

U.S. Tax Considerations for Inbound/Outbound Taxpayers



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- Accounting Today's
Top Firms in the Capital Region for 2021





Presenters

Meet the Instructors



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What We Will Cover Today

1. Who is subject to U.S. tax reporting – inbound and outbound
2. Common U.S. tax filing obligations for International Taxpayers
3. Reporting challenges/Best Practices



Far-reaching taxation brought to you by U.S. tax code & IRS

TAX POLICY COMMITTEE



"This is just a thought, but is there any way we could tax *other* countries?"



Who is required to file

U.S. person is subject to income tax on his/her worldwide income from all sources.

- U.S. Person: U.S. citizen or U.S. resident alien (for non-U.S. citizen/national)
- The U.S. tax code imposes taxes on every individual of various tax filing statuses. §1.
- All income from all sources subject to tax unless nonresident alien or specifically exempt from tax. §2(d), §61.
- Filing threshold identical to domestic taxpayers
- Income tax obligation separate from Immigration status or military status



Who is required to file – “U.S. person”

2 Tests – Green Card Test & Substantial Presence Test

A non-U.S. citizen/non-U.S. national individual is a U.S. person when one of the two tests is met:

(1) Green Card test

- ✓ Lawful permanent resident of the U.S.
 (“Green card holder”) at any time during year

- ✓ Residency starting date:
 - 1st day in U.S. after Green card received in foreign country
 - Green card issue date if substantial presence not met (183 days during 3-year period)
 - If substantial presence met, earlier of 1st in U.S. or 1st day in U.S. as a green card holder



Who is required to file – “U.S. person”

2 Tests – Green Card Test & Substantial Presence Test

(2) Substantial presence test

- ✓ 31 days during the current year, and
- ✓ 183 days during the 3-year period :



$$\begin{aligned} & \text{U.S. days in current year} \\ + & \quad \frac{1}{3} * \text{U.S. days in 1}^{\text{st}} \text{ year before current year} \\ + & \quad \frac{1}{6} * \text{U.S. days in 2}^{\text{ND}} \text{ year before current year} \\ = & \text{ total } \geq 183 \end{aligned}$$

EXAMPLE:

<u>YEAR</u>	<u>Ratio</u>	<u>U.S. Days</u>	<u>Weighted U.S. Days</u>
2022	100.00%	150	150
2021	33.33%	180	60
2020	16.67%	30	5
		Total	215

Who is required to file – “U.S. person”

Substantial Presence Test – Day Counting

Day counting for Substantial presence test

** do not count:

Days Taxpayer commutes to work in the U.S. from Canada or Mexico if regular commute

Days Taxpayer is in the US for less than 24 hours while in transit overseas

Days in the U.S. as a crew member of a foreign vessel

Days Taxpayer unable to leave the U.S. due to medical condition

-must file Form 8843

Days when Taxpayer is an exempt individual

-foreign government visa A-3, G-5 ; teacher/trainee visa J, Q; student visa F, J,

M, Q

-professional athlete temporarily in U.S. to compete in charitable sports event



Who is required to file – “U.S. person”

U.S. Residency Termination

- Ending U.S. residency for tax purposes
 - General rule – ends on December 31 of departure year
 - Last day of U.S. presence if closer connection to foreign country that is tax home for the remainder of the year
 - ** Must file statement attached to the tax return, showing
 - Name, address, TIN, US visa & passport information
 - Facts establishing tax home and closer connection to foreign country
 - Copies of documents for greencard status termination
 - ** Separate expatriation requirements for U.S. citizen/long-term resident

Who is required to file – “U.S. person”

Dual Status

- **Dual status** when residency status changes in the same year
(e.g., Nonresident to resident, resident to Nonresident)
- Taxed on :
 - All income for U.S. resident period
 - U.S. source income only for nonresident period
- First year choice
- Dual status individual married to U.S. citizen or resident may elect to file a joint return



Who is required to file – “U.S. person”

Dual Status (cont'd)

- What needs to be filed:
 - Form 1040 (if resident at year end) ; Form 1040-NR (if nonresident at year-end)
 - Cannot e-file
 - Must attach dual status statement
- Restrictions:
 - No standard deduction, Itemized only
 - No Head of Household
 - No joint return (exception when married to US citizen or resident alien + election)
 - Must use tax table for Married filing separately (no MFJ or single)
 - No Earned Income Credit, education credit, credit for elderly or disabled

Nonresident Family Members

- Non-U.S. citizen spouse:
 - Spouse cannot be a dependent
 - Joint return not available if not a U.S. person
 - Election can be made to file with a nonresident alien spouse
 - Caution if the spouse has substantial foreign income or assets
- Non- U.S. citizen dependent
 - Cannot be claimed as a dependent if not a U.S. person
 - A minor non-U.S. citizen child can be claimed as other dependent, if ITIN obtained
 - A non-U.S. citizen child must have a valid social security number to be considered a Qualifying Child.
 - Child tax credit / State tax deductions may also be limited

Tax Reporting

Overview of Tax Reporting Requirements

U.S. Tax reporting for International Taxpayers

LSM/VK	EJ+EO	IDGH	EJ+EO	LSM/VK	EJ+EO	EJ+EO	IDGH	EJ+EO	EJ+EO	IDGH	EJ+EO
▲ 24.7050	▲ 86.560	0.650	86.560	▲ 24.7050	▲ 86.560	86.560	0.650	86.560	▲ 86.560	0.650	86.560
▲ 47.0540	▲ 57.030	807.5	57.030	▲ 47.0540	▲ 57.030	57.030	807.5	57.030	▲ 57.030	807.5	57.030
▲ 6760.70	▲ 5.7540	0.607	5.7540	▲ 6760.70	▲ 5.7540	5.7540	0.607	5.7540	▲ 5.7540	0.607	5.7540
▲ 24.7050		0.650	86.560	▲ 24.7050		86.560	0.650	86.560			

TAX

- Foreign Earned Income Exclusion
- Foreign Tax Credit
- FBAR
- FATCA
- FDAP
- FIRPTA
- Tax Treaties
- ECI

Foreign Earned Income Exclusion

Form 2555

-
- Allows exclusion of foreign earned income (e.g., wages) up to annual cap (\$107,600 for 2020, \$108,700 for 2021) and/or housing deduction.
 - * Wages from working abroad as employee of the U.S. Government **does NOT** qualify.
 - * Contractors or employees of contractors supporting the U.S. Armed Forces in designated combat zones **may** qualify.
See current “Combat Zones” <https://www.irs.gov/individuals/military/combat-zones>
 - Foreign country: any territory under the sovereignty of a government other than that of the United States.
 - Tax Home: Taxpayer’s regular or principal place of business, or regular place of abode in a real and substantial sense (*not necessarily same as Taxpayer’s domicile*)

Foreign Earned Income Exclusion

Form 2555

- Who qualifies – must meet two tests

- Tax home test; and,

Example Taxpayer employed on an offshore oil rig in the territorial waters of a foreign country and work a 28-day on/ 28-day off schedule. He returns to his family residence in U.S. during his off periods. He does not meet the tax home test.

- bona fide residence test or the physical presence test

- ❖ BONA FIDE RESIDENCE TEST (US Citizen, or Greencard holder if foreign country has income tax treaty with U.S.)

- ✓ true bona fide resident of another country for an uninterrupted period that includes entire tax year
- ✓ taxpayer may not have issued a statement of nonresidence to the host country's government
- ✓ taxpayer must generally be subject to income tax imposed by the host country

- ❖ PHYSICAL PRESENCE TEST (US CITIZENS/GREEN CARD HOLDERS)

- ✓ Physically present in a foreign country or countries for 330 full days in any consecutive 12-month period. 330 days need not be consecutive.
- ✓ full days are a 24-hour period from midnight to midnight

Foreign Earned Income Exclusion

Form 2555

Bona fide residence test :

Example 1. Alice, US citizen lives in Washington, DC and goes on **INDEFINITE** assignment to Lisbon, Portugal beginning **Nov 1, 2019**. On **April 1, 2020** Alice travels back to D.C. for work and returns on **May 1, 2020** while family stays in Lisbon.

On **January 1, 2021**, Alice completes one uninterrupted period of residence for a full tax year (2020).

Example 2. Same as in Example 1, except Alice is transferred back to D.C. on **December 13, 2020**. Alice would not qualify as a bona fide resident of Portugal. (she may still meet the physical presence test)

Example 3. John was a bona fide resident of Japan from **March 1, 2018** through **September 14, 2021**. John returns to U.S. on **September 15, 2021**.

John was a bona fide resident for all of 2019, he also meets bona fide resident from March 1, 2018 – Dec 31, 2018 and from January 1, 2021 to Sept 14, 2021.

Foreign Earned Income Exclusion

Form 2555

Physical Presence test :

Example 1. Yuna leaves California for Singapore on **June 10, 2020**. She arrives in Singapore at 8:00 a.m. on **June 11, 2020**. Yuna's first full day in Singapore is **June 12, 2020**.

Example 2. Daniel has a tax home in China from **January 1, 2021**, through **August 31, 2022**, except that he spends 28 days in **February 2021** on vacation in the U. S.

Daniel meets the physical presence test for both 2021 and 2022. Daniel was in China from January 1, 2021 - December 31, 2021, and September 1, 2021- August 31, 2022.

Foreign Earned Income Exclusion

Form 2555

WHY DOES “qualifying period” matter?

- The qualifying period for the FEIE will determine the exclusion amount

Example: if qualifying period is for the entire year, exclusion available up to 100% of maximum exclusion (\$108,700 for 2021). If the qualifying period is for 9 Months, exclusion available up to 75% of the maximum exclusion (\$81,525 if 2021).

- Many U.S. expats need to extend to qualify for either BFR or PPT in first Qualifying year
 - Extension until October 15: Form 4868
 - Extension until June 15th : automatic if overseas on April 15 (statement required)
 - Extension until December 15th : must send request letter
 - Extension until January 30th : possible with Form 2350



Foreign Earned Income Exclusion

Form 2555

- Foreign Housing Deduction

- Housing amount = total foreign housing expenses – Base housing amount

Housing expenses include:	Housing expenses DO NOT include:
<ul style="list-style-type: none">•Rent,•Fair rental value of housing provided in kind by employer,•Repairs,•Utilities (other than telephone charges),•Real and personal property insurance,•Nondeductible occupancy taxes,•Nonrefundable fees for securing a leasehold,•Rental of furniture and accessories, and•Residential parking.	<ul style="list-style-type: none">Expenses that are lavish or extravagant;Deductible interest and taxes;Cost of buying property, e.g., principal payments on a mortgage;Cost of domestic labor (maids, gardeners, etc.);Pay television subscriptions;Improvements;Purchased furniture or accessories; orDepreciation/amortization of property or improvements.

Foreign Tax Credit

Form 1116

- Mechanism to avoid double taxation
- Generally must be foreign income tax liability actually paid
- No credit for tax on excluded income (e.g., FEIE)
- Limited to U.S. tax liability ; excess may be carried back (1 yr) or forward (10 yrs)
- Can be either on cash basis or accrual basis ; cash basis is default. Once switched to accrual, can't change for all future years.
- Foreign currency conversion per spot rate for cash basis ; average for accrual basis
- Taxpayer can choose either credit or deduction each year.

Form 1116 for Foreign tax credit ; Schedule A for foreign tax deduction.

Credit is generally more beneficial (must be analyzed case by case)

Reporting of Foreign Financial Assets

FBAR

- FBAR (FinCEN 114)
 - Any U.S. person with an interest in, or signature authority over, foreign financial accounts of which aggregate total value exceeds \$10,000 at any time during the year
 - Must be filed directly with the Financial Crimes Enforcement Network (not IRS)
 - Due April 15 or October 15 with extension
 - Under Title 31 (Bank Secrecy Act), not Title 26 (IRC) – 6 years audit period



Individuals Filing the Report of Foreign Bank & Financial Accounts (FBAR)

Reporting of Foreign Financial Assets

FBAR

- FBAR
 - Civil and Criminal penalty may be assessed - Serious penalty consequence (adjusted for inflation each year)
 - Non-willful failure to file FBAR - penalty up to \$10,000
 - Willful failure to file FBAR subject to penalty up to \$100,000 or 50% of balance
 - Supreme Court to decide whether 10K per account vs per year – pending
 - Bittner*, No. 21-1195 (U.S. 6/21/22) (petition for *cert.* granted)
 - Must be aligned with Schedule B, Form 8938 and other international reporting

Reporting of Foreign Financial Assets

FATCA

- Form 8938, Statement of Specified Foreign Financial Assets.
- Who needs to file:
 - **Specified Individual - U.S. citizen, resident alien, NRA elects to be treated as a resident alien**
 - **Specified Domestic Entity**
- Special rule for Dual Status taxpayer
- Filing thresholds :

Residency	Filing Status	Maxium Value during the year	Value at Year-end (12/31)
Living in the U.S.	Married Filing Jointly	150,000	100,000
Living in the U.S.	All other statuses	75,000	50,000
Living outside the U.S.	Married Filing Jointly	600,000	400,000
Living outside the U.S.	All other statuses	300,000	200,000

**living in/outside the US determined based on bona fide residence vs physical presence test (similar to 2555 standards)

Reporting of Foreign Financial Assets

FBAR and FATCA (cont'd)

- A foreign account holding virtual currency is not reportable on the FBAR at this time.
 - Expressly stated that FinCEN intends to propose to amend to include virtual currency as a reportable account. [FinCEN Notice 2020-2](#)
- Reportable?
 - Cryptocurrency held in a foreign based crypto exchange or trading platforms;
 - Cryptocurrency in a foreign crypto bank account;
 - Cryptocurrency investment in a foreign crypto managed fund
 - Cryptocurrency in a foreign-based wallets

International Tax Reporting

Common considerations for International Taxpayers Inbound to the U.S.

- **Fixed Determinable Annual Periodic (FDAP)**
 - Fixed 30% withholding
 - Income sourcing
- **Foreign Investment in Real Property Tax Act (FIRPTA)**
- **Tax Treaties**
- **Effectively Connected Income (ECI)**
 - Taxed at graduated rates up to 37%

Fixed, Determinable, Annual or Periodic (FDAP) income

- FDAP income includes
 - Interest
 - Dividends
 - Rents
 - Royalties
 - Services
 - Wages
- U.S. source FDAP income paid to non-U.S. tax resident is subject to 30% withholding at source
 - ** The withholding agent is liable to pay the tax if it fails to withhold.**

Income Sourcing Rules , Generally

Item of Income	Factor in Determining Source	U.S. Tax Code
Interest	Residence of Payor (not recipient)	§861(a)(1)
Dividends	Place of incorporation	§861(a)(2)
Rents	Location of property	§§861(a)(4) and 862(a)(4).
Royalties	Location of property otherwise where property is used	§§861(a)(4) and 862(a)(4).
Sale of Real Property	Location of property	§§861(a)(5) and 862(a)(5)
Sale of Personal Property	Location of seller's tax home	§§865(a)
Salaries/Wages/Non-employee compensation	Where services are performed	§861(a)(3)

Form 1042, 1042-T, 1042-s

- **Form 1042**
 - Annual withholding tax return for US Source income of Foreign Persons
 - Summary of all 1042-s filings
- **Form 1042-S**
 - Foreign Person's US Source Income Subject to Withholding
- **Form 1042-T is also required when some 1042-S filings must be paper filed**

Separate extension request for Form 1042 and Form 1042-S

International Tax Reporting

Forms commonly required to file for International Taxpayers

- FinCEN Form 114 : Foreign bank account reporting
- Form 2555 : Foreign Earned Income Exclusion
- Form 1116 : Foreign Tax Credit
- Form 8938 : FATCA, Specified Foreign Financial Assets
- Form 5471 : Foreign Corporations
- Form 8865 : Foreign Partnerships
- Form 3520 / 3520-A : Foreign Gift and Trust
- Form 8833 : Tax Treaty Position
- Other informational/withholding forms



Common Reporting Challenges

Reporting challenges



- Address changes – tax refunds, other IRS payments (e.g., EIP), Notices
- Difficulty in gathering tax data
- U.S. Social Security Benefits – difficult to apply for entitled benefits while overseas
- U.S. employer unfamiliar with employees who are in foreign country or nonresident aliens
- Complexity in tax reporting – difficult to complete, cross reporting, harsh consequences of non-compliance (U.S. Income tax code now spans more than 70,000 pages according to Tax Foundation)
- Foreign pension income

Reporting challenges (cont'd)

- U.S. person (U.S. tax residents) may still be required to file and pay state residency while living/working overseas
- States have different rules
 - Statutory residency
 - Domicile
- State residency will be harder to break if the taxpayer maintains “substantial” ties to the state



Considerations for International Taxpayers

- Check on tax reporting in departure year
- ✓ Potential Tax benefits for outbound taxpayers - Foreign Earned Income Exclusion, Foreign Tax Credit
- ✓ Additional requirements – FBAR, Specified Foreign Financial Assets, Passive Foreign Investment Company, etc.



Considerations for Inbound/Outbound Taxpayers

- Pre-move / immigration planning
 - Employee moving for assignment
 - ✓ Tax equalization – compensation, allowance, housing
 - ✓ Moving expense, tax reporting, former primary residence
- Non-U.S. citizen/resident taxpayer leaving the U.S.
 - ✓ Still has to file the U.S. tax return if Dual status
 - ✓ U.S. Social Security benefits, pretax deferrals
 - ✓ "Accidental Americans"

Questions?

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