US TAX GUIDE FOR

AMERICANS RETIRING ABROAD

10 things every retiree needs to know about Social Security, investments, insurance and cost-saving deductions, credits and exclusions

GREENBACK EXPAT TAX SERVICES™

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info@greenbacktaxservices.com

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Introduction

When moving overseas, one of the biggest considerations but sometimes the least thought of is expat taxes. Unfortunately, America is one of a handful of countries that vigorously pursues taxes worldwide–so don't expect to avoid a US tax debt by moving overseas. As a matter of fact, even giving up your US citizenship doesn't eliminate your tax obligation.

America has tax treaties with more than 42 countries where the IRS and the foreign tax agencies exchange tax data on their residents. Many Americans think because they're earning money in another country–and paying that country's taxes–they have no liability when it comes to their home country and that they are not required to pay US taxes. Unfortunately, that is not the case. You still should file a return with the US every year, whether you have income or not. You are not legally required to do so if you don't owe US taxes or earn a minimum amount. However, it's an important preventative measure, as there is a statute of limitations on tax disputes, and many of the tax deductions and exclusions expats can utilize do not kick in until you file a tax return. If there is a dispute over backtaxes, you start running down the clock on the statute of limitations if you file. If you decide not to file, the IRS can conduct a personal audit at any point in the future and you'll be liable if they find you owe taxes.

Taxation Of Retirement Income

The US expects you to file a tax return, even if you live overseas and are retired. Any US retirement savings will be taxed (aside from Roth products) by the US government and potentially by local government as well. This includes income from a 401k, 403b, Traditional IRAs. etc. There are protections in place to help you avoid double taxation such as the Foreign Tax Credit, which will be discussed below.

US citizens are eligible to receive Social Security benefits while living abroad as long as they have paid into the Social Security system. Individuals planning to live in a country that has a totalization agreement in place with the US will be eligible to receive the same payment they would receive if they lived in the USA. However, dependents and survivors will need to meet additional requirements such as having had residency in the US for at least five years. It is important to note that your Social Security payments may be taxed by the IRS if you have additional income over and above your Social Security payments.

Tax Tip 1

Social Security payments are considered US-sourced so they cannot be included as a deduction under the Foreign Earned Income Exclusion. Your benefits are 85% taxable on your US tax return and may incur tax liability in your host country, too.

Social Security payments are considered US sourced (as are payments from other US-based retirement vehicles) and therefore cannot be included as a deduction under the Foreign Earned Income Exclusion. As such, your Social Security benefits are 85% taxable on your US taxes and may incur a tax liability in your host country as well.

More information and a complete list of eligible countries can be found on the Social Security Administration website at http://www.ssa.gov/international/. In addition, IRS Pub 915, *Social Security and Equivalent Railroad Retirement Benefits,* is a good source of information on this subject.

How will the foreign country tax your retirement income?

You need to research the tax laws of your chosen country, as well as the US tax treaty with that country (if there is one), to see how pensions, annuities, investment income, etc. for foreign residents will be taxed. Most countries have a government website on the internet so that is a good place to start your research.

It is important to keep in mind that any foreign tax-free retirement benefits, such as the 25% tax free lump sum payment in the UK, are taxable for US tax purposes. Similarly, any other type of “tax-free” income in a foreign country, such as lottery winnings in Ireland, are still subject to US income tax.

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Avoid Double Taxation With The Foreign Tax Credit

The Foreign Tax Credit (FTC) is a dollar-for-dollar tax credit on your US taxes for taxes that are paid to or incurred with a foreign government. This credit is deducted from the actual US tax liability, rather than the income, so you can completely eliminate your US tax liability if you reside in a high tax country. The purpose of the FTC is to mitigate all or some of the double taxation that arises when US taxpayers are taxed in a foreign country. It is important to note that the FTC is limited to the US tax that arises from foreign income. Foreign taxes used for claiming FTC must be similar to the US income tax in nature (cannot be, say, real estate taxes), and must be imposed during that tax year by the foreign government. For example, an individual cannot decide to pre-pay a government a lump sum for several years and take a credit for the amount on his or her US Individual Income Tax Return.

> **Tax Tip 2**
>
> The Foreign Tax Credit is your best weapon against double taxation. It mitigates all or some of the double taxation if you are taxed in a foreign country as well as the US. However, it only applies to foreign sourced income, not income sourced in the US.

