings if required to withhold foreign income tax
- Employee may file Form 673 to claim exemption from withholdings if eligible for exclusions



Military Personnel

- Taxable income:
 - Active & reserve duty pay
 - Special pay, incl. hostile fire & special duty
 - Re-enlistment bonus
 - Leave
- Non-taxable income:
 - Combat pay as designated by Presidential Order
 - Living, death, family, moving & travel allowances
 - In-kind benefits (e.g., medical and dental care)
- Automatic 2- month extension if serving abroad; additional 6-month grace if serving in combat zone
- Tax forgiven for current & prior year if death occurs while in active-duty combat zone



To Qualify for Exclusions...

- Must be US citizen or resident alien (*not* an NRA)
- Must have foreign earned income
 - Source determined where services are performed, not where taxpayer receives payment
- Must pass either test:
 1. Bona Fide Residence (BFR) – reside in foreign country > 1 full tax year from January 1st through December 31st
 2. Physical Presence Tests (PPT) – be physically present in foreign country ≥ 330 days during any consecutive 12-month period
- Must have tax home in foreign country* – no US abode
 - any territory not under US sovereignty (Guam, American Samoa, US Virgin Islands, Puerto Rico)
 - Does not include Antarctica since it is considered to be sovereign-less region



Examples of Qualified Taxpayers

Example 1:

US citizen lived in Germany from 9/1/09 – 10/31/10 (14 months)

→ Fails BFR since not in Germany for full *calendar* year (will pass PPT in 2010)

Example 2:

US citizen employed on oil rig off UK coast with 28-day on/28-day off schedule; returns to US during off-periods

→ Fails both BFR & PPT with abode in US & no tax home abroad

Example 3:

US Executive transferred to Paris for ≥ 18 months, but kept US house. Moved family, furniture & pets, obtained foreign driving license, opened local bank acct

→ Passes test with tax home in foreign country

Example 4:

Contractor provided services to military in Afghanistan & Iraq; was not allowed to leave base. Family stayed at home in UT.

→ Fails both BFR & PPT since he did nothing to establish residence abroad



Special BFR & PPT Rules

- Taxpayer ineligible for exclusion/deductions if living in foreign country contrary to US law (e.g., Cuba)
 - But taxpayers serving at Guantanamo Bay are eligible
- Time limits may be waived if taxpayer is forced to leave foreign company due to war
 - In 2013, IRS waived for Egypt, Lebanon, Pakistan & Yemen
- If unable to satisfy time limits by due date of return, taxpayer may file Form 2350 if taxpayer expects to satisfy either test soon → extension for 30 beyond date of test limit
- Or, taxpayer may amend a prior-year return on which he did not claim the income exclusion because he had not yet been in-country for the requisite 330 days



Foreign Earned Income Exclusion

- Earned income must be received for personal services performed
- Does not include:
 - Value of meals/lodging
 - Pension or annuity payments
 - US government salaries
 - Investment or passive income
- Maximum exclusion equals foreign earned income less foreign housing exclusion claimed (\$99,200/person in 2014)
- Use Form 2555 (may use Form 255EZ if income > max exclusion amount & no SE earnings)
- May claim on late-filed return no later than 1 year after original due date

Excluded income may be subject to Social Security tax



Foreign Housing Exclusion

- Amounts received for employer-provided housing are eligible for exclusion
 - Rent, repairs, utilities, insurance, occupancy taxes, furniture rental & parking
 - Mortgage interest, property taxes, leasehold improvements, depreciation & cost of domestic labor not eligible
- “Employer-provided”
 - All earnings except self-employment
 - It is presumed that employee uses employer-provided funds (wages) to pay for housing
 - all housing expenses – whether paid by employer or employee – are eligible for exclusion



Housing Exclusion Limitations

- Only amounts in excess of government-calculated base amount are excludable
 - Base amount = 16% of allowable Income Exclusion pro-rated on daily basis
 - In 2014: $\$99,200 \times 16\% \div 365 \text{ days} = \$43.48/\text{day}$
- Housing Exclusion limited to maximum 30% of Income Exclusion
 - In 2014: Expenses between \$43.48 and \$81.53/day are excludable
 - Certain high-cost locales eligible for additional exclusion amounts
- Housing expenses may not exceed foreign earned income



Housing & Income Exclusions

- Housing Exclusion must be claimed *before* Income Exclusion
- Housing Exclusion may be claimed *in addition to* Income Exclusion
 - Housing Exclusion claimed on Line 36 of Form 2555
 - Income Exclusion claimed on Line 42
 - Total allowable exclusion on Line 43 equals sum of Lines 36 & 42
- Combined exclusion may exceed annual threshold [\$99,200 in 2014]

In 2012, Joe's foreign earned income was \$150,000 (greater than allowable Income Exclusion of \$95,100)

Joe may claim Income Exclusion of \$95,100 plus Housing Exclusion of \$37,380 → Total exclusions claimed = \$132,580



Foreign Housing Deduction

- Available only to self-employed
- Cannot exceed foreign earned income less Income and/or Housing Exclusion claimed
- Excess deductions may be carried over 1 year
- Deduction is calculated like Exclusion but claimed as an Adjustment to Income – enter on Form 1040, Line 36 with notation “Form 2555”

Carry-over not available for Housing Exclusion



Example of Housing Deduction

Facts

- In 2012, Felipe earned \$130K incl. \$65K from wages & \$65K from self-employment
- Housing expenses totaled \$12K, one-half was employer-provided

