# Foreign Earned Income: Form 2555 Exclusion Reporting and Other Tax Issues for Expat Workers

TUESDAY, JULY 9, 2019, 1:00-2:50 pm Eastern

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# Foreign Earned Income: Form 2555 Exclusion Reporting and Other Tax Issues for Expat Workers

July 9, 2019

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# Foreign Earned Income: Form 2555 Exclusion Reporting and Other Tax Issues for Expat Workers

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# Speaker Biography

Marc J Strohl, CPA (mstrohl@protaxconsulting.com) is a founding Principal at Protax Consulting Services Inc. established 2001, previously with Deloitte & Touche LLP, PricewaterhouseCoopers, and Ernst & Young LLP.

He has more than 20 years of extensive experience specializing in international U.S. individual income taxation issues, as related to individual U.S. expatriates and nonresident aliens or foreign nationals serving individual clients as well as the employees of employer-sponsored programs of multinational public, non-profit companies and professional firms.

Marc is multi state licensed CPA and is a member of the AICPA and NYSSCPA including their International Taxation and Taxation of Individuals Committees. He is a regular contributor to the NYSSCPA's "The Trusted Professional" and blog publications and is featured internationally including in the critically *Thomson Reuters'* Reuters' monthly newsletter publications *Journal of International Taxation* and *Practical Tax Strategies*, replacing their publication *Practical International Tax Strategies*.

Marc's concise and informative, industry benchmark authoritative executive summary tax articles regarding U.S. Expatriate and Foreign National-Nonresident and/ or Resident Aliens tax are world renown and standard issue at the big 4 to staff and clients.

In addition to being a regular speaker at the NYSSCPA - FAE Technical Sessions and Committee Conferences, Marc is a frequent external speaker on U.S. international individual taxation matters and featured faculty at *CCH Wolters Kluwer*, *Lawline.com, Furthered* and *Strafford Publications* providing online C.P.E. and C.L.E. education courses to CPA's and Attorney's worldwide.

He earned a Master's degree in Public Accountancy from McGill University, Montreal, Canada and a Bachelor of Science Honoring in Chemistry.

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# Speaker Biography

Stephen Flott (sflott@flottco.com) advises on international business and tax matters, including taxation of US citizens living outside the United States, Mr. Flott also advises on US citizenship, including expatriation and its associated tax issues, and compliance challenges associated with non-filing of US tax returns and financial reports.

He began practicing law in Toronto in 1975. In 1978, he became the chief operating officer of the Ontario Trucking Association. In 1983, he was a founding partner of the Trade & Transportation Group, and in 1984, moved to the US to open its office in Washington, DC.

After completing a graduate degree in law at George Washington University in 1986, he worked at two US law firms, primarily dealing with domestic and international shipping and tax issues before founding the firm, which has since evolved into Flott & Co. PC, in January 1990.

Mr. Flott was admitted to the practice of law in the Province of Ontario (with honors) in 1975, the District of Columbia in 1987, State of Maryland in 1988; and the Commonwealth of Virginia in 1997. He is a member of the tax sections of the American and District of Columbia Bar Associations.

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# U.S. Taxation System

➢United States (U.S.) Resident Aliens, include the following categories:

1. U.S. Citizens
2. Green Card Holders (Legal Permanent Residents) and
3. U.S. visa holders meeting Substantial Presence Test (SPT)

✓In the U.S. Category (1) and (2) resident aliens are U.S. taxable on their worldwide income indefinitely, category (3) for as long as they continue to meet the SPT on an annual basis, therefore they are not the main focus of this seminar.

✓Most countries worldwide assess local taxation based upon “tax residency”, not legal immigration status as in the U.S.

✓Where “tax residency” in other countries is generally severable based upon a variety of facts and circumstances, e.g.: (i) permanence and purpose of stay abroad, (ii) personal property & social ties, (iii) disposition of spouse, dependents and dwelling and (iv) the establishment of residence ties elsewhere.

✓U.S. state requirements re. residence vary from state to state, but typically involve domicile facts and circumstance tests and/ or a statutory residence tests, as in New York State.

# The U.S. Expats Three Options

➢When U.S. resident aliens live and work outside the U.S., we call them Expatriates or Expats. There are three ways U.S. expats can avoid double taxation:

1. The Foreign Earned Income Exclusion (FEIE)
2. The Foreign Housing Exclusion (HE) (if employed) *or* Foreign Housing Deduction (HD) (if self–employed) and
3. The Foreign Tax Credit (FTC)

✓The FEIE, HE and HD under categories (1) and (2) above are contained in IRC Sec 911, the FTC under category (3) above is found in IRC Sec 901 and further guidance is available in IRS Publication 54- Tax Guide for U.S. Citizens and Resident Aliens Abroad.