The FTC is grouped into buckets of income that are separated by nature. For instance, there is a "general" category, into which pensions, wages and salaries fall, and there is a "passive" category, into which items such as interest, dividends, and rents fall. As such, the number of Forms 1116 Foreign Tax Credit that must be filed depends on the income categories, rather than taxpayers. For joint filers, tax incurred on similar types of income will be grouped together.

Calculating Eligible Income

Eligible income needs to be calculated, as not all income may be eligible. Total foreign income (less foreign exclusions) is reduced by the directly related deductions (such as moving expenses), and a ratio of the non-directly attributable deductions (most of the itemized deductions). The ratio to figure the attributable portion is the foreign earned income over total income. The net foreign earned income is later used to calculate the portion of the US tax due that is related to that portion of income.

After calculating the net foreign income, an individual must report the foreign taxes paid, using the average exchange rate for the year. They may either report the tax on a "paid" basis, or on an "accrual" basis. Although US individual taxpayers are required to report items on their returns on a "paid" basis, this is one area they are allowed to elect an accrual method. This method may be beneficial when individuals expatriate to locations with a fiscal year rather than a calendar year for tax purposes. This allows for more appropriate income-to-tax matching. However, individuals should be aware that once the accrual method is elected, it cannot be reversed.

The foreign tax paid is then reduced by any Foreign Earned Income Exclusion (discussed below) that was taken (the IRS tries to prevent double benefits). The less income that is excluded via the FEIE, the higher the FTC. The remaining foreign tax, plus any carry-forwards, is then the foreign tax available for credit. This amount is compared to the US tax attributable to the foreign income, and the lower of the two is used as the FTC. Should there be excess foreign tax that cannot be used (generally in foreign jurisdictions where the tax is higher than that in the US), then the excess can be carried forward to future years.

More Savings With The Foreign Earned Income Exclusion

Many individuals choose to continue to work while they retire abroad. If you have earned income received for services performed in a foreign country such as wages, salary and professional fees, you may be eligible to exclude a significant portion of this income from your US taxes. This would be done via the Foreign Earned Income Exclusion (FEIE), which allows you to exclude up to $99,200 of income from your 2014 taxes ($100,800 in 2015). However, it should be noted that this does not include pay received as a direct-hire employee of the US government or its agencies. This includes Armed Forces exchanges, officers' messes and State Department commissaries or State Department Employee Associations. On the other hand, if you are an independent contractor of the US government, you may very well be able to exclude income you earn overseas working for the US government.

Tax Tip 3

Make sure you qualify for the Foreign Earned Income Exclusion using either the Physical Presence test or the Bona Fide Residence test. It allows you to exclude $99,200 in earned income on your US taxes ($100,800 in 2015)!

Qualifying for FEIE

Your tax home must be in a foreign country. Your "tax home" is generally the place where you have your main place of business or employment. The focus here is on where you are permanently or indefinitely engaged to work, and is not necessarily the place that you consider your residence. This can be pretty confusing, and the IRS does little to clear up the matter in its discussion of "tax home" in its publications. Before we go any further in an effort to understand "tax home," there are some terms that need to be defined:

Abode:

This term is defined by the IRS as one's home, residence, or place of dwelling. It is used in the sense of where you have domestic ties, rather than business ties. It does not have the same meaning as "tax home" for that reason, but you cannot have a tax home in a foreign country if you have an abode in the US. This seems to directly contradict the statement above that your tax home and residence do not have to be in the same place.

However, the distinction can be seen in one of the examples used by the IRS in Publication 54, *Tax Guide for US Citizens and Resident Aliens Abroad.* In the example, you are sent overseas by your employer for a period greater than a year. You pack up the family and move them with you, but you keep your home in the US and rent it to another family. You put all your belongings in storage. Once you are in the foreign country, you and your family establish ties there such as opening bank accounts, getting library cards, joining local clubs, etc. You are considered by the IRS to have your "abode" and your "tax home" in the foreign country even though you have retained your residence in the US and will move back to it when your overseas assignment is finished.

Residency Tests:

If your tax home is in a foreign country, you must also meet either (a) the Bona Fide Residence test or (b) the Physical Presence test. These two tests are quite different in their underlying rationales. The Bona Fide Residence test requires that you establish

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"residence" in a foreign country and that determination will depend on the specific circumstances of your case, including your intention and the purpose of your stay. The Physical Presence test, on the other hand, is a test only of how many days you are physically present in a foreign country.