Step 1: Compute Housing Exclusion
→ Taxpayer may claim \$6,000

Step 2: Compute Income Exclusion

65,000	Income Exclusion (wages)
<u>65,000</u>	Income Exclusion (self-employment earnings)
130,000	Total Earnings
<u>- 95,100</u>	Max. Exclusion in 2012
34,900	Taxable Income (in excess of annual exclusion limit)

Step 3: Compute Housing Deduction
\$6K eligible but Felipe exceeded the limitation (\$95,100 in 2012)
→ Carry deduction forward to 2013

On 1040:

130,000	Gross Income
<u>-101,100</u>	Income & Housing Exclusions
28,900	Adjusted Gross Income
6,000	Housing Deduction carry-forward



Foreign Tax Credit or Deduction

- Taxpayer may elect to claim as Credit (Form 1116) or as Deduction (Schedule A)
 - May claim credit directly on Form 1040 if all foreign income derived from interest & dividends on stocks held \geq 16 days and foreign tax liability $<$ \$300 (Single) or \$600 (MFJ)
- Election may be amended within 10 years from due date of return
- Credit/Deduction may not be claimed on foreign taxes
 - imposed by countries not recognized by US govt.
 - that would be refundable if taxpayer filed a claim
 - connected to certain oil and gas transactions
 - on dividends from stock held $<$ 16 days
- Expatriates may not claim credit or deduction...

No Credit (Deduction) for foreign taxes paid on amounts excluded by Income or Housing Exclusions



No Credit for Excluded Income

Facts

- Taxpayer claimed Earned Income Exclusion on \$70K wages
- Paid foreign income tax of \$10K on wage income to India
- Received \$2K dividends from India
- Paid foreign income tax of \$600 to India

\$70,000	Wages
<u>2,000</u>	Dividends
\$72,000	Total Income
<u>- 70,000</u>	Foreign Earned Income Exclusion
\$2,000	Taxable Income [taxed at marginal rate applicable to \$72,000]

- **May only claim \$600 Credit (or Deduction) since remaining tax was attributable excluded income**



Foreign Tax Limitations

- Credit (Deduction) limited to lesser of
 - i. US tax that would have been paid on foreign income if taxed by US or
 - ii. the actual foreign tax paid

**If foreign tax rate < US tax rate,
taxpayer will be liable for
difference on Form 1040**

Facts

- US citizen's income subject to 60% tax rate in Germany
- Same income would be subject to only 25% in US

→ maximum allowable Credit (Deduction) is amount of tax subject at 25% rate

→ excess tax paid eligible for 1 year carry-back & 10-year carry-forward [Credit expires if unused]



Calculating Maximum Credit

Foreign Source Taxable Income

Worldwide Taxable Income

X US Income Tax before Credit

- Foreign-source income must be adjusted for foreign capital gains eligible for LT rates on US return
- Interest expense must be allocated between foreign and US-source income



Deduction vs. Credit

- Deduction claimed on Schedule A → reduces taxable income
STRATEGY: Use for taxes ineligible for Credit, incl. taxes
 - imposed by terrorist states or unrecognized governments
 - on dividends or capital gains from stock held < 16 days
- Credit claimed on Form 1116 → yields dollar-for-dollar reduction of tax liability (generally more valuable than Deduction)
STRATEGY: Use if itemized deductions < Standard Deduction or if planning to carry-over excess Credit
- Election to claim Credit or Deduction applies to all foreign taxes paid or accrued during year (choice may change yearly)





Form 1116

Part I: Foreign Taxable Income

Form **1116** Foreign Tax Credit (Individual, Estate, or Trust)
 Department of the Treasury Internal Revenue Service (900) OMB No. 1545-0121
2011 Attachment Sequence No. 19
 Name _____ Identifying number as shown on page 1 of your tax return _____
 Use a separate Form 1116 for each category of income listed below. See **Categories of Income** in the instructions. Check **only one** box on each Form 1116. Report all amounts in U.S. dollars except where specified in Part II below.
 a Passive category income c Section 901(j) income e Lump-sum distributions
 b General category income d Certain income re-sourced by treaty
 f Resident of (name of country) ▶
Note: If you paid taxes to only one foreign country or U.S. possession, use column A in Part I and line A in Part II. If you paid taxes to more than one foreign country or U.S. possession, use a separate column and line for each country or possession.

Part I Taxable Income or Loss From Sources Outside the United States (for Category Checked Above)

	Foreign Country or U.S. Possession			Total (Add cols. A, B, and C.)
	A	B	C	
g Enter the name of the foreign country or U.S. possession ▶				
1a Gross income from sources within country shown above and of the type checked above (see instructions):				1a
b Check if line 1a is compensation for personal services as an employee, your total compensation from all sources is \$250,000 or more, and you used an alternative basis to determine its source (see instructions) <input type="checkbox"/>				
Deductions and losses (Caution: See instructions):				
2 Expenses definitely related to the income on line 1a (attach statement)				
3 Pro rata share of other deductions not definitely related:				
a Certain itemized deductions or standard deduction (see instructions)				
b Other deductions (attach statement)				
c Add lines 3a and 3b				
d Gross foreign source income (see instructions)				
e Gross income from all sources (see instructions)				
f Divide line 3d by line 3e (see instructions)				
g Multiply line 3c by line 3f				
4 Pro rata share of interest expense (see instructions):				
a Home mortgage interest (use worksheet on page 14 of the instructions)				
b Other interest expense				
5 Losses from foreign sources				
6 Add lines 2, 3g, 4a, 4b, and 5				6
7 Subtract line 6 from line 1a. Enter the result here and on line 15, page 2 ▶				7

Taxpayer must file separate Forms 1116 for each type of income.



