U.S. EXPAT TAX GUIDE

TAX SAMARITAN'S INDISPENSABLE GUIDE TO HOW U.S. TAXPAYERS ABROAD CAN SAVE ON THEIR TAXES AND KEEP THE IRS & STATE TAX AUTHORITIES HAPPY

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TAX SOLUTIONS & WEALTH MANAGEMENT

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DO I NEED TO FILE A TAX RETURN?

As a U.S. citizen or resident living abroad, you can determine whether you need to file a tax return by considering three factors:

1. Your **gross income**: includes all income you receive in the form of money, goods, property, and services that isn't exempt from tax. It also includes income from sources outside the United States (in other words **all worldwide income**).

2. Your **filing status**: Your filing status depends on whether you are single or married and on your family situation. Your filing status is determined on the last day of your tax year, which is December 31 for most taxpayers.

3. Your **age**. If you are 65 or older at the end of the year, you generally can have a higher amount of gross income than other taxpayers before you must file. You are considered 65 on the day before your 65th birthday. For example, if your 65th birthday is on January 1, 2016, you are considered 65 for 2015.

To find out if you must file, you will want to refer to Table 1-1, Table 1-2 and Table 1-3 of IRS Publication 17, which is available on the IRS website.

Worldwide Income and Citizenship-Based Taxation

The United States is the one of the only countries that taxes worldwide income for all of its citizens, no matter where they live and regardless of how long they have been overseas.

Thus, if you are a U.S. citizen or resident alien, the rules for filing income, estate, and gift tax returns and paying estimated tax are generally the same whether you are in the United States or abroad. This is affectionately known as the “citizenship-based” income tax.

Elsewhere in the world, the basic rule is that taxes are based on residency and not based on citizenship.

The United States’ taxation of worldwide income has been around since the 1860s, when it was enacted as part of the Revenue Act of 1861. The purpose was to stop wealthy people from fleeing the U.S. in a time of crisis and taking their money with them. The defense of ongoing citizenship-based taxation income rests on the belief that U.S. citizenship offers benefits even enjoyed by non-residents. Thus, overseas taxpayers are required to pay for this benefit even when they earn money elsewhere.

Even as the rest of the world has moved toward a different model of taxation, the United States' citizenship-based taxation remains in place. In fact, there has not been a serious attempt to reverse this law. Instead, the debate usually focuses on how much tax overseas citizens should pay.

Filing Requirements

The filing requirements for most taxpayers are adjusted on an annual basis. A return is usually required if your gross income is at least the total of the standard deduction for your filing status for you and your spouse (if applicable).

For tax year 2018, the **Filing Requirements** for most taxpayers are:

IF your filing status is...	AND at the end of 2018 you were...*	THEN file a return if your gross income was at least...**	
single	under 65	$12,000	
	65 or older	$13,600	
married filing jointly***	under 65 (both spouses)	$24,000	
	65 or older (one spouse)	$25,300	
	65 or older (both spouses)	$26,600	
married filing separately	any age	$5	
head of household	under 65	$18,000	
	65 or older	$19,600	
qualifying widow(er) with dependent child	under 65	$24,000	
	65 or older	$25,300	
*		If you were born on January 2, 1954, you are considered to be age 65 at the end of 2018. (If your spouse died in 2018 or if you are preparing a return for someone who died in 2018, see Pub. 501.)	
**		Gross income means all income you received in the form of money, goods, property, and services that isn't exempt from tax, including any income from sources outside the United States or from the sale of your main home (even if you can exclude part or all of it). Don't include any social security benefits unless (a) you are married filing a separate return and you lived with your spouse at any time during 2018 or (b) one-half of your social security benefits plus your other gross income and any tax-exempt interest is more than $25,000 ($32,000 if married filing jointly). If (a) or (b) applies, see the instructions for Form 1040 or 1040A or Pub. 915 to figure the taxable part of social security benefits you must include in gross income. Gross income includes gains, but not losses, reported on Form 8949 or Schedule D. Gross income from a business means, for example, the amount on Schedule C, line 7, or Schedule F, line 9. But, in figuring gross income, don't reduce your income by any losses, including any loss on Schedule C, line 7, or Schedule F, line 9.	
***		If you didn't live with your spouse at the end of 2018 (or on the date your spouse died) and your gross income was at least $5, you must file a return regardless of your age.	

You must also file a tax return if you earned at least $400 from self-employment. In addition, if you qualify for a refund, you may want to file a tax return even if it isn't required.

INCOME TO REPORT ON YOUR RETURN

All US citizens, residents and green card holders must report all worldwide income on a U.S. tax return.

Some of the income subject to tax includes:

- Wages, salaries, bonuses and commissions
- Certain types of fringe benefits (all remuneration other than stated pay), such as car and housing allowances
- Unemployment compensation
- Interest and dividends
- Refund of state and local taxes (for some taxpayers who itemize deductions)
- Self-employment income
- Capital gains
- Pension and annuity income
- Rental income
- IRA and other retirement distributions (part or all may be exempt)
- Taxable portion of social security or railroad retirement benefits
- Jury duty pay
- Gambling winnings
- Some scholarships and fellowships
- Debt cancellation
- Most court awards
- And much more…

HOW CAN I SAVE MONEY ON MY RETURN LIVING OUTSIDE OF THE US?

SAVE MONEY WITH THE FOREIGN EARNED INCOME EXCL

As a U.S. citizen or resident alien living abroad, you are taxed on your worldwide income and you must file a U.S. return for all the years that you are residing abroad. However, as a U.S. expat, you may be able to reduce your U.S. taxable income by some or all of your foreign earnings with the foreign earned income exclusion. The limit on this deduction is adjusted annually for inflation ($104,100 for tax year 2018). In addition, you can exclude or deduct certain foreign housing amounts with the foreign housing exclusion.

The exclusion amount is now tied to the Chained Consumer Price Index, which generally rises at a more gradual rate than the previously used Consumer Price Index.

Qualification is based on a thorough and careful analysis of your situation. However, some of the basic requirements are listed below.

Foreign Earned Income Exclusion Requirements

In order to be eligible for the foreign earned income exclusion, you must meet all three of these requirements:

- Must have a tax home in a foreign country
- Must have foreign earned income
- Must meet either the bona fide residence test or physical presence test

Tax Home In A Foreign Country

Your tax home is the general area of your main place of business, employment, or post of duty, regardless of where you maintain your family home. Your tax home is the place where you are permanently or indefinitely engaged to work as an employee or self-employed individual.

To be considered indefinite or permanent, your engagement in this location must last or be expected to last for more than one year. If it doesn't last for at least a year, it is considered temporary in most cases. For example, if you are away from the U.S. on business for less than a year, you would not qualify for the foreign earned income exclusion.

For the purposes of this exclusion, a "foreign country" is any territory (including the air space and territorial waters) under the sovereignty of a government other than that of the U.S. It does not include Puerto Rico, American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, The U.S. Virgin Islands or other U.S. possessions.

What Is Foreign Earned Income?

Foreign "Earned" income includes salaries, wages, commissions, bonuses and self-employment income earned for services that were "physically" performed while in a foreign country.

It does not include:

- Non-earned income or passive income such as investment income (interest, dividends and capital gains), social security
- Income earned as an employee of the U.S. government
- Income for services performed in international waters
- Amounts included in your income because of your employer's contributions to a non-exempt employee trust or to a nonqualified annuity contract

• Self-employment taxes: while you can exclude your self-employment income, your self-employment income is subject to self-employment taxes (social security and Medicare taxes) unless the services were performed in a country that has a totalization agreement with the United States.

Bona Fide Residence Test

If you are U.S. citizen or resident (who is a citizen of a country with which the U.S. has a tax treaty with a non-discrimination clause), you meet the bona fide residence test if you are also a bona fide resident of a foreign country or countries for an uninterrupted period that includes an entire tax year (generally January 1 through December 31).

During the period of bona fide residence in a foreign country, you can leave the country for brief trips back to the United States or elsewhere for vacation or business. To keep your status as a bona fide resident of a foreign country, you must have a clear intention of returning from these trips to your foreign residence or to a new bona fide residence without unreasonable delay.

It is important to note that just because you live in a foreign country for an entire tax year does not mean that you automatically meet the bona fide residence test.

Example:

If you go to Afghanistan to work on a particular construction job for a specified period of time, you ordinarily will not be regarded as a bona fide resident of that country even though you work there for 1 tax year or longer. The length of your stay and the nature of your job are only two of the factors to be considered in determining whether you meet the bona fide residence test.

Bona Fide Residence Test Can Only Be Used By U.S. Citizen Or Resident Alien

The bona fide residence test applies to U.S. citizens and to any U.S. resident alien who is a citizen or national of a country with which the United States has an income tax treaty in effect. If you are a resident alien, you must determine if a treaty exists to meet this test.

To see if you meet the bona fide residence test in a foreign country, you must find out if you have established such a residence in a foreign country. Your bona fide residence is not necessarily the same as your domicile. Your domicile is your permanent home, the place to which you always return or intend to return.

Example:

You could have your domicile in Las Vegas, Nevada, and a bona fide residence in Paris, France if you intend to return eventually to Las Vegas. The fact that you go to Paris does not automatically make Paris your bona fide residence. If you go there as a tourist, or on a short business trip, and return to the United States, you have not established bona fide residence in Paris.

But if you go to Paris to work for an indefinite or extended period and you set up permanent housing there for yourself and your family, you probably have established a bona fide residence in a foreign country, even though you intend to return eventually to the United States.

If your residency is not as clearly defined as either of these illustrations, it may be more difficult to decide whether you have established a bona fide residence.

Determination

Questions of bona fide residence are determined on a case-by-case basis, taking into account such factors as:

- Living Quarters (purchased residence, rented house or apartment, employer provided housing, hotel)
- Family members residing with taxpayer or in U.S.
- Paying taxes to foreign government
- Contractual terms and conditions of employment
- Visa type and duration
- Maintenance of U.S home
- The nature and length of your stay abroad

Since no one factor will determine if an individual meets the bona fide residence test, it is based on a careful and professional evaluation of all factors and facts of your specific situation. The IRS decides whether you qualify as a bona fide resident of a foreign country largely based on the facts you report on IRS Form 2555, Foreign Earned Income. The IRS cannot make this determination until you file Form 2555.

Bipartisan Budget Act of 2018

The Bipartisan Budget Act of 2018 changed the tax home requirement for eligible taxpayers, enabling them to claim the foreign earned income exclusion even if their “abode” is in the United States. Under prior law, many otherwise eligible taxpayers who lived and worked in designated combat zones failed to qualify because they had an abode in the United States. The new law makes it clear that contractors or employees of contractors providing support to U.S. Armed Forces in designated combat zones are eligible to claim the foreign earned income exclusion. Employees of the U.S. government and members of the U.S. military are still not eligible to take the foreign earned income exclusion.

Paying Income Tax To The Country Where You Claim Bona Fide Residence

It’s also important to note that if you claim to be a non-resident of the foreign country to the foreign country’s government and therefore do not pay income taxes to such government, you would not pass the bona fide residence test.

Physical Presence Test

If you do not pass the bona fine residence test, may still qualify for the foreign earned income exclusion under the physical presence test.

To pass the physical presence test, you must be physically present in a foreign country or countries 330 full days during a period of 12 consecutive months. While the months must be consecutive, the days don’t need to be.

This means that you are limited to a maximum of 35 days in the United States during the 12-month qualifying period. Full days are defined as a 24-hour period beginning at midnight. Time spent on or over international waters in transit to or from the United States does not count towards a day present in a foreign country. You can count all full days you spent abroad for any reason. Whether you spent days in a foreign country or foreign countries for personal or business reasons is not relevant.

12-Month Physical Presence Period

There are four rules you should know when figuring the 12-month physical presence period:

1. Your 12-month period is not limited to a calendar year period (i.e. January 1 – December 31), it can begin with any day of the month. It ends the day before the same calendar day, 12 months later.

