Five US expat tax nightmares and how to avoid them

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It's no secret that filing US expat taxes can be intimidating. There are many nuances to consider and myriad of forms to sort through – not to mention the prospect of stiff penalties if you do things wrong – willingly or not.

However, knowing where the pitfalls lie can be the first step toward staying out of trouble, and with that in mind we caught up with David McKeegan, Co-Founder of Greenback Expat Tax Service for insights on five common "nightmare scenarios" for US expats – and what you can do to avoid them.

Not filing your US federal tax return

It's a common scenario: you've left the US more or less permanently, lived abroad for years and dutifully filed your foreign tax return each year. All good, right? Not so fast. A few years down the line, you learn you still have tax filing obligations in the US. Yikes! Surely this can't be true, right?

"It's true: you are required to file your federal tax return annually and report all worldwide income," McKeegan warns.

If you've forgotten to file due to "unfamiliarity" with the law, the IRS offers the Streamlined Procedures Program that allows ignorant taxpayers to catch up (this being the IRS, there's even a special form for certifying your lack of filing was "non-wilful").

And what if you knew the rules but did "wilfully" ignore them, perhaps because you didn't want to disclose foreign accounts or have to deal with reporting on foreign investments?

"Those who didn't file after knowing their obligations may consider the Offshore Voluntary Disclosure Program (OVDP)," advises McKeegan.

The OVDP, besides giving you yet another memorable IRS abbreviation, lets you come clean and avoid the risk of and IRS investigation or (gulp) criminal prosecution.

Not filing the Statement of Specified Foreign Financial Assets (Form 8938)

Be warned! This nightmare scenario can result in a $10,000 penalty – with further penalties up to $50,000 if don't file your Form 8938 following IRS warnings.

But who exactly needs to file this Statement of Specified Foreign Financial Assets?

"You are meant to file this form along with your federal tax return if your specified financial assets at the end of the calendar year are over $200,000 living abroad or $50,000 if living in the US," McKeegan explains.

"This is the big one - so much so that the US government enacted it under the Foreign Account Tax Compliance Act (FATCA) with the intent of preventing tax evasion."

FATCA imposes reporting requirements on US expats as well as banks, foreign investment companies, brokers, and insurance companies, all of which must report to the IRS directly on financial accounts or foreign entities owned by US persons.

"If the income relating to these foreign assets is not declared on the tax return, you are penalized at 40 percent on the attributable tax," McKeegan adds.

Non-compliance with FBAR (Foreign Bank Account Reporting)

This is another doozy of a nightmare. Indeed, non-compliance on your FBAR can leave your financial life FUBAR.

"Those who are required and do not file may be looking at civil monetary penalties," says McKeegan. "Up to $12,459 per violation judged to be non-wilful. And for wilful violations, the penalty may be $124,588 or 50 percent of the balance in the account – whichever is higher."

Ouch! And what exactly is FBAR?

"As a US person you are required to file an FBAR if you had ownership or signature authority on one or more financial accounts outside of the US and if the aggregate balance of all the accounts was more than $10,000 at any time during the year – for even a day," he explains.

And just to make things trickier, the FBAR filing procedure is a bit different. Rather than filing with your federal tax return, the FBAR is filed online via the BSA E-Filing System – although it should still be filed by the April 15th tax filing deadline, although it is possible to get an automatic six-month extension until October 15th.

Getting lost trying to navigate PFIC rules

Do you own any foreign mutual funds? If so, you'd better pay attention to this additional gem of an IRS abbreviation.

PFIC stands for Passive Foreign Investment Companies and refers to non-US registered funds. Reporting rules for them were originally aimed to discourage taxpayers living in the US from investing in foreign tax havens. And getting the reporting right is no easy task.

"The IRS estimates over forty hours are required to research the law, record keep, and prepare the form for one mutual fund," says McKeegan. "In addition, each PFIC needs to be reported separately on separate 8621 forms, which can be both expensive and time-consuming."

Indeed, sorting out the proper reporting and calculations for Form 8621 is so complex that your best option is getting help from a tax professional.

"And even if you're not required to file Form 8621, you still need to confirm if you are required to report it on Form 8938," he adds.

Complex foreign company investments

Having more than a 10 percent ownership stake in a foreign company can also result in a nightmare scenario when it comes to correctly filing US tax returns.

In such cases, you may need to file Form 5471 - Information Return of US Persons With Respect to Certain Foreign Corporations.

"Be warned that you will need to delve into the four categories of individual filers and understand what a public officer or directorship may entail, as well as the surrounding intricacies. Each category filer has specific forms to be completed and must be accurate to be considered compliant," says McKeegan.

Things get even more complex if a company in which you own more than a 10 percent is incorporated in a foreign country.

"Like the other scenarios, the penalties can be harsh. Even if the company is reporting losses or not trading it is very important to file," McKeegan adds.

And if you have expatriated or are contemplating doing so, you *really* need to make sure you file Form 5471 – not doing so may jeopardize the certification that you have been compliant for the preceding five years or, worse yet, classify you as a covered expat, and leave you subject to hefty expatriation tax penalties.

Bottom line? Speak with a tax professional experienced in this area who can help make sure you comply with all the requirements.

One option is tuning in to this video from a recent free webinar with Greenback Expat Tax Services.

For further information about these scenarios and others, or to speak with an expert on expat tax requirements, contact Greenback Expat Tax Services today!

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