Form 1116

Part II: Foreign Taxes

Part II Foreign Taxes Paid or Accrued (see instructions)											
Country	Credit is claimed for taxes (you must check one) (h) <input type="checkbox"/> Paid (i) <input type="checkbox"/> Accrued	Foreign taxes paid or accrued									
		In foreign currency				In U.S. dollars					
		Taxes withheld at source on:				(n) Other foreign taxes paid or accrued	Taxes withheld at source on:			(r) Other foreign taxes paid or accrued	(s) Total foreign taxes paid or accrued (add cols. (c) through (r))
		(j) Date paid or accrued	(k) Dividends	(l) Rents and royalties	(m) Interest		(o) Dividends	(p) Rents and royalties	(q) Interest		
A											
B											
C											
8 Add lines A through C, column (s). Enter the total here and on line 9, page 2									8		

For Paperwork Reduction Act Notice, see Instructions. Cat. No. 11440U Form **1116** (2011)

Taxpayer may claim Credit (Deduction) for taxes paid or *accrued*.



Form 1116

Part III: Calculating the Credit

Form 1116 (2011) Page **2**

Part III Figuring the Credit

9	Enter the amount from line 8. These are your total foreign taxes paid or accrued for the category of income checked above Part I	9	
10	Carryback or carryover (attach detailed computation)	10	
11	Add lines 9 and 10	11	
12	Reduction in foreign taxes (see instructions)	12	()
13	Taxes reclassified under high tax kickout (see instructions)	13	
14	Combine lines 11, 12, and 13. This is the total amount of foreign taxes available for credit	14	
15	Enter the amount from line 7. This is your taxable income or (loss) from sources outside the United States (before adjustments) for the category of income checked above Part I (see instructions)	15	
16	Adjustments to line 15 (see instructions)	16	
17	Combine the amounts on lines 15 and 16. This is your net foreign source taxable income. (If the result is zero or less, you have no foreign tax credit for the category of income you checked above Part I. Skip lines 18 through 22. However, if you are filing more than one Form 1116, you must complete line 20.)	17	
18	Individuals: Enter the amount from Form 1040, line 41, or Form 1040NR, line 39. Estates and trusts: Enter your taxable income without the deduction for your exemption <i>Caution: If you figured your tax using the lower rates on qualified dividends or capital gains, see instructions.</i>	18	
19	Divide line 17 by line 18. If line 17 is more than line 18, enter "1"	19	
20	Individuals: Enter the amount from Form 1040, line 44. If you are a nonresident alien, enter the amount from Form 1040NR, line 42. Estates and trusts: Enter the amount from Form 1041, Schedule G, line 1a, or the total of Form 990-T, lines 36 and 37 <i>Caution: If you are completing line 20 for separate category e (lump-sum distributions), see instructions.</i>	20	
21	Multiply line 20 by line 19 (maximum amount of credit)	21	
22	Enter the smaller of line 14 or line 21. If this is the only Form 1116 you are filing, skip lines 23 through 27 and enter this amount on line 28. Otherwise, complete the appropriate line in Part IV (see instructions)	22	
Part IV Summary of Credits From Separate Parts III (see instructions)			
23	Credit for taxes on passive category income	23	
24	Credit for taxes on general category income	24	
25	Credit for taxes on certain income re-sourced by treaty	25	
26	Credit for taxes on lump-sum distributions	26	
27	Add lines 23 through 26	27	
28	Enter the smaller of line 20 or line 27	28	
29	Reduction of credit for international boycott operations. See instructions for line 12	29	
30	Subtract line 29 from line 28. This is your foreign tax credit . Enter here and on Form 1040, line 47; Form 1040NR, line 45; Form 1041, Schedule G, line 2a; or Form 990-T, line 40a	30	

Form **1116** (2011)



Form 2555

Part I: General Taxpayer Info

Form 2555	Foreign Earned Income	OMB No. 1545-0074
Department of the Treasury Internal Revenue Service	▶ See separate instructions. ▶ Attach to Form 1040.	2011 Attachment Sequence No. 34
For Use by U.S. Citizens and Resident Aliens Only		
Name shown on Form 1040		Your social security number
Part I General Information		
1 Your foreign address (including country)		2 Your occupation
3 Employer's name ▶		
4a Employer's U.S. address ▶		
b Employer's foreign address ▶		
5 Employer is (check any that apply):		
a <input type="checkbox"/> A foreign entity		
b <input type="checkbox"/> A U.S. company		
c <input type="checkbox"/> Self		
d <input type="checkbox"/> A foreign affiliate of a U.S. company		
e <input type="checkbox"/> Other (specify) ▶		
6a If, after 1981, you filed Form 2555 or Form 2555-EZ, enter the last year you filed the form. ▶		
b If you did not file Form 2555 or 2555-EZ after 1981 to claim either of the exclusions, check here <input type="checkbox"/> and go to line 7.		
c Have you ever revoked either of the exclusions? <input type="checkbox"/> Yes <input type="checkbox"/> No		
d If you answered "Yes," enter the type of exclusion and the tax year for which the revocation was effective. ▶		
7 Of what country are you a citizen/national? ▶		
8a Did you maintain a separate foreign residence for your family because of adverse living conditions at your tax home? See Second foreign household in the instructions <input type="checkbox"/> Yes <input type="checkbox"/> No		
b If "Yes," enter city and country of the separate foreign residence. Also, enter the number of days during your tax year that you maintained a second household at that address. ▶		
9 List your tax home(s) during your tax year and date(s) established. ▶		



Form 2555

Part II: Bona Fide Residence?