2. Your 12-month period must be made up of consecutive months. Any 12-month period can be used if the 330 days in a foreign country fall within that period.

3. You do not have to begin your 12-month period with your first full day you arrive or end with the day you leave, but rather you can choose the 12-month period that gives you the greatest exclusion.

4. 12-month periods can overlap one another and can differ from tax year to tax year.

35 Days Or Less In The United States

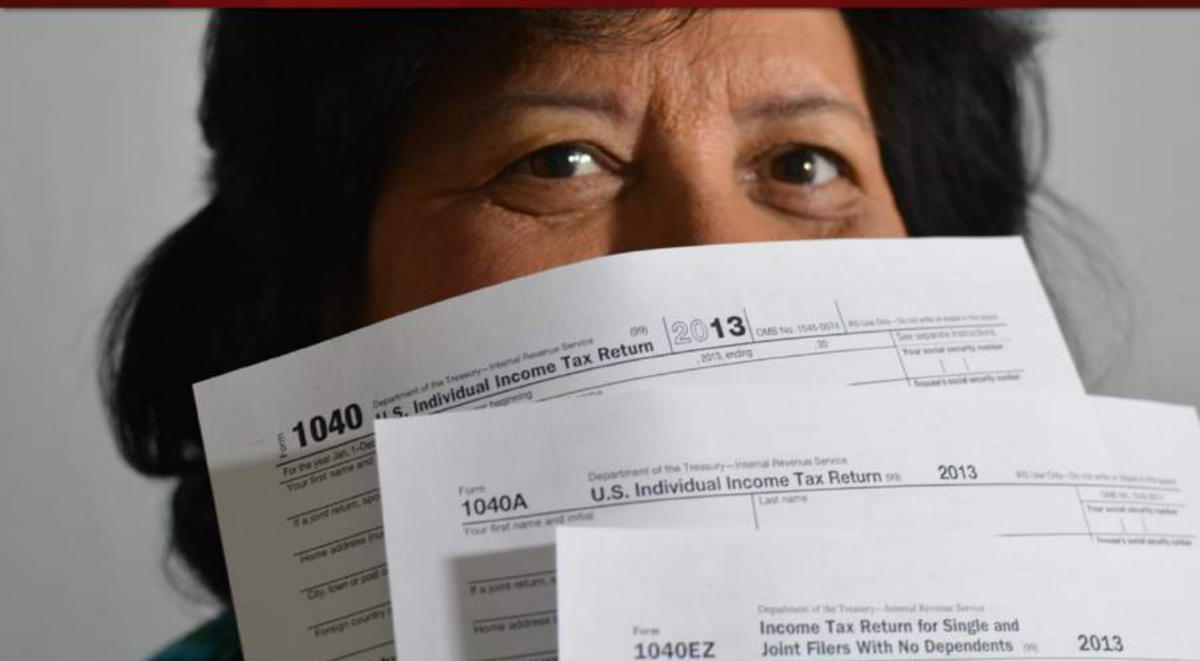
After you establish that your tax home is in a foreign country, it is very important to plan all trips to the United States accordingly. If you plan trips without keeping the physical presence test in mind, you may miss out on qualifying for this major tax benefit for U.S. citizens living abroad.

How Does The Foreign Income Exclusion Impact Tax Rates?

Taxpayers claiming the foreign income exclusion will pay tax on non-excluded income at the tax rates that would have applied if they hadn't claimed the exclusion.

To calculate your federal tax, calculate what you would have owed without the foreign earned income exclusion and then subtract the tax calculated on the excluded foreign earned income.

To simplify this calculation, use the Foreign Earned Income Tax Worksheet found in the Instructions for the Form 1040.



ADJUSTMENTS THAT CAN LOWER YOUR TAXABLE INCOME

Other adjustments that may lower your taxable income include:

- Educator expenses
- Certain business expenses of reservists, performing artists, and fee-basis government officials
- Health savings account deduction
- Deductible part of self-employment tax
- Moving and storage expenses*
- Self-employed SEP, SIMPLE, and qualified plans
- Self-employed health insurance deduction
- Penalty on early withdrawal of savings
- Alimony paid
- IRA deduction
- Student loan interest deduction
- Tuition and fees deduction
- Domestic production activities deduction

Moving Expenses

A very common adjustment for taxpayers overseas is moving expenses.
If you moved because of a change in your job or business location, or because you started a new job or business, you may be able to deduct some related expenses. You can deduct your qualifying moving expenses if you meet all three of the following requirements:

- Your move closely relates to the start of work
- You meet the distance test
- You meet the time test

In addition, if you are paying for storage while living overseas, these expenses may be deductible on an annual basis as well.

*The Tax Cuts and Jobs Act of 2017 eliminated the moving and storage expense deduction for all taxpayers except those that are active duty military members for tax years 2018 through 2025.

Alimony Paid

For divorce agreements entered prior to December 31st, 2018, the payor typically receives a deduction for the amount of alimony paid and the recipient includes the income on their return.

The Tax Cuts and Jobs Act removed the requirement for taxpayers to report alimony paid or received. The new law applies to divorce and separation agreements entered after December 31st, 2018. As a result, income used to pay alimony is taxed on the payors return.

IRA Deduction

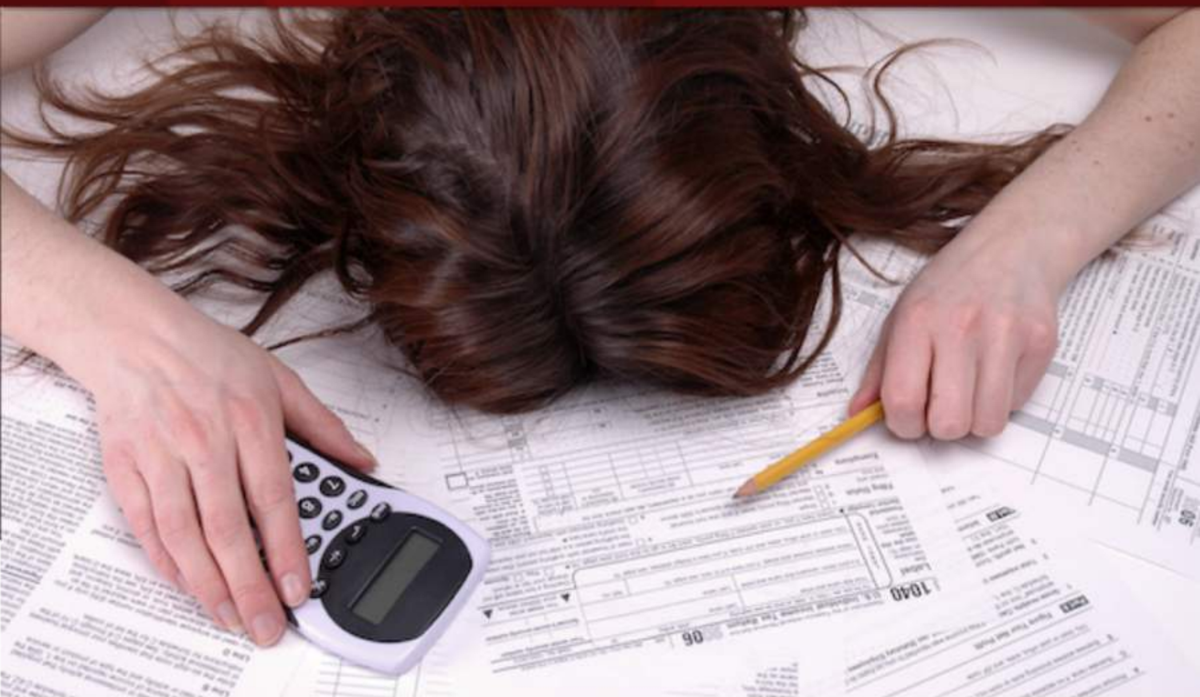
Your contributions to a traditional IRA are limited to the smaller of your taxable compensation (earned income, alimony or separate maintenance payments and nontaxable combat pay) or $5,500 ($11,000 with a spousal IRA; $6,500 if age 50 or older; $13,000 if both spouses are age 50 or older).

However, if you (or your spouse) were covered by an employer retirement plan at any time during the year, the amount you may deduct may be reduced or eliminated depending on your AGI.

It is important to note that if all of your earned income has been excluded by the foreign earned income exclusion, you will not qualify to make an IRA contribution and deduction.

Tuition and Fees Deduction

The deduction for tuition and fees has currently not been extended by Congress for tax years after 2017. However, many taxpayers end up benefiting more from using the American Opportunity Tax Credit or Lifetime Learning Credit if they are eligible. These two credits are still available for eligible taxpayers.



REDUCE DOUBLE TAXATION WITH THE FOREIGN TAX CREDIT

Foreign Tax Credit And Double Taxation

Most taxpayers working abroad worry about "double taxation" – paying taxes to two different countries. A U.S. taxpayer overseas may be able to reduce U.S. taxable income and "double taxation" by claiming the foreign tax credit on Form 1116. Should any foreign income not be fully offset by the foreign earned income exclusion, housing exclusion or housing deduction, the foreign tax paid or accrued may be used as a deduction or credit on the U.S. tax return.

Taxpayers can elect to either deduct the taxes as an itemized deduction on Schedule A or claim a credit against tax. In most cases, taking the tax credit is most beneficial.

"Foreign income taxes" are income taxes the taxpayer paid to any foreign country. It is important to note that any foreign taxes paid on income that was excluded from U.S. income (i.e. from the foreign earned income exclusion) cannot be claimed as either a credit or a deduction. If foreign earned income was fully excluded, then no credit or deduction will be available. If the foreign earned income was only partially excluded, the foreign taxes must be allocated between the income excluded and the income not excluded.

When choosing between the foreign earned income exclusion and foreign tax credit, it is an easy choice to use the exclusion if no foreign taxes were paid. However, if you are working in a country where the tax rate is the same or higher than the U.S, it may be better to claim the foreign tax credit only. Further, depending on your income and the rate of tax in your resident country, it may make more sense to use a combination of the exclusion and credit. Either way, a proper analysis and comparison is recommended to determine what is most beneficial for the current tax year.

Foreign Tax Credit Requirements

In order to be qualify for the foreign tax credit, you must meet all four of the following requirements:

- **The tax must be imposed on you**. You can claim a credit only for foreign taxes that are imposed on you by a foreign country.

- **You must have paid or accrued the tax**. You can claim a credit on Form 1116 only for foreign taxes that have already been paid or accrued.

- **The tax must be the legal and actual foreign tax liability.** The amount of foreign tax that qualifies to be reported on Form 1116 is not necessarily the amount of tax withheld by the foreign country. Only the legal and actual foreign tax liability that you paid or accrued during the year qualifies for the credit.

- **The tax must be an income tax**. Generally, only income, war profits, and excess profits taxes (income taxes) qualify for the foreign tax credit to be reported on Form 1116. Foreign taxes on wages, dividends, interest, and royalties generally qualify for the credit. Furthermore, foreign taxes in lieu of an income, war profits, or excess profits tax also qualify.

Foreign Income

The foreign tax credit can only apply to foreign-sourced income (not US-source income). Foreign taxes may have been paid on a variety of different types of foreign income such as:

- Compensation for services performed outside the United States
- Interest income from a payer located outside the United States
- Dividends from a corporation incorporated outside the United States
- Gain on the sale of non-depreciable personal property you sold while maintaining a tax home outside the United States, if you paid a tax of at least 10% of the gain to a foreign country

Foreign Tax Refund

You cannot claim a foreign tax credit on Form 1116 for income taxes paid to a foreign country if you could qualify to have the amount refunded, credited, rebated, abated, or forgiven.

For example, the United States has tax treaties with many countries allowing U.S. citizens and residents reductions in foreign tax rates. However, some treaty countries require U.S. citizens and residents to pay the tax figured without regard to the lower treaty rates and then claim a refund for the excess amount. The qualified foreign tax is the amount figured using the lower treaty rate and not the amount actually paid, since the excess tax is refundable.

