



How To Take Charge Of Your US Expat Taxes

An Audio Seminar with David
McKeegan, Co-founder
Greenback Expat Tax Services

San Juan Live Interview Series

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Claudia Gonella: Welcome to this audio seminar on US expat taxes brought to you by San Juan Live. I'm Claudia Gonella and it's good to be here. Many US expats living in Nicaragua are concerned about what seem to be an ever-expanding set of filing requirements, required by the IRS. So the goal for this audio seminar is to simplify things and give you a good understanding of what you need to know when it comes to the preparation of your US expat taxes.

And we've got the perfect person to help us. David McKeegan Co-founder of [Greenback Expat Tax Services](#) is here and he's on board to help get our questions answered. Thanks very much for being with us David.

David McKeegan: Thank you for having me.

Claudia: To kick things off David I think it would be helpful if you could tell us a little about yourself and about Greenback Expat Tax Services.

David: OK I'm an expat. I've been living overseas since about 2002. My wife and I originally left the US to go to Barcelona, Spain to do our MBAs. Upon completing our MBAs we moved to London, worked there for a couple of years, and then started Greenback a bit over 5 years ago.

The main reason we started the business was because we saw a lot of our friends as well as ourselves having problems getting good tax preparation from people that understood about how expat taxes worked.

The companies that did seem to know how to do it – the big 4 accountancies and local people who had left the big 4 - were charging thousands and

thousands of dollars to do it. So we decided that this was something that we could tackle and we started Greenback. We started hiring accountants putting them through a pretty rigorous hiring process to make sure they knew how to do all the expat tax work. And have been growing the business ever since.

Claudia: Excellent. Your experience reflects a lot of the feedback we get from our readers. People are concerned about their taxes and they're not really sure how to get help. So that's great.

David: Yes it's one of those things that has just become so complicated over the years. You can generally handle it if you're living in the US and you don't have a very complicated situation. But as soon as you go overseas it becomes much more difficult because you're trying to avoid double taxation, you're reporting foreign accounts – all these different things that can really trip you up.

Claudia: Yes. And what we'll try to do is get a little into the detail of that through this call. So let's start right at the beginning, then, and try to simplify things.

Who is required to file with the IRS when we're thinking from the expat perspective?

David: Basically anybody with earned income or income needs to file. The lowest threshold is for people that are self-employed. If you have self-employment income of \$400 you have to file. If you have employment income it goes up a bit. We're talking a threshold of around \$10,000 for people that need to file.

So pretty much everybody needs to file and a lot of people say, "Oh I never knew I had to file." We see that all the time. And the IRS has been pretty

accepting in the past of people who are voluntarily coming forward to catch up for late filing.

But if you have a look inside your US passport it actually says you have to file your taxes.

Claudia: Right.. yes [laughs]. I think that's the only passport in the world that actually says that?

David: Yeah, I think so. [laughs]

Claudia: So some of the acronyms we hear bandied about are FATCA and FBAR. It would be great if you could give us an outline of what those two are.

David: OK. FATCA is the Foreign Account Tax Compliance Act and FBAR is the Foreign Bank Account Report. FATCA is a form that gets filed with your taxes to report foreign accounts and foreign assets. The FBAR is a separate form that gets filed directly with the US Treasury where you have to report foreign bank accounts if you have over \$10,000 or the foreign currency equivalent in all of your combined accounts.

Claudia: OK they are effectively forms. So if I am trying to answer the question "What forms do I need to file?" I have to file a FACTA form and a FBAR form if I have a bank account at that threshold. Is that correct?

David: Exactly. So if you have over \$10,000 in all of your foreign bank accounts combined – even if it only for one day – then you need to file the FBAR form. You can have an accountant file that for you or you can file it yourself online. If you go to the US Treasury website you can register and file it online. That's due

by June 30th each year. There is no extension for the FBAR.

Claudia: How about the FATCA? How is that filing done and are there any extensions?

David: Yes the FATCA is a form that gets filed with your taxes. That gets submitted alongside your tax return. So whatever your deadline for your tax return is, your deadline for your FATCA would be the same.

The FATCA thresholds start at \$50,000 of assets if you are living within the US and I believe it's \$200,000 worth of assets if you're living outside the US. That one gets a little trickier because there is some overlap between the two forms but not everything is overlapped. I know you had some questions about owning property. Sometimes if you own property through a foreign corporation that will trigger the FATCA requirement so things like that you have to watch out for.

Claudia: OK I just wanted to pick up on your point about living outside the US. Is there a certain amount of time each year – some kind of threshold that governs filing requirements?

David: Basically here are two tests that American expats can use to qualify for the expat tax breaks. The first one is known as the Bonafide Resident Test. This is for people that are living abroad full time. They're residents in a foreign country, they're working in a foreign country, their children are in school in a foreign country and they have no intention of returning to the US. The IRS will call these individuals Bonafide Residents. So that's the first test.

The second test – and you only have to pass one, you don't have to pass both – is known as the Physical Presence Test. The Physical Presence Test says that

you have to be physically present in a foreign country for 330 days in a 365 day period. So it does not have to be the calendar year or anything like that, it's just in a 365 day period. You have to be inside a foreign country for 330 days.

