EXPAT TAX GUIDE

Americans Teaching Abroad

10 key points you must know

(Money Saving Tips)

EXPAT TAX SPECIALISTS ON A MISSION

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10 Key Points to Know

1. U.S. citizens and permanent residents (Green Card holders) are **required to file U.S. income tax returns** – even if their only source of income is in a foreign country

2. It may be **financially beneficial** to file your U.S. tax return

3. Use the **foreign earned income exclusion** (FEIE) to exclude almost a $100,000 of income on your U.S. tax return – most expats end up not owing any U.S. taxes

4. To qualify for the FEIE, you must be in a foreign country for **330 days** during a 12-month period, or be considered a bona fide resident

5. Don't forget important deductions (e.g., moving and educator expenses)

6. Take advantage of the **foreign tax credit** if you have paid foreign taxes – useful option for high-earning expats who live in a country with higher tax rates than the United States

7. The **filing deadline for U.S. expats is June 15th**, not April 15th – if you need to file an extension, it is the same as in the U.S. (unless you are filing an extension to qualify for the FEIE)

8. Individuals with $10,000 or more (aggregate balance) in foreign bank accounts at any point during the year must file **FinCen 114** (FBAR)

9. Be aware of **FATCA** – foreign financial institutions will begin reporting to the IRS account information pertaining to U.S. persons

10. In certain cases, you may have to file a **state tax return**

Do I Need to File a Tax Return?

All U.S. citizens and permanent residents (Green Card holders) are required to file U.S. income tax returns if they have gross income that exceeds certain minimum thresholds – see below table for 2013 tax year.

Filing Status	Age (as of 12/31/2013)	Gross Income (AGI)
Single	Under 65	$10,000
	65 or older	$11,500
Married Filing Jointly	Under 65 (both)	$20,000
	Under 65 (one)	$21,200
	65 or older (both)	$22,400
Married Filing Separately	Any age	$3,900
Head of Household	Under 65	$12,850
	65 or older	$14,350
Qualifying Widow(er) with dependent child	Under 65	$16,100
	65 or older	$17,300

U.S. expats are required to report **worldwide income** (regardless of location). Unfortunately, many are not aware of this fact, and do not file – only be audited by the IRS, at which point they are subject to penalties and interest.

Is there a reason to file taxes – even if you're not required?

Even if there is no obligation to file based on the income thresholds, many expats should consider filing a tax return in order to receive special tax credits/refunds. For example, families with a child or children (<17 years of age) may be eligible for the Child Tax Credit, which is worth up to $1,000 per child.

Secondly, filing a tax return starts the clock on the IRS statute of limitation. Generally speaking, the IRS has 3 years to audit a tax return (6 years if substantial income is not reported). Not filing a tax return may also result in potential inquiries and audits by the IRS – something better to be avoided.

Understanding the Foreign Earned Income Exclusion

U.S. citizens and permanent residents are subject to U.S. income tax on worldwide income – it doesn't matter where you generate your income. Fortunately, the U.S. government offers an important tax relief to Americans living and working abroad (to alleviate the burden of double taxation).

Foreign earned income exclusion (Form 2555):

1. For 2013, up to $97,600 of **foreign earned income** earned while living abroad can be excluded from federal tax;
2. You must either meet the **bona fide residence** or **physical presence** test (explained below)

Foreign earned income excludes any U.S. based income including pension and other retirement or deferred income. It also excludes any foreign income that was <u>not earned</u> (e.g., interest, dividends, rental income, and pension). The $97,600 exclusion works alongside deductions and exemptions. As a result, an expat can have over $100K in income, and pay no taxes. If you're married filing jointly, it's possible to double the exclusion amount, provided both you and your spouse are earning income abroad.

Bona fide residence and physical presence tests:

- The **bona fide residence test** is met if you have an established "residence" within a foreign country and have lived there during an entire calendar year. Furthermore, your intentions must be to remain in that country.
- The **physical presence test** is met if you are outside the U.S. for 330 out of 365 consecutive days.

Most expats who qualify for the FEIE **for the first time** meet the requirement via the physical presence test. The 365 days is not based on a calendar year. It usually starts around the time you begin living abroad.