✓To solve the double taxation inequity to U.S. expats (U.S. tax treatment versus that of other countries, as above) the U.S. introduced tax laws that mitigated the effects of U.S. taxation since tax residency could not be severed.

# The FEIE

➢**Foreign Earned Income Exclusion (FEIE)** is currently set at $105,900 for 2019 ($103,900- for 2018, $102,100- for 2017, $101,300- for 2016, $100,800- for 2015, $99,200- for 2014, $97,600- for 2013, $95,100- for 2012, $92,900- for 2011 and $91,500- for 2010.)

✓FEIE is claimed using the IRS 3 page Form 2555, Foreign Earned Income, broken out by Part I page 1- General Information, Parts II & III pages 1 and 2- qualification tests, Parts VI, VII, VIII and IX page 3- FEIE calculation and includes the HE and HD calculation.

✓FEIE is an election that allows U.S. expats the ability once the earned income is included in their tax return as either wage or self-employed income, to then exclude it on Form 1040 line 21, using Form 2555.

✓The FEIE is pro-ratable in partial (non full calendar- years of expatriation and repatriation) years residing abroad, based upon the number of days in that calendar year residing abroad over 365 (366 leap year) days.

✓May not file Form 2555 with Form 1040 until all tests are met- THT and either the BFR or PPT. Taxpayers may, therefore, be required to substantially delay their U.S. tax filings until such time as both tests are met. Form 2350 , Application for Extension of Time to Filer U.S. Income Tax Return, would be the extension form to employ in these circumstances.

✓Additionally IRS Form 673 , Statement for Claiming Exemption From Withholding on Foreign Earned Income Eligible for the Exclusion(s) Provided by Section 911, may be used by expatriates as a payroll (similar to Form W-4) form to avoid the withholding of U.S. taxes on foreign earned and thus excludable income- up to first $105,900 for 2019 + HE and HD.

✓May revoke (go back and cancel after first claiming) the FEIE by an amended filing for any tax year, separately by year, with white paper statement. Certain positions are deemed revocations, see Rev. Ruling 90-77, when FTC but no FEIE claimed. Revocation once made, effective for all subsequent years, may not claim without Commissioner's consent until sixth tax year following tax year revocation first became effective.

# The FEIE

➢What it all means- The 'F' in FEIE:

✓*'F' in FEIE- Foreign-* means non U.S. sourced income. The sourcing of earned income is dependent on where the related services are physically performed, by workdays. Therefore, earned income may be allocable between U.S. and Foreign workdays.

a. Wages, bonus, options are *always* allocable between U.S. and foreign workdays.

b. Compensation items generally considered *100% foreign always*- would not arise unless on foreign assignment, therefore, specifically related to foreign workdays only:
   i. Quarters,
   ii. Home leave,
   iii. Education,
   iv. COLA,
   v. Hardship premiums,
   vi. Moving expenses,
   vii. Tax equalization or protection.

✓Rev. Ruling 69-238: IRS position is that all compensation is based on workdays, unless employer pays an item of compensation related specifically to the foreign workdays.

# The FEIE

➢What it all means- The ‘F’ in FEIE- Determining U.S. versus Foreign:

✓When determining your total workdays, general convention is that standard workdays is 20 workdays per month and 240 workdays per annum.

✓This assumes standard vacation (14 workdays) and holiday (7 workdays) but no weekends worked. Adjustments may, therefore, be required to standard. However, you should encourage your clients to go through their calendar to determine actual workdays, in case of an IRS audit and the resulting required substantiation.

✓A vacation day worked is a workday. A sick day is not a workday. A leave of absence is not a workday. A holiday or vacation day is not a workday. A weekend day worked is a workday. Days on your laptop or Blackberry intermittently with clients are not workdays, these are expected in these times.

# The FEIE

➢What it all means- The 'EI' in FEIE:

✓'EI' in FEIE- Earned Income- means:

a. Wages or
b. self-employed income,

✓ May also include:

a. Business profits and
b. Royalties and Rent

✓But never:

a. Pension,
b. Annuity,
c. Social security benefit,
d. U.S. government wage income,
e. Other income such as
    a. Alimony,
    b. Prizes and gambling winnings
f. Income from property such as:
    a. interest,
    b. dividend and
    c. capital gain income.

# Stacking

- Effective January 1, 2006 as amended by IRC Sec. 515 of the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA)- “Stacking” drives up expat income taxes.

- Up to December 31, 2005 the excluded income was not considered in the graduated rate system to determine the tax on the unexcluded income. Such that the next dollar earned overseas was treated as though it were the first dollar of income and taxed at the very lowest tax bracket.

- New “Stacking” law results in the next dollar of income taxed at a much higher marginal rate of tax, since the stacking feature assumes that the excluded foreign earned income is actually present for tax calculation purposes.

- Thus, effectively using the tax bracket in which it would have been taxed had the excluded foreign earned income actually been present for tax calculation purposes.