Residency Requirements for Married Couples Filing Jointly:

If you are married filing jointly, only the spouse earning foreign wages needs to meet the above criteria. Thus, for example, if the working spouse qualifies under the Physical Presence test, the non-working spouse does not have to meet those same requirements for living out of the US for 330 days in 12 consecutive months, but is free to come and go as he/she pleases.

Tax Tip 4

The Foreign Earned Income Exclusion is not automatic. You must complete Form 2555 to apply.

Home Ownership While Living Overseas

Personal residence in a foreign country:

It is perfectly acceptable for you to purchase and live in a dwelling you consider your "personal residence," even if it is located in a foreign country. You will be entitled to all the tax benefits, such as deducting home mortgage interest and property taxes that would be available to a homeowner in the US. The only problem you might face is that, if all your income is excluded as foreign sourced, there may be nothing against which to deduct these expenses. Thus, if your taxable income is $0.00 to start with, $10,000 of deductible mortgage interest doesn't do you much good! However, if the home appreciates in value, then when you sell it, you can exclude from income up to $500,000 ($250,000 for a single taxpayer) in gain from the sale. However, you must be aware that to qualify for the exclusion, you must have owned and used the property as a principal residence for at least two of the five years preceding the sale.

Tax Tip 5

If you purchase a home in a foreign country, you are entitled to all the tax benefits, such as deducting home mortgage interest and property taxes, just like you would if you owned a home in the US!

Personal residence converted to rental property in the US:

Occasionally when Americans retire overseas, they decide not to sell their home in the US. It may make sense to rent it out and earn additional income. Under IRS regulations, you are allowed to convert a home to a rental property. If it happens at any time other than the beginning of the tax year, you will have to divide the expenses between personal and rental use for that tax year. Starting in the initial transition year, you will need to file a Schedule E, Supplemental Income and Loss, to report income and expenses, including depreciation. If you end up with a net gain, you will have to report it as income on the Form 1040. If you have a net loss, you may be able to deduct the loss against other income. NOTE: Your losses may be limited or disallowed if the losses exceed $25,000 per year or your income exceeds certain limits.

Tax on Depreciation

If you have used all or part of your home as a rental property or for other business purposes and taken depreciation deductions, you need to be aware of special rules that will apply on the sale of your home. Specifically, you cannot exclude from tax any gain up to the amount of depreciation taken (or allowed to be taken) for any business or rental usage after May 6, 1997. To put this in plain English, let's suppose you bought a residence in July 2003, and then moved overseas in July 2005. You rented the property out from July 2005 until September 2006, and took depreciation of $10,000 during that time. You then moved back into the property and sold it in December 2008. You will have to pay tax on the $10,000 of depreciation as if it were gained even if you otherwise are below the maximum excludable gain of $250,000 ($500,000 for married, filing jointly).

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Tax Considerations For Owning Your Own Business

Self-Employment Tax

It is important to be aware of the US self-employment tax requirements if you are self-employed, even abroad. If you're an employee of a foreign company (which could, in fact, be your own foreign corporation) and have payroll taxes from that country taken out of your pay, you don't have to also pay Social Security taxes to the US. If you are self-employed or acting as an independent contractor, then you must file a Schedule C with your US tax return and pay the appropriate US payroll taxes on your net earnings. The self-employment tax rate is 15.3%, and the Foreign Earned Income Exclusion mentioned before does not reduce this liability.

Tax Tip 6

If you own 10% or more of a foreign corporation you must file Form 5471 each year with your US tax return.

Foreign Corporations, Trusts, and PFIC

If you are a US person (i.e. a US citizen or Green Card holder) and own 10% or more of a foreign corporation (a corporation organized and operating outside the US), you are responsible to file Form 5471 every year. If you own part of a partnership, you must file Form 8865.

Any US person who received a distribution from a foreign trust, was a grantor of or a transferor to a foreign trust must also Form 3520. A trustee of a foreign grantor trust with a US grantor must file Form 3520-A. *Annuitants and Beneficiaries of Passive Foreign Investment Companies* (PFIC) may be required to file Form 8621.

What Information Must Be Provided?

The required information starts by listing the identity of the US shareholder and details about the foreign corporation. It must also include data on transactions between you and the foreign corporation, original capital contributions and other relevant data. The form is four pages long. Several other schedules are required, which can make it a total of approximately six pages. Among the schedules to be filled are the balance sheet for the corporation and income and expense sheet for the current year of operation.