Part II Taxpayers Qualifying Under Bona Fide Residence Test (see instructions)

10 Date bona fide residence began _____, and ended _____

11 Kind of living quarters in foreign country ▶ a Purchased house b Rented house or apartment c Rented room
d Quarters furnished by employer

12a Did any of your family live with you abroad during any part of the tax year? Yes No
b If "Yes," who and for what period? ▶ _____

13a Have you submitted a statement to the authorities of the foreign country where you claim bona fide residence that you are not a resident of that country? See instructions Yes No
b Are you required to pay income tax to the country where you claim bona fide residence? See instructions Yes No
If you answered "Yes" to 13a and "No" to 13b, you do not qualify as a bona fide resident. Do not complete the rest of this part.

14 If you were present in the United States or its possessions during the tax year, complete columns (a)–(d) below. Do not include the income from column (d) in Part IV, but report it on Form 1040.

(a) Date arrived in U.S.	(b) Date left U.S.	(c) Number of days in U.S. on business	(d) Income earned in U.S. on business (attach computation)	(a) Date arrived in U.S.	(b) Date left U.S.	(c) Number of days in U.S. on business	(d) Income earned in U.S. on business (attach computation)

15a List any contractual terms or other conditions relating to the length of your employment abroad. ▶ _____

b Enter the type of visa under which you entered the foreign country. ▶ _____

c Did your visa limit the length of your stay or employment in a foreign country? If "Yes," attach explanation Yes No

d Did you maintain a home in the United States while living abroad? Yes No

e If "Yes," enter address of your home, whether it was rented, the names of the occupants, and their relationship to you. ▶ _____

For Paperwork Reduction Act Notice, see the Form 1040 instructions. Cat. No. 11900P **Form 2555** (2011)

Taxpayer must reside in foreign country 1 full calendar year from January 1st through December 31st

Form 2555

Part III: Physical Presence?

Part III Taxpayers Qualifying Under Physical Presence Test (see instructions)

- 16 The physical presence test is based on the 12-month period from through
- 17 Enter your principal country of employment during your tax year.
- 18 If you traveled abroad during the 12-month period entered on line 16, complete columns (a)–(f) below. Exclude travel between foreign countries that did not involve travel on or over international waters, or in or over the United States, for 24 hours or more. If you have no travel to report during the period, enter “Physically present in a foreign country or countries for the entire 12-month period.” Do not include the income from column (f) below in Part IV, but report it on Form 1040.

(a) Name of country (including U.S.)	(b) Date arrived	(c) Date left	(d) Full days present in country	(e) Number of days in U.S. on business	(f) Income earned in U.S. on business (attach computation)

Taxpayer must be physically present in foreign country ≥ 330 days during any consecutive 12-month period.

Once PPT is satisfied, taxpayer may amend a prior-year return to claim pro-rated Exclusion based on number of days present during tax (calendar) year.



Form 2555

Part IV: Calculate Foreign Income

Part IV All Taxpayers

Note: Enter on lines 19 through 23 all income, including noncash income, you earned and actually or constructively received during your 2011 tax year for services you performed in a foreign country. If any of the foreign earned income received this tax year was earned in a prior tax year, or will be earned in a later tax year (such as a bonus), see the instructions. Do not include income from line 14, column (d), or line 18, column (f). Report amounts in U.S. dollars, using the exchange rates in effect when you actually or constructively received the income.

If you are a cash basis taxpayer, report on Form 1040 all income you received in 2011, no matter when you performed the service.

2011 Foreign Earned Income		Amount (in U.S. dollars)	
19	Total wages, salaries, bonuses, commissions, etc.	19	
20	Allowable share of income for personal services performed (see instructions):		
a	In a business (including farming) or profession	20a	
b	In a partnership. List partnership's name and address and type of income. ▶	20b	
21	Noncash income (market value of property or facilities furnished by employer—attach statement showing how it was determined):		
a	Home (lodging)	21a	
b	Meals	21b	
c	Car	21c	
d	Other property or facilities. List type and amount. ▶	21d	
22	Allowances, reimbursements, or expenses paid for your behalf for services you performed:		
a	Cost of living and overseas differential	22a	
b	Family	22b	
c	Education	22c	
d	Home leave	22d	
e	Quarters	22e	
f	For any other purpose. List type and amount. ▶	22f	
g	Add lines 22a through 22f	22g	
23	Other foreign earned income. List type and amount. ▶	23	
24	Add lines 19 through 21d, line 22g, and line 23	24	
25	Total amount of meals and lodging included on line 24 that is excludable (see instructions)	25	
26	Subtract line 25 from line 24. Enter the result here and on line 27 on page 3. This is your 2011 foreign earned income ▶	26	

Form 2555 (2011)



Form 2555

Pts V - VIII: Housing & Inc. Exclusions

Form 2555 (2011) Page **3**

Part V All Taxpayers

27 Enter the amount from line 26 27

Are you claiming the housing exclusion or housing deduction?
 Yes. Complete Part VI.
 No. Go to Part VII.

Part VI Taxpayers Claiming the Housing Exclusion and/or Deduction

28 Qualified housing expenses for the tax year (see instructions) 28

29a Enter location where housing expenses incurred (see instructions) 29a

b Enter limit on housing expenses (see instructions) 29b

30 Enter the **smaller** of line 28 or line 29b 30

31 Number of days in your qualifying period that fall within your 2011 tax year (see instructions) 31 days

32 Multiply \$40.72 by the number of days on line 31. If 365 is entered on line 31, enter \$14,864.00 here 32

33 Subtract line 32 from line 30. If the result is zero or less, do not complete the rest of this part or any of Part IX 33

34 Enter employer-provided amounts (see instructions) 34

35 Divide line 34 by line 27. Enter the result as a decimal (rounded to at least three places), but do not enter more than "1.000" 35 x

36 **Housing exclusion.** Multiply line 33 by line 35. Enter the result but do not enter more than the amount on line 34. Also, complete Part VIII. 36

Note: The housing deduction is figured in Part IX. If you choose to claim the foreign earned income exclusion, complete Parts VII and VIII before Part IX.

