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SESS: When Self-Employed Expats Pay Taxes Twice

The IRS's double whammy that for some is unavoidable



The tax that packs a punch. PHOTO: ISTOCK

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When Amanda Ponzio-Mouttaki, an American freelance writer and culinary tour operator, moved to Morocco three years ago, she didn't realize the IRS would require her to pay Self-Employment Social Security (SESS) tax, a tax levied on many, but not all, self-employed American expats.

Morocco also requires Ms. Ponzio-Mouttaki to pay into its social security system—a taxation double whammy.

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Both in the U.S. and abroad, SESS tax is a 15.3% “combined tax” consisting of a 12.4% social security tax and 2.9% Medicare tax on a self-employed taxpayer's entire net earnings. For certain high earners (based on filing status) an additional Medicare surcharge of 0.9% may apply.

But while Medicare covers U.S.-based taxpayers, taxpayers living abroad receive no Medicare benefits.

American citizens and resident aliens living abroad and employed (though not contracted) by the U.S. government or a U.S. company share social security tax with their employers. Those employed by a foreign company or who incorporate overseas do not pay into social security.

Although [25 countries](#) have signed a bi-national social security agreement (what the IRS calls a Totalization Agreement) with the U.S. that prevents double taxation of income with respect to social security taxes, Morocco isn't one of them. In fact, not one country in the Middle East has signed the agreement, and Chile is the only Latin American country to do so. In Asia, only Japan and South Korea have totalization agreements with the U.S.

“The double taxation makes me crazy, especially because Morocco and the U.S. have so many treaties relating to trade, the military, and many other things,” Ms. Ponzio-Moutakki said. “This just penalizes Americans who are living abroad.”

The fact that many expats, especially those living in Western European countries, are exempt from the tax while others are not “feels unfair,” she said.

Jane Bruno, a Florida-based accountant specializing in expatriate taxes, said self-employed American citizens and resident aliens living outside the U.S. often assume they are exempt from SESS “since the first \$101,300 of employment income an individual earns is otherwise excluded from U.S. income tax” under the Foreign Earned Income Exclusion.

Finding that they must pay SESS even though they don't pay income tax is “often a big and unwelcome surprise,” Ms. Bruno said.

While expat taxpayers often hate the double-tax liability, those who contribute to social security for at least 40 quarters (in other words, 40 three-month intervals) “will receive social security benefits when they retire, either in the U.S. or abroad, so assuming the system is still in place, it may be worth it,” said David McKeegan, co-founder of Greenback Expat Tax Services in Florida.

Paying solely into their host country's social security or national insurance systems could leave Americans living abroad financially vulnerable at retirement age, Mr. McKeegan said.

The IRS is aware that expats forced to pay twice often feel burdened, but it has no authority to cancel the tax, said Bruce Friedland, an IRS media relations specialist.

“It is part of the Internal Revenue Code enacted by Congress, and the IRS has no discretion to exempt self-employed U.S. citizens or U.S. resident aliens living abroad from the self-employment tax. In the case of the United States, the Social Security Administration and not the Treasury Department is the relevant agency responsible for negotiating these agreements,” Mr. Friedland said.

While self-employed expats often blame the U.S. for their double-taxation woes, totalization agreements aren't a one-sided decision, said Larry Stern, a partner at Aboulafia Avital Shrensky & Company, an Israeli accounting firm with many expat clients.

“Generally countries don't sign totalization agreements if they feel they have something to lose. If you have Israelis living in America, for example, Israel would be required to provide the same national insurance benefits it provides its resident citizens,” Mr. Stern said.

In Israel, those benefits include a pension, paid maternity leave and universal health care.

Meanwhile, self-employed Americans working in Israel are subject to up to 16% national insurance tax in addition to the 15.3% SESS tax.

Mr. Stern said expats can avoid SESS payments by being employed by a foreign individual or entity. “That can mean creating a foreign company and providing yourself a salary,” he said.

Unfortunately, creating a foreign company often involves some hefty accounting fees and other tax pitfalls if not planned properly.

No two self-employed taxpayers are the same, the accountant emphasized.

“For some, especially those nearing retirement age and who have paid into the system, it's a good thing. But for others, it's questionable whether they'll reap many benefits.”

“Every case should be analyzed individually,” Mr. Stern said.

For an overview on Self-Employment Social Security, visit the [Social Security Administration information](#) and [the IRS](#).



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