Depending on which of the five categories apply to the taxpayer (in fact there are four categories because Category 1 has just been repealed), different schedules must be completed. An officer or director of a controlled foreign corporation (CFC) who is not an owner of the CFC will be required to file under Category 2 where certain US persons have acquired additional stock in the corporation. A Category 2 filer is only required to complete page one and schedule G. Where a US corporation is the 100% owner of a foreign corporation that is not a Foreign Personal Holding Company (FPHC), the filer could be classified as a Category 3, 4 or 5. Quite often, more than one category can be applied to one filer, so one needs to check and complete the required schedules for each category filed.

When is it Due?

The form is due with the income tax return of the affected shareholder. For most corporations, that would be March 15th or the extended due date. For most individuals, that would be April 15th or, if you are an expat, June 15th. This form is filed along with your personal tax return (or your business / LLC tax return if it is the owner of the foreign corporation).

How Long Does it Take to Prepare?

The IRS estimates that it takes approximately 38 hours on average to prepare Form 5471 (aside from the record keeping time and the time required to learn about the relevant law and instructions). The learning time could be much longer for someone who is not familiar with the pertinent sections of the tax law. IRS estimates that the average time required for record keeping to prepare the form is 82.5 hours and that the average time required for learning about the form is 16 hours. And that does not include the separate time estimates for schedules J, M, N and O.

What Happens if You Don't File Form 5471 or File it Late?

The penalties for a failure to file the return are severe-and it is not necessary for the corporation to have any profits for the penalties to apply. A return must be filed even if there is no taxable income to report.

Until recently, it was rare even to get a response from the IRS about the filing, even in the event that the form was filed late. However-as of late, the IRS has been vocal about the automatic penalties assessed by the computer for late filing of Form 5471. The penalty under IRC Section 6038(b)(1) is $10,000 for each late or incomplete Form 5471.

You must remember that this is mostly an informational form that does not result in any tax due for the taxpayer. So the $10,000 penalty is a "disclosure penalty," unrelated to the actual tax consequences of the information provided on the Form 5471. If the failure continues for more than 90 days after the date the IRS mails notice of failure, an additional $10,000 penalty will apply for each 30-day period. The additional penalty is limited to a maximum of $50,000.

Controlled Foreign Corporation

If you, along with other US persons, own more than 50% of a foreign corporation, it is then defined as a controlled foreign corporation (CFC). Certain types of income (called Subpart F Income) may be taxed and flow through to the US shareholders. This would cause them to pay tax on that income on their US personal tax returns. The rules for determining which types of income are considered Subpart F are rather complex.

Any types of corporate income such as dividends, interest, rental income, insurance income, offshore shipping income and personal service income under certain conditions may be treated as Subpart F income. Subpart F income is taxable on the US shareholder's personal return (or corporate return if a US corporation is the owner) in the year it occurs as ordinary income. This happens whether the income was distributed.

Dividends paid to shareholders of foreign corporations are occasionally eligible for a reduced qualified dividend rate (same rate as capital gains) when paid from the foreign corporation that is located in a country with which the US has a tax treaty.

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Should a US Corporation with Net Operating Losses Still be Concerned?

With current tough economic climate, many US companies have accumulated significant net operating losses (NOLs). Therefore, their managers may not be concerned with filing of Form 5471—since they expect that the firm's NOLs would protect them from potential problems with the IRS. However, because the failure to file Form 5471 results in a penalty (and not a tax), NOLs would not offer any protection.

In addition, the three-year statute of limitations that applies to normal tax returns does not start counting until Form 5471 is properly filed. This is because failure to file Form 5471 renders the personal tax return as incomplete at the time of original filing.

Passive Foreign Investment Company

A form of foreign entity not discussed previously is a passive foreign investment company (PFIC), which is essentially a foreign mutual fund. But the definition of this entity can encompass operating corporations that are temporarily idle and have cash or temporary investments during a period of organization or liquidation. The PFIC rules can impose a harsh tax treatment on US persons who own stock in the foreign corporation.

Healthcare And ObamaCare Impacts

With President Obama's victory at the polls, it is clear that the massive health care law commonly called Obamacare is here to stay. In 2014, in particular, two additional Medicare taxes will kick in. However, these tax increases will only affect high income taxpayers: married couples with adjusted gross incomes over $250,000 and singles with AGIs over $200,000. This is a tiny percentage of the population - only about 4% of all taxpayers earn more than $200,000. However, the one-third of taxpayers who itemize could be affected by the more restrictive limits on deducting medical expenses.