Examples
1. *Jane Smith moves to Costa Rica on March 1, 2012. She does not leave the country. Jane qualifies for the physical presence test 330 days later. Jane can file her 2012 expat tax return prior to April 15.* 2. *Kevin Johnson moves to Thailand on October 1, 2012. He does not leave the country. Kevin also qualifies for the physical presence test 330 days later. In order for Kevin to qualify for the foreign earned income exclusion, he should file a 6-month extension (Form 2350).* *In the examples above, both Jane and Kevin would not be able to exclude the full $97,600 exclusion amount. The exclusion amount is prorated based on the number of days during 2012 that Jane and Kevin were abroad.*

Establishing a tax home in a foreign country:

In order to qualify for the foreign earned income exclusion, one must establish a **tax home** in a foreign country. The concept of a tax home can be somewhat tricky. A tax home is defined as the general area of your main place of business or employment. You do not have to maintain your home ("**abode**") in the same area as your tax home. Your tax home is the place where you are permanently or indefinitely engaged to work. You are <u>not</u> considered to have a tax home in a foreign country for any period in which your "abode" is in the U.S.

Revoking the foreign earned income exclusion:

Some people elect to revoke the foreign earned income exclusion. However, once the exclusion is revoked, the person generally cannot utilize the exclusion again for 5 years.

Moving and Educator Expenses

Individuals who move to a different country (for employment-related reasons) can usually deduct moving expenses if they are not reimbursed by an employer. The deduction covers the cost of moving and storage of household goods, and travel/transportation expenses for the household. To qualify for the deduction, you must work full-time for at least 39 weeks during the first 12 months immediately following your arrival in your new job location.

It is important to note that if an individual exercises the foreign earned income exclusion, there will be a reduction in the amount of moving expenses that can be deducted. The reduction is calculated in the following manner:

$$\text{Moving Expenses} \times \frac{\text{Excluded Foreign Income}}{\text{Total Foreign Income}} = \text{Reduction in Deduction}$$

Some individuals are better off exercising the FEIE, foregoing some or all of the moving expense deduction. Others may find it advantageous to hold off on the FEIE, and take the moving expense deduction instead. The decision should be made in context of the income level and makeup of the household.

/Regardless of geography, teachers are entitled to the educator expense deduction. This deduction is worth up to $250, and covers any unreimbursed expenses incurred as an educator (e.g., books, supplies, computer equipment, software, etc.)

Understanding the Foreign Tax Credit

The foreign tax credit (FTC) offsets certain foreign taxes paid against U.S. tax obligations. It is a useful option for high-earning expats who live in a country with higher tax rates than the United States (see tax tables on the next page). Otherwise, the foreign earned income exclusion probably makes more sense. Unlike with the foreign earned income exclusion, there is no bono fide residence or physical presence test required with the FTC.

Taxes paid to other countries qualify for the foreign tax credit when:

- They were levied on your income;
- You were legally obliged to pay them;
- You did pay them;
- You did not gain from paying them; and
- The United States has not sanctioned the country

It is important to note that the FTC is limited to U.S. tax obligations related to foreign income only. The useable credit may not exceed a taxpayer's U.S. income tax liability prorated for the percentage of foreign taxable income to taxable income from all sources worldwide. Any unused FTC may be carried back to a previous tax year, or carried forward to a future tax year. You can carry-back the foreign tax credit to the immediately preceding tax year, or carry-forward the credit for the next 10 tax years.

Tax Rate (2013) for Single

If Taxable Income Is:	The Tax Is:
$0 - $8,925	10% of the taxable income
$8,926 - $36,250	$892.50 + 15% of the excess over $8,925
$36,251 - $87,850	$4,991.25 + 25% of the excess over $36,250
$87,851 - $183,250	$17,891.25 + 28% of the excess over $87,850
$183,251 - $398,350	$44,603.25 + 33% of the excess over $183,250
$398,351 - $400,000	$115,586.25 + 35% of the excess over $398,350
$400,001+	$116,163.75 + 39.6% of the excess over $400,000

Tax Rate (2013) for Married Filing Jointly

If Taxable Income Is:	The Tax Is:
$0 - $17,850	10% of the taxable income
$17,851 - $72,500	$1,785 + 15% of the excess over $17,850
$72,501 - $146,400	$9,982.50 + 25% of the excess over $72,500
$146,401 - $223,050	$28,457.50 + 28% of the excess over $146,400
$223,051 - $398,350	$49,919.50 + 33% of the excess over $223,050
$398,351 - $450,000	$107,768.50 + 35% of the excess over $398,350
$450,001+	$125,846 + 39.6% of the excess over $450,000

Catching Up on Your Tax Filing Obligations

There are numerous U.S. expats who are delinquent on their tax filing and other reporting obligations. The IRS offers two programs to help people catch-up. Furthermore, many U.S. expats utilize an approach known as "quiet disclosure," which we also discuss in this section.

