KOZROG Consult
US TAX SERVICES

U.S. Tax Guide for Americans Moving Abroad

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Introduction

Moving abroad! Taking on the adventure to explore other parts of the world, to experience new culture, new food, new environment, and new people. But besides exciting, "new" can also be overwhelming, because some of the things you don't want changing will also change...such as your taxes. Like it wasn't hard enough to figure them out the first time around.

There are different reasons why Americans decide to move abroad - seek new job opportunities, go to school, retire peacefully, or take on an adventure of a lifetime. Whatever the reason might be, one thing expats have in common is that they all have to deal with taxes. This guide is designed for U.S. citizens or residents who are planning to move or have recently moved abroad to help answer basic questions like "Do I still need to file a tax return?" and to shed a light on expats' U.S. tax obligations.

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Tax Return Obligation

Do I need to file a U.S. tax return while living abroad?

The U.S. tax system taxes American citizens and permanent residents on their worldwide income (U.S. and foreign), regardless of where they live and regardless of where that income is paid. If you live and work in a foreign country, the income you "earn" in that country is taxable in the U.S. The rules for filing a tax return are the same for Americans who live in the U.S. and the ones who live abroad. As such, U.S. expatriates must continue to file U.S. tax returns, unless their gross income is below the minimum filing limit (2015 amounts) listed in the table below. This rule leaves most working expats with an obligation to file.

IF your filing status is…	**THEN** file a return if your gross income was at least…
Single, under the age of 65	$10,300
Married filing jointly, under the age of 65	$20,600
Married filing separately, at any age	$4,000
Head of household, under the age of 65	$13,250

Planning Tip:

When moving, take copies of your tax returns for the prior three years. Tax preparers would often ask to see your prior year returns and it will be helpful to have them handy.

Does that mean I will be taxed twice?

The IRS has adopted various methods to help mitigate double taxation. As discussed later, such methods may allow you to exclude part of your foreign earned income and housing, claim a tax credit for taxes paid to a foreign country, and even take advantage of tax treaties. It is because of these tax provisions that a lot of expats end up not owing U.S. tax. But note that these tax provisions are not automatic; you have to file a tax return in order to claim them.

Exclusions from Income

Foreign Earned Income Exclusion

As already mentioned, U.S. Citizens and Residents are taxed on their worldwide income, including income earned overseas such as wages, salaries, bonuses, and self-employment income. However, the Foreign Earned Income Exclusion allows for up to $100,800 (2015) of income earned overseas to be excluded from taxable income, essentially making such income not taxable in the U.S. In the case of married couples, each working spouse can claim the exclusion separately. See Qualifying for the Exclusion later.

If a person only qualifies for part of the calendar year (which normally happens in the first year of expatriacy), the maximum exclusion is prorated based on the number of days on which the person qualifies for the exclusion. The more qualifying days in a tax year, the larger the exclusion limit.

Foreign Housing Exclusion

Luckily, the IRS understands that living overseas can get expensive. So, in addition to the foreign earned income exclusion, expats are allowed an exclusion for qualifying housing expenses. Qualifying expenses include: rent, repairs, utilities, insurance, residential parking, etc. Non-qualifying expenses are: the cost of buying a property, paid television subscription, purchased furniture, domestic labor, etc.

Tip: *Because of the existence of a lower limit (see below), claiming the housing exclusion is only advantageous when your foreign earned income exceeds this minimum.*

Two limitations apply to the foreign housing exclusion - a minimum “base” and a maximum limit. Only housing expenses that exceed the base, but do not exceed the maximum can be excluded. The base is calculated as 16% of the foreign earned income exclusion limit, and the maximum as 30% of that limit. The rules allow for a higher maximum limit if you move to a city included on the IRS list of high-cost areas. Identically to the foreign earned income exclusion, the limits are prorated if a person only qualifies for part of the year.

- Housing expense limitation = $30,240 ($100,800 x 30%)
- Base housing cost of $16,128 ($100,800 x 16%)
- Maximum housing exclusion for 2015 = $14,112 ($30,240 - $16,128)

Qualifying for the Exclusion

Merely living overseas does not automatically make you eligible to take advantage of the above mentioned exclusions. To qualify, you have to meet all three of the following:

1 Have Foreign Earned Income

This includes compensation received for personal services performed in a foreign country, as well as self-employment income from a business. Income is considered "foreign" when the work is physically performed in a foreign country, even if your employer is a U.S. company. Examples of "earned" income are salaries, wages, commissions, bonuses, professional fees. Certain non-cash payments such as allowances and reimbursements for home leave, education, cost of living, etc., can also be considered earned income. If you are in a position where you do part of your work in the U.S. and part in a foreign country, you would need to apportion your income between U.S. and foreign. Only your foreign "earned" income is eligible for the exclusion.

