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ADVISORS**



Tax Strategies for U.S. Expats and Investors Abroad

Agenda

- Who needs to file
- Foreign Earned Income Exclusion FEIE
- Physical Presence Test & Bona Fide Residence Test
- Foreign Tax Credit
- Foreign Housing Deductions/Exclusion
- Foreign Source Income & Exchange Rates
- Foreign Account Reporting FBAR & Foreign Asset Reporting Form 8938
- Crypto Taxation
- 1031 Exchange
- Passive Foreign Investment Company PFIC
- Foreign Corporations, Partnerships & Trusts
- Offshore Business Structuring
- Back Tax Filing
- Renunciation of US Citizenship

Should I file?

- All US Citizens and green card holders must file a federal tax return each year if their income is over the minimum threshold
- You may be required to file a state return if you have ties to your former state (e.g. a driver's license, a home, etc.)
- Regardless of where the income is sourced (US or abroad) or if you pay taxes locally, you are still required to file
- The filing thresholds are currently:
 - Single with income over \$12,000
 - Married filing jointly with income over \$24,000
 - Married filing separately with income over \$5
 - Head of Household with income over \$18,000
 - Self-employed with net income over \$400

Tax Breaks for Expats

- Income earned outside of the US is subject to taxes equal to the minimum amount that one would pay as a US resident
- However, two unique tax breaks for expats can help mitigate their US tax burden
 - Foreign Earned Income Exclusion FEIE
 - Foreign Tax Credit FTC

Foreign Earned Income Exclusion

Form 2555 - *Foreign Earned Income Exclusion and Housing Exclusion/ Deduction*

- Allows expats to earn up to **\$108,700 free of US taxation (2021)**
- Also excludes amounts equal to housing expenses (limited by location) in certain areas
- Can be used **in conjunction with the Foreign Tax Credit** (discussed next)
- To qualify, expats must fulfill either:
 - The Bona Fide Residence test – by being an official resident of a foreign country, or
 - The Physical Presence test – by living outside the US for 330 days out of 365 over any 12 month period. The measured period need not be all within the same calendar year.

Bona Fide Residence Test

- Not automatically granted by living or working outside of the U.S.
- Court focuses on factors such as:
 - Taxpayer's intention
 - Establishment of a temporary home in a foreign country for indefinite period
 - Community participation on social and cultural level, general assimilation
 - Physical presence in the foreign country consistent with employment
 - Nature, extent and reasons for temporary absences for foreign home
 - Marital status and residence of the family
 - Assumption of economic burdens and payment of foreign taxes

Physical Presence Test

- Strictly quantitative test requiring **330 days** of presence abroad of foreign country
- 330 days can be in any 365 day period
 - Does not necessarily have to be calendar year (Jan 1-Dec 31)
 - A partial year exclusion is possible!
- Travel days count as a full day spent in the US! Even if only connecting through the US or literally flying over the US

Foreign Tax Credit

Form 1116 – *Foreign Tax Credit*

- Provides a dollar for dollar tax credit for taxes paid to foreign governments, regardless of residency status
 - You may also deduct your foreign taxes on Schedule A, but this is not generally advised
- FTC can be taken against income in excess of the FEIE (\$108,700) or in lieu of the FEIE – If you do not qualify for the FEIE, you may qualify for the FTC
- FTC may be beneficial in cases where certain other credits or tax benefits may be disallowed if one is claiming the FEIE, such as the Child Tax Credit or Roth IRAs for certain income levels
- FTC prevents double taxation of income, but you may still be taxed by the US if you are in a low tax jurisdiction, as they “gross up” your tax level to US rates
- Unused portions of the FTC (i.e. if you live in an area with taxes higher than in the US), can be carried over to future years.