The foreign tax credit is a “dollar for dollar” reduction on income tax liability for taxes paid to a foreign government, even if it doesn’t always appear to be. This credit reduces only U.S. taxes on foreign source income. It cannot reduce U.S. taxes on U.S. source income.

Ineligible Foreign Taxes

The foreign tax credit is not available if you paid taxes to a foreign country that the United States:

- Does not recognize as a sovereign state
- Has severed diplomatic relations with
- Does not conduct diplomatic relations with
- Has designated as a country that supports terrorism

Foreign Tax Credit – Categories Of Income Reported On The Form 1116

There are five different categories of income for purposes of the Foreign Tax Credit.

Foreign taxes need to be reported on a separate Form 1116 to report and calculate the credit for each category of foreign source income.

Unfortunately, foreign taxes from one category cannot be used to offset taxes in another category.

The five categories of income are:

- Passive Category Income. Includes passive income and specified passive category income such as interest, dividends, and capital gains.

- General category income. Typically includes wages, salary and self-employment income.

- Section 901(j) Income. No credit is allowed for foreign taxes imposed by and paid or accrued to certain sanctioned countries. However, income derived from these countries is subject to a separate foreign tax credit limitation. Therefore, you must use a separate Form 1116 for income derived from each country.

- Certain Income Re-Sourced by Treaty. If a sourcing rule in an applicable income tax treaty treats U.S. source income as foreign source, and you elect to apply the treaty, the income will be treated as foreign source.

- Lump-Sum Distributions. This category is used to take a foreign tax credit for taxes you paid or accrued on a foreign source lump-sum distribution from a pension plan.

- Foreign Branch Income. The Tax Cuts and Jobs Act of 2017 created a new category for foreign branch income.

Foreign Tax Rate

If your local country's tax rate is higher than your U.S. tax rate, your foreign tax credit will likely offset any taxes due to the US. If the foreign rate is lower, then you can expect to pay the difference to the USA.

Foreign Tax Credit Or Foreign Tax Deduction

Each tax year, you can choose to claim qualifying foreign taxes as a credit or as an itemized deduction on Schedule A. However, as a general rule, you must make the same selection for all qualified foreign taxes. If you choose to take a credit for qualified foreign taxes, you must take the credit for all of them. Conversely, if you choose to deduct qualified foreign taxes, you must deduct all of them.

It's usually more beneficial to claim a credit, but you should still review both scenarios when preparing your returns. If you decide to change your election for a given tax year, you can do so at any time while the statute of limitations to claim any refund or credit remains open for that year.

Carryback And Carryover Of The Foreign Tax Credit On Form 1116

Any foreign tax credit amount in excess of the limit as reported on Form 1116 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.

How To Claim The Foreign Tax Credit Or Deduction

To choose the deduction, you must itemize deductions on IRS Form 1040, Schedule A. To choose the foreign tax credit you generally must complete IRS Form 1116 and attach it to your Form 1040. If you are a cash basis taxpayer, you can take the foreign tax credit only in the year you pay the qualified foreign tax unless you elect to claim the foreign tax credit in the year the foreign taxes are accrued. Once you make this election, you cannot switch back to claiming the taxes in the year paid.

SOCIAL SECURITY AND TOTALIZATION AGREEMENTS

The United States has entered into agreements, called Totalization Agreements, with several nations for the purpose of avoiding **double taxation of** income with respect to **social security taxes**. As of this time, the following nations have entered into Totalization Agreements with the United States:

- Australia
- Austria
- Belgium
- Canada
- Chile
- Czech Republic
- Denmark
- Finland
- France
- Germany
- Greece
- Hungary
- Ireland
- Italy
- Japan
- Luxembourg
- Netherlands
- Norway
- Poland
- Portugal
- Slovak Republic
- South Korea
- Spain
- Sweden
- Switzerland
- United Kingdom

International Social Security agreements, often called "Totalization agreements," have two main purposes.

First, they eliminate dual Social Security taxation, the situation that occurs when a worker from one country works in another country and pays Social Security taxes to both countries on the same earnings.

Second, the agreements help fill gaps in benefit protection for workers who have divided their careers between the United States and another country. The agreements assign coverage to just one country and exempt the employer and employee from the payment of Social Security taxes in the other country.

Determining Eligibility For The Totalization Agreements

Determining eligibility for the totalization agreements and required reporting is based on proper analysis and the individual facts of the taxpayer.

US TAX TREATY BENEFITS

The United States has income tax treaties with a number of foreign countries. One of the primary tax treaty benefits is protection from double taxation.

Under these agreements, citizens and residents of the U.S. who are subject to taxes imposed by foreign countries receive tax treaty benefits for certain credits, deductions, exemptions, and reductions in foreign tax rates. Treaty provisions are usually applicable to both treaty countries.

Tax Treaty Benefits

Tax treaties are stuffed with legalese and complex language, so you must review these treaties carefully to determine how they will affect your tax liability. Below is a brief summary of how it works for Nonresident Aliens of the U.S. and U.S. Citizens and Residents.

Nonresident Aliens

For nonresident aliens, treaties limit or eliminate U.S. taxes on various types of personal services and other income, such as pensions, interest, dividends, royalties, and capital gains. Many treaties limit the number of years you can claim a treaty exemption. For students, apprentices and trainees, the limit is usually four to five years. For teachers, professors and researchers, the limit is usually two to three years. In some cases, if you exceed the limit, the income is taxed retroactively for earlier years. There may also be other requirements for tax treaty benefits.

Tax Treaty Benefits For U.S. Citizens and Residents

U.S. citizens and residents usually cannot reduce their U.S. tax based on treaty provisions because of the saving clause (described below). However, those who are subject to taxes imposed by a treaty partner are still entitled to certain credits, deductions, exemptions and reductions in the rate of taxes paid to that foreign country.

Each tax treaty must be closely reviewed to determine if the treaty benefits are applicable to U.S. citizens and resident aliens who do not reside in the U.S. Foreign taxing authorities sometimes require certification from the U.S. government that an applicant filed an income tax return as a U.S. resident before the applicant can receive treaty benefits.

Saving Clause

Most tax treaties have a saving clause that preserves the right of each country to tax its own residents as if no tax treaty were in effect. As a result, U.S. citizens and residents generally cannot use the treaty to reduce their U.S. tax liability, but they may be able to reduce foreign tax liability under the treaty.

Some treaties provide exceptions to saving clauses that allow certain provisions of the treaty to be claimed by U.S. citizens or residents. It is important that you examine the saving clause to determine if an exception applies to your tax situation.

Tie Breaker Rules

For cases where a taxpayer is a resident of both countries, each treaty contains provisions on tie-breaker rules that are used to determine the taxpayer's country of residence for purposes of the tax treaty benefits. Some of the common tie breaker rules include:

- The taxpayer is a resident of the country in which he or she has a permanent home.

- If the taxpayer has a permanent home available in both countries, the taxpayer is a resident of the country in which his or her personal and economic relations are closer (center of vital interests).

- If the country in which the taxpayer's center of vital interests cannot be determined, or if the taxpayer does not have a permanent home available to him or her in either state, the taxpayer is a resident of the country in which he or she has a habitual abode.

- If the taxpayer has a habitual abode in both countries or in neither country, the taxpayer is a resident of the country in which he or she is a citizen.

- If the taxpayer is a citizen of both countries or of neither country, the competent authorities of the two countries will settle the matter by mutual agreement.

Claiming Tax Treaty Benefits

If you claim tax treaty benefits that override or change any provision of the Internal Revenue Code (IRC) and also reduce your tax liability, you must attach Form 8833, Treaty-Based Return Position Disclosure, to your tax return.

Copies of Tax Treaties

To view a specific tax treaty, go to the IRS website and search for “tax treaties.” You will find the text of each treaty, and in most cases, the Technical Explanation that provides more detail on the treaty.

COMMON ADDITIONAL FORM FILING REQUIREMENTS THAT MAY APPLY

The following section includes information on common tax and information reporting forms that apply to U.S. taxpayers abroad. Not every tax professional will be familiar with the forms described below. If you need to file any of these forms, make sure your preparer has the proper training and experience.

FBAR (FINCEN FORM 114 AND FATCA FORM 8938)

FBAR Filing Deadline

Many overseas taxpayers are required to file the Foreign Bank Account Report, or FBAR (FinCen Form 114). The FBAR filing deadline is April 15th (or the preceding business day if April 15th falls on a weekend) – with an extension available to October 15th.

Any reports received after the deadline are considered delinquent. In addition, unlike most other tax forms, the FBAR must be filed electronically.

FBAR Filing Requirements

The FBAR exists to help the U.S. government identify people who may be using foreign bank accounts to circumvent United States law. With FACTA, IRS criminal investigators will use the FBARs to help them identify or trace funds used for illicit purposes, to identify unreported income abroad, and to identify undisclosed foreign accounts.

This is an important IRS compliance requirement with huge monetary civil penalties at stake, as well as potential criminal consequences. In addition, because of FACTA, foreign financial institutions are starting to disclose U.S. account holder information, which makes it easier for the U.S. to enforce this law.

You must file an FBAR with the Treasury Department if you are a U.S. person with a financial interest in, or signature authority over, foreign financial accounts with an aggregate value of more than $10,000 at any point during the tax year. Foreign financial accounts include bank accounts, brokerage accounts, mutual funds, trusts or other types of foreign financial accounts maintained with a financial institution.

If you have specified foreign financial assets that exceed certain thresholds, you must also report those assets to the IRS on Form 8938. In some cases, you may be reporting the same accounts twice, but both forms are still required.

Who Is a U.S. Person?

A U.S. person for purposes of FBAR reporting includes U.S. citizens, U.S. residents, and entities including but not limited to corporations, trusts, estates, partnerships or limited liability companies that were created or organized in the U.S. under the laws of the U.S.

FBAR Late Filing And Non-Filing

Civil penalties for non-willful FBAR violations may be as high as $10,000 per violation. For willful violations, the maximum penalty is usually the greater of $100,000 or 50 percent of the account balance per violation. Criminal penalties can result in fines of up to $500,000 and imprisonment of up to 10 years. It is possible to incur both civil and criminal penalties for the same violation.

FBAR Reporting

Effective July 1, 2013, all FBARs must be electronically filed with the BSA E-filing system.

IRS Form 8938 – Purpose Of The Form

IRS Form 8938 is used to report your specified foreign financial assets.

Unless an exception applies, you must file Form 8938 if you are a specified individual that has an interest in specified foreign financial assets with a value higher than the applicable reporting threshold.

If you are required to file IRS Form 8938, you must report all specified foreign financial assets in which you have an ownership interest, even if these assets don't affect your tax liability.

Exception If No Income Tax Return Required

If you do not have to file an income tax return for the tax year, you do not have to file IRS Form 8938 either, even if you meet the Form 8938 filing requirements.

Who Is A Specified Individual For IRS Form 8938?

You are a specified individual if you are:

- A U.S. citizen.
- A resident alien of the United States for any part of the tax year. You are a resident alien if you are treated as a resident alien for U.S. tax purposes under the green card test or the substantial presence test.
- A nonresident alien who makes an election to be treated as a resident alien in order to file a joint income tax return.
- A nonresident alien who is a bona fide resident of American Samoa or Puerto Rico.

Reporting Thresholds For IRS Form 8938

Taxpayers Living In The United States

If you live inside the United States and no exception applies, your reporting thresholds are as follows:

- **Unmarried taxpayers.** If you are not married, you satisfy the reporting threshold only if the total value of your specified foreign financial assets is more than $200,000 on the last day of the tax year or more than $300,000 at any time during the tax year.
- **Married taxpayers filing a joint income tax return.** If you are married and you and your spouse file a joint income tax return, you satisfy the reporting threshold only if the total value of your specified foreign financial assets is more than $400,000 on the last day of the tax year or more than $600,000 at any time during the tax year.
- **Married taxpayers filing separate income tax returns**. If you are married and file a separate income tax return from your spouse, you satisfy the reporting threshold only if the total value of your specified foreign financial assets is more than $200,000 on the last day of the tax year or more than $300,000 at any time during the tax year.