Streamlined Filing Program

The IRS recognizes that many U.S. expats are not aware of their filing obligations, and have not submitted their tax returns or FBARs for many years. The new streamlined program is an attractive opportunity to get caught up with the IRS and avoid penalties.

To be eligible, you must:

- Have resided outside the U.S. since January 1, 2009; and
- Have not filed a U.S. tax return over the same period; and
- Certify that previous failures to file tax returns were non-willful

As of July 1, 2014, the IRS has eliminated certain criteria, which previously had prevented thousands of expats from qualifying for the Streamlined Program.

To file using the streamlined process: (1) submit overdue tax returns for the past three years that are overdue and for the current year, (2) submit electronically any overdue FBARs for the past six years, (3) submit a completed questionnaire for the streamlined program, and (4) enclose payment along with the tax returns.

The streamlined program is specifically for those who are behind in their tax filing requirements. It is not for individuals who wish to amend prior year tax returns.

Important to note: If you apply for the streamlined program but then are rejected, you are automatically disqualified from using the OVDP (see below). Furthermore, there is much higher probability of an audit and financial penalties, given that the IRS now has all your information.

Offshore Voluntary Disclosure Program (OVDP)

With this program, the IRS is offering people with **undisclosed income** from offshore financial accounts an opportunity to get current with their tax returns. The OVDP involves significant paperwork, high penalties and interests. The upside is that individuals can avoid criminal prosecution.

Although we believe that the OVDP is mainly focused on very rich Americans who are evading taxes with offshore accounts, it is nevertheless having a profound impact on U.S. expats around the world. Many who do not qualify for the streamlined procedure opt for OVDP, only to be subject to its hefty requirements. Important to note: As FATCA (see separate section) rolls out, and foreign financial institutions begin reporting information about accounts held by U.S. persons, more and more expats will hit the IRS radar screen.

OVDP Penalties
• 20% accuracy-related penalty • Failure-to-file penalty • Failure-to-pay penalty • FBAR and FATCA penalties (failure-to-file) • Penalty based on account balance – 27.5% of the highest aggregate balance (lesser penalties for low balance and other mitigating circumstances; but a higher 50% penalty if the financial institution is under investigation by the IRS or the Department of Justice)

“Quiet” Disclosure

Under this approach, an individual submits delinquent tax returns and FBARs without utilizing either of the formal programs offered by the IRS. Based on the statute of limitations, up to three years of tax returns are typically submitted. The basic process is the same as if one were to file a tax return the normal way.

When an individual does not owe any taxes and is not required to file an FBAR, this approach makes sense. Sometimes, however, there is a modest amount of taxes owed. The individual can submit the tax return with payment, and hope that the IRS does not assess penalty and interest. This is a gamble – the only thing working in your favor is time (given the statute of limitation).

Then there are U.S. expats who utilize a quiet disclosure to amend previously submitted tax returns. They report foreign investment income in the amended returns, and submit overdue FBARs. Often times, we do not recommend this course of action. The IRS is explicitly going after these types of quiet disclosure.

Recent Statement from the IRS
“The IRS is aware that some taxpayers have attempted so-called “quiet” disclosures by filing amended returns and paying any related tax and interest for previously unreported offshore income without otherwise notifying the IRS…..Those taxpayers making “quiet” disclosures should be aware of the risk of being examined and potentially criminally prosecuted for all applicable years.”

Filing an Extension

U.S. expats receive an automatic 2-month extension to file their tax return with the IRS. Therefore, the deadline for filing U.S. expat tax returns is **June 15th** of each year. To extend the due date to October 15, one should file Form 4868 (the same as in the United States). However, those waiting to qualify for the Foreign Earned Income Exclusion should file Form 2350.