Foreign Housing Deduction/Exclusion

- **Foreign Housing Exclusion** for expats *employed* abroad
 - Allows expats to exclude the amount equal to the sum of certain housing expenses from their taxable income in excess of the FEIE
 - Exclusion starts at \$17,392 (16% of FEIE) and is capped at \$32,610 (\$114,300 for Hong Kong) – This means that any amount spent over \$17,392 annually and below \$32,610 (\$114,300 if Hong Kong resident) can be excluded from taxation
- **Foreign Housing Deduction** for *self-employed* expats
 - Allows expats to deduct certain housing expenses from their gross income
 - While the Foreign Housing Deduction lowers the overall tax liability, it does not reduce the Self-Employment Tax liability burden

Foreign Housing Deduction/Exclusion

- Qualifying expenses for both the Housing Exclusion and Deduction include:
 - Rent
 - Utilities (other than telephone charges)
 - Real and personal property insurance
 - Rental of furniture and accessories
 - Repairs
 - Residential parking

What is Foreign Source Income?

- Only **“foreign sourced”** earned income is eligible for the FEIE and Housing Exclusion/ Deduction – Unearned income, e.g. passive income, is not eligible
- It is defined as “income for performance of services outside of the United States”
 - May require allocation of income when services are performed in both the US and abroad.
- **Even if you are abroad, certain income will be treated as if you were still living in the United States:**
 - **US Sourced Income**
 - Capital gains
 - Dividends
 - Interest
 - Rental income
 - Other passive, unearned income
 - Salary earned while working on US soil

Exchange Rates

- The IRS requires that your **foreign income be converted to US Dollars** on your tax return
- You can use either:
 - The Foreign Exchange rate on the day you earned the money,
 - The average FX rate for the month, or
 - The average FX rate for the year

You can use sources including the IRS, Oanda, or the Treasury, as long as it is applied consistently!

To use the optimal conversion rate, look at all 3 options

Foreign Bank Account Reporting FBAR

- If you have foreign financial accounts and the **aggregate value exceeds \$10,000** at any point in the tax year, you must report the maximum value of each account to the US Treasury (not the IRS).
- All “US Persons” must file. US Persons are defined as a citizen or resident of the US, a domestic partnership, a domestic corporation, or a domestic estate or trust.
- Failure to file annually may result in stiff fines and potential jail time.
- You must e-file an FBAR, reporting information for each account individually, at www.fincen.gov by April 15th following each tax year. A 6 month extension is now available.
- Help in completing Form FBAR can be found online at IRS.gov. Questions regarding the FBAR can be sent to FBARquestions@irs.gov.

Foreign Asset Reporting – Form 8938

- There is some overlap between the foreign bank report (i.e. FBAR) and Form 8938 as they may cover the same foreign financial accounts
- You must file Form 8938 with your tax return if the total value of your foreign financial assets exceeds:

Living outside the US

Single or married filing separately

- \$200,000 on 12/31/2021
- \$300,000 at any time during 2021

Married filing jointly

- \$400,000 on 12/31/2021
- \$600,000 at any time during 2021

Living in the US

Single or married filing separately

- \$50,000 on 12/31/2021
- \$75,000 at any time during 2021

Married filing jointly

- \$100,000 on 12/31/2021
- \$150,000 at any time during 2021

Foreign Asset Reporting – Form 8938

- Assets to be reported include:
 - Depository, custodial, or other financial accounts maintained by a foreign financial institution (such as a bank or brokerage company)
 - Shares of a foreign company held directly and not through a broker
 - Foreign Pension Funds/Mutual Funds
 - Interests in foreign entities
 - Loans to foreign persons or entities
 - Any financial instrument or contract held for investment that has a foreign issuer or counterparty
- For any income generated from your foreign financial assets, Form 8938 also requires a summary of income reported on the tax return along with form and line numbers

What is Not Reportable?

- Foreign real estate you own in your own name
 - However, if you hold foreign real estate through a foreign entity (e.g., a foreign corporation or LLC), it becomes a financial asset
- Physical gold bars, bullion or coins in vault
 - Gold Certificates held in foreign financial accounts are reportable (i.e. Perth Mint, GoldMoney, etc)
- Tangible assets held for investment
 - Examples include art, antiques, jewelry, cars and other collectibles
- Safe deposit box at a foreign bank
- Any assets under the name of a foreign spouse (if not filing jointly)