Presence abroad. You satisfy the presence abroad test if you are:

- A U.S. citizen who has been a bona fide resident of a foreign country or countries for an uninterrupted period that includes an entire tax year.

- A U.S. citizen or resident who is present in a foreign country or countries at least 330 full days during any period of 12 consecutive months that ends in the tax year being reported.

What Specified Foreign Financial Assets Must Be Included On IRS Form 8938?

Examples of financial accounts include savings, deposit, checking, and brokerage accounts held with a bank or broker-dealer. And, to the extent held for investment and not held in a financial account, you must report stock or securities issued by someone who is not a U.S. person, any other interest in a foreign entity, and any financial instrument or contract held for investment with an issuer or counterpart that is not a U.S. person.

Examples of these assets that must be reported if not held in an account include:

1. Stock or securities issued by a foreign corporation;
2. A note, bond or debenture issued by a foreign person;
3. An interest rate swap, currency swap, basis swap, interest rate cap, interest rate floor, commodity swap, equity swap, equity index swap, credit default swap or similar agreement with a foreign counterpart;
4. An option or other derivative instrument with respect to any of these examples or with respect to any currency or commodity that is entered into with a foreign counterpart or issuer;
5. A partnership interest in a foreign partnership;
6. An interest in a foreign retirement plan or deferred compensation plan;
7. An interest in a foreign estate;
8. Any interest in a foreign-issued insurance contract or annuity with a cash-surrender value.

When And How To File Form 8938

Attach Form 8938 to your individual tax return and file by the due date (including extensions) for that return.

STATE TAX RETURNS

Determining State Income Tax Return Residency When Residing Overseas

Many overseas taxpayers incorrectly assume that if they are living overseas, they are no longer considered a state resident in the U.S and won't have any state tax filing requirements or liability.

However, this is not necessarily the case.

If your residence before moving overseas was in a state that has no state income tax, you will continue to have no state income tax filing requirements. There are currently seven states with no state income tax: Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming. In addition, New Hampshire and Tennessee have no tax on personal income but do tax profits from the sale of bonds and property.

However, if you previously lived in a state with income taxes, you may need to file. The state income tax return residency rules for taxpayers that reside overseas vary greatly from state to state, and states use different methods to determine whether you must file a return and pay taxes.

Some states use a “time based” test, while other states, such as California, look at whether you are considered to have “tax domicile” in the state. This is often not as simple as whether you are physically present in the state or not. There are many criteria used in determining whether the state is a taxpayer’s domicile, and each state has its own definition. Definitions may consider time spent in the state, family ties to the state, voter registration, active driver’s licenses, the existence of financial holdings, ownership of property, and other factors.

Most states consider you a resident (and fully liable for taxes) if you are domiciled in the state or living in the state for at least six months out of the year. Most states define a “non-resident” as someone who earns money from a state but doesn’t live there, or someone who lives in the state for less than half the year.

States sometimes choose to challenge the residency status of taxpayers living overseas. This is especially common among states with ongoing budget issues, such as California, Massachusetts, New York, Virginia, etc. To reduce your risk of future demands of state tax returns or liability, it is important that you research your state tax filing requirements carefully and make any necessary changes prior to leaving the country.

For further assistance with determining your state income tax residency as part of an engagement for services, please be sure to contact Tax Samaritan or your tax professional. If you are preparing you own return, we recommend checking the regulations with the relevant state tax authority.

FORM 5471 (FOREIGN CORPORATION)

Form 5471 is lengthy. In fact, the instructions state that it could take over 32 hours to complete.

The purpose of this form is to supply the IRS with a foreign corporation's income statement, balance sheet, and data on its loans, operations and other shareholders. It also includes information on dividends and managerial payments made to shareholders, officers and directors.
Information on this form must be presented using US Generally Accepted Accounting Principles (U.S. GAAP), which generally differ from those used to produce foreign financial statements. Converting financial statements to the required format requires some time and effort.

Failing to file this form when it is required may result in a $10,000 penalty. In the past, it was difficult for the IRS to secure information on foreign corporations, but it is becoming easier because of FACTA, tax treaties, and other U.S. initiatives. If you have not filed this form when it was required, you should file as soon as possible.

What Is Form 5471?

Form 5471 is an information return for certain U.S. citizens and residents who are officers, directors, or shareholders in certain foreign corporations and includes mechanisms through which the US Government can tax foreign profits even before they are distributed as dividends, known as Subpart F.

Because this form isn't commonly required among U.S. taxpayers, many tax professionals are unfamiliar with it.

Form 5471 Filing Requirements

Form 5471 is required if a U.S. person:

- Becomes a director or officer of a foreign corporation
- Acquires an ownership interest in a foreign corporation in excess of the prescribed limits
- Disposes of stock in a foreign corporation that reduces his or her interest in the foreign corporation to less than the prescribed limits

• Is in control of a foreign corporation during the annual accounting period of the foreign corporation.

• Is a 10% or more shareholder in a foreign corporation that is a “controlled foreign corporation” at any time during any tax year of the foreign corporation, and who owned that stock on the last day in that year on which it was a controlled foreign corporation..

To say that the Form 5471 filing instructions are complex and difficult to understand would be an understatement. Determinations of ownership interest involve the complex rules of direct, indirect, and constructive ownership. In addition, several different categories of filers exist, which makes the filing process even more confusing. These categories are used to determine which schedules, statements and/or other information must be included with the filing.

Categories of Filers for Form 5471

Form 5471 currently has five Categories of Filers based upon ownership and control of the corporation. All U.S. persons that meet the criteria for one or more of the categories must file a Form 5471.

Category 1 Filer

This category includes a U.S. shareholder of a foreign corporation that is a section 965 specified foreign corporation (defined below) at any time during any tax year of the foreign corporation, and who owned that stock on the last day in that year onwhich it was an SFC, taking into account the regulations under section 965.

Section 965 specified foreign corporation (SFC) - For purposes of Category 1, an SFC (as defined in section 965) is: 1. A CFC (see Category 5 for a definition), or 2. Any foreign corporation with respect to which one or more domestic corporations is a U.S. shareholder. However, if a passive foreign investment company (as defined in section 1297) with respect to the shareholder is not a CFC, then such corporation is not an SFC.

Category 2 Filer

This includes a U.S. citizen or resident who is an officer or director of a foreign corporation in which a U.S. person (defined below) has acquired (in one or more transactions):

1. Stock which meets the 10% stock ownership requirement (described below) with respect to the foreign corporation or

2. An additional 10% or more (in value or voting power) of the outstanding stock of the foreign corporation.

A U.S. person has acquired stock in a foreign corporation when that person has an unqualified right to receive the stock, even though the stock is not actually issued.

Stock ownership requirement – For purposes of Category 2 and Category 3, the stock ownership threshold is met if a U.S. person owns:

1. 10% or more of the total value of the foreign corporation's stock or

2. 10% or more of the total combined voting power of all classes of stock with voting rights.

U.S. person. For purposes of Category 2 and Category 3, a U.S. person is:

1. A citizen or resident of the United States,

2. A domestic partnership,

3. A domestic corporation, and

4. An estate or trust that is not a foreign estate or trust defined in section 7701(a)(31).

Category 3 Filer

This category includes:

- A U.S. person (defined above) who acquires stock in a foreign corporation which, when added to any stock owned on the date of acquisition, meets the 10% stock ownership requirement (described above) with respect to the foreign corporation;

- A U.S. person who acquires stock which, without regard to stock already owned on the date of acquisition, meets the 10% stock ownership requirement with respect to the foreign corporation;

- A person who is treated as a U.S. shareholder under section 953(c) with respect to the foreign corporation;

• A person who becomes a U.S. person while meeting the 10% stock ownership requirement with respect to the foreign corporation; or

• A U.S. person who disposes of sufficient stock in the foreign corporation to reduce his or her interest to less than the stock ownership requirement.

Category 4 Filer

This includes a U.S. person who had control (defined below) of a foreign corporation during the annual accounting period of the foreign corporation.

U.S. person. For purposes of Category 4, a U.S. person is:

1. A citizen or resident of the United States;

2. A nonresident alien for whom an election is in effect under section 6013(g) to be treated as a resident of the United States;

3. An individual for whom an election is in effect under section 6013(h), relating to nonresident aliens who become residents of the United States during the tax year and are married at the close of the tax year to a citizen or resident of the United States;

4. A domestic partnership;

5. A domestic corporation; and

6. An estate or trust that is not a foreign estate or trust defined in section 7701(a)(31).

Control. A U.S. person has control of a foreign corporation if, at any time during that person's tax year, it owns stock possessing:

1. More than 50% of the total combined voting power of all classes of stock of the foreign corporation entitled to vote or

2. More than 50% of the total value of shares of all classes of stock of the foreign corporation.

A person in control of a corporation that, in turn, owns more than 50% of the combined voting power, or the value, of all classes of stock of another corporation is also treated as being in control of such other corporation.

Category 5 Filer

This includes a U.S. shareholder who owns stock in a foreign corporation at any time during any tax year of the foreign corporation, and who owned that stock on the last day in that year on which it was a controlled foreign corporation.

U.S. shareholder. For purposes of Category 5, a U.S. shareholder is a U.S. person who:

1. Owns (directly, indirectly, or constructively, within the meaning of sections 958(a) and (b)) 10% or more of the total combined voting power of all classes of voting stock of a CFC or, in the case of a tax year of a foreign corporation beginning after December 31, 2017, 10% or more of the total combined voting power or value of shares of all classes of stock of a CFC; or

2. Owns (either directly or indirectly, within the meaning of section 958(a)) any stock of a CFC (as defined in sections 953(c)(1)(B) and 957(b)) that is also a captive insurance company.

U.S. person. For purposes of Category 5, a U.S. person is:

1. A citizen or resident of the United States,
2. A domestic partnership,
3. A domestic corporation, and
4. An estate or trust that is not a foreign estate or trust defined in section 7701(a)(31).

CFC. A CFC is a foreign corporation that has U.S. shareholders that own (directly, indirectly, or constructively, within the meaning of sections 958(a) and (b)) on any day of the tax year of the foreign corporation, more than 50% of:

1. The total combined voting power of all classes of its voting stock or
2. The total value of the stock of the corporation.

Filing Requirements For Categories Of Filers

The Filing Requirements for Categories of Filers is illustrated in the chart below:
The required information may be as minimal as the identification of the US shareholder and the name and address of the foreign corporation — or as extensive as a balance sheet and income statement converted from multiple foreign currencies into US dollars and also converted into the GAAP method of accounting.

Unlike domestic corporations that report their taxes using Form 1120 or 1120s, Form 5471 is more extensive and requires foreign corporations to report and evaluate other important issues such as subpart F income, transfer pricing, and foreign tax credits. Please see our article on Subpart F Income to learn more about this area.

When determining if Form 5471 is required to be filed, it is very also important to remember that a foreign limited liability company (LLC) will be treated as a foreign corporation if an election has not been made to classify the entity as a foreign disregarded entity or a foreign partnership (which in itself would have to file a form similar to 5471, the Form 8865). Additionally, according to the IRS, a “foreign corporation” also includes an “International Business Company” (IBC) in which a U.S. person has partial ownership.

Form 5471 Filing Deadline

The Form 5471 must be filed by the shareholder's income tax return due date (including extensions). For most corporations, the deadline is March 15th or the extended due date. For most individuals, the deadline is April 15th or the extended due date.

IRS Form 5471 Penalties

If you fail to file Form 5471 and were required to do so, you can be subject to a substantial penalty of $10,000 or more per year.

Additional penalties of up to $50,000 are charged for instances of continued failure. Any person who fails to file or report all of the information required within the time prescribed will be subject to a reduction of 10% of the foreign taxes available for credit. Continued cases of failure are also subject to additional reductions. Criminal penalties may also apply for failure to file.