- Resulting in the taxpayer being pushed into an initially higher starting tax bracket.

- The implementation of the ‘stacking” mechanism results in two additional obvious factors in addition to a tax grab: 1) The usefulness or effectiveness of the foreign tax credit (FTC) and 2) the potential for the FTC carryover, are both diminished.

## Who Qualifies for the FEIE

- To qualify for the FEIE a taxpayer must meet two tests:
  - 1) the Tax Home Test (THT) and
  - 2) Either:
    - a) Bona Fide Residence Test (BFR) or
    - b) Physical Presence Test (PPT).

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## Tax Home Test (THT)

- **Tax Home Test (THT)** requires taxpayers to have their 'Tax Home' in a *foreign country* for a full 12 fiscal month period.

- Tax Home- defined:

a) *Main place of business*, employment or post of duty. Place where you are permanently or indefinitely (must be in excess of one fiscal year) engaged to work. Employee or self-employed person, or

b) *Tax home is a place where you regularly live*, if no regular or main place of business, or

c) *Tax home is where you work*- itinerant- no main place of business, no place where you regularly live.

Tax home is not residence or domicile- Place you always intend to return to whenever you are away.

# Tax Home Test (THT)- Continued…

➢**Tax Home and Abode**:

✓Tax home and domicile are connected *only* by the definition of *abode*.

✓U.S. Abode could disqualify the THT, as you are *not considered to have a tax home in a foreign country for any period of time in which your abode is in the U.S.:*

a. Abode is a home, habitation, residence, domicile or place of dwelling. It does not mean your principal place of business. "Abode" has a domestic rather than a vocational meaning and does not mean the same as "tax home." The location of your abode often will depend on where you maintain your economic, family, and personal ties.

b. Not considered to have a tax home in a foreign country for any period of time in which your abode is in the U.S.

c. IRS holds (developed through case law) that "alternating blocks of time" or "rotational XX days on/ XX days off scheduling" in the U.S. constitutes a U.S. abode.

d. No U.S. abode while temporarily in the U.S., define temporary?

e. Abode is not in U.S. merely because you maintain a dwelling in the U.S. even if inhabited by your family- spouse and dependents. As such the FEIE is per spouse.

# Bona Fide Residence Test (BFR)

➢**Bona Fide Residence Test (BFR)** requires taxpayers to have their 'Bona Fide Residence' in a *foreign country* for a full calendar year. That is January 1 to December 31.

✓Strictly a qualitative test.

✓For U.S. citizens or U.S. resident aliens which are nationals of countries the countries of which have an income tax treaty with the U.S. containing a non-discrimination clause, without regard to the savings clause in the treaty (Rev. Ruling 91-58).

✓Not necessarily your domicile, where domicile is your permanent home, the place that you always intend to return.

✓BFR not automatically acquired by living or working in a foreign country(s) for one year or longer. Factors include:

a. Length of stay
b. Nature of the job
c. Intention and
d. Purpose

✓BFR is determined on a case by case basis . See next slide.

✓Once acquired, you may leave the foreign country for brief or temporary trips to the U.S., however, to maintain BFR status you must have the clear intention of returning to your foreign country BFR from such trips without unreasonable delay. Suggest obtaining return ticket to return overseas upon departure.

# Bona Fide Residence Test (BFR)

➢ **Bona Fide Residence Test (BFR)**

✓ BFR is determined on a case by case basis.

✓ The IRS makes this determination based upon the filing of Form 2555 and does have the right displayed by recent court cases to employ case law/ Technical Memo released 2/13/09 to restrict use- rare but must be considered.

✓ IRS may perform an analysis of the specific facts and circumstances, since IRC Sec 911(d)(1)(A) requires that a taxpayer establish bona fide residence to the "satisfaction of the Secretary".

✓ Courts have construed this statutory language as imposing a "strong proof" standard on taxpayers to demonstrate residence in a foreign country as opposed to the lesser preponderance of evidence standard for proving 'tax home' status.

✓ Schoneberger v. Commissioner, 74 T.C. 1016, 1024 (1980) as an example of Court opinions that have provided guidance for determining bona fide residence by focusing on factors, such as:

1. Taxpayer intention;
2. Establishment of a home temporarily in the foreign country for an indefinite period;
3. Participation in community activities on a social and cultural level, general assimilation;
4. Physical presence in foreign country consistent with employment;
5. Nature, extent and reasons for temporary absences from foreign home;
6. Assumption of economic burdens and payment of foreign taxes;
7. Status of a resident of the foreign country as contrasted to that of a transient or sojourner;
8. Treatment of taxpayer's income tax status by employer
9. Marital status and residence of family;
10. Nature and duration of employment; prompt accomplishment within definite or specified time;
11. Good faith making trip abroad- tax evasion?