Planning Tip: *Keep a schedule of your working days in the U.S. The income can be apportioned based on the number U.S. working days.*

Earned income does not include alimony, pensions, social security benefits, and the so-called "passive" income, such as interest, dividends and capital gains. In some cases variable-types income such as rents, royalties and business profits, can also be considered unearned. These payments are not eligible for the exclusion.

2 Have your tax home in a foreign country

Your tax home is your principal place of business, employment, or post of duty regardless of where your family home is located. It is where you are permanently and indefinitely engaged as an employee or a self-employed individual. An assignment is considered indefinite if it is expected to last for more than 1 year. Thus, most expats who accept foreign assignments lasting longer than one year will meet the tax home requirement.

3 Meet the Physical Presence OR the Bona Fide Residence Test

Planning Tip: *If you are married filing jointly, only the working spouse needs to meet the the requirements.*

Physical Presence Test (PPT)

To qualify under this test, a U.S. citizen or resident has to be physically present in a foreign country or countries for 330 full days during a period of 12 consecutive months. The 12 months do not have to constitute a calendar year (it can be any 365-day period) and the 330 days do not have to be consecutive. A day counts as "full" if you have been in a foreign country for the entire 24 hours starting at midnight.

The PPT is easy to use in that it is solely based on the number of days spent abroad. This method can be particularly beneficial in the first and last years of expatriacy as it offers a way to maximize the exclusion by shifting the 12-month period and increasing the qualifying period by up to 35 days. As previously mentioned, more days in a qualifying period result in a bigger exclusion limit.

Planning Tip:

Keep all travel documentation and maintain a travel schedule. This information would be needed for the preparation of your tax return.

Bona Fide Residence Test (BFR)

While the PPT is solely based on the number of days spent overseas, the BFR test is a lot more subjective and based on your individual circumstances. This test applies to U.S. citizens who have established a residency in a foreign country and who have been bona fide residents of a foreign country for an uninterrupted period of at least one calendar year (green card holders can qualify only if certain treaty benefits apply.) A lot of times it can be hard to determine if and when an individual has become a resident of a country. Merely being present in a foreign country does not automatically qualify you for a bona fide resident status. Factors to consider are things like your intention to stay, the purpose of your trip, the nature, and the length of your stay abroad.

Even if all residency characteristics are satisfied, one factor that would automatically disqualify a person from meeting the test is making an official non-residency statement to the foreign country authorities. Many countries offer tax breaks to nonresidents who are temporary working and living in the country. Claiming such benefits essentially proves that you are not a resident of the foreign country and therefore, do not meet the BFR residency requirement.

One of the benefits of the BFR test is that, unlike the Physical Presence Test, spending more than 35 days in the U.S. will not automatically disqualify an individual from meeting the test. This is only if your stay is temporary and you have no intention of returning to live in the U.S.

Foreign Tax Credit

What if I don't qualify for the exclusion? Does that mean I will be taxed twice?

The U.S. uses a credit system to help mitigate double taxation. Expats are allowed to claim a credit for income taxes paid to a foreign country, regardless of whether they qualify for the foreign earned income exclusion. When claiming the foreign tax credit, U.S. tax is first assessed on your foreign income at the U.S. tax rate; the foreign taxes you paid are then used to offset that U.S. tax dollar-for-dollar. If you live in a country with high tax rates, the foreign taxes you pay would most likely be sufficient to fully eliminate the U.S. tax on your foreign income. If you are paying taxes to a low tax country, however, your foreign taxes may not be enough to cover your U.S. tax liabilities and you may end up owing tax in the U.S.

If you do qualify for the foreign earned income exclusion, you can take advantage of it in combination with the foreign tax credit. This is especially beneficial for people with foreign income which exceeds the exclusion limit. The credit in this case is reduced by the portion of foreign taxes related to the excluded income and the remaining amount is used against the U.S. tax on the non-excluded part of the income. A big advantage of claiming foreign tax credit is the ability to carry forward excess credits to subsequent tax years and use them to offset foreign income.

Other Taxes

Social Security & Medicare (FICA)

Whether you would be subject to FICA while working overseas depends on the type of your employer and the country where you work. If you are employed with a foreign company, your wages will generally not be subject to FICA withholding. You will continue to pay FICA if you are employed with a U.S. company or its foreign affiliate.