Last but not least, if the form is not filed, your Form 1040 would be considered to be non-filed by the IRS, leaving your individual return open for audit and penalties indefinitely. This is a dream come true for the IRS, but a nightmare for any taxpayer.

Tax Cuts and Jobs Act - Form 5471 Changes

The Tax Cuts and Jobs Act, signed into law on December 22nd, 2017 by President Donald Trump made significant changes to the way foreign corporations are taxed. The new law is effective for the last taxable year of a specified foreign corporation that begins before January 1st, 2018 and requires repatriation of earnings held in certain specified foreign corporations. All controlled foreign corporations are considered specified foreign corporations, as well as any foreign corporation (except passive foreign investment companies) that have a U.S. shareholder who owns ten percent or more of voting stock. Those U.S. shareholders that find themselves in this situation will need to include their pro rata share of accumulated post-1986 foreign earnings on their tax return.

Fortunately, taxpayers can elect to pay the liability in eight installments rather than one lump sum. The installment payments can be broken down as follows:

- 8 percent of the net tax liability in the case of each of the first 5 of such installments
- 15 percent of the net tax liability in the case of the 6th such installment
- 20 percent of the net tax liability in the case of the 7th such installment
- 25 percent of the net tax liability in the case of the 8th such installment

If electing the pay the liability in installments, you must make the first installment payment by the original due date of your return even if you filed for an extension. Each subsequent installment is due on the due date of the following year's tax return. Earnings that were already subject to tax can be distributed in the future tax free.

Certain rules associated with Subpart F as it relates to controlled foreign corporations were also changed in the Tax Cuts and Jobs Act. The definition of a U.S. shareholder under the pre-act law included only individuals that own ten percent or more of the *voting* stock of a foreign corporation. The new definition for tax years after 2017 now includes U.S. shareholders who own ten percent or more of voting stock or the total *value* of the foreign corporation's stock. Further, the new legislation eliminates the thirty-day requirement in regard to controlled foreign corporations. Prior to the Act, U.S. shareholders of foreign corporations would have to include Subpart F income on their return only if the foreign corporation was a deemed a controlled foreign corporation for at least thirty consecutive days during a taxable year.

Effective January 1st, 2018, the TCJA repealed Section 958(b)(4) of the code. As a result, one can now constructively own stock via downward attribution through foreign entities. For example, stock of a corporation owned by a person that owns 50 percent or more in value of the stock of another corporation is treated as owned by such other corporation.

Global Intangible Low-Taxed Income

Effective for tax years after December 31st, 2017, shareholders of controlled foreign corporations will now have to include their share of income deemed as global intangible low-taxed income on their return. For the purposes of Section 951, the term 'global intangible low-taxed income' is the excess of a shareholder's net tested income from a controlled foreign corporation over the net deemed tangible income for the year. Net tested income is generally considered to be the controlled foreign corporation's gross income, not including Subpart F income, foreign oil and gas extraction income, and income subject to U.S. tax as effectively connected income. Net deemed tangible income is the excess of 10 percent of the aggregate of such shareholder's pro rata share of the qualified business asset investment of each controlled foreign corporation, over the amount of interest expense taken into account in determining the shareholder's net CFC tested income.

Qualified business asset investment (QBAI) is defined as the average of such corporation's aggregate adjusted bases as of the close of each quarter of such taxable year in specified tangible property. This applies to all assets used in a trade or business of the corporation and assets for which a deduction is allowed under Section 167. As a result, QBAI is generally property, plant, and equipment used in a trade or business and allowed a depreciation deduction under the code.

Deprecation must be calculated under Section 168(g) It is important to determine the QBAI with an understanding of which assets are used to generate net tested income as an allocation will apply if assets are used to generate gross income that is excluded from the tested income (e.g. subpart F income). A dual-use ratio will be used to properly allocate the QBAI in this circumstance.

The IRS has given anti-abuse rules under Prop Treas. Reg §951A-3(h), stating that certain property transferred or purchased with the intent of reducing the GILTI inclusion will be disregarded. This includes transfers of property to a related party even if the principal purpose of the transaction was not to reduce the GILTI inclusion.

With this significant change in tax law, a U.S. person that owns at least 10 percent of the value or voting rights (ownership is either direct, indirect or constructive ownership) in one or more CFCs will be required to include its global intangible low-taxed income, also known as GILTI, as currently taxable income, regardless of whether any amount is distributed to the shareholder.

As a U.S. shareholder of a CFC, you must file Form 8992, U.S. Shareholder Calculation of Global Intangible Low-Taxed Income (GILTI) , Schedule A to report the pro rata share of amounts for each CFC (the taxable year of which ends with or within the shareholder's taxable year) from each CFC's Form 5471, Schedule I-1, Information for Global Intangible Low-Taxed Income, to determine the U.S. shareholder's GILTI, if any, and to determine the amount of the U.S. shareholder's GILTI, if any, allocated to each CFC (caution: please note that this is only a draft version of the Form 8992).

It is important to note that the GILTI calculation is separate from any Subpart F calculations and a U.S. shareholder may have both a GILTI calculation and a Subpart F calculation. In addition, even if there is no Subpart F due to no current earnings and profits, there still can be a GILTI inclusion.

If you are eligible for a deduction for your GILTI inclusion under Section 250, the Form 8993, Section 250 Deduction for Foreign-Derived Intangible Income (FDII) and Global Intangible Low-Taxed Income (GILTI) is used to report your eligible deduction (caution: please note that this is only a draft version of the Form 8993). This Section provides a 37.5 percent deduction of foreign-derived intangible income, a 50 percent deduction of the GILTI inclusion amount, and an amount (attributable to the GILTI inclusion amount) treated as a dividend received by the domestic corporation under Section 78.

TAX CUTS AND JOBS ACT OF 2017

Affordable Care Act Individual Mandate

The individual mandate put into place by the Obama administration through the Affordable Care Act was repealed in the Tax Cuts and Jobs Act. Starting in 2019, there will be no more penalty imposed for those without health insurance meeting minimum essential coverage standards. Taxpayers can still face penalties for tax year 2018 and should ensure that they have minimum essential coverage or a valid exemption. Penalties can be up to 2.5% of annual income over the federal filing threshold or $695 per adult and $347.50 per child, depending on whichever amount is greater. Those living abroad for a substantial portion of the year can generally claim an exemption from the penalty.

Significant Adjustments to Schedule A

The standard deduction is a dollar amount that reduces the amount of income on which you are taxed. This deduction varies according to your filing status, and there is an additional standard deduction for individuals who are blind or age 65 or over. Taxpayers can choose to itemize their deductions on Schedule A or claim the standard deduction. For tax years beginning after December 31st, 2017 and before January 1st, 2026, the standard deduction has been increased to $24,000 for taxpayers filing jointly ($12,000 for single taxpayers, $18,000 for heads of household).

Taxpayers who itemize their deductions will suffer from the loss of miscellaneous deductions and the limitation of the state and local tax deduction. Taxpayers are now only able to deduct up to $10,000 ($5,000 for taxpayers married filing separately) in state and local taxes on Schedule A. This includes sales tax, state and local income tax, and real-estate taxes. Miscellaneous itemized deductions that were subject to the 2% floor are suspended for tax years 2018-2025. This includes deductions for unreimbursed business expenses (such as union dues, travel expenses, and business meals), tax preparation expenses, and other expenses (such as investment advisory fees, safe deposit box rental, and casualty/theft losses).

Taxpayers abroad should note that property taxes paid related to foreign real estate are no longer deductible on Schedule A.

Medical Expense and Mortgage Interest Deductions

Taxpayers who itemize can also reduce their taxable income by the amount of mortgage interest paid for their principal or second residence. The total value of mortgage and home equity indebtedness is now limited to $750,000 ($375,000 for married taxpayers filing separately). This provision applies to indebtedness incurred after December 15th, 2017. Taxpayers who refinance mortgages incurred prior to December 15th, 2017 will not be subject to the reduced limit unless the refinancing results in additional amounts borrowed.

Personal Exemptions and Child Tax Credit

The personal exemption has been completely suspended for tax years 2018-2025. You can’t claim a personal exemption for yourself, your spouse or your dependents.
The child tax credit is for taxpayers who have a qualifying child and can help reduce tax liability for many families. In general, a qualifying child must be under the age of 17 at the end of the tax year, have not provided more than half of his or her own support, lived with the taxpayer for more than half of the year, be claimed as a dependent on the taxpayers return, and be a U.S. citizen for tax purposes.

For tax years 2018-2025, the Act doubles the maximum child tax credit to $2,000 for each qualifying child. In addition, the refundable portion of the credit is now $1,400. The increase in the credit comes along with an increase in the phase-out threshold. The phase-out threshold for the child tax credit is now $400,000 for married taxpayers filing jointly and $200,000 for all other filers. The Act also allows an additional $500 non-refundable credit for certain non-child dependents. Taxpayers who file Form 2555 (foreign earned income exclusion) with their return are still ineligible for the additional child tax credit.

Qualified Business Income Deduction

Available for tax years 2018-2025, taxpayers with qualified business income may now be eligible for a twenty percent deduction from adjusted gross income depending on the circumstances.

This deduction is not available to taxpayers who operate 'specified service trades or businesses'. Specified service trades or businesses are largely considered any business in the law, accounting, health, actuarial, consulting, financial or brokerage industries where the principal asset of the business is the reputation or skill of one or more of its employees. This limitation will exclude a vast majority of taxpayers, but there is an exclusion available for taxpayers with less than $157,500 of taxable income ($315,000 for joint filers) that will generally allow them to claim the full twenty percent deduction. The deduction is phased out completely for single taxpayers if taxable income is $50,000 or more over the threshold ($100,000 for joint filers). The twenty percent deduction is only taken into consideration when calculating federal income tax and will not reduce the amount of self-employment tax owed.

Americans and U.S. taxpayers abroad should be aware that qualified business income does not include foreign earned income. For the purposes of Section 199A, qualified items of income are effectively connected to a trade or business within the United States. The requirement means that most taxpayers living abroad will not be eligible for the deduction.

FORM 8621
(PASSIVE FOREIGN INVESTMENT COMPANY– PFIC)

The PFIC Nightmare

The tax rules for Passive Foreign Investment Companies (PFIC) are almost unmatched in their complexity. Countless times, Americans overseas have come to us to prepare what they thought would be straightforward tax returns – only to later learn that the small foreign investment they had made in a non-US mutual fund is now subjecting them to all the significant filing requirements and tax obligations that apply to a PFIC. While it is beyond the scope of this document to cover all the numerous details related to PFIC reporting requirements, our hope is to provide guidance and insight into the world of PFICs so that they can be avoided whenever possible.

What Is A PFIC?

A foreign corporation is classified as a PFIC (passive foreign investment company) if it meets either of the following tests that apply to passive income:

• PFIC Income Test: 75% or more of the corporation's gross income is passive income (interest, dividends, capital gains, etc.), or the

• PFIC Asset Test: 50% or more of the corporation's total assets are passive assets (passive assets are investments that produce interest, dividends and/or capital gains)

PFICs often include foreign-based mutual funds, money market accounts, pension funds, partnerships and other pooled investment vehicles (such as many foreign REITs) that have at least one U.S. shareholder. In addition, a foreign holding company that possesses passive investments (like rental real estate or government bonds) would be subject to PFIC regulations if the company were set up as a corporation.

PFICs include almost all foreign mutual funds, hedge funds and many insurance products. It might even encompass your bank account if that account is a money-market fund rather than just a straight deposit account because money market accounts are essentially short-maturity fixed-income mutual funds. Furthermore, the rules that apply to PFICs often apply to investments held inside foreign pension funds unless those pension plans are recognized by the U.S. as "qualified" or as an "employee trust."

PFICs are subject to complicated and strict tax guidelines. Both the PFIC and the shareholder must keep accurate records of all transactions, including share basis, dividends and any undistributed income earned by the company.