Part VII Taxpayers Claiming the Foreign Earned Income Exclusion

37 Maximum foreign earned income exclusion 37 \$92,900 00

38 • If you completed Part VI, enter the number from line 31.
 • All others, enter the number of days in your qualifying period that fall within your 2011 tax year (see the instructions for line 31). 38 days

39 • If line 38 and the number of days in your 2011 tax year (usually 365) are the same, enter "1.000."
 • Otherwise, divide line 38 by the number of days in your 2011 tax year and enter the result as a decimal (rounded to at least three places). 39 x

40 Multiply line 37 by line 39 40

41 Subtract line 36 from line 27 41

42 Foreign earned income exclusion. Enter the smaller of line 40 or line 41. Also, complete Part VIII 42

Part VIII Taxpayers Claiming the Housing Exclusion, Foreign Earned Income Exclusion, or Both

43 Add lines 36 and 42 43

44 Deductions allowed in figuring your adjusted gross income (Form 1040, line 37) that are allocable to the excluded income. See instructions and attach computation 44

45 Subtract line 44 from line 43. Enter the result here and in parentheses on Form 1040, line 21. Next to the amount enter "Form 2555." On Form 1040, subtract this amount from your income to arrive at total income on Form 1040, line 22 45



Form 2555

Part IX: Housing Deduction

Part IX Taxpayers Claiming the Housing Deduction— Complete this part only if (a) line 33 is more than line 36 and (b) line 27 is more than line 43.			
46	Subtract line 36 from line 33	46	
47	Subtract line 43 from line 27	47	
48	Enter the smaller of line 46 or line 47	48	
	<i>Note: If line 47 is more than line 48 and you could not deduct all of your 2010 housing deduction because of the 2010 limit, use the worksheet on page 4 of the instructions to figure the amount to enter on line 49. Otherwise, go to line 50.</i>		
49	Housing deduction carryover from 2010 (from worksheet on page 4 of the instructions)	49	
50	Housing deduction. Add lines 48 and 49. Enter the total here and on Form 1040 to the left of line 36. Next to the amount on Form 1040, enter "Form 2555." Add it to the total adjustments reported on that line	50	

Form 2555 (2011)





US taxpayers take note...

- Charitable contributions:
 - Payments to *foreign* charities are not deductible [except certain Canadian, Israeli & Mexican organizations as per treaties]
 - Payments to US charities which forward funds to foreign entities are deductible
- Moving expenses:
 - US citizens/residents may deduct moving expenses into and out of US on Form 3903
 - NRA may only deduct the cost of *incoming* moves



Expatriation Tax

- Exit tax on taxpayer who renounces (or inadvertently forfeits*) US citizenship if principal purpose is tax avoidance
- IRS presumes tax avoidance for high-income, high net worth taxpayer:
 - Average annual income for previous 5 yrs > \$155K (in 2013) OR
 - Net worth > \$2 million
 - OR
 - If non-compliant with US tax laws for preceding 5 years



Exempt Expats

- Minors who relinquish US citizenship before age 18½ & were residents < 10 years
- Dual citizens if they became citizens of the US and another country at birth AND have no substantial contact with US
 - Never US resident
 - Never held US passport
 - Never present in US > 30 days during any 10 years prior to expatriation



Expatriation

- Renounce citizenship
 - voluntarily & intentionally appear in person at US consulate,
 - in a foreign country, and
 - sign an oath of renunciation irrevocably relinquishing all rights
- Forfeit citizenship accidentally
 - Green Card holder claims Income Exclusion by qualifying under PPT which requires that he is away from US
 - but violates immigration laws which require him to be physically present in US
- Must file Form 8854 Information Stmt. at time of renunciation as well as annually – greater of 5% of expatriation tax or \$10K penalty for failure to file
- Must File Form 1040NR for 10 years on US-sourced income

Expats not eligible for Income or Housing Exclusions



Amount of Expat Tax

- Global assets are deemed sold at FMV on day prior to expatriation
- Gains > \$668K (in 2014) are reported on Forms 4797 or 8949 & Schedule D
- Expat tax is due 90 days after expatriation
- Payment may be deferred on an asset-by-asset basis until the due date (plus extensions) of tax return for year in which asset is actually sold – taxpayer must furnish bond
- Expatriates may not benefit from otherwise applicable treaty rates
- Expatriation becomes effective only after all notification & tax satisfaction certificates have been filed with IRS and Homeland Security





Foreign Accounts

- US person (citizen, resident, entity) must e-file FinCEN Foreign Bank Account Report (FBAR) annually if at any time during calendar year:
 - had financial interest in or signature authority over
 - foreign financial account(s)
 - With aggregate value > \$10,000
- Financial interest includes holding title (directly or indirectly) or having beneficial interest in 3rd party account

Example

US citizen infant has foreign accounts

➔ parent must file for baby since FBAR applies to all ages (even if infant does not have a US income tax filing requirement)

- Filing deadline is June 30th – must be received by Treasury (no extension!)