## Physical Presence Test (PPT)

➢**Physical Presence Test (PPT)** requires taxpayers to maintain 330 full days (a full day is a complete twenty-four hour period) of presence abroad in a *foreign country* out of any 12 month, 365 day (366 leap year) fiscal consecutive period.

✓Strictly a quantitative test, no further considerations are required.

✓For U.S. citizens or U.S. resident aliens. *No* income tax treaty with the U.S. containing a non-discrimination clause required.

✓Must be 330 FULL days in a foreign country, that is days that are full 24 hour periods. Any second of any day not spent in a *foreign country* (i.e.- in the U.S. or in or over international waters or airspace) disqualifies that entire day from the 330 day count.

## IRC Sec 911- 'Foreign Country' Defined

➢ **'Foreign Country'** is defined as any territory under the sovereignty of a government other than the United States.

✓Does not include ships or aircraft traveling in or above international waters. Nor does it include offshore installations which are located outside the territorial waters of any individual nation.

✓Additionally, includes the country's airspace and territorial waters, in addition to the seabed and subsoil of those submarine areas adjacent to the country's territorial waters over which it has exclusive rights under international law to explore and exploit the natural resources.

✓Does not include Antarctica or U.S. possessions such as:

a. Puerto Rico,
b. Guam,
c. The Commonwealth of the Northern Mariana Islands,
d. The US Virgin Islands and
e. Johnston Island.

# PPT over BFR

➢ **PPT over BFR-** What factors to consider:

✓Typically the PPT is used in years of transition, that is, in both years of expatriation and in years of repatriation.

✓PPT places an advantage over BFR in these transition years for two reasons:

**a.** **Slide days-** if up to the point of expatriating or repatriating the taxpayer has been in a foreign country for more than a full 330 full days in the 12 month fiscal consecutive period under PPT, there is opportunity to use those 35 (36 leap year) or less days (365 (366 leap year) consecutive period less the 330 days required to meet the test) as slide days to increase the total days abroad for the purposes of calculating PPT. -

Accomplished by either sliding the taxpayer back (expatriating) or ahead (repatriating) respectively by those 35 (36 leap year) or less days.

It is, therefore, prudent planning in the expatriating and repatriating years to limit the days back to the U.S., so that these potential 35 (36 leap year) slide days can be optimized to obtain excess FEIE; results in $105,900 for 2019 /365 x 35 slide days= $10,155 of extra FEIE.

**b.** **Quicker filing-** in transition expatriating years meeting the BFR test will encompass waiting for a full calendar tax year to elapse subsequent to the date of U.S. departure and prior to filing that year's tax return. Whereas, using the PPT test, if the qualifications are met, may allow for a U.S. tax filing in advance.

**c.** **Green card holders-** who are nationals of countries the countries of which do not have an income tax treaty with the U.S. containing a non-discrimination clause, without regard to the savings clause in the treaty (Rev. Ruling 91-58)

# Foreign Housing Exclusion (HE) and Deduction (HD)

➢ **Housing Exclusion (HE) versus Housing Deduction (HD)-** HE is used when individual assignee is employed, HD is used when individual assignee is self- employed.

✓Claimed using IRS Form 2555 page 3, Part(s) VI, VII, VIII and IX.

✓Opportunity to augment FEIE by an overseas taxpayer's reasonable qualified foreign housing expenses. Where reasonable= not lavish or extravagant.

✓Qualified foreign housing expenses (actual foreign housing expenses, not allowances) are typically much higher than a taxpayer's taxable employer paid housing income, allowance, or quarters.

✓Often overlooked by practitioners.

✓Does *not* matter who pays for these qualified housing expenses. Regardless of whether the employee directly pays for these costs or the employer directly pays (or reimburses the employee), these costs are still includable as qualified foreign housing costs for determining the HE or HD.

✓However, these costs may also need to be included in the taxpayer's employment income as taxable compensation. Or may be for convenience of the employer on the employer premises, as in a man camp and not considered taxable compensation.

✓If a taxpayer maintains a separate second abode outside the U.S. for his/ her spouse and dependents and they do not reside with him/ her because of living conditions which are dangerous, unhealthful or otherwise adverse (e.g.: residing on employer premises- construction site, drilling rig…where not feasible for employer to provide housing for family) then they shall take into account this second abode qualified housing expenses also. May only have one second abode.

# Foreign Housing Exclusion (HE) and Deduction (HD)- Continued…

- Qualified Foreign Housing Expenses include:

  a. Rent,

  b. Fair Market Value (FMV) of employer provided housing,

  c. Foreign real-estate or occupancy taxes, TV taxes,

  d. Utilities (but not telephone),

  e. Real or personal property insurance,

  f. “Key” money or other similar nonrefundable deposits paid to secure a lease,

  g. Repairs and maintenance,

  h. Furniture rental,

  i. Temporary living expenses, and

  j. Residential parking.