PFICs are reported on Form 8621. Form 8621, Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund, must be filed with the taxpayer's federal income tax return every year in which the taxpayer recognizes certain gains or distribution, makes a taxation method "election," or has an annual filing requirement to do so. A separate Form 8621 must also be filed for each PFIC.

The tax treatment of PFICs is extremely punitive compared to the tax treatment of mutual funds in the U.S. After taxes and interest are applied to these investments, many taxpayers will find a huge dent in any investment gains.

Why PFIC Taxation?

PFIC taxation began with the Tax Reform Act of 1986 in hopes of leveling the playing field for U.S. based investment funds (i.e. mutual funds).

Before 1986, U.S.-based mutual funds were forced to pass-through all investment income earned by the fund to its investors (resulting in taxable income). Foreign mutual funds, on the other hand, were able to shelter their taxable income as long as it was not distributed to its U.S. investors. Once this law was passed, foreign mutual funds became much less advantageous to U.S. investors.

Most investors in PFICs must pay income tax on all distributions and appreciated share values, regardless of whether capital gains tax rates would normally apply.

The Story Of Foreign Mutual Funds and PFICs – Falling Down The Foreign Mutual Fund Rabbit Hole

If you are a U.S. citizen or resident (i.e. "Green-Card Holder") and have investments in a foreign financial institution that includes foreign mutual funds, you need to understand Passive Foreign Investment Companies (PFICs).

Why?

The passage of the Foreign Account Tax Compliance Act (FATCA) is bringing about a new era of dramatically heightened enforcement by the U.S. of laws regarding taxation of and reporting on foreign investments held by U.S. taxpayers. Thus, it is becoming increasingly more difficult if not impossible to be ignorant of filing requirements, including the filing requirements of PFICs.

One of the most confusing aspects of foreign investing is the difference in the reporting and taxation of foreign mutual funds as compared to U.S.-based mutual funds.

It is very clear that the US tax laws have been designed to deter US persons from investing in mutual funds outside the US, but oftentimes US taxpayers are caught unaware about the reality of the investment in PFICs that they already have.

But be aware and forewarned!!! Investing in a mutual fund outside of the U.S. and PFICs in general is a trap of mammoth proportions for the unwary.

At Tax Samaritan, we frequently hear from taxpayers that were lured by investments in offshore mutual funds with false promises of tax-free earnings until the profits are repatriated back to the U.S. Unfortunately, every year, many U.S. investors fall for these pitches and invest in foreign mutual funds, usually in the form of an insurance policy or retirement account.

While no tax may be payable in the fund's jurisdiction or foreign country of residence, U.S. taxation often applies.

Who Must File The Form 8621

Generally, a U.S. person that is a direct or indirect shareholder of a PFIC must file Form 8621 for each tax year if he or she:

- Receives certain direct or indirect distributions from a PFIC,
- Recognizes gain on a direct or indirect disposition of PFIC stock,
- Is reporting information with respect to a QEF or mark-to-market election,
- Is making an election reportable in Part II of the form, or
- Is required to file an annual report

A separate Form 8621 must be filed for each PFIC in which stock is held directly or indirectly.

The Reporting Pain Of PFICs

With PFICs, the U.S. taxpayer is subject to one of three methods to determine the amount of taxable income the taxpayer incurs as a result of the investment.

Two of the methods are elective options subject to strict rules and timing of election, while the third is the default method absent any election.

Section 1291 Method – The "Excess Distribution" Method

The default method for calculating taxable income incurred from PFICs is the Section 1291/Excess Distribution method. This method is most common, as many taxpayers don't become aware of their PFIC filing and taxation requirements until after it is too late to choose another method.

The excess distribution method applies to any distribution (also known as a dividend) in excess of 125% of the average distributions received by the investor over the immediately preceding three-year period or any disposition (sale of mutual fund shares). The excess distribution is deemed to have been earned ratably over the period of the taxpayer's investment in the PFIC. For a disposition, any gain is treated as having been earned ratably over the investment period as well.

The tax that would have been paid in prior years is computed at the highest ordinary income rate, and the associated interest is calculated at the underpayment rate as determined under Code Section 6621.

This method leads to a significant amount of taxes and interest for most taxpayers. It is also very difficult to complete. Furthermore, even if a taxpayer has a loss on disposition, it will not be deductible.
Yikes.

QEF (Qualifying Election Fund)

For most investors, the most favorable method of taxation will be to treat the PFIC as a "qualified electing fund" ("QEF" for short). The QEF election allows the taxpayer to distinguish between capital gain and ordinary income of the PFIC.

However, in order for the QEF election to be effective, the PFIC must provide the taxpayer with a "PFIC Annual Information Statement" that includes enough information to allow the taxpayer to accurately determine his or her pro rata share of the PFIC's ordinary income and capital gain for the taxable year.

So you may be asking, "why doesn't everyone make a QEF election for foreign mutual fund shares?"

It's simple. The reason that few investors make QEF elections for foreign mutual fund shares is that it is impossible to do so in most cases.

Foreign mutual funds, even those that are essentially offshore clones of U.S. funds, simply do not keep U.S. books and tax records and provide U.S. tax information to their shareholders, which is a requirement for making the QEF election.

Mark-To-Market Election

If it isn't possible to make a QEF election, U.S. taxpayers holding PFICs may elect to annually treat the investment on a "mark-to-market" basis. In order to make the mark-to-market election, the units the investor owns in the PFIC must be "marketable stock."

The term "marketable stock" is defined by the Code as stock regularly traded on a national securities exchange that is regulated by a foreign government (equivalent to the SEC in the United States).

The mark-to-market election allows the taxpayer to include in gross income the difference between the taxpayer's basis for the investment in the PFIC (the "mark") and the investment's fair market value (the "market") at the end of the taxable year (this is known as the "mark-to-market gain"). Any mark-to-market gain, as well as any gain on sale or disposition of the investment in the PFIC, is treated as ordinary income.

Both the QEF and mark-to-market elections are made on Form 8621, Information Return By A Shareholder Of A Passive Foreign Investment Company Or Qualified Electing Fund. These elections must generally be made by the regular due date of the tax return.

When To File The Form 8621

Form 8621 is attached to the shareholder's tax return (or, if applicable, partnership or exempt organization return), and both must be filed by the due date of the return, including extensions.

Penalties For Failure To File Form 8621

A U.S. individual shareholder who fails to disclose a directly held PFIC investment on either Form 8621 or Form 8938 when required can be subject to a $10,000 penalty under §6038D(d).
In addition, failure to file a required Form 8621 can result in the suspension of the statute of limitations with respect to the U.S. shareholder's entire tax return until the shareholder files this form. This means the IRS could have an unlimited amount of time to audit your tax return and assess tax if the you fail to file a required Form 8621. However, if you have reasonable cause for your failure to file, the statute of limitations will be suspended only with respect to the unreported PFIC investment and not to other unrelated portions of your return.

Compliance Taint Of PFICs

High taxation rates are not the only big disadvantage of PFICs for American investors. Complying with IRS reporting rules for PFICs is a difficult task for most taxpayers, making investment in PFICs even more of a burden.

Ownership of PFICs is most common among expatriate Americans, many of whom employ tax professionals specializing in tax preparation for Americans abroad. However, hiring an expatriate tax specialist does not guarantee that you are in compliance with PFIC reporting and taxation regulations. While the field of tax professionals that specialize in expatriate tax returns is small, the field that is familiar with and experienced in the reporting and taxation of PFICs and Form 8621 is even significantly smaller. Tax Samaritan is one such firm that has extensive experience in this arena.

At Tax Samaritan, we often see that taxpayers inadvertently fails to divulge (and the tax professional fails to request or inquire further) about any possible PFIC holdings.

In other cases, if the client and the tax preparer have negotiated a fixed fee for tax preparation, the preparer may be reluctant to ask about possible PFICs because record keeping and preparation time for the complex Form 8621 is estimated by the IRS to be 46 hours per mutual fund, per year. In other words, it is neither a simple or inexpensive undertaking.

Furthermore, many tax professionals simply lack the ability to properly prepare the Form 8621. At Tax Samaritan, we have the experience and knowledge to prepare the Form 8621 and related calculations and do so at a reasonable fee.

FATCA Makes PFIC Reporting Essential

As a US taxpayer, you may be thinking about an obvious question. If PFICs are such a big trap, why has there not been more discussion of the issue and why have I never read about it before? The reason is that, until now, the IRS faced many obstacles to enforcing the PFIC rules. With FATCA information sharing and disclosures made by taxpayers, it won't be long before the IRS starts to focus on these known investments and the companies that promote them.

In the past, the IRS has shown interest in the disclosure of PFICs as part of the Offshore Voluntary Disclosure Program. Under newly changed streamlined programs, this interest may expand.

Failure to file Form 8621 and properly report PFICs has hardly ever resulted in an audit or a prosecution for tax fraud. The PFIC issue has been safely ignored until now, even by professional tax preparers. But times have changed. With a potential penalty of $10,000 for failure to report and disclosure of the underlying investment accounts as part of the FBAR (with the FinCen Form 114) and Form 8938 disclosures, there is a significant risk to not report.

The FATCA legislation not only requires new self-reporting on PFICs and other foreign held financial assets, but also requires all “foreign financial institutions” to report on the assets held by U.S. citizens and U.S. permanent residents directly to the IRS.

While it may seem hard to believe that foreign financial institutions would willingly comply with such reporting requirements, the fact is that industry observers expect nearly universal compliance with the new rules by banks, brokerages, insurance companies, mutual funds (anything “financial”) around the world, because of the severe sanctions the FATCA law imposed on non-compliant financial institutions. In fact, most foreign governments, which have similar tax compliance issues with their own citizens are only too eager to trade information.

The result is that all U.S. citizens must assume that, as of July 1, 2014, the IRS will have a direct and easily accessible window into their holdings in foreign financial institutions.

PFIC Avoidance Strategy

As a general rule, a U.S. taxpayer would be in far better position to invest directly in the stock of foreign corporations that are not PFICs or to invest in a U.S. mutual fund that invests in foreign stocks or foreign mutual funds.

The bottom line? Don’t believe any foreign investment adviser regarding the U.S. tax consequences of any investment. Know the consequences of investing in foreign mutual funds before you invest by getting tax advice from a qualified U.S. tax practitioner, such as Tax Samaritan.

THE IMPORTANCE OF FILING AND PAYING

INTERNATIONAL DATA EXCHANGE

What Does This Mean For Your Foreign Bank Account Reporting?

On January 12, 2015, the IRS announced the opening of the International Data Exchange Service (IDES) for enrollment. Financial institutions and host country tax authorities will use IDES to securely send their information reports on financial accounts held by U.S. persons to the IRS under the Foreign Account Tax Compliance Act (FATCA) or pursuant to the terms of an intergovernmental agreement (IGA).

FATCA was passed as part of the HIRE Act of 2010 and requires foreign financial institutions to report on the holdings of US taxpayers to the IRS or face steep penalties of up to 30 percent on the US source income. The international data exchange was created to support the requirements of FATCA. While there has been significant controversy, the US has also been signing IGAs with the tax authorities in other countries.

More than 145,000 financial institutions have already registered through the IRS FATCA Registration System. The U.S. also has more than 110 IGAs, either signed or agreed upon.

The opening of the International Data Exchange Service is the start of a secure system of automated, standardized information exchanges among government tax authorities. This will enhance the ability of the IRS and other foreign countries to detect hidden accounts and help ensure fairness in the tax system.

Given the gravity of the potential penalties for underreporting, even small errors or mistakes can result in a substantial income for the U.S. government (and losses for taxpayers). At Tax Samaritan, we anticipate that the IRS will eventually use this information in an automated fashion to identify under-reporting of income and non-disclosure of foreign accounts. We also anticipate that the IRS approach will be similar to processes used today to match information reported on the Form 1040 to what has been reported to the IRS by third parties (such as W2s from your employers, 1099s, etc.).

