Do I Stay Or Do I Go?

Tax Matters

International
Accounting &
Compliance

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Tax Compliance for Expats

Staying

U.S. WORLDWIDE INCOME TAX

- U.S. taxpayers are required to report and pay taxes in the U.S. on their worldwide income, regardless of where it was earned, where they lived and even if they already paid taxes to another country. In general these types of income include compensation income, interests, dividends, and other investment income, business income, capital gains, rental income and pension income.

- Obligation is lifelong for citizens (unless citizenship is renounced)

- For LPRs this begins when you arrive in the country with your green card until you formally abandon status (immigration law and tax law differ). Once residency has been established it is irrelevant if the LPR remains present in the U.S.

WHAT ARE MY REPORTING OBLIGATIONS WHEN LIVING OUTSIDE OF THE U.S.?

While the scope of this presentation is not large enough to encompass all of the potential reporting obligations of a U.S. Taxpayer, below you will find some common examples of reporting obligations when living offshore:

- Report your worldwide income annually on IRS Form 1040. Some items such as the earned income exclusion must be elected on the return to be claimed.

- Report all of your offshore financial accounts to the United States Treasury on an annual basis if the aggregate value exceeds $10,000 at any time during the year. These include those beneficially owned by you in any way, and also accounts to which you are a signatory (such as business and trust accounts on FINCEN 114).

- Report beneficial ownership of specified foreign financial assets which includes any financial account, stock or securities issued by someone who is not a U.S. person, any interest in a foreign entity, any financial instrument or contract with an issuer or counterparty that is not a U.S. person. This obligation begins when (if filing single or separately) the foreign financial assets exceeds (1) $50,000 on the last day of the year, or (2) $75,000 on any day during the tax year, for married couples the threshold is (1) $100,000 on the last day of the tax year, or (2) $150,000 on any day during the tax year [Reported on IRS Form 8938, Statement of Specified Foreign Financial Assets].

- Report ownership of certain foreign corporations, regardless of value (on form 5471).

- Report ownership of certain passive foreign investment companies and calculate and pay taxes due (even if no taxable event on form 8621)

WHAT ARE SOME OF THE BENEFITS OF LIVING OVERSEAS?

- The Foreign Earned Income Exclusion (up to $100,800)
- The Foreign Housing/Exclusion Deduction (up to appr. $25,872 per year for HCMC)
- The Foreign Tax Credit
- Potential Deferral of Income (Foreign Corporations, Subject to Subpart F Income Inclusions)
- Great Food

CONTROLLED FOREIGN CORPORATIONS

A Controlled Foreign Corporation is a Corporation which is

- Owned (or voted) more than 50% by U.S. persons
- Owner is defined as more than 10% owner

For CFCs Income is Taxable if

- Distributed to the U.S. Shareholder
- U.S. source income
- Subpart F Income (Complex):
  - Insurance income
  - "Foreign base company income" (essentially U.S. connected or related party services, passive income, shipping and oil)
  - Income from boycotted countries
  - Illegal bribes, kickbacks
  - Income from countries which have severed diplomatic relationships with the U.S

PASSIVE FOREIGN INVESTMENT COMPANIES (PFICs)

Test (Any Foreign Corporation that Meets the Assets and Income Test)

- 75% or more of its gross income is passive
- 50% or more of its assets are passive
- Almost all foreign funds are PFICS

Actions

- Market to Market Election:
  - Report all distributions (interest, dividends, capital gains, etc.) as ordinary income; and
  - Recognize all increases/decreases to the value of the fund as a gain/loss on their holdings as if the funds were sold at the end of each year.
- Qualifying Election Fund (QEF) Election:
  - Under the QEF election, investors must, on an annual basis, include their pro-rata share of the mutual fund's earned income for U.S. tax purposes.
- Do nothing:
  - Any gains recognized on disposition of the PFIC shares and distributions received from a PFIC during the year greater than 125% of the average distributions received during the previous three years would be taxed as ordinary investment income. This income would be considered earned over the holding period on a pro-rata basis.
  - The amounts allocated to prior tax years will be subject to U.S. tax at the highest marginal rate and also subject to deemed interest charge.

WHAT HAPPENS IF I DON'T COMPLY?