Passive Foreign Investment Company - PFIC

- Biggest single investment issue for US taxpayers investing abroad
- The definition of a PFIC incorporates most non-US collective investments if over 11 shareholders of a foreign corporation that owns passive investments i.e. foreign mutual funds, foreign REITs etc.
- Essentially means investment income is taxed at highest rate – not banded
- Interest is due for period of time investment held and tax not paid – in layman's terms, it's BAD!
- Can potentially be avoided by a CHECK THE BOX election, whereas a Mock K1 is issued to the investor for US tax reporting purposes
- If you make any investments via a Self Directed IRA, the PFIC issues is avoided
- PFIC INVESTMENTS WORTH **MORE THAN \$25,000** MUST BE INDIVIDUALLY REPORTED on form 8621

Back Tax Filing

3 Options to get back into compliance with the IRS if you have not filed taxes during your time abroad

1. Streamlined Filing Compliance Procedure

Available for non-resident U.S. taxpayers who:

- Have not filed a U.S. tax return during their period abroad
- Demonstrated non willful conduct and are considered a “low compliance risk”

If you qualify, then the IRS will expedite the review of your submission, and will not assess penalties or pursue follow up actions.

Back Tax Filing

2. Information Disclosure Program

- For people who were unaware of informational return filings such as 3520 (foreign trusts), 5471 (foreign companies) and FBAR.
- Need to file all backyears of returns

3. Quiet Disclosure

A third option is to “quietly” submit unfiled returns and FBARs and hope that the IRS does not pursue further action

Foreign Corporations, Partnerships, Trusts

- Foreign corporations, partnerships and trusts all offer advantages depending on their desired purpose, for example:
 - Estate tax protection
 - Asset protection
 - 10.5% effective tax rate
 - No self employment tax (take salary from foreign corp)
- However, if you are an officer, shareholder or majority owner in a foreign company, you are **REQUIRED** to file form 5471.
 - For Partnerships – Form 8865
 - For Foreign Trusts – Form 3520/3520A
- There are different levels of filing required depending on your role
- Failure to file will result in a \$10,000 fine