IRS CUSTOMS HOLD

IRS Customs Hold – An Enforcement Tool For Delinquent Taxpayers

IRS revenue officers can request an IRS customs hold to be entered into the Treasury Enforcement Communication System (TECS) for delinquent taxpayers. Once a taxpayer is entered into TECS, the US Department of Homeland Security notifies the IRS whenever the taxpayer travels into the United States.

The IRS has stated that the IRS customs hold is one of the most effective enforcement tools available for dealing with international delinquent taxpayers. IRS international revenue officers use information obtained from an IRS customs hold to attempt to contact the delinquent taxpayer while they are in the US and to locate is or her assets.

If a customs hold is in place, the taxpayer is notified with Letter 4106, Letter Advising Taxpayer of Department of Homeland Security Notification, that an international revenue officer has taken action to advise Homeland Security that the taxpayer has outstanding tax liabilities and that this may result in an interview by a Customs and Border Protection Officer if he or she attempts to enter the United States. In addition, Homeland Security can stop delinquent taxpayers identified on TECS to collect their contact information for their time in the US.

IRS CAN REVOKE PASSPORTS

Owe $50,000 Or More To The IRS? The IRS Has The Power To Revoke Passports For Tax Delinquents

President Obama signed a controversial law that grants authority to the IRS to prevent issuance or revoke the US passport for US taxpayers that owe $50,000 or more in unpaid federal taxes, penalties and/or interest in which a lien has also been filed. The new law went into effect on January 1, 2016.

While the right to travel has been recognized as fundamental, if you are a US taxpayer overseas and you haven't filed a return in years or you have had a tax debt that has been ignored, this can have a devastating effect on both travel and daily activities.
In addition to an impact on travel, there are many other negative consequences associated with a revoked passport, such as the ability to open bank accounts, stay in hotels abroad, etc.

This law is clear evidence that the U.S. is becoming increasingly more serious about the collection of tax from delinquent taxpayers and enforcement of US tax laws.

With funding cutbacks at the IRS, most IRS offices overseas have closed and other services by phone have deteriorated due to the lack of manpower. Unfortunately, this has made it even more challenging for taxpayers to resolve their tax issues and has only served to increase the need for help from a tax professional.

WHEN ARE RETURNS DUE?

Tax Filing Deadline

For most Americans, the deadline to file tax returns and pay any taxes due is April 15th of the following tax year.

NEED MORE TIME TO FILE YOUR RETURN?

Tax Filing Deadline For Expats

If, on the regular due date of your return, you are out of the country and a U.S. citizen or resident, you are allowed two (2) extra months to file your return and pay any amount due without requesting an extension. However, any tax owed will be charged interest for the period of April 15 to June 15.

Tax Filing Deadline With Extension

If you need additional time, you can file for an extension until October 15th. The extension must be filed by April 15 (or June 15 if overseas on April 15).

Additional Discretionary 2-Month Extension To The Tax Filing Deadline

In addition to the 6-month extension to October 15, taxpayers whose main place of business is outside the United States and Puerto Rico and who live outside those jurisdictions can request a discretionary 2-month extension of time to the tax filing deadline to file their returns (to December 15 for calendar year taxpayers).

To request this extension, you must send the IRS a letter explaining why you need extra time. Send the letter by the extended due date (October 15 for calendar year taxpayers).

Unlike other extension requests, unfortunately, you will not receive any notification from the IRS unless your request is denied.

If any of the above dates fall on a weekend or a U.S. or District of Colombia holiday (such as Emancipation Day), the deadline is extended to the next business day.

Our recommendation is always to start and complete your return as soon as you have the necessary tax documents – optimally in February so that there is no last-minute rush to file. If there are taxes due as a result of your return, you can file your return early and then pay your taxes on the tax payment deadline of April 15 (which is the same for all taxpayers).

Form 2350 - A Tax Extension Of Time To Meet Tests

You generally cannot get an extension of more than 6 months. However, if you are outside the United States and meet certain requirements, you may be able to get a longer extension. You can get an extension of more than 6 months to file your tax return if you need the time to meet either the bona fide residence test or the physical presence test to qualify for either the foreign earned income exclusion or the foreign housing exclusion or deduction.

You can request an extension if all three of the following apply:

- You are a U.S. citizen or resident alien.
- You expect to meet either the bona fide residence test or the physical presence test, but not until after your tax return is due.
- Your tax home is in a foreign country (or countries) throughout your period of bona fide residence or physical presence, whichever applies.

If you are granted an extension, it generally will be to 30 days beyond the date on which you can reasonably expect to qualify for an exclusion or deduction under either the bona fide residence test or the physical presence test.

You must file Form 2350 by the due date for filing your return to request the tax extension to meet tests.

FBAR Filing Deadline

For the FBAR (FinCEN Form 114) , the filing deadline is April 15th, however an extension to October 15th is available.

Any reports filed after the deadline or extended deadline date are considered delinquent, and electronic filing is required.

Combat Zone Extension

As A Contractor, Do I Qualify For The Special Combat Zone Extension?

As a contractor serving in a combat zone, you may qualify for a special combat zone extension.

If you are a qualified contractor working in a combat zone, compliance actions with the IRS, such as audits or enforced collections, are delayed until 180 days after have left the combat zone. In addition, the deadline for filing tax returns, paying taxes, filing claims for refund and taking other actions with the IRS is automatically extended if you qualify.

If you are serving in a combat zone or a contingency operation in support of the Armed Forces, such as Red Cross personnel, accredited correspondents and civilian personnel acting under the direction of the Armed Forces in support of those forces, you may qualify for the combat zone extension.

COMMON PROBLEMS AND SOLUTIONS FOR US TAXPAYERS OVERSEAS

DELINQUENT / LATE TAX RETURNS

Back Tax Returns? Get Taxes Off Your Back And File

IRS Identification Of Non-Filers

Every year, the IRS improves their methods of identifying delinquent tax filers. Regardless of the cause of your back tax-filing problem, you need to take this issue very seriously. Even if the IRS hasn't found you yet, they will, and you may face very serious consequences if you continue to ignore the situation.

Expat Unfiled Tax Returns

Expat unfiled tax returns are very hard to explain away to a federal or state tax authority. While a common mishap, claiming ignorance is balanced by the issue of willfulness. The IRS will raise this issue if you show, through previous filings, that you understood that the US taxes its citizens and permanent residents on worldwide income rather than just money earned stateside. Have you ever filed a US tax return in your entire life? Have you ever filed a US tax return while living or working overseas?

But I Didn't Know…

If you have ever filed a return in the past, the IRS can say your failure to file in recent years is a "willful" act; you "decided" to skip a year… or two… or three. Ignorance and forgetfulness are not acceptable excuses. Naturally, your foreign employer didn't send you a US Form W2 or Form 1099 and you didn't know what to do. Nevertheless, you still have to report the income.
It is to your advantage to file a tax return if you are living or working overseas because you may benefit from the Foreign Earned Income Exclusion and other valuable credits that can significantly reduce your tax liability. However, you can only claim these benefits if you do so before the IRS takes action to obtain the unfiled returns.

What Are The Penalties For Expat Unfiled Tax Returns?

- Failure to File Penalty: 5% of unpaid balance for each month or part of a month the return is late. Maximum 25%. If the return is more than 60 days late, the minimum penalty is the lesser of $135 or tax due. There is no penalty if the return shows a refund.

- Failure to Pay Penalty: 0.5% of unpaid balance for each month or part of a month there is an unpaid balance. Maximum 25%.

If your only issue is non-compliance (i.e. expat unfiled tax returns), you are just looking at an administrative issue, and you will be back on the good side of the IRS simply by filing your late returns.

Why Sooner Than Later? Why You Should File Your Expat Unfiled Tax Returns Sooner

You should act sooner than later. You need to submit expat unfiled tax returns as soon as possible because the IRS Statute of Limitations is ticking away.

While not filing is a criminal offense, not paying your taxes is just a civil offense. Don't let the fear of a tax bill stop you from complying with your filing requirements.

If you have unfiled expat tax returns, usually you will have to file the previous six (6) years, plus the current year. Depending on what years the IRS requests, this "fix" may satisfy them. We usually wait for any request before we prepare returns going back further then six (6) years. While this is common IRS practice, the tax code and Statute of Limitations (discussed further below) leaves you open for additional unfiled tax years. Sometimes it takes several years for the IRS to notify you that you did not file your return. This is not the situation you want. After several years pass, you may have lost vital records, and have forgotten much about your financial situation. The interest and penalties for filing and paying late may be insurmountable!

In addition, the IRS has concluded the Offshore Voluntary Compliance Program on September 28th, 2018 & there is always potential for other similar programs (i.e. streamlined filing compliance procedures) to close as well.

IRS Statute Of Limitations

The statute of limitations refers to how long the IRS has to inquire about your tax return, audit you, charge taxes, penalties and interest, etc. Generally, there is a 3-year statute of limitations for the IRS auditing a tax return and a 10-year statute of limitations for the IRS collecting tax.

If you underreport your gross income by 25% or more of the amount shown on your return, then the statute of limitation is six (6) years. The statute of limitations does not apply if you file a fraudulent return with the intention to evade taxes (i.e. they can come after you indefinitely) or if your tax return was prepared by the IRS (i.e. a substitute filed return).

Some US Expats have spent a good amount of time researching their situation and have found that the statute of limitations for collection expires in 10 years – that is, the IRS cannot collect and it becomes bad debt after 10 years. A taxpayer could enter into payment agreements and at the end of 10 years, regardless of the balance left, owe the IRS nothing.

While this sounds great, don't get too excited. According to IRS Code Section 6503(c), "Taxpayer Outside United States", the running of the period of limitations on collection after assessment prescribed in section 6502 shall be suspended for the period during which the taxpayer is outside the United States if such period of absence is for a continuous period of at least 6 months.

If you have unfiled tax returns, the clock hasn't started on your statute of limitations. That means that the IRS can seek your unfiled returns six years from now, 15 years later, 30 years later and so forth. In other words, there is no statute of limitations to go after your back tax returns. The statute of limitations clock doesn't start until you file your return.

The IRS may send you a notice requesting that you file a delinquent tax return right away, or they may take several years to inform you that they haven't yet received your tax return. Regardless, you can be sure that the IRS will eventually notice that you haven't filed a tax return and will pursue you for any associated back taxes. The IRS does not forget. The IRS does not go away.

Back Tax Returns

Just because the IRS has not contacted you does not mean they have missed your failure to file. Eventually, the IRS will prepare your return based on what is in the best interest of the government, usually with little or no deductions. This results in the IRS overstating what taxes you owe and, consequently, what you owe in penalties and interest.

The only deductions you'll see are standard deductions and one personal exemption. You will not get credit for other deductions to which you may be entitled, such as exemptions for spouses, children, mortgage interest and real estate taxes on your home, the cost basis of any stock sales, and business expenses for your self-employment income reported on a 1099-MISC, etc.

Consequences Of Not Filing Back Tax Returns

You may be tempted to ignore your unfiled returns, hoping to fly under the radar and escape the IRS's notice. This is a risky choice. Failing to address your tax problem can result in serious consequences, including:

- Potential criminal charges
- Difficulty obtaining a job
- Civil penalties
- Wage and Social Security garnishment
- A "Substitute for Return" filed by the IRS
- Tax collection enforcement
- Tax liens

- Bank account levies
- You and your dependents will be ineligible for student loans
- Difficulty obtaining credit to refinance a home or obtain new credit
- Loss of passport

As you can see, the IRS can financially paralyze you. To avoid these consequences, it is important that you address the situation immediately.

Make no mistake, this is not a situation to take lightly, failing to file your tax returns can be a criminal offense. The further passage of time only contributes to the amount of back tax help that will be needed to fix your tax problems. The IRS will not entertain any type of tax settlement (such as an Offer in Compromise) or installment payment plan to settle your back taxes until you have filed all legally required tax returns.