Taxpayers must also report foreign dividend & interest income on Schedule B & check box in Part III



Accounts Defined

- All financial accounts held outside US, including
 - Banks
 - Brokerage accounts
 - Insurance cash values
 - Annuities
 - Mutual funds
- Foreign accounts do not include
 - military banking facilities
 - accounts held in Guam, Puerto Rico or US Virgin Islands
 - IRAs in US bank
 - Real or personal property

Example

Individual owns Canadian RRSP and TFSA accounts (similar to IRA & ROTH accounts in US)

➔ Must file FBAR since IRA exemption applies only to US account

Must also file Form 8891 U.S. Information Return for Beneficiaries of Certain Canadian Registered Retirement Plans with US tax return



Signature Authority

- Signature authority allows individual to control assets

Example

Individual has power to direct how account is invested but cannot withdraw funds

➔ No FBAR requirement since no “signature authority”

Example

US resident has PoA over parents’ reportable accounts in Thailand

➔ Must file FBAR whether or not PoA exercised

- Multiple signatories must each file separate FBAR
- Spouse may file joint FBAR to report joint accounts but separate accounts must be reported on individual FBAR



Account Valuation

- Each account must be valued independently at its highest value at any time during year
- Valuation may be based on monthly or quarterly statements issued by financial institution
- All values must be converted to US dollars based on exchange rate at year-end

REMEMBER: Foreign income is converted to US dollars at time received



FBAR Threshold

- Aggregate all account values after conversion to determine whether FBAR threshold has been met

Example

US citizen has \$8K at Bank A

He transfers entire balance to Bank B during the year

➔ No FBAR requirement since threshold not satisfied at any time during year

Example

US citizen has \$8K at Bank A & \$4K at Bank B

➔ He has FBAR filing requirement since threshold met in the aggregate



Miscellaneous Rules

- Mandatory e-file: <http://bsaefiling.fincen.treas.gov/main.html>
- Taxpayer must sign Form 114a to authorize e-file
- To amend FBAR: Open previously saved file, make correction, re-submit electronically
- Penalties:
 - \$10,000 for failure to file
 - Greater of \$100K or 50% of acct. value if willful violation
 - Possible criminal sanctions (10 years & \$500,000)
- Case Law:
 - 79-yr old widow paid \$22 million on \$43 million acct
 - Beanie Baby founder paid \$54 million penalty on \$107 million Swiss acct
 - 87-yr old Florida man subject to 150% penalty (\$2.2 million) when IRS applied willful penalty to each year (May 2014)



Offshore Voluntary Disclosure Program

Prior Programs

- Repatriate offshore credit & debit cards (2003)
- Swiss bank accounts before UBS disclosure (2009)
- Accounts in Israel, India & Hong Kong during HSBC prosecution(2011)

Current Program

- Reduced civil penalties & no criminal prosecution if full disclosure
 - Penalty: 27.5% of highest year's aggregate value in most recent 8 yrs
 - Penalty may be reduced to 12.5% if highest account balance <\$75K
 - Penalty may be reduced to 5% if US citizen lives abroad & has < \$10K US-sourced income
- Available for all foreign reporting, incl. Forms 8938, 3520, 5471 & FinCEN 114

Ineligible if already under examination or investigation



Alternatively...

Quiet Disclosure

- File amended income tax returns with previously omitted foreign income
- Pay tax, interest & penalties
- Cannot participate in OVDP

Missing FBARs

- If foreign income previously reported & all tax paid
 - IRS FAQ # 17 instructs that taxpayer should simply e-file all missing foreign account reports
- No failure-to-file penalties will be imposed

PREPARER TIP: Always refer client with unreported foreign accounts &/or income to tax attorney



Reporting Foreign Assets

Individuals must file Form 8938 with tax return – **in addition to FinCEN 114** – if foreign financial assets exceed certain thresholds

Reportable Assets

- Depository or custodial accounts at foreign financial institutions
- Stocks or securities issued by foreign persons
- Any financial instrument held for investment issued by non-U.S. person
- Any interest in a foreign entity
- Gold certificates issued by foreign person

Exempt Assets

- Foreign real estate (e.g., personal residence or rental property)
- Foreign currency holdings
- Shares of US mutual fund that owns foreign securities
- Account with US financial institution that holds foreign securities
- A US branch of foreign financial institution
- Foreign social security payments
- Collectibles & precious metals



Filing Thresholds

Domestic Taxpayers

Singles: Aggregate value of \$50K on Dec. 31st or \$75K any time during yr

Married: Aggregate value of \$100K on Dec. 31st or \$150K at any time during yr

“Foreign” Taxpayers (US taxpayers living abroad)

Singles: Aggregate value of \$200K on Dec. 31st or \$300K any time during yr

Married: Aggregate value of \$400K on Dec. 31st or \$600K at any time during yr

- Valuations are based on highest value during the year
- Converted to US dollar at exchange rate on that date

FBAR values are converted at year-end

- Use Treasury Dept. Financial Management Service rate or any accepted currency converter (e.g., OANDA)



Form 8938 Penalties

- \$10K for failure to disclose
- Plus \$10K for each 30-day period after IRS issues its 90-day Notice
- Maximum penalty \$50K

BEWARE: Statute on tax return remains open until Form 8938 with all reportable assets has been filed

RELIEF: For US citizens abroad who pose “low compliance risk”, IRS requires filing of delinquent tax returns for 3 years and FBARs for 6 years
→ cannot submit OVDP if relief procedure used