When you work in a foreign country, chances are you would also be subject to the social security system of that country, which may lead to double taxation. To help alleviate this issue, the U.S. has entered into "totalization" agreements with 25 countries. Under these agreements residents of the U.S. are only being subject to the social security taxes in one country.

Planning Tip:

If the country you live in has a totalization agreement with the U.S., ask your U.S. employer to request a U.S. "Certificate of Coverage". This certificate shows that you are not subject to social security taxes of the foreign country.

State Taxes

Regardless of having to file a federal tax return, as an American living overseas, you may or may not have to file a state tax return. Your filing obligation depends on the laws of the last state where you last resided and its rules about who is considered a "resident" of that state.

The state residency rules, however, can be as different as the 50 states themselves! Some states may continue to consider you their resident even after you've lived abroad for years (yes, this can happen). Being a resident of a state means that you have to continue filing a return in that state and possibly pay tax. Some states base their residency rules on physical presence, so as long as you are out of the state for an extended period of time, you would be considered a "nonresident" and won't be liable for tax. Other states, however, follow "domicile" rules and will consider you a resident based on certain ties you have with the state and your intention to return to that state. Such states make it very difficult to break residency. You don't have to worry about any of this if you happen to be a lucky resident of a state that does not impose income tax.

Planning Tip:

Review your state's rules and consider taking the necessary steps to break any ties before leaving. Having a driver license, bank account, voting registration or property in a given state are examples of state ties.

Besides having different residency rules, states also have different ways of calculating taxable income for state purposes. Some states may follow the federal approach, others may allow certain exclusions and deductions and disallow others. This is why, in preparing your taxes, you need to consider whether the approach you take on your federal return will also produce a good result for state purposes and vice versa. It is best to handle your federal and state returns together to maximize the overall tax saving.

Self-Employed Expats

Self-employed individuals moving abroad enjoy similar benefits as employee expats do. They are allowed to exclude part of their foreign earned income, use a deduction for housing expenses, claim foreign tax credits, and moving expenses. In considering whether taking the foreign earned income exclusion and housing deductions is advantageous in your case, account for the fact that your business expenses will be prorated and only the portion related to non-excluded income would be deductible.

Foreign Housing Deduction

The foreign housing deduction concept is essentially identical to the foreign housing exclusion but applied to self-employed individuals. One advantage of the housing deduction is the ability to carry over any part of the deduction that exceeds the maximum limit to the following year.

Self-Employment Tax

Self-employed individuals generally continue to be liable for U.S. self-employment taxes while working overseas. The caveat of calculating the self-employment liability is that the foreign earned income exclusion is not taken into account. So even if all of your foreign income is excluded for income tax purposes, you may still owe self-employment tax. There are a number of strategies available that can help self-employed individuals decrease their tax liability. Talk to your tax advisor to figure out the best approach for your specific situation.

Other Filings

FBAR

One of the first things expats do when they move abroad is open a bank account. One thing to be aware of is that, in addition to filing a federal and state income tax returns, most expats with reasonable savings also find themselves under an obligation to file form FINCen 114, commonly known as FBAR. This is a form that U.S. citizens or residents must file if the aggregate value of their foreign financial accounts exceeded $10,000 at any given time during the calendar year. The filing is simply informational and does not result in any tax.

The "aggregate value" measurement is the trickiest part of determining your filing obligation. "Aggregate" essentially means that if you had three bank accounts and the maximum value of each reached $4,000 at some point during the year, all three have to be reported on an FBAR because their combined value exceeded the $10,000 threshold.

The requirement applies to "foreign financial accounts", which extends far beyond regular checking and saving bank accounts. It also includes securities and brokerage accounts, certain insurance policies, retirement saving accounts, and other. Additionally, it could cover accounts not directly owned by you, but over which you happen to have signature authority as an employee or an officer. In this case, however, the rules are far more detailed and case specific. Knowing that disclosing personal bank information can be sensitive for a lot of people, the IRS has gone above and beyond to ensure that no one is tempted to withhold any of it by imposing rather intimidating civil and criminal penalties. The penalty for inadvertent failure to file is up to $10,000 and willful violation penalties can reach $100,000 or 50% of the account balance. Filing the form itself does not protect you from being penalized; you also have to make sure to report the correct information.