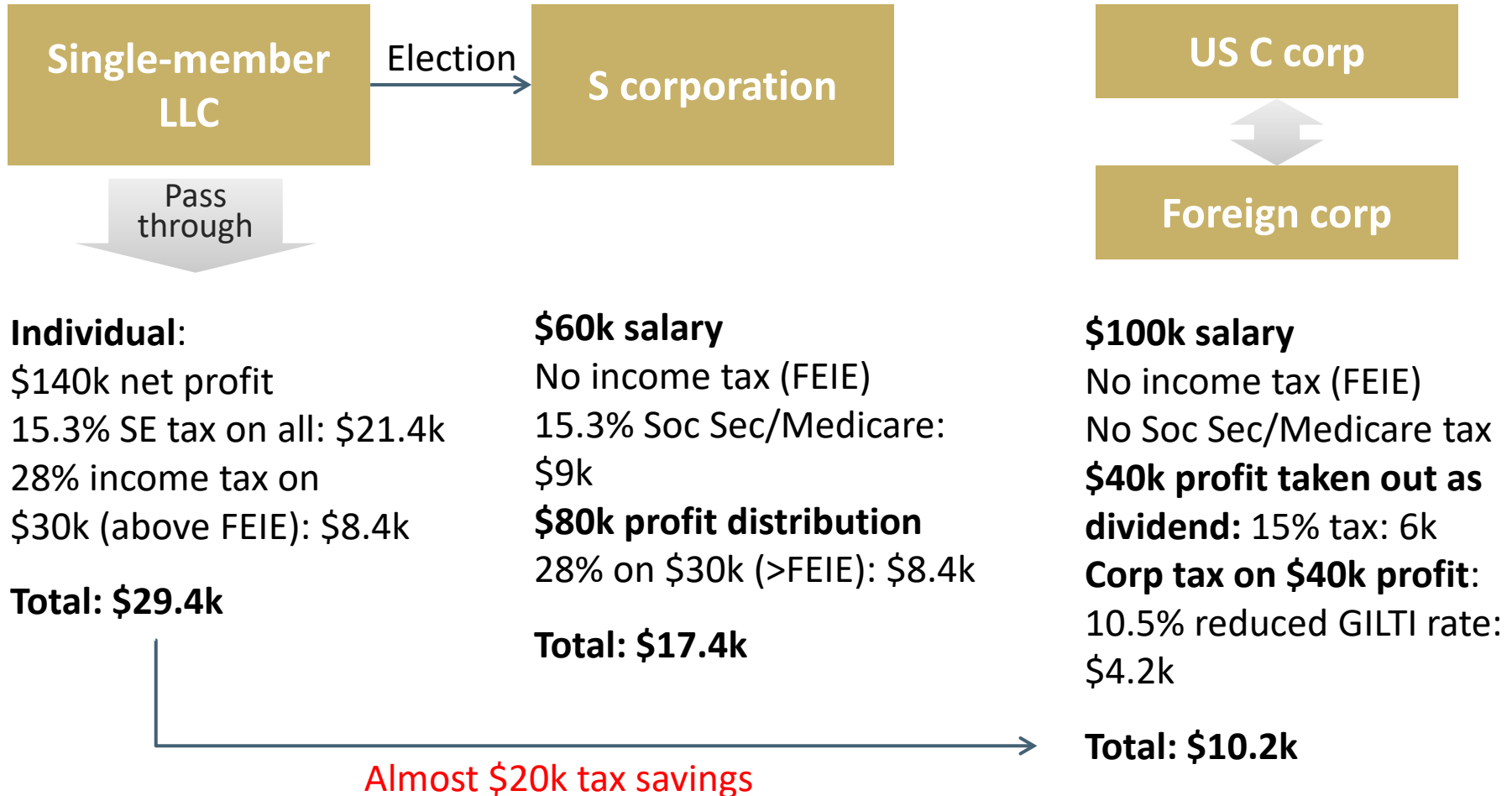
Offshore Business Structuring

Instead of going fully offshore to a low/no tax jurisdiction, you can hold a foreign company without US presence through a US C corp

Benefits:

- Reduced 10.5% GILTI tax rate on foreign earnings
- Better asset protection
- Salary can be excluded under FEIE

Offshore savings example



Renunciation of US Citizenship

STEP 1: Get a Second Passport

- You need a second passport and must bring this with you to the renunciation appointment in order to renounce your US passport. Even though expatriation is your right, the State Department will deny anyone the right to renounce their US citizenship if they don't have a second passport.

STEP 2: Review the Renunciation Forms and Prepare DS-4079

- The documents listed below are the ones required by the State Department to process your renunciation. You only need to fill out DS-4079 (Information for Determining Possible Loss of U.S. Citizenship) before your appointment.

STEP 3: Book Your Renunciation Appointment

- Ideally you would book your appointment at the embassy or consulate in the country (and possibly city) where you plan to live once you renounce your passport.

Renunciation of US Citizenship

STEP 4: Attend Your Renunciation Appointment

- Make sure you take both of your passports to your renunciation appointment. Bring your birth certificate and a certificate of naturalization from the country of your second passport, if you have. At the end of the renunciation appointment you will receive DS-4083, called the CLN for Certificate of Loss of Nationality.

STEP 5: File Your Final US Tax Return

- Your final tax return will be from January 1st through the day you expatriate. The day you renounce, you are no longer a taxable person to the IRS. If your renunciation date is any day other than December 31st, you'll be filing Form 1040 and 1040NR (if applicable) for your final return.
- IRS Form 8854, the expat tax form, targeted at “covered expatriates.” A covered expatriate is someone having a net worth of \$2 million or more, or a threshold annual tax liability from the preceding five years. If you have foreign accounts already extant before you expatriate, you'll also need to file a U.S. Treasury form called the “FBAR” (FinCEN Form 114). You may have done this before since the form applies to all U.S. citizens and is not related to expatriation.

Tax Deadlines

✓ **April 15th**

US tax filing and payment deadline (all tax must be paid or be subject to interest/penalties, even if you do not file) and new FBAR deadline (if filing your tax return by then)

✓ **June 15th**

US expat tax filing deadline

✓ **October 15th**

Final US tax deadline if you filed for an extension (using Form 4868) and FBAR deadline, if filing tax return via extension

Questions

- Your US expat tax preparation can be a very important and financially significant decision. Please make sure you find a preparer who understands how US expat taxes work and is able to guide you through the process.
- If you would like a free 30 minute consultation, feel free to reach out directly to vincenzo@onlinetaxman.com or visit us at – www.onlinetaxman.com