Form 8938

Form 8938 (November 2011) Department of the Treasury Internal Revenue Service	Statement of Specified Foreign Financial Assets ▶ See separate instructions ▶ Attach to your tax return	OMB No. 1545-2195 Attachment Sequence No. 175
If you have attached additional sheets, check here <input type="checkbox"/>		
Name(s) shown on return		Identifying number
Number, street, and room or suite no. (if a P.O. box, see instructions)		
City or town, province or state, and country (including postal code)		
For tax year beginning _____, 20____, and ending _____, 20____		
Note. All information must be in English. Show all amounts in U.S. dollars. Show currency conversion rates in Part I, line 6(2), or Part II, line 6(2).		
Type of filer		
a Specified individual (1) <input type="checkbox"/> Married filing a joint return (2) <input type="checkbox"/> Other individual b Specified domestic entity (1) <input type="checkbox"/> Partnership (2) <input type="checkbox"/> Corporation (3) <input type="checkbox"/> Trust (4) <input type="checkbox"/> Estate		
Check this box if this is an original, amended, or supplemental Form 8938 for attachment to a previously filed return <input type="checkbox"/>		
Part I Foreign Deposit and Custodial Accounts (see instructions)		
If you have more than one account to report, attach a continuation sheet with the same information for each additional account (see instructions).		
1	Type of account <input type="checkbox"/> Deposit <input type="checkbox"/> Custodial	2 Account number or other designation
3	Check all that apply a <input type="checkbox"/> Account opened during tax year b <input type="checkbox"/> Account closed during tax year c <input type="checkbox"/> Account jointly owned with spouse d <input type="checkbox"/> No tax item reported in Part III with respect to this asset	
4	Maximum value of account during tax year \$	
5	Did you use a foreign currency exchange rate to convert the value of the account into U.S. dollars? <input type="checkbox"/> Yes <input type="checkbox"/> No	
6	If you answered "Yes" to line 5, complete all that apply.	
	(1) Foreign currency in which account is maintained	(2) Foreign currency exchange rate used to convert to U.S. dollars
		(3) Source of exchange rate used if not from U.S. Treasury Financial Management Service
7	Name of financial institution in which account is maintained	
8	Mailing address of financial institution in which account is maintained. Number, street, and room or suite no.	
9	City or town, province or state, and country (including postal code)	
Part II Other Foreign Assets (see instructions)		
Note. If you reported specified foreign financial assets on Forms 3520, 3520-A, 5471, 8621, or 8865, you do not have to include the assets on Form 8938. You must complete Part IV. See instructions.		
If you have more than one asset to report, attach a continuation sheet with the same information for each additional asset (see instructions).		
1	Description of asset	2 Identifying number or other designation
3	Complete all that apply	
	a Date asset acquired during tax year, if applicable	
	b Date asset disposed of during tax year, if applicable	
	c <input type="checkbox"/> Check if asset jointly owned with spouse d <input type="checkbox"/> Check if no tax item reported in Part III with respect to this asset	
4	Maximum value of asset during tax year (check box that applies)	
	a <input type="checkbox"/> \$0 - \$50,000 b <input type="checkbox"/> \$50,001 - \$100,000 c <input type="checkbox"/> \$100,001 - \$150,000 d <input type="checkbox"/> \$150,001 - \$200,000	
	e If more than \$200,000, list value \$	
5	Did you use a foreign currency exchange rate to convert the value of the asset into U.S. dollars? <input type="checkbox"/> Yes <input type="checkbox"/> No	
For Paperwork Reduction Act Notice, see the separate instructions. Cat. No. 37793A Form 8938 (11-2011)		



Form 8938

Part II Other Foreign Assets (continued)

6 If you answered "Yes" to line 5, complete all that apply.

(1) Foreign currency in which asset is denominated	(2) Foreign currency exchange rate used to convert to U.S. dollars	(3) Source of exchange rate used if not from U.S. Treasury Financial Management Service
---	---	--

7 If asset reported in Part II, line 1, is stock of a foreign entity or an interest in a foreign entity, report the following information.

a Name of foreign entity _____

b Type of foreign entity **(1)** Partnership **(2)** Corporation **(3)** Trust **(4)** Estate

c Check if foreign entity is a PFIC

d Mailing address of foreign entity. Number, street, and room or suite no. _____

e City or town, province or state, and country (including postal code) _____

8 If asset reported in Part II, line 1, is not stock of a foreign entity or an interest in a foreign entity, enter the following information for the asset.

Note. If this asset has more than one issuer or counterparty, attach a continuation sheet with the same information for each additional issuer or counterparty (see instructions).

a Name of issuer or counterparty _____
 Check if information is for Issuer Counterparty

b Type of issuer or counterparty
(1) Individual **(2)** Partnership **(3)** Corporation **(4)** Trust **(5)** Estate

c Check if issuer or counterparty is a U.S. person Foreign person

d Mailing address of issuer or counterparty. Number, street, and room or suite no. _____

e City or town, province or state, and country (including postal code) _____

Part III Summary of Tax Items Attributable to Specified Foreign Financial Assets (see instructions)

Asset Category	Tax Item	Amount reported on form or schedule	Where reported	
			Form and line	Schedule and line
I. Foreign Deposit and Custodial Accounts	a Interest	\$		
	b Dividends	\$		
	c Royalties	\$		
	d Other Income	\$		
	e Gains (losses)	\$		
	f Deductions	\$		
	g Credits	\$		
II. Other Foreign Assets	a Interest	\$		
	b Dividends	\$		
	c Royalties	\$		
	d Other Income	\$		
	e Gains (losses)	\$		
	f Deductions	\$		
	g Credits	\$		

Part IV Excepted Specified Foreign Financial Assets (see instructions)

If you reported specified foreign financial assets on the following forms, check the appropriate box(es). Indicate number of forms filed. You do not need to include these assets on Form 8938 for the tax year.