PENALTIES AND RISKS ARE HIGH

Non-compliance with the U.S. tax laws are severe and can include criminal liability. While the scope of this presentation is not large enough to encompass all of the potential penalties for not meeting filing obligations, here are some common penalties that an LPR can face:

- Failure to file a U.S. tax return – penalties are 5% of the balance due plus and additional 5% per month, up to a maximum of 25% of the tax due.
- Failure to pay taxes when due – a penalty of .5% of the amount of the unpaid tax per month up to a maximum of 25%.
- Accuracy related penalties – If the amounts reported on an income tax return are later adjusted by the IRS and a tax increase results, an additional penalty may be assessed of 20% - 40% of the increase of the taxes due in some cases.
- Fraud penalties – if you fail to file a return or pay tax due and the IRS can demonstrate fraud, you can be liable to penalties that amount to 75% of the unpaid tax, and criminal prosecution.
- Taxpayers who are shareholders of corporations which are controlled by U.S. persons (controlled foreign corporations) are required to file and annual disclosure statement. If such form is not timely filed penalties can be assessed at $10,00 to $50,000 per form.
- Failure to file Statement of Specified Foreign Financial Assets – up to $10,000 for failure to disclose and an additional $10,000 for each 30 days of non-filing after IRS notice for a failure to disclose; for a potential maximum penalty of $60,000; criminal penalties many also apply.
- Failure to disclose foreign bank and financial accounts can carry (among other penalties) the greater of $100,000 or 50% of the account balances, interest, and also criminal penalties which may include arrest and prosecution (in the case of an LPR likely removal/deportation).

POTENTIAL CRIMINAL LIABILITY

Possible criminal charges related to tax returns include tax evasion (26 U.S.C. § 7201), filing a false return (26 U.S.C. § 7206(1)) and failure to file an income tax return (26 U.S.C. § 7203). Willfully failing to file an FBAR and willfully filing a false FBAR are both violations that are subject to criminal penalties under 31 U.S.C. § 5322.

A person convicted of tax evasion is subject to a prison term of up to five years and a fine of up to $250,000. Filing a false return subjects a person to a prison term of up to three years and a fine of up to $250,000. A person who fails to file a tax return is subject to a prison term of up to one year and a fine of up to $100,000. Failing to file an FBAR subjects a person to a prison term of up to ten years and criminal penalties of up to $500,000.

Amnesty (Voluntary Disclosures)

Streamlined Foreign Offshore (non-willful)

- File 3 years of income tax returns, pay taxes due and interest
- File 6 years of FBARs
- Certify non-willful nature of non-filing/reporting
- Qualify as either non-U.S resident for any one of the 3 of the last 3 years (330 days) or U.S. resident
- No penalty for non-U.S. residents, 5% for others

“Regular” Offshore Voluntary Disclosure (willful)

- File 8 years of income tax returns, pay taxes, interest and 20% accuracy related penalty
- File 8 years of FBARs
- Pay 50% offshore penalty (highest value of accounts over 8 year period)

Renunciation and Abandonment

Going

TAX ISSUES - RENUNCIATION

Exit Tax Test

- Income Tax Test: The expatriate's average tax liability is $160,000 or more for five years
- Net Worth Test: The expatriate's net worth is at least $2 million
- Compliance Test: The expatriate must certify that he/she has met all U.S. tax obligations for the five years preceding renunciation

Exit Tax (Covered Expatriate)

- Mark to market "deemed sale" (reported on IRS form 8854)
- The first $690,000 of gain is excluded
- I.R.S. also provides a deferral option, whereby an expatriate can elect to defer payment of the exit tax by agreeing to pay interest charges during the deferred period and posting a form of "adequate" security as collateral
- U.S. Estate and gift taxes on recipients in the future (to U.S. persons)

Exceptions

- Became a dual citizen at birth and continued to be a citizen and resident of the other country at the time of renunciation, and;
- Was a resident of the U.S. for no more than ten of the fifteen tax years ending with the tax year during which the renunciation of citizenship occurred

OR

- Renounces his or her U.S. citizenship before the age of 18 and a half, and
- Was a resident of the U.S. for no more than ten years before the age of 18 and a half

TAX ISSUES – GC ABANDONMENT

Green card must be formally abandoned, mere expiration and non-renewal does not count (must do this by filing I-407 or letter stating abandonment enclosing the GC).

Termination date

- Last day of calendar year, unless;
- If LPR can establish tax home is in a foreign country then terminates the date green card is surrendered

Long-Term LPR

- LPR for 8 of the prior 15 years
- Must file IRS form 8854
- Termination date is day the 8854 is filed
- Tested as to whether LPR is considered "covered expatriate"
- May be subject to exit tax

CONTACT US

Gray welcomes your questions, comments and inquiries and would like the opportunity to serve you.

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