Important to note, an extension to file does not extend the time to pay your outstanding tax obligations. The deadline for tax payments remains April 15. Expats should make an estimated payment along with their extension request to cover taxes owed (if applicable).

Generally speaking, at least 90% of the tax amount due must be paid to the IRS throughout the year. Therefore, U.S. expats should make estimated (quarterly) payments if your employer is not withholding taxes.

FinCen 114 (FBAR) and FATCA

The U.S. government is increasingly interested in knowing about the foreign assets held by its citizens and residents. The **FBAR** (Foreign Bank Account Report) is one of the key reporting requirements that Uncle Sam utilizes in its monitoring efforts. FATCA (Foreign Account Tax Compliant Act) is a second and distinct requirement. U.S. expats often get these two confused with one another.

What are the FBAR requirements?

U.S. citizens, permanent residents and legal entities (e.g., U.S. corporations, partnerships, LLCs) with an interest or signature authority over foreign financial accounts that have an aggregate balance exceeding $10,000 are required to file the FBAR.

- Foreign financial accounts or assets include: banks accounts, brokerage accounts, mutual funds, annuities, life insurance policies with cash value, and indirect interests in foreign financial assets through an entity (if >50% ownership);
- The threshold is met if the aggregate balance (combining all the accounts) exceeds $10,000 at any point during the year;
- The FBAR is a separate from your income tax filing;
- The due date is June 30th of each year (with no extensions)

To complete the FBAR, it is advisable to maintain records of your monthly account balances. Otherwise, the paperwork may become a difficult exercise. Account balances need to be converted to U.S. dollars, using the F/X rate as of the last day of the year. Failure to report (non-willful) carries a penalty up to $10,000. Willful non-compliance potentially raises the penalty up to $100,000 or 50% of the taxpayer's foreign assets (whichever is greater).

New Electronic FBAR (FinCEN 114)

As of July 1, 2013, the FBAR has gone electronic, and is now called FinCEN 114. FYI, the acronym FinCen stands for Financial Crime Enforcement Network.

What are the FATCA requirements?

U.S. persons who receive proceeds from foreign financial accounts that have an aggregate balance exceeding certain thresholds (see below) are required to file Form 8938, which is included with your tax return.

- U.S. persons include citizens, permanent residents, and non-residents that file a joint tax return with a U.S. citizen.
- Foreign financial accounts or assets include: banks accounts, brokerage accounts, mutual funds, annuities, life insurance policies with cash value, and financial interest in a foreign partnership

Thresholds for U.S. Expats	Single	Married Filing Jointly
Account Balance on Last Day of Year, or	**$200,000**	**$400,000**
Account Balance at Any Time During Year	**$300,000**	**$600,000**

The maximum penalty for failing to file Form 8938 is **$60,000 for each foreign asset that you failed to report** (even more onerous than for the FBAR).

FATCA – Intergovernmental Agreements

The U.S. government is busy inking deals with other countries whereby foreign financial institutions (FFIs) will be required to:

- Identify accounts of U.S. persons;
- Report certain information to the IRS regarding those accounts;
- Withhold a 30% tax on certain payments to non-participating FFIs and account holders unwilling to provide the required information

As of the publication of this booklet, roughly 80 countries have either signed intergovernmental agreements with the United States or are in discussions.

State Tax Returns

Many U.S. expats assume that state tax filing obligations go away once they move abroad. Unfortunately, this is not always true. There are certain states that have stiff rules that regulate residency status. California is an example. Some of the factors that determine CA residency include:

- State that issued your driver's license
- State in which you maintain professional license(s)
- State in which you are registered to vote
- Location of banks where you maintain accounts
- Location of your medical professionals, accountants, attorneys

Furthermore, California has an aggressive stance on what constitutes income taxable by the state. Residents are taxed on **all income**. Non-residents are taxed on income from California sources (distributions from pensions and other qualified plans are an exception). Important to note, California <u>does not allow</u> a foreign tax credit or foreign earned income exclusion.

Fortunately, most other states are less aggressive. The best states to have been a resident prior to expatriating are: Wyoming, Washington, Texas, South Dakota, Nevada, Florida and Alaska. None of these collect income tax from their residents (including expatriates from the state).

The rules vary state-by-state. However, leaving dependents or property in most states could keep your residency status tied to that state.