Now if you pass either of these tests then you receive a number of credits and deductions as an expat that people inside the US don't receive.

Claudia: Right...those sounds good... What might they be?

David: The first one people want to know about is called the Foreign Earned Income Exclusion. This allows people who are living and working overseas to exclude a pretty significant chunk of their earned income from US taxes. This is indexed for inflation so it increases each year. For the 2013 tax year it's going to be \$97,600.

So if you are living and working overseas you might be able to exclude all of your income from US tax using the Foreign Earned Income Exclusion. The way you qualify for this is with the Physical Presence Test or the Bonafide Resident Test. You need to pass one of those two to qualify for the Foreign Earned Income Exclusion.

Now the next big tax break that people can get is called the Foreign Tax Credit. This is filed on Form 1116. Basically what this does is if you are paying tax to a foreign country – so let's say you are living and working in Nicaragua and you're paying tax to the Nicaraguan government – it gives you a dollar for dollar tax credit to reduce your US taxes. So again this can be pretty significant. I'm not sure what the top tax rates are in Nicaragua right now but generally speaking people in Western Europe, places where you have tax rates in the 40-60% range, find this to be very useful.

The third thing people should know about is the Foreign Housing Deduction. This is part of the Foreign Earned Income Exclusion but it allows you to deduct some of your foreign housing costs above a threshold of about \$15-16,000. If you are paying above \$15 -16,000 then you may be able to deduct some of your housing costs such as your rent or your insurance on your rental property or your utilities. Things like that can be deducted.

Claudia: That all sounds really good David. I think all this information on credits and deductions that American expats can qualify for is always good to hear so thanks for going over that.

Just to continue, some of our readers are a bit concerned about penalties and fines they can face. What happens if they make a mistake with their filing? What kind of penalties can they receive?

David: With expats the penalties are fines that they face a lot of the time where people are most worried about are the ones they hear about relating to the FBAR. The FBAR penalties can start at \$10,000 for failing to report a foreign bank account and the penalty can go all the way up to 50% of the account balance. So that can be something very scary for somebody if you are just looking at that or you read about that in a news article or something like that.

Now we've done thousands of tax returns for people and we have yet to see an expat get hit with a penalty like that – for failing to file an FBAR. Most of the time what people can say is that they didn't know they needed to file the FBAR and that they're now catching up by filing their late FBARs and they'll be compliant going forward.

The thing you don't want to do is file one year, forget to file the next year, file

again the third year. Because then the IRS will be less lenient because they already know that you know you are supposed to be doing this.

The other penalties and fines are all related to whether or not you owe income. So if you don't owe income on your tax return then you're not going to owe any penalties or fines for filing late. That's important for people to remember. If you can use the Foreign Earned Income exclusion, the Foreign Tax Credit to reduce or minimize any tax you would owe in the US then you're not going to have to worry about any late payments or penalties or anything like that.

One thing I'll just throw in there because this can really trip people up is if you're self-employed you will still have to pay your Social Security tax and that's paid before the Foreign Earned Income Exclusion. So that going to be an out of pocket expense for anyone who's self employed. And that can trip you up on the penalties side as well because if you have not been paying that you may owe penalties on the underpayment for the self-employment.

Claudia: Right OK, that's useful to know thanks. David is there a statute of limitations on unfiled tax returns?

David: Really there's not. The way it works is there is no statute of limitations on an unfiled tax return. So if you are 30 years behind on your taxes – you don't have to file for all 30 years if you are – but lets say you filed for a year 20 years ago, you have 6 years from when you filed the return.

Claudia: Now just a question that's a bit timely. How will Obamacare impact expats?

David: This is sort of a tricky one and it's still being worked through. Basically

the way it works right now is that if you qualify as a Bonafide Resident or you qualify under the Physical Presence Test then you're excluded from Obamacare.

Now if you don't. Lets say you are someone that wants to spend 6 months in the US and 6 months in Nicaragua or something like that then you do fall under the Affordable Care Act (or Obamacare) and you will need to either buy US based health insurance which can be very costly or you would need to pay the penalty which starts at about \$100 or 1% of your income. That's going to increase over the next couple of years. It goes up to 2.5% of your income over the next three years.

Claudia: And you said this hasn't been quite worked out yet. Do you know the timeline as to when the requirements will be fixed?

David: Well there's a bit of a question as to whether they're going to bother fixing things for expats. As it's written right now is probably the way it's going to be for a while. But the 7 million Americans that live overseas seem to have been largely overlooked.

If you take my family for instance, we have foreign health insurance. It's excellent health insurance. It covers us everywhere in the world except for the US and Canada. And if we spend less than 330 days in a foreign country we would then either need to pay the penalty in the US or buy a US health insurance policy.

I actually went on the Affordable Care Website to look up how much some of these polices would cost for a family of 4, for my family, and one of the quotes, if you believe it, was \$72,000 for the year.

Claudia: Oh my goodness.