Increased Medicare Taxes for Workers

Everyone who works—whether a business owner or an employee—is required to pay Social Security and Medicare taxes. Employees pay one-half of these taxes through payroll deductions; the employer must contribute the other half and send the entire payment to the IRS. Business owners must pay all of these taxes themselves. These taxes consist of a 12.4% Social Security tax up to an annual income limit, and a 2.9% Medicare tax on all wage or net self-employment income.

Beginning in 2014, the 2.9% Medicare tax will go up by 0.9%. However, this increase will apply only to married taxpayers with wage or self-employment income of $250,000 and single taxpayers with income of $200,000. Only the amount over these thresholds is subject to the additional 0.9% tax. Thus, for example, a self-employed single person with net self-employment income of $300,000 would pay a 2.9% tax on the first $200,000 and a 3.8% tax on the remaining $100,000. If a single employee has wage income of $300,000, the employer would withhold a 1.45% Medicare tax up to the $200,000 threshold and 2.45% after that. Employees will have to pay the entire increase out of their own pockets. Thus, employers will continue to pay a 1.45% Medicare tax on their employees' wages. Employees will continue to pay 1.45% until their wages reach the $200,000 or $250,000 ceiling. Then they will pay the additional 2.45%.

New Medicare Tax on Investment Income

Starting in 2014, high income taxpayers will also be subject to a brand new Medicare tax on their "unearned income." A 3.8% Medicare contributions tax will be imposed on the lesser of (1) the taxpayer's net investment income, or (2) any *excess* of modified adjusted gross income over $200,000 ($250,000 for married taxpayers filing jointly). Thus, all single taxpayers with MAGI over $200,000 and married taxpayers with MAGI over $250,000 will be subject to this tax. This is a small portion of the population, but a significant one for the real estate industry.

The tax applies only to investment income. This includes:

- gross income from interest
- dividends
- royalties
- rents other than those derived from an active business
- net gain earned from the sale or other disposition of investment and other non-business property
- any other gain from a passive trade or business (which includes just about any income not derived from an active business or from employee compensation)

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Example:

Sue and Sam, a married couple filing jointly, have a MAGI of $300,000 in 2013 that includes $100,000 of net investment income. Their MAGI is $50,000 over the $250,000 threshold thus they must pay the 3.8% tax on $50,000 of their investment income. This results in a $1,900 tax.

Reduced Personal Deduction for Medical Expenses

All taxpayers are entitled to a personal income tax deduction for medical and dental expenses for themselves and their dependents. Eligible expenses include both health insurance premiums and out-of-pocket expenses not covered by insurance. However, there are significant limitations on the deduction, which make it virtually useless (unusable) for most taxpayers.

To take the personal deduction, you must (1) itemize your deductions on IRS Schedule A, and (2) only deduct the portion of your medical expenses that exceeds an adjusted gross income threshold. For many years, the threshold has been 7.5% of AGI. Starting in 2014, the threshold for the itemized medical expense deduction goes up to 10% of AGI. However, people 65 or older will be exempt from the increase until 2017.

Example:

In 2013, Sue and Sam have an AGI of $100,000 in 2013 and $30,000 in uninsured medical expenses. They may deduct only the portion of their expenses that exceeds 10% of their $100,000 AGI ($10,000). Thus, they may only deduct $20,000 of their expenses.

New Streamlined Procedure For Late Filers

If you are a United States expat who has been living and/or working in a foreign country for a number of years, it's possible you've misfiled your US expat tax return by either forgetting required forms or forgetting to file a US tax return altogether. If this is the case, there may be an opportunity for you to become current on your US taxes via a new streamlined procedure the IRS introduced on September 1, 2012.

Tax Tip 7

You will not be subject to penalties if you file under the Streamlined Procedures!

Goal of Streamlined Procedure

The goal of this program is to get you caught up with any past due taxes. The IRS has 3 primary objectives, and they are to get you to:

- File all delinquent US expat tax returns with all required forms for the previous 3 year period
- File **all FBARs (Foreign Bank Account Reports)** for the previous 6 year period
- Pay all taxes due including accrued interest

Qualification for the Streamlined Procedure

In July of 2014, the IRS announced major changes to this program that eliminated the requirements that previously restricted participation from many expats. The changes include:

- Extension of eligibility to include US taxpayers residing in the United States
- Eliminating a requirement that the taxpayer have $1,500 or less of unpaid tax per year
- Elimination of the risk assessment process
- Requiring the taxpayer to certify that previous failures to comply were due to non-willful conduct
- Waiving of all late payment, late filing and FBAR penalties for US taxpayers living abroad

The last point may be the most significant—no penalties! Many expats are hesitant to come forward because of the fear of harsh penalties but the IRS has eliminated that fear with these changes. Most expats will now be eligible to get caught up using this program.

