

Tax Seminar for Americans Living Abroad

**Hosted by the U.S. Embassy Athens &
American-Hellenic Chamber of Commerce**

Wednesday, 12 February 2014

*The American School of Classical Studies
Athens, Greece*

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Topics to be covered

❖ Taxation

❖ Who has to file

❖ Earned Income Exclusion

❖ Foreign Housing Exclusion/Deduction

❖ Foreign Tax Credits

❖ Social Security

❖ Dealing with unfiled tax returns

Topics to be covered (continued)

- ❖ **Foreign Bank Account Reports (FBAR)**
- ❖ **Who has to file**
- ❖ **Dealing with unfiled FBAR's**
- ❖ **Penalties**
- ❖ **Offshore Voluntary Disclosure Program**

Topics to be covered (continued)

- ❖ **Foreign Account Tax Compliance Act (FATCA)**
- ❖ **Form 8938**
- ❖ **Penalties**
- ❖ **Foreign Bank reporting of “U.S.” financial accounts to the Internal Revenue Service**

Taxation

Starting Point: US Citizenship Taxation

- ❖ **US citizens are subject to US tax on their worldwide income from all sources regardless of where they live**
- ❖ **Tax is levied as provided for under the Internal Revenue Code even if no income is from sources in the U.S.**
- ❖ **All provisions of the Code apply, e.g. estate taxes and “foreign” source income rules**

Taxation

Which U.S. citizens must file?

❖ Start with filing status

- **Single, under or over 65**
- **Head of household, under or over 65**
- **Married filing jointly, under or over 65 both spouses or one**
- **Married filing separately, any age**
- **Qualifying widow or widower, under or over 65 with a dependent child**

Taxation – Who files

Status	Age	Gross Income
Single	under 65	\$10,000
	65 or older	\$11,500
Head of household	under 65	\$12,850
	65 or older	\$14,350
Married, filing jointly	under 65 (both spouses)	\$20,000
	65 or older (one spouse)	\$21,200
	65 or older (both spouses)	\$22,400
Married, filing separately	any age	\$3,900
Qualifying widow(er) with dependent child	under 65	\$16,100
	65 or older	\$17,300

Taxation – US Income Tax Return Filing Deadline

- ❖ US citizens living abroad have until **June 15** to file their income tax return for the prior year
- ❖ US citizens also have until **June 15** to pay their income tax liability - Treasury Regulation §1.6081-5(a)(5)
- ❖ An automatic extension to file tax returns to **October 15** is available, but tax liabilities must be paid by **June 15**

Taxation – Section 911 Foreign Earned Income Exclusion (FEIE)

- ❖ FEIE allows US citizens who are *bona fide* residents in a foreign country or who have a physical presence outside the US to exclude up to a set amount of their earned income from US tax

Taxation – FEIE

- ❖ *Bona fide* residence is a “facts and circumstances” test
- ❖ Generally, anyone who lives permanently outside the US, has set up a home, sends their children to local schools, etc. meets the test
- ❖ Being required to pay tax where one lives is also determinative

Taxation – FEIE

- ❖ **Physical presence test requires that the US citizen live outside the US for no less than 330 full days in any consecutive 12 month period**
- ❖ **It is an “all or nothing” test; 329 full days is not sufficient**
- ❖ **The days do not have to be in one tax year- counting can be tricky**

Taxation – FEIE

- ❖ **US citizens working in a foreign country for the US government or a US government agency cannot use the FEIE**

Taxation – FEIE

- ❖ **FEIE covers only “earned income”**
 - **Salary, wages, commissions, bonuses, professional fees, tips, consulting or self-employed earnings**
 - **Interest, dividends, capital gains, rents, etc. are not earned income**
 - **Pensions and annuities are not earned income**

Taxation – FEIE

- ❖ **Social security is NOT earned income**
- ❖ **FEIE cannot be used to exclude social security payments**

Taxation – FEIE

- ❖ **Both spouses can take FEIE if both work and meet the residence or physical presence tests**
- ❖ **Spouses DO NOT have to meet the same qualifying test**

Taxation – FEIE

- ❖ **FEIE automatically triggers Alternative Minimum Tax (AMT) calculation**
- ❖ **AMT is very complex; but generally speaking, AMT is calculated as if FEIE is NOT taken**

Taxation – FEIE

- ❖ **Maximum exclusion is set each year**
 - **For 2010 it was \$91,500**
 - **For 2011 it was \$92,900**
 - **For 2012 it is \$95,100**
 - **For 2013 it is \$97,600**
 - **Value of the exclusion is always calculated in USD**

Taxation – FEIE

- ❖ **FEIE must be claimed by filing Form 2555 or 2555EZ with Form 1040**
- ❖ **Earnings above the FEIE limit are taxed at the taxpayer's marginal rate as if FEIE had NOT been used, i.e., usually beginning at 28%**

Taxation – Foreign Housing Exclusion (FHE)

- ❖ To claim FHE, the taxpayer must meet the *bona fide* residence or physical presence test
- ❖ FHE covers rent, utilities, occupancy taxes, furniture rentals, etc. paid by an employer
- ❖ Must be reasonable based on job

Taxation – FHE Calculation

- ❖ Start with base housing expense which equals 16% of the FEIE maximum exclusion
- ❖ $\$97,600 \text{ times } .16 = \$15,616 \text{ (2012)}$
- ❖ Subtract base housing expense from the amount of housing expenses paid to reach FHE exclusion

Taxation – FHE Calculation

- ❖ **Example: Employer pays housing expenses equal to \$30,000 in 2013**
- ❖ **$\$30,000 - \$15,616 = \$14,384$ FHE**
- ❖ **Maximum FHE is 30% of FEIE**
 $\$97,600 \text{ times } .3 = \$29,280$
- ❖ **IRS Notice 2013-31 lists cities for which the maximum is higher (e.g, for Athens it is \$40,400)**

Taxation – Foreign Housing Deduction (FHD)

- ❖ **FHD has same requirements as FHE**
- ❖ **FHD covers self-employed persons**
- ❖ **Excess over maximum may be carried forward one year**
- ❖ **Foreign tax credits are not allowed on FEIE, FHE or FHD**

Taxation – Foreign Tax Credits (FTC)

- ❖ Taxpayers may apply income taxes paid to a foreign government on income as credits to their US tax obligations
- ❖ VAT, business or real estate taxes or any other tax NOT levied on income is excluded
- ❖ “Solidarity tax” is a tax on income

Taxation – FTC

- ❖ Credits must be broken down into categories on Form 1116
 - Passive, General, Section 901(j), income re-sourced by treaty and lump sum distributions
- ❖ Form 1116 AMT must be filed with Form 1116
- ❖ AMT may reduce FTC

Taxation – Social Security

- ❖ **Up to 50% of social security benefits are taxable if**
 - **filing as an individual with “combined income” of between \$25,000 and \$34,000**
 - **filing a joint return with “combined income” of between \$32,000 and \$44,000**

- ❖ **85% is taxable if “combined income” exceeds these maximum amounts**

Taxation – Social Security

- ❖ **85% of social security benefits are taxable if a married person files a separate return**
- ❖ **“Combined income” equals adjusted gross income + tax exempt interest + 1/2 of social security benefits**

Taxation – Social Security Totalization Agreements

- ❖ **US and Greece (and many other countries) have entered into these agreements**
 - **to prevent people from having to contribute to two systems**
 - **to coordinate benefits between systems**
 - **to reduce chances that a person will not qualify for benefits in either country**

Taxation – Social Security Totalization Agreements

- ❖ **Taxpayers cannot choose which country's mandatory system they will participate in**
- ❖ **Agreements spell out the rules**

Taxation – US-Greece Agreement

Working in Greece for a US employer

Sent to Greece; worked five years or less	US
Sent to Greece; worked more than five years	Greece

Hired in Greece	Greece
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<i>Working in Greece for a non-US employer</i>	Greece
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Working in Greece for the US government

US national	US
Greek national	Greece

Taxation – US-Greece Agreement

Working in the US for an employer in Greece

Sent to US; worked five years or less	Greece
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Sent to US; worked more than five years	US
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Hired in the US	US
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<i>Working in the US for a non-Greek employer</i>	US
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Working in the US for the Greek government

Greek national	Greece
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US national	US
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<i>Self-employed and living in the US</i>	US
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<i>Self-employed and living in Greece</i>	Greece
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Taxation – Unfiled US Tax Returns

- ❖ There is no statute of limitation on an unfiled tax return**
- ❖ There is a three year statute of limitations on a filed tax return**
- ❖ In limited situations the three year limit can be increased to six**
- ❖ Penalties are based on tax due with a minimum penalty of \$135.**

Taxation – Unfiled US Tax Returns

- ❖ **The US is a low tax jurisdiction compared to most of the rest of the world**
- ❖ **Foreign tax credits tend to reduce US taxes despite ATM's FTC reduction**
- ❖ **Six years of tax returns should be filed regardless of how long returns have not been filed**

Foreign Bank Account Report (FBAR)

- ❖ **FBAR was mandated by the Bank Secrecy Act of 1970 to address money laundering**
- ❖ **It is not a tax filing, but a report of defined financial accounts held outside the United States**
- ❖ **Enforcement was minimal until 2009**

FBAR – Who must file?

- ❖ **US citizens**
- ❖ **Permanent US residents**
- ❖ **Trusts**
- ❖ **Estates**
- ❖ **US domestic legal entities**

FBAR – Who must file (continued)?

- ❖ **The persons/entities listed on the prior slide IF they have financial accounts located outside the U.S. AND the TOTAL on deposit in all such accounts AT ANY TIME