# Foreign Housing Exclusion (HE) and Deduction (HD)- Continued…

- The Base/ Deductible or "Housing Norm" and the Cap:

✓Effective January 1, 2006 as amended TIPRA provides for two changes regarding the HE and HD:

**a.** **Base (or deductible)** representing the amount that needs to be exceeded before any qualified housing costs are excluded or deducted, effective January 1, 2019 has risen from $45.55 per day or $16,624 for a full 365 days for 2018 **to** $46.42 per day or $16,944 for a full 365 days for 2019.

Represents 16% of the amount of the FEIE or $105,900 for 2019 ($103,900- for 2018).

***b.*** ***New* cap** on the total qualified housing costs eligible for consideration for either the HE or HD. TIPRA introduced the cap for the first time. This cap had not existed prior to January 1, 2006.

Represents 30% of the FEIE of $105,900 for 2019 ($103,900- for 2018) or for 2019 $31,770 (30% * $105,900). For 2018- $31,170 ($103,900* 30%).

Therefore, the maximum excludable or deductible qualified housing expenses is the cap of $31,770 less the deductible of $16,944, which equals $14,826 or $40.62 per day for a full 365 days.

Further to the ratification of TIPRA, the IRS continues to issue Notice(s) as for 2018- IRS Notice 2018- 33 released April 23, 2018, later replaced by 2018-44 issued May 2, 2018- which allows for certain cities (of 52 countries worldwide) with very high housing costs a higher overall exclusion cap, effectively overriding the 30% limitation on the FEIE of $30,770 2019 cap. May elect to apply 2019 adjustments once released presumably March/ April 2019 to 2018 tax year, in lieu of the adjusted 2019 adjustments if 2019 limitations are higher.

# FEIE- BFR/ PPT, HE and HD

➢**Waiver of Time Requirements- IRC Sec 911(d)(4):**

✓The BFR and PPT minimum time requirements can be waived if you must leave a foreign country because of war, civil unrest or similar adverse conditions in that country.

a. Must be able to show that you could reasonably have expected to meet the minimum time requirements if not for adverse conditions,
b. Have your home in a foreign country and
c. Be a bona fide resident of or physically present in the foreign country on or before the beginning of the waiver

✓ IRS publishes list of the only countries that qualify for the waiver and effective dates.

✓ If you left one of those listed countries and can qualify under BFR or PPT without meeting the minimum time requirements you will qualify.

✓ However exclusions calculated using days of actual residence only, attaching a white paper explanation statement.

➢ **U.S. Travel Restrictions- IRC Sec 911(d)(8):**

✓If you are present in a foreign country in violation of U.S. law, your BFR, PPT, FEI and Housing Expenses are treated as not existing.

✓For 2014 the only restricted travel is Cuba (not Guantanamo Bay U.S. Naval Base), for all of 2016.

✓Revenue Ruling 2005-3 and Notice 2003-52 removed Iraq and Libya from the U.S. Travel Restriction list

# Employed versus Self- Employed

➢Employed Versus Self-Employed (SE)- persons on foreign assignments generally, have two distinct advantages over being self-employed (SE).

a. *Eliminated under TCJA 2017 ~~Foreign~~* ~~unreimbursed employee expenses will be excluded from Schedule A therefore not affecting the amount of the FEIE claim;~~ conversely, all overseas SE person's Schedule C *foreign* expenses and applicable *foreign* self-employed adjustments e.g. ½ the SE tax, the SEHI deduction, etc dollar for dollar reduce the amount of the FEIE available.

b. A SE person's net SE income is subject to U.S. FICA where SE persons additionally end up paying both the employee and employer portions at 15.3%. Which is always assessable if net income on Schedule C arises, since SE FICA taxes are *not* affected by the FEIE and HD. However, persons *employed* abroad and not on U.S. payroll, but instead locally hired on a foreign payroll are not subject to U.S. employee FICA taxes at all. They would become subject to the social security tax regime of the respective country in which they work, if any.

✓IRS always views the *substance over legal form* of an employee-employer or master-servant relationship under common law definition to hold.

✓Consider IRS Revenue Ruling 87-41- twenty point analysis.

✓If they work for a foreign corporation then there are no U.S. SE or FICA tax implications.

# Employer versus Self- Employed- Continued…

➢Employed Versus Self-Employed (SE)- ways out of Self-Employment….

✓Where above does not apply also consider :

a. Totalization/ Social Security Agreements ,
b. Foreign or a third party payroll,
c. Client payroll,
d. Non-related person owning a foreign entity or
e. Doing business directly through a foreign entity.