You *do* need to certify that your lack of filing was non-willful—meaning you weren't purposely hiding assets from the IRS. If you were purposely hiding money, you would need to consider filing under their other program, the Offshore Voluntary Disclosure Program (OVDP). This program is designed for those who may be facing criminal liability or significant penalties for a willful hiding of offshore assets. If you think you may need to file under OVDP, we highly suggest you contact a tax attorney who specializes in these types of cases prior to applying to the program. OVDP filers are subject to some hefty penalties, so it is important to ensure this is the right option before you choose it!

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Filing Deadlines And Extensions

If you are wondering where, when and how to file your taxes, here's what you need to know. If you live overseas and have no principal place of business in the US, you can file with the Internal Revenue Service Center in Austin, TX 73301-0215.

As to the "when", the due date for filing your return is normally April 15, following the close of your tax year (assuming you file on a calendar year basis). However, if you have both your tax home and your abode outside the US and Puerto Rico on the due date of the return, you automatically get a two-month extension to file your return and pay any tax due. For most Americans living overseas, this means you need to have your return postmarked no later than midnight, June 15th, of the year following your tax year.

> **Tax Tip 8**
>
> Expat tax returns are due June 15th, but interest on any tax due accrues as of April 15th, so it pays to file as early as you can.

If you use the two-month extension, you will need to attach a statement to your return showing that you qualify for it. If you owe tax and don't pay it until you file in June, you will owe interest on the amount of tax owed from the original due date (April 15) until the tax is paid.

The "how" part is evolving as private delivery services increase in popularity. You can now use the following services (in addition to the postal service) to meet the "timely mailing as timely filing/paying" rule for tax returns and payments:

- DHL Express: DHL Same Day Service, DHL Next Day 10:30 A.M., DHL Next Day 12:00 P.M., DHL Next Day 3:00 P.M., and DHL 2nd Day Service.
- FedEx: FedEx Priority Overnight, FedEx Standard Overnight, FedEx 2Day, FedEx International Priority, and FedEx International First.
- United Parcel Service: UPS Next Day Air, UPS Next Day Air Saver, UPS 2nd Day Air, UPS 2nd Day Air A.M., UPS Worldwide Express Plus, and UPS Worldwide Express.

The address to use if you engage a private delivery service is:

Internal Revenue Service Center
3651 South Interregional Highway #35
Austin, TX 78741
Telephone: (800) 829-1040

E-Filing:

Electronic filing is actually the method the IRS prefers for filing your tax return. It is now possible to e-file even with a foreign address. There are three ways to e-file: using an authorized IRS e-file provider, using your personal computer, or using a telephone. Detailed instructions for e-filing can be obtained at the IRS website or you can consult your tax preparer to determine if you meet all the criteria for e-filing.

There are three types of extensions you can get if the need arises:

Automatic Six-Month Extension

This extension gives you an extra six months from the regular filing date of April 15th and is obtained by filing a Form 4868, *Application for Automatic Extension of Time to File US Individual Income Tax Return,* by the due date of the return (April 15). The IRS allows either paper filings or e-filings of this form. In either case, if you file this form by April 15, you are basically letting the IRS know that you are aware of your obligation to file, and the IRS will not charge you a penalty for failure to file if you do not pay all the tax you owe when you request the extension. (However, you will have to pay interest and possibly a late payment penalty if you have not paid at least 90% of your tax by April 15.)

Extension for those who have not met the Physical Presence or Bona Fide Residence test

If you live in a foreign country and expect to meet one of these two tests, but haven't done so by the time of the other extension deadlines, you can request an extension for up to 30 days beyond when you expect to qualify. The form you file is Form 2350, *Application for Extension of Time to File US Individual Income Tax Return.* This should be filed in duplicate with the IRS in Austin or a local IRS representative as it requires the permission of the IRS. As with the automatic extension, Form 2350 must be filed by April 15th.

However, you are encouraged to file this request early so that if it is denied you can still file on time. If you know that you will owe some tax, you can pay the estimated amount due with the Form 2350 request for extension. The biggest incentive to do this is the fact that you will otherwise be charged interest on the unpaid tax from the regular due date of the return to the date the tax is paid **plus** you could be hit with a **penalty for failure to pay tax** (which is half of one percent of any additional tax due for each month or part of a month the tax remains unpaid beyond the due date).

Additional additional extention of time for taxpayers out of the country

In addition to the six-month extension, you can request a discretionary two-month additional extension if you are overseas (December 15 for calendar year taxpayers). You will need to send a letter to the IRS explaining why you need the additional time, and this letter must be sent by the extended due date (October 15).

You will NOT receive any notification from the IRS unless your request is denied for being untimely. That means that, as long as you get the request in by October 15, you should get the additional two months to file.

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FBAR And FATCA

FBAR, Foreign Bank Account Report, requires you to file a report if you have a foreign financial account or even signature authority over a foreign account with balances over a certain threshold. Foreign financial accounts include bank accounts, brokerage accounts, mutual fund, trust or other types of foreign financial accounts.

FBAR reporting is necessary if an individual has one or more accounts whose total value exceeded $10,000 at any time during the course of a given year. Willful failure to file a required FBAR can result in significant penalties. If one's failure to file is non-willful, for example if one did not know about the filing requirement, then there is no penalty. If willfully unreported, penalties can be astonishingly high-the greater of $100,000 or half the amount in the account for each violation.

It is clear that FBAR reporting must be taken seriously. As of September, 2013, FBAR forms must be filed electronically—paper filings are no longer available.

Tax Tip 9

Individuals with more than $10,000 in foreign bank accounts at any point in the year must file FinCEN 114, FBAR. Failure to file FBAR can result in harsh penalties!

Foreign Account Tax Compliance Act (FATCA)

FATCA has become a hot topic in the international community. Under FATCA, certain US taxpayers holding financial assets outside the United States must report those assets to the IRS. In addition, FATCA will require foreign financial institutions to report directly to the IRS certain information about financial accounts held by US taxpayers, or by foreign entities in which US taxpayers hold a substantial ownership interest.

Reporting by US Taxpayers Holding Foreign Financial Assets

FATCA requires certain US taxpayers holding foreign financial assets with an aggregate value starting at $50,000 to report certain information about those assets on a new form (Form 8938) that must be attached to the taxpayer's annual tax return. The following chart summarizes the filing requirements for US residents and US expats.

Tax Tip 10

In addition to reporting your foreign bank accounts, you may also be required to file Form 8938, Statement of Specified Foreign Financial Assets. This is also known as the FATCA form, and is due at the same time as your Federal Tax Return.

	US Expat			US Resident		
Account Balance on:	Single	Married Filing Jointly	Married Filing Separately	Single	Married Filing Jointly	Married Filing Separately
Last Day of Year	$200,000	$400,000	$200,000	$50,000	$100,000	$50,000
Any Time During Year	$300,000	$600,000	$400,000	$75,000	$150,000	$75,000

Reporting applies to assets held in taxable years after March 18, 2010. Failure to report foreign financial assets on Form 8938 will result in a penalty starting at $10,000 (and a penalty up to $50,000 for continued failure after IRS notification). Further, underpayments of tax attributable to non-disclosed foreign financial assets will be subject to an additional substantial understatement penalty of 40 percent.

The United States Treasury Department is now actively working with more than 50 nations to share Americans' personal financial data that will reveal who is compliant, including American expats living overseas.

The inception of, roll out and implementation of FATCA has been clever, if not masterful on the part of the US Treasury. The United States enacted FATCA and began by leaning mostly on foreign financial entities and mandating that they comply with certain new rules, including reporting of data on American clients—and withheld money to ensure their compliance. Foreign financial interests, in turn, desperately sought relief from their own governments. The US mandates were burdensome and cost prohibitive for them to implement. The solution for financiers was for their own governments, many of whom already have the data the US wants, to take on the sharing requirement that the US is forcing on everyone.

More than 50 countries in all are clamoring to get on board. In part because of the controversial nature of FATCA itself and the fact its implementation is so prohibitively expensive, foreign financial entities are pleading with their own governments to facilitate the newly required reporting that the US laws mandate. For many, it is impossible to continue doing business with American clients, and so the banks are closing their accounts. Additionally, foreign banks and investment houses who do not comply face a 30% withholding on their own transactions that occur within the US, so there's no way to opt-out.

Mark Mazur, Assistant Secretary of the US Treasury, said in a public statement, "Global cooperation is critical to implementing FATCA in a way that is targeted and efficient. By working cooperatively with foreign governments and financial institutions, we are intensifying our ability to combat tax evasion while minimizing burdens on financial institutions."

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State Returns

The first time you move overseas, you are almost certainly moving from some state in the US that considers you a resident to your overseas location. If the state assesses income tax, you were probably filing a return each year you lived there. Thus, the question arises as to whether you must continue to pay income tax to that state. There are probably as many answers to that question as there are Americans moving overseas.

However, to help clarify this issue, let's start with some basic definitions of terms that arise in this context.

Domicile

The technical definition of "domicile" is a residence or physical presence at a particular place accompanied by proof of an intention to remain there for an unlimited time. In general, you must do two things concurrently to establish domicile in a particular place:

Be resident at that place, and intend to remain there for an indefinite period of time. It is the place where you have a settled connection for legal purposes, either because your home is there, or because the place is assigned to you by law. With that in mind, you need to understand three more interesting things about domicile:

- You must have a domicile somewhere,
- You can only have one domicile at a time, and
- In order to change your domicile, you must not only move your residence to a new locality, **but you must also intend to remain in that new locality**. Until the new domicile is acquired, the old one remains. And simply changing your residence, without more, does not change your domicile.

The element of "intent" will be determined by looking at all the circumstances surrounding your move and then drawing a reasonable inference. Therefore, you cannot establish domicile in a particular place simply by declaring that you regard that place as your domicile if your acts or other facts are inconsistent with that declaration. Some of the pro-active things you can do to establish "domicile" in a particular state are registering to vote, getting a driver's license, and opening a bank account. However, if another state claims you are still domiciled there, those indications of intent may not be sufficient alone to satisfy the state that you have a new domicile elsewhere. States will also look at such things as where you have family ties, where you own property and have other financial holdings, your principal place of business or work, and where you maintain memberships in a church or synagogue or fraternal organizations or clubs. Thus, your goal is to show that not only do you intend to change your domicile to another state or even another country, but to take actions that back up that intent.

Residence

A "residence" is defined as a place of abode, a dwelling, the act of abiding in a place for some amount of time. It is distinguished from "domicile" in that you can have a residence in more than one place, *and* you can be resident in a place without being domiciled there. Thus, in a very simple example, it should be apparent that you could be resident in France while retaining your domicile in New Jersey.

Tax Consequences of Domicile And Residence

You may be thoroughly confused by the legalese of the above sections, but if you are reading this chapter at all, it is probably because you have some concern about state tax liability. This is because many states, once they have their tax hooks in you, don't want to let go. Unless they are satisfied you are no longer domiciled in their state, they may pursue you, even overseas, in an effort to collect tax. Other states, interestingly, are quite generous in this regard. They will allow you to still be considered domiciled in their state, but will not tax you on your foreign income so long as you meet certain requirements.

Still other states have no income tax at all, so it becomes very attractive to be domiciled in those states. Many states have a provision where you will be taxed as a resident of the state if you are physically present in that state for a specified number of days in the tax year (usually around 183).

This rule looks only to physical presence — not domicile. Therefore, it is possible that you will be domiciled in one state and subject to tax there at the same time that you are physically present in another state and thus subject to tax by that state as well. In most cases, you will need to file a tax return in each state and try to get a credit in one state for the tax paid in the other state. Which state actually gets your tax dollar will depend on the states involved. To complicate matters even further, some states will give you a credit for foreign tax paid.

If you move overseas mid-year and qualify as physically present in a particular state for the tax year, you should file a part-year return with that state, assuming you are not also domiciled in that state. If you have a domicile elsewhere (say in a no-tax state), you can indicate that on the return.

Finally, most states have tax rules for nonresidents. A "nonresident" is generally defined as an individual who earns income or interest in the specific state, but does not live there or lives there less than the time required to be a resident (usually 183 days in the tax year). You will need to file a nonresident return in that state if you meet this definition, and your income is above the filing threshold for the state. Suppose, for example, you owned a rental property in Virginia as well as had money deposited in several Virginia banks. Your net income from these investments was $8,000. Even if you lived overseas for the last two years and considered yourself to be domiciled in Florida, you would still need to file a nonresident return for Virginia and pay Virginia tax on the $8,000.

Most states have a filing threshold, meaning that if you make less than a certain amount, you don't need to file. However, if you fall below that threshold because of the Foreign Earned Income Exclusion, you are still better off to file and report the income. This preventive measure not only establishes your domicile in that state, but protects you from non-filing penalties or other possible claims by the state.

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United States Tax Treaties

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U
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- Union of Soviet Socialist Republics (USSR)
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- Uzbekistan

V
- Venezuela

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Greenback Expat Tax Services
www.greenbacktaxservices.com
info@greenbacktaxservices.com

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