3520 Number of forms _____
 3520-A Number of forms _____
 5471 Number of forms _____
 8621 Number of forms _____
 8865 Number of forms _____



FBAR vs. Form 8938

	FBAR	Form 8938
Enactment	Bank Secrecy Act (1970)	Foreign Account Tax Compliance Act (2010)
Regulatory Authority	Dept. of Treasury	IRS
State of Limitations	None	3 yrs if filed 6 yrs if omitted income > \$5K
Privacy & Confidentiality	Available to all law enforcement agencies	Protected by IRC § 6103



Additional Reporting Requirements

Form 3520

- Must report foreign gifts & bequests over \$100K by April 15th
- NO extension available!
- Mexican Land Trusts used by non-Mexican citizens to hold property exempt from filing Forms 3520 & 8939

FinCEN 104

- Financial institutions must report all currency transactions > \$10K
- Formerly Form 8300

FinCEN 105

- Individual must file if he brings in, sends out or receives > \$10K
- Formerly Form 4790



Form 3520

Form **3520**

Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts

OMB No. 1545-0159

2011

Department of the Treasury
Internal Revenue Service

▶ See separate instructions.

Note. All information must be in English. Show all amounts in U.S. dollars. File a separate Form 3520 for each foreign trust.

For calendar year 2011, or tax year beginning _____, 2011, ending _____, 20

A Check appropriate boxes: Initial return Final return Amended return

B Check box that applies to person filing return: Individual Partnership Corporation Trust Executor

Check all applicable boxes:

- (a) You are a U.S. transferor who, directly or indirectly, transferred money or other property during the current tax year to a foreign trust,
- (b) You hold an outstanding obligation of a related foreign trust (or a person related to the trust) issued during the current tax year, that you reported as a "qualified obligation" (defined in the instructions) during the current tax year, or
- (c) You are the executor of the estate of a U.S. decedent and (1) the decedent made a transfer to a foreign trust by reason of death, (2) the decedent was treated as the owner of any portion of a foreign trust immediately prior to death, or (3) the decedent's estate included any portion of the assets of a foreign trust. **Complete all applicable identifying information requested below and Part I of the form and see the instructions for Part I.**
- You are a U.S. owner of all or any portion of a foreign trust at any time during the tax year. **Complete all applicable identifying information requested below and Part II of the form and see the instructions for Part II.**
- (a) You are a U.S. person who, during the current tax year, received a distribution from a foreign trust, or
- (b) You are a U.S. person who is also a grantor or beneficiary of a foreign trust (1) that has made a loan of cash or marketable securities, directly or indirectly, to you or a U.S. person related to you during the current tax year, or (2) from which you or a U.S. person related to you received the uncompensated use of trust property. **Complete all applicable identifying information requested below and Part III of the form and see the instructions for Part III.**
- You are a U.S. person who, during the current tax year, received certain gifts or bequests from a foreign person. **Complete all applicable identifying information requested below and Part IV of the form and see the instructions for Part IV.**

Service Center where U.S. person's income tax return is filed ▶

1a Name of person(s) filing return (see instructions) **b** Identification number

c Number, street, and room or suite no. (if a P.O. box, see instructions) **d** Spouse's identification number

e City or town **f** State or province **g** ZIP or postal code **h** Country

2a Name of foreign trust (if applicable) **b** Employer identification number (if any)

c Number, street, and room or suite no. (if a P.O. box, see instructions)

d City or town **e** State or province **f** ZIP or postal code **g** Country

3 Did the foreign trust appoint a U.S. agent (defined in the instructions) who can provide the IRS with all relevant trust information? Yes No
If "Yes," complete lines 3a through 3g. If "No," be sure to complete Part I, lines 15 through 18.

3a Name of U.S. agent **b** Identification number (if any)

c Number, street, and room or suite no. (if a P.O. box, see instructions)

d City or town **e** State or province **f** ZIP or postal code **g** Country

4a Name of U.S. decedent (see instr.) **b** Address **c** TIN of decedent

d Date of death **e** EIN of estate

- f** Check applicable box:
- U.S. decedent made transfer to a foreign trust by reason of death.
 - U.S. decedent treated as owner of foreign trust immediately prior to death.
 - Assets of foreign trust were included in estate of U.S. decedent.

Under penalties of perjury, I declare that I have examined this return, including any accompanying reports, schedules, or statements, and to the best of my knowledge and belief, it is true, correct, and complete.

Sign Here Signature _____ Title _____ Date _____

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check <input type="checkbox"/> if self-employed	PTIN
Firm's name ▶	Firm's EIN ▶		Phone no.	
Firm's address ▶				



Other Information Returns

- Form 926 – Transfers to a Foreign Corporation
- Form 3520A – Annual Foreign Trust Return
- Form 5471 – Controlled Foreign Corporations
- Form 5472 – US Corp with 25% Foreign Ownership
- Form 8621 – Passive Foreign Investment Company
- Form 8865 – Controlled Foreign Partnerships
- Form 8891 – Beneficiary of Canadian Retirement Plan
- Form 8898 – Resident of U.S. Possession



Is it working?

- IRS reports that as of June 2014, OVDPs resulted in
 - 45,000 disclosures
 - \$6.5 billion revenues collected
- FATCA compliance prior to July 1, 2014 effective date:
 - 77,000 foreign and US financial institutions signed up to report account info directly to IRS
 - US has 33 Intergovernmental Agreements (IGAs) in place, incl. Switzerland & Cayman Islands

GUIDING PRINCIPLE for US citizens: Stay at home or, at least keep your money here!



Monica Haven, E.A., J.D., L.L.M.

(310) 286-9161 PHONE

(310) 557-1626 FAX

mhaven@pobox.com

WEBSITE: www.mhaven.net

The information contained herein is for educational use only and should not be construed as tax, financial, or legal advice. Each individual's situation is unique and may require specialized treatment. It is, therefore, imperative that you consult with tax and legal professionals prior to implementation of any strategies discussed.