File Delinquent Tax Returns—Fix Back Taxes

However, peace of mind and good night's sleep is well within reach – get the peace of mind you deserve by getting back into tax compliance. If you voluntarily file your delinquent returns, you'll likely avoid further problems in the future. It's in your best interest to file returns for those missing years as soon as possible. The longer you wait, the higher your possible tax liability.
Before anything can be done to extract you from this predicament, all the returns must be filed. Filing an original return vs. an IRS prepared return will give you a chance to state what you truly owe. If you haven't filed a tax return in a while, you may owe back taxes, but perhaps you may even have a refund.

The first step is to gather all of your tax information and documentation for each year you failed to file a tax return. Research thoroughly any missing information to be sure the return you file is accurate and complete. Tax Samaritan can assist you with this first step by researching with the IRS all the background information that is available on your account, which includes all wage and income information that has been reported to the IRS and help you identify what other information may be needed for your return.

What Should You Do If You Have Unfiled FBAR Forms?

As a taxpayer with unfiled FBAR reports (the FinCEN Form 114), once you learn about the filing obligations and the penalties for noncompliance, the next question you may have is "what do I do about getting into compliance with filing the unfiled FBAR forms?" How you choose to file your unfiled FBAR reports is ultimately up to you, the taxpayer. After you educate yourself about the various options available and determine the level of acceptable risk, you can make a decision.

Unfiled FBAR Forms – What To Do?

The reality nowadays with FATCA is that, if you are an American with accounts overseas, it is only a matter of time before the undisclosed foreign financial accounts and unfiled FBAR forms are discovered by the government.

The Foreign Account Tax Compliance Act (FATCA) requires foreign financial institutions to sort through their account base and disclose accounts with ties to the United States. At some point, most, if not all, foreign financial institutions and countries will be sharing financial information.

As a result of FACTA, many American account holders are receiving communications from their foreign banks requesting proof of FBAR compliance and advising those account holders that their account information will be disclosed to the IRS.

FBAR Late Filing Options

The implementation of FATCA and ongoing efforts to uncover FBAR late filing by the IRS, Treasury Department, and the U.S. government in general has raised awareness of FBAR filing requirements among U.S. taxpayers.

As a result, many taxpayers are exploring their options for getting back in compliance with these requirements and addressing the inherent problems and risks associated with FBAR late filing. Some of the options available include:

- Streamlined Filing Compliance Procedures
- Delinquent FBAR Submission Procedures
- Delinquent International Information Return Submission Procedures

Because the facts and circumstances of taxpayers vary widely, there is no one-size-fits all approach. A number of factors should be evaluated, preferably with assistance with a professional firm such as Tax Samaritan.

Streamlined Filing Procedures

The current streamlined procedures are available to both taxpayers residing outside of the U.S. (the Streamlined Foreign Offshore Procedure) and those residing in the U.S. (the Streamlined Domestic Offshore Procedure) for FBAR late filing. For taxpayers that reside outside of the U.S., all penalties are waived. However, for those residing in the U.S., the only penalty will be the Title 26 miscellaneous offshore penalty equal to 5% of the foreign assets that were not disclosed, in addition to tax and interest owed on unreported income.

Under the streamlined procedures, all taxpayers must:

- File original or amended tax returns for the most recent 3 years. Note: While only the most recent three years of returns can be filed within the streamlined procedures, delinquent returns for any prior years must be filed outside of the streamlined procedures. It is important to note that there is no statute of limitations for unfiled tax returns and that while the IRS in general will not request more than the prior six years to be filed, it is not unheard of the IRS requesting more. For any delinquent returns not filed, there will always be a risk that the IRS could pursue filing and penalties related to any unfiled returns 10, 20, 30 years later as the statute of limitations remains open indefinitely until a return has been filed.

- File delinquent FBARs (FinCEN Form 114) for the most recent 6 years
- Under the streamlined filing compliance procedures, either the “Streamlined Foreign Offshore Procedures” (for U.S. Taxpayers Residing in the United States) or the “Streamlined Domestic Offshore Procedures” (for U.S. Taxpayers Residing in the United States), taxpayers must certify that their conduct relating to the failure to file FBARs (FinCen Form 114) and disclosing foreign accounts was not willful on the Certification Of Non-Willful Conduct on Form 14654 or Form 14653.

Delinquent FBAR Submission Procedures

Under the delinquent FBAR submission procedures, the delinquent FBARs (FinCEN Form 114) are filed along with a statement explaining why there is an FBAR late filing. The delinquent procedure can be used if:

- Have an FBAR late filing – have not filed required FBAR.
- Are not under a civil examination or criminal investigation by the IRS.
- Have not been contacted by the IRS about FBAR late filing / delinquent FBARs or a request for delinquent tax returns

Under the delinquent FBAR submission procedures, the IRS will not impose a penalty for FBAR late filing if you have properly reported and paid tax on all income from the foreign financial accounts being reported on the delinquent FBARs.

While FBAR late filing under this option will not automatically subject the FBAR disclosure to audit or extra scrutiny, it may still be selected for audit through the standard IRS audit selection process.

Delinquent International Information Return Submission Procedures

The procedures are appropriate for taxpayers who do not need to use the OVDP or the Streamlined Filing Compliance Procedures to file delinquent or amended tax returns to report and pay additional tax, but who:

- Have not filed one or more required international information returns,
- Have reasonable cause for not timely filing the information returns,

- Are not under a civil examination or a criminal investigation by the IRS, and

- Have not already been contacted by the IRS about the delinquent information returns should file the delinquent information returns with a statement of all facts establishing reasonable cause for the failure to file.

Describe Your Situation In The Reasonable Cause Statement

As part of the reasonable cause statement, taxpayers must also certify that any entity for which the information returns are being filed was not engaged in tax evasion. If a reasonable cause statement is not attached to each delinquent information return filed, penalties may be assessed in accordance with existing procedures. Tax Samaritan can help you prepare an appropriate reasonable cause statement to accompany your delinquent information return.

Information returns filed with amended returns will not be automatically subject to audit but may be selected for audit through the existing audit selection processes that are in place for any tax or information returns.

HELP WITH YOUR TAX RETURN

Enrolled Agents Are America's Tax Experts!

An IRS enrolled agent (EA) is a person who has earned the privilege of representing taxpayers before the Internal Revenue Service by either passing a three-part comprehensive IRS test covering individual and business tax returns, or through experience as a former IRS employee. All candidates are subjected to a rigorous background check conducted by the IRS.

Enrolled agent status is the highest credential the IRS awards. Individuals who obtain this elite status must adhere to ethical standards and complete 72 hours of continuing education courses every three years. Because of the expertise necessary to become an enrolled agent and the requirements to maintain the license, there are less than 50,000 practicing enrolled agents worldwide.

Enrolled agents, like attorneys and certified public accountants (CPAs), are unrestricted as to which taxpayers they can represent, what types of tax matters they can handle, and which IRS offices they can represent clients before. Learn more about enrolled agents in Treasury Department Circular 230.

The big advantage that you get by using an EA to do your tax return is that the same team that handles the preparation of the return can represent you if you are audited. This can be a big advantage if your return is at all complicated.

What Is An Enrolled Agent With The IRS?

"Enrolled" means to be licensed to practice by the federal government, and "Agent" means authorized to appear in the place of the taxpayer at the IRS. Only enrolled agents, attorneys, and CPAs have unlimited rights to represent taxpayers before the IRS. The enrolled agent profession dates back to 1884 when, after questionable claims had been presented for Civil War losses, Congress acted to regulate persons who represented citizens in their dealings with the U.S. Treasury Department.

How Can An Enrolled Agent Help Me?

IRS enrolled agents advise, represent, and prepare tax returns for individuals, partnerships, corporations, estates, trusts, and any entities with tax-reporting requirements. Enrolled agents' expertise in the continually changing field of taxation enables them to effectively represent taxpayers at all administrative levels within the IRS.

Enrolled Agents vs. CPAs – What Are The Differences?

Only enrolled agents are required to demonstrate to the IRS their competence in all areas of taxation, representation and ethics before they are given unlimited representation rights before IRS.

Certified Public Accountants' (CPA), who are state licensed, specialize in accounting and may or may not choose to specialize in taxes. Unlike attorneys and CPAs, all enrolled agents specialize in taxation.

Are Enrolled Agents Bound By Any Ethical Standards?

Enrolled agents are required to abide by the provisions of the Department of Treasury's Circular 230, which provides the regulations governing the practice of enrolled agents before the IRS.

TOP FIVE THINGS TO EVALUATE

Top Five Should Ask Questions Before Hiring A Tax Professional

When hiring a tax professional there are several questions that you should ask to narrow down to the cream of the crop.

However, the bottom line is that hiring a tax professional is a personal choice and ultimately you want to then find the right match or connection – there's no one size fits all.

You want to find the right tax professional.

A professional that you will hopefully have a long-lasting, fruitful and profitable relationship with – one that will save you money on your taxes and more…

Here’s a list of our top five should ask questions that we recommend before hiring a tax professional:

1. What Is Your Tax Credential? An enrolled agent (EA) has earned the privilege of representing taxpayers before the Internal Revenue Service by either passing a three-part comprehensive IRS test or through experience as a former IRS employee. EA status is the highest credential the IRS awards and the sole credential focused on the subject of taxes (CPAs are more broadly focused on Accounting and Attorneys more broadly focused on Law). EAs must adhere to ethical standards and complete 72 hours of continuing education courses every three years.

2. What Happens If I Get Audited? How will the tax professional handle an audit or examination from a taxing authority – the IRS or state? Do they provide any representation? Can they represent you? Note: Not all tax professionals are eligible to represent taxpayers before the IRS.

3. Do You Offer Year-Round Service? Most tax professionals close up shop after tax season and then go on vacation the rest of the year. Will you be able to get in touch with them the rest of the year? Make sure that you can.

4. Do You Have References? Ask for testimonials and/or Better Business Bureau (BBB) review information on the business. Make sure that they have been around for a while. There should be overwhelmingly positive reviews, but having a few negative reviews is normal and to be expected.

5. Do You Have A PTIN (Preparer Tax Identification Number)? This is a very important question when working with all tax professionals but even more so with overseas tax professionals. ALL tax professionals that prepare federal tax returns are required to have a PTIN by the IRS. Check the IRS Directory of Federal Tax Return Preparers to confirm that your tax selected tax professional has a PTIN. In addition, you can also search and confirm for other credentials, such as Enrolled Agent or EA.

What To Do Next

Tax Samaritan offers a complimentary "30 Minute Consultation" which we conduct over the telephone or video call (such as Skype) with you. Here is what we accomplish together in this fast-paced, zero-nonsense session:

• Understand Your Complex U.S. Tax Filing Requirements: One missed disclosure or unreported income or can have a devastating impact on your taxes. This can be quickly and easily avoided – so long as you know what critical misstep not to take. We'll answer your questions on your recommended filing needs based on your information provided. This will immediately remove any confusion or uncertainty that you may be experiencing with the filing of your U.S. tax return.

• Tax Problems: Lying awake at night worried about tax problems? We've helped hundreds of clients clear this hurdle with several strategies and options whether it is getting caught up with unfiled tax returns or unpaid tax liabilities.

The 30 Minute Consultation is conducted by the principal of our company, Randall Brody or one of our Senior Tax Professionals. Please be assured that this consultation will not be a thinly disguised sales presentation; it will be an opportunity for you to get answers to all of your pressing questions and concerns. There is no charge for this call, but please be advised that the call must be strictly limited to 30 minutes.

To secure a time for this consultation, please complete our brief quote questionnaire at https://www.taxsamaritan.com/tax-return-getting-started/tax-quote/ which will permit us to understand your filing requirements and provide you with a detailed quote and filing recommendations. Once completed, please email us at info@taxsamaritan.com to let us know your availability over the next five business days including your local time zone and best contact number and we will advise regarding available time slots.

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TAX SOLUTIONS & WEALTH MANAGEMENT