FATCA

Yet another filing requirement some expatriates may face is FATCA - Foreign Account Tax Compliance Act. And if you think it sounds similar to the above mentioned FBAR, you are correct. However, the reach of FATCA covers a comprehensive list of foreign financial assets above the ones reported on your FBAR. In addition to foreign bank and financial accounts, reportable are also interest in foreign partnerships, foreign hedge and private equity funds, directly owned stock and other. FATCA also differs from FBAR in that it has a filing threshold limit. The threshold for qualifying individuals residing outside the United States is $200,000 on the last day of the tax year or $300,000 at any time during the tax year ($400,000 and $600,000, respectively, for married individuals filing jointly).

Reporting for Investments in Foreign Entities

Americans who are business owners and investors in foreign entities enjoy additional filing obligations. Even though, a foreign firm operating overseas does not have to file with the IRS, certain U.S. citizens or residents who have interest in the business are required to file informational returns to disclose specific information about the entities in which they are invested. A return must be filed even if the entity had no activity or income during a given year. Here are some of the forms you may be required to file:

- Form 5471 – Applies to U.S. citizens and residents who are officers, directors, or shareholders in certain foreign corporations.
- Form 8865 - Applies to U.S. citizens and residents who are partners of certain foreign partnerships.
- Form 8858 - Applies to certain U.S. persons that own a foreign disregarded entity directly, indirectly, or constructively.

Despite the fact that these forms are simply informational and don't result in any U.S. tax, the IRS takes the filing requirements very seriously. The penalty for not filing or even filing late is $10,000.

Penalties

Living abroad can sometimes make it easy to forget about the unpleasant things in the U.S., such as the IRS, but don't let that be a reason to fall behind on your taxes! The consequences of being determined non-compliant by the IRS are, frankly, frightening and can go far beyond assessing interest and penalties. If you don't file a tax return for some time, the IRS might file one for you, with the information they have available and usually, without applying any deductions. If you don't pay the assessed tax on time, the IRS has the power to retain your refunds, levy your bank accounts and salary, and place liens on your personal and real property. Filing your tax return timely and accurately can save you a lot of headache later. Also, remember that even if all of your income is eligible to be excluded, the only way to claim the exclusion is by filing a tax return.

Filing Deadlines

When do I have to file?

April 15th is the standard due date for filing a tax return. Knowing that expats sometimes may need additional time to figure out their filing, the IRS has allowed for multiple extensions.

Extensions for Expats

- Automatic 2-Month Extension - Taxpayers who are residing abroad as of April 15th, are granted an automatic extension until June 15th to file a return and pay the tax due (interest will still apply).

- Automatic 6-Month Extension - Extends the filing of the tax return until October 15^{th} upon filing form 4868.

- Additional 2-month Extension - Expats who need extra time can request an additional extension to file their return. The request must be sent by the extended due date.

- Extension to meet tests (Form 2350) - Taxpayers who are expecting to meet either the Physical Presence or Bona Fide Residence test, but have not done so by one of the other extensions deadlines, can request an extension to file a return for up to 30 days after they qualify. The request has to be filed by April 15^{th}, or June 15^{th} if you already resided abroad.

Due Dates

- April 15 - Standard tax return filing and tax payment deadline.

- June 15 - Due date for taxpayers who were living abroad as of April 15^{th}.

- June 30 - FBAR filing due date.

- October 15 - Final tax return filing due date for expats who requested 6-month extension.

- December 15 - Final due date to file a return for expats who were granted an additional 2-month extension.

About KOZROG Tax Services

KOZROG Consult is a U.S. based tax preparation and consulting firm specializing in assisting expatriates with their U.S. tax filings. We offer reliable CPA expertise, transparent flat fees, and customer-focused service. With a convenient and secure process that is entirely online, we are able to serve clients around the globe the same way we would assist them in our office. We are not simply tax preparers, we are tax advisors! In addition to preparing returns we actively seek opportunities for current and future tax savings for our clients.

We know that dealing with taxes can be a stressful task for most people. Here is why, besides providing exceptional quality service, KOZROG is also proud to offer a simple and straightforward process designed to save you time and money. This includes the following:

- Ease of information sharing by using our online client portal
- Electronic tax return filing
- Fixed, transparent pricing

KOZROG Consult offers the following services to expats:

- Federal income tax return preparation
- State income tax returns preparation
- FBAR Compliance
- FATCA Compliance
- Forms 8858, 5471, 8865
- Amended tax return preparation
- Personal consultations
- Late filing

Hopefully this guide has helped answer a lot of the questions you had about how your move affects your U.S. taxes. Keep in mind that as it often happens in the world of tax most answers vary, sometimes greatly, depending on the circumstances. If you are not sure how to handle your particular situation, it is best to seek professional advice. Doing so will give you a piece of mind while you are away and also help save you tax dollars.