✓With above consider additional U.S. reporting requirements:

a. Form 5471- Information Return of U.S. Persons with Respect to Certain Foreign Corporations,

b. Form 8865- Return of U.S. Persons with Respect to Certain Foreign Partnerships,

c. Form 8858- Information Return of U.S. Persons with Respect to Certain Foreign Disregarded Entities - may come into play along with, and

d. Form 926- Return of a U.S. Transferor of Property to a Foreign Corporation.

## ~~Moving Expenses~~ Eliminated under TCJA 2017

➢**~~Foreign Moving Expenses~~**~~- Any moving expenses whether employed or self-employed, if claimed and to the extent that they are considered *foreign* moves, would also reduce dollar for dollar the amount of the FEIE available on Form 2555 Part VIII line 44.~~

—

✓~~Moves back to the U.S. are *not* considered *foreign*, whereas moves U.S. to foreign and foreign to foreign are considered *foreign* moves.~~

—

✓~~Consider the need to add employer direct paid or reimbursements to foreign or U.S. wages.~~

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# FTC

➢**Foreign Tax Credit (FTC)** claimed domestically using IRS Form 1116, Foreign Tax Credit, and also included in most federally negotiated international income tax treaties (typically OECD Model Article XXIV- Elimination of Double Taxation), to avoid double tax.

✓There is a separate FTC for passive income and for general limitation income categories (wage/ SE income), where for general limitation category there is a reduction or scale down in respect of both excluded foreign tax and excluded foreign income. i.e. taxpayers may not claim a FTC on income that has already been excluded on Form 2555.

✓Amount of foreign income and tax eligible for the FTC must both be scaled down for excluded income, as above.

✓As a result of the FTC, taxpayers are always protected and *theoretically* should never pay double tax on their worldwide income. However, the FTC calculation is limited to the lower of the actual foreign tax paid or the U.S. tax on that foreign income. If the U.S. tax on that income is less and is calculated using the average rate (versus marginal) of U.S. tax this may obviate perfect integration.

✓For this reason and “stacking” below, it is always suggested and preferable to maximize the available exclusions prior to using the available FTC.

✓Please see above slide on the effects of "Stacking“ – the “stacking” mechanism results in: 1) The usefulness or effectiveness of the foreign tax credit (FTC) and 2) the potential for the FTC carryover are both diminished.

✓Effective January 1, 2005 there is no longer a 90% limitation on the Alternative Minimum Tax (AMT) FTC. Therefore when in AMT it is now possible to achieve a full U.S. FTC against U.S. income tax and reduce the U.S. tax liability to nil when there is no U.S. source income.

# FBAR Form 114

## ➢ FBAR- FinCEN Form 114 - & Schedule B Part III

- ✓ All United States (U.S.) persons (under IRC Sec 7701(b)) having a financial interest in or signature authority over any foreign (non-U.S.) financial accounts with aggregate (not individual) fair value balances exceeding $10,000 USD. at their (individual) highest point in the tax calendar year, MUST report such relationships to U.S. Treasury by e-filing as at April 15 of each succeeding filing tax year deadline, similar to tax return deadlines. Extendable.
- ✓ Define Financial interest- owner of record, holder legal title, even if held for benefit of other person, - agent, nominee, directly or indirectly owns 50%+ by value/vote, profits/ capital of any corporation or partnership respectively or for Trusts- grantor, 50+ beneficial interest in assets or income.
- ✓ Define Foreign Accounts- includes/ not limited to- any Foreign bank or any securities, Foreign insurance policy or annuity policy with cash surrender value, a Foreign account with gold bullion, but not a Foreign Defined Benefit plan or Employer Sponsored pension plan.
- ✓ FBAR penalties for failure to disclose the required information to U.S. Treasury may result to the client in civil penalties for non-willful violations of $10,000 per account, and willful violations the greater of $100,000 or 50% the value of the account and / or criminal penalties.
- ✓ Minors also are responsible for filing FBARs, if the minor cannot file his or her FBAR for any reason the minors parent, guardian or other legally responsible person must file and sign it on behalf of the minor
- ✓ Under the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 Starting for tax season 2016, the 2017 calendar tax year the FBAR is due on the same due dates as the personal tax return filing April 15, and now extendable for the first time.
- ✓ Regarding extensions of time to file- There are current discussions, an AICPA comment letter on how such mechanisms may work

# FATCA Form 8938

- **The Foreign Account Tax Compliance Act (FATCA)-**

was enacted under HIRE (Hiring Incentives To Restore Employment Act) in 2010 by Congress and signed into law on March 18, 2010 by the president to target non-compliance by U.S. taxpayers using foreign accounts.

- Two Primary FATCA Requirements:
  - Foreign financial institutions are annually required to report directly to the U.S. government information about financial accounts held by U.S. taxpayers, or held by foreign entities in which U.S. taxpayers hold a substantial ownership interest and
  - U.S. taxpayers with specified foreign financial assets that exceed certain thresholds must report those assets to the IRS annually on an information return.

✓ Effective 2011 for individuals, requires the reporting with Form 1040 on Form 8938- Statement of Specified Foreign Financial Assets- (FFA's) (in addition to the FBAR reporting requirements) of U.S. resident aliens (Defn. under IRC Sec 7701(b) or 6013 or 301.7701(b)-7(a)(1)- TTB) whose total value of foreign financial assets exceed an applicable 'reporting thresholds'.

✓ Filing thresholds:-

-Single/ MFS/HOH- More than $50,000 ($200,000 live outside U.S.) on 12/31/18 or more than $75,000 ($300,000 live outside U.S.) at any time in 2018.

-MFJ- more than $100,000 ($400,000 live outside U.S.) on 12/31/18 or more than $150,000 ($600,000 live outside U.S.) at any time in 2018.

# FATCA Form 8938

✓Specified Foreign Assets include:-

✓1) FBARs and

✓2) Personally held foreign assets:- i) non U.S. stocks,

✓ii) interest (capital or profits) in foreign entities- partnership, corporation or trust/ estate and/ or

✓ii) non U.S. issued financial instruments or contracts, i.e. notes, bonds, debentures issued by foreign person or interest rate/ currency/basis/equity/equity index/credit default- swaps, interest rate floor or similar agreements with foreign counterpart, options, or other derivative instruments with foreign counterparty or issuer.

✓Does not include Real estate, cash, foreign currency, art or collectibles, safety deposit box

✓No Duplicate Reporting:

- ❖ No Form 8938 reporting of FFA if reported on Form(s) 3520, 3520-A, 5471, 8621, or 8865.

✓No income tax filing requirement, therefore no Form 8938 requirement, even if you exceed the threshold testing requirements,

✓Failure to file penalties- similar to FBAR penalties.

## Immigration vs. Tax Law

- **Do Not Play Immigration Attorney!!!**

- ✓ Must plan in consort with taxpayer immigration attorney;
- ✓ INA- tightly worded document subject to interpretation;
- ✓ Three immigration attorneys, 10 different opinions;
- ✓ Need for green card waiver- white paper passport- since presumption that while in possession of a green card taxpayer resident in U.S.;
- ✓ Could result in revocation at border crossing, very common these days with certain border crossing infamous for revocation, detention and return;
- ✓ So ask immigration attorney- BFR or PPT or FTC only, must be mindful of immigration pitfalls;
- ✓ Form N-400- Application for Naturalization- must certify that taxpayer did not claim non-residence of Federal (U.S.), State or Local income tax filing.

## Other Tid Bits of Information-

a. **SOFA- North Atlantic Treaty Status of Forces Agreement-** employees of private companies that in turn are under contract with the U.S. Armed Forces and covered by SOFA or a member of a "Civilian Component" of SOFA, have agreed that their employees are not resident of that foreign country. As a result, their employees may not claim BFR. Result is that on Form 2555- Part II- Question 13(a) you must check *Yes* and 13(b) will always be *No*, as such by default BFR may not be used. However, PPT may be still be used to qualify for the FEIE.

b. **Closing agreement-** As a condition of employment, the taxpayer may have signed a closing agreement with their employer, wherein they agreed to waive their rights to elect the FEIE. Common where taxpayer works for major defense contractor who in turn has executed an agreement with the foreign government and Department of Defense whom in turn alerts the IRS that their employees are not subject to local country tax. As such, as a condition they may not claim the FEIE.

c. **FEIE, HE and HD-** are elective and should not be used when they trigger income inclusion. This would occur where Schedule C expenses outstrip income and these expenses are added back to actually create income.

d. **Cannot pick and choose-** income that you wish to exclude and income for which you elect not to exclude. It is an all or nothing approach.

## Other Tid Bits of Information - Continued…

e. **Abode-** If the taxpayer ends one foreign assignment and continues with another foreign assignment abroad, then this will not affect either the tax home or BFR or PPT tests. However, if the taxpayer happens to pack up their belongings and move back to the U.S. (transferring their abode back to the U.S.) for work in the U.S. during this interim period, then the taxpayer has forgone either or both the THT and/ or BFR tests, not to mention the PPT. And the taxpayer may need to re-qualify for these tests- please see discussion on slide above.

f. **No U.S. source income-** Theoretically, if the taxpayer has no U.S. source income, then using the FEIE, HE, HD and FTC, the U.S. tax liability should be NIL.

g. **Other deductions-** Since U.S. resident aliens are taxable on their worldwide income, they are also able to deduct their worldwide deductions. This would include foreign mortgage interest. Eliminated under TCJA 2017- ~~real estate taxes and other. However, as above, the ability to deduct foreign unreimbursed employee expenses on Schedule A is prevented when the FEIE is used to the extent the income to which the deductions relate is excluded. No double dipping.~~

# Other Tid Bits of Information - Continued…

**h.** **FTC-** There is an option to use either the accrued basis or paid basis to record foreign taxes for the purposes of calculating the FTC. As a general rule, the paid basis is used if the foreign tax cycle is a calendar year tax cycle analogous to the U.S. and the accrued basis if the foreign tax cycle is a fiscal tax year, unlike the U.S. tax system.

The accrued election forces recognition of the foreign taxes for U.S. tax purposes by looking at the U.S. calendar year in which the foreign fiscal year-ends. Thus, the need to calculate the individual withholdings separately or allocate subsequently received refunds is obviated. However, once elected the accrued method must continue to be used indefinitely. Furthermore, the accrued basis may be dangerous, because it creates series of mismatching or timing differences of foreign tax to foreign income. While it provides tax relief in the last assignment year abroad, it can be tax costly in the first year. So, there are pros and cons to the accrued basis. Please also consider foreign tax credit carry back options.

**i.** **Totalization/ Social Security Agreements-** If the U.S. has federally negotiated a Totalization or Social Security Agreement with the country wherein the taxpayer is employed or self-employed, there may be an opportunity to obtain a retroactive Certificate of Coverage to ensure that taxpayers can continue to pay in to the U.S. or foreign social security system for a specified maximum number of years to receive full benefit for your social security contributions on earnings abroad in either the U.S. or foreign country. Please visit http://www.ssa.gov/international/ to determine if such an agreement exists in your circumstances.

**j.** **Automatic extension-** Taxpayers outside the U.S. on April 15 of any tax year automatically qualify for an extended filing deadline of two months to June 15. You should write “Taxpayer Abroad on April 15” on the top of your extension Form 4868- Application for Automatic Extension of Time to File U.S. Individual Income Tax Return- which grants an extension of time until October 15 to file.

## Other Tid Bits of Information - Continued…

**k.** **Additional two month extension-** In addition to the automatic 6-month extension to October 15 (Form 4868), taxpayers who reside outside the U.S. (ambiguous) may request (by the extended October 15 due date) a discretionary extended filing deadline of an additional two months to December 15, under IRC Sec 6081(a) and Reg. Sec. 1.6081-1(a) on white paper statement listing out taxpayers

**l.** **Statutory limit-** Although there is a statutory three year limit with respect to claiming refunds, there is no statutory limit on the filing of an original claim of FEIE or to an amended filing where the FEIE is being claimed for the first time. For example, a taxpayer who failed to claim the benefits of the FEIE, HE or HD 10 years ago may still make the claim.

**m.** **Sale of Principal residence**- Unaffected by TCJA 2017- IRC Sec 121- In the five year window prior to sale of your principal residence you must have: 1) owned *and* 2) used or lived in the home for at least two years ( 24 months or 730 days) for both spouses to qualify for the $250,000 per spouse exclusion of gain. The two years for the owned and use test do not have to be the same two years within the five years prior to sale.

If you do not have the two years for both tests, you will not qualify for the exclusion unless you have one of three 'primary reasons' that includes: change in location of employment, health reasons or unforeseen circumstances.

## Other Tid Bits of Information - Continued…

**m. Sale of Principal residence**-

For each of the three 'primary reasons' you would look at i) specific primary reason "safe harbors" and/ or ii) individual facts and circumstances for the primary reason, including such factors as: close in time, owned & used at time of specific primary reason, primary reason not reasonably foreseeable, material change in impairment of financial ability to maintain, use during ownership.

Safe harbors for change in location of employment (focal point of this session) (where employment includes new or continuing employment or self employment) include where change occurred during period of ownership and use of main home.

As such a U.S. expatriate who moves to a foreign country and continues to maintain their U.S. main home subsequently renting it out and selling it years after expatriating abroad, will still qualify under the change in location of employment primary reason.

The obvious handicap for expats is that, although they usually meet the two year test for ownership, they do not usually meet the two year test for use.

If the home is *not* your "main home" or principal residence or you do not meet the above tests and you have held it for more than one year, then the gain would be taxed at the long term capital gain rate, which is currently 15% and maybe 20% starting January 1, 2013 for taxpayers in the new 37% bracket.

## Other Tid Bits of Information - Continued…

**m. Sale of Principal residence**- Cont.…

*Non-qualified use*-In the calculation of the gain from the sale or exchange of the principal residence the pro-rata portion of the gain attributable to non-qualified use in tax years 2009 or later, where neither you nor your spouse used the property as a main home, within certain exceptions will not be excludable under the above rules

An exception, however to the above is any portion of the 5-year period ending on the date of the sale or exchange after the last date you or your spouse used the property as your main home. In practicality what this means is that if there is any rental use during the 5 year window prior to sale, this rental period use it is NOT considered non-qualified use and the gain would not have to ne pro-rata apportioned between qualified and non-qualified use.