David: [Laughs] It's a bit absurd. The lowest quote I think was \$10,000. Or maybe it was \$7,000 for the lowest. But the highest one was \$72,000. So my advice is if you are living overseas make sure you're going to qualify for Bonafide Resident or Physical Residence Test because you don't want to have to buy insurance that you're not going to use and you're not going to need.

Claudia: Right. That's useful advice, thank you. And I think we'll probably maintain a watching brief on this and see how things roll out.

David: Yeah it will be interesting to watch. It's a very new program and it's got a lot of kinks that need to be worked out of it. But I lived in the UK for a number of years and I've seen how an arguably well-managed national insurance plan can work. And it does work. So we'll see if we can get it to work in the US.

Claudia: Yes, one to watch I think. So David coming back to taxes. If people are late on their taxes, if they haven't filed for a few years or perhaps they filed in an irregular manner in the past, what is it that they can do to catch up?

David: The IRS has a couple of different programs that they're running right now to help people get caught up on their taxes and on their FBARS. The first one which a lot of people may have heard of is called the Offshore Voluntary Disclosure Program. This one is designed for people who have been hiding money overseas or hiding assets overseas and they can come forward and avoid criminal prosecution and pay a fixed penalty on what they should have been paying tax on already.

Now anybody in that situation I would always recommend they speak to an

attorney first before going into the process because they really want make sure that they're going to qualify for the program and make sure they qualify for the amnesty. You don't want to come forward and end up going through a criminal prosecution.

So that's the first one that's out there and that's had a lot of publicity. So many people hear about that and they get very nervous because they think, "Oh my goodness I've forgotten to file my taxes, I'm going to jail." That program is really for people who have been evading taxes purposefully as opposed to expats who just forgot to file.

The next program, which is more designed for expats who have forgotten to file, is called the IRS Streamlined Program. The way this one works is if you owe less than \$1,500 in taxes for the past 3 tax years and you don't have any signs of advance tax planning – basically you are just a regular person living and working overseas who forgot to file – then you can get completely caught up by filing 3 years of federal tax returns and 6 FBARS.

There are some special forms that you have to submit as well saying that you're going through the Streamlined process, but that a very good program for anybody that is just falling behind and isn't doing anything to draw additional attention to it. We've seen a lot of people use that program to get caught up.

The third way people get caught up. This isn't an official program but it has got its own name now. It's called Quiet Disclosure and this is just coming forward and filing your past tax returns and filing your past FBAR returns, submitting them to the IRS and then waiting to see if the IRS contacts you. And again, we've seen a lot of people use this, a lot of people have gotten caught up this way and for the most part people aren't getting contacted by the IRS. The IRS

is accepting these late returns, saying thank you very much, please remember to file going forward.

Claudia: Well from what you are saying then David, it seems that any effort an expat might make to voluntarily come forward is being well received by the IRS?

David: Yes it definitely is. The problem is the IRS is really going after people that are hiding money overseas. This includes bad people – terrorist, drug dealers, all these people – but it's also catching all the expats in the crossfire. It's not easy to live overseas for an extended period of time without having a foreign bank account or without buying or renting property.

These are some of the things that when you're analyzing data you look for to see "Oh this person is moving money overseas to Nicaragua, they must be a drug dealer" They're not. There are some people that are, but it shoots up a red flag and all of a sudden the IRS wants to know more about you.

With the FATCA rules that are coming out, all these banks are going to be reporting your foreign bank accounts to the IRS. All of a sudden the IRS is going to know that you are there. They're going to know you have an account there, a mortgage or whatever it is. They're going to be able to find you. So if you are behind, arguably now is the time you want to come forward and get caught up because it's much worse if the IRS finds you than if you find the IRS and say "Sorry I did not know about this."

Claudia: Yes, that makes sense. Well David I feel like we have covered a lot of ground here. So thinking though next steps for people listening, how can US expats make the whole filing process less stressful and less time-consuming?

David: My first recommendation for people would be hire an accountant to do the work for you. A lot of people are used to doing their own taxes when they live in the US. They use TurboTax or they use the IRS system or something like that. But your taxes get a lot more complicated as soon as you become an expat because you do want to qualify for the Foreign Earned Income Exclusion, the Foreign Tax Credit and you have different thresholds for things like FACTA. You've got FBAR to look at and all these different things.

So my advice would be hire an expert to help you with it. There are a lot of companies out there including ours that charge pretty reasonable fees. I think in the US right now the average tax return costs about \$350 to have a professional prepare it. With our CPAs and IRS enrolled agents we charge \$359 to do the Federal Tax Return and it includes pretty much all the forms most expats need.

If you run your own businesses or if you're doing a lot of trading, the fees go up a little bit. But we try to keep our pricing as all inclusive as possible because we want it to be a service that everyone can use and everybody gets a good benefit out of.

Claudia: Thanks David, thanks for setting that out. Its been really good to have this overview of the IRS tax filing requirements for expats, thanks so much for being on the call. Now, so that people can get hold of you if they want to discuss their tax needs I'll include a link in the audio transcript for this interview (Here's the link to [Greenback Expat Tax Services](#)). I'll also add a link to Greenback on the page with the audio file.

So thanks again, it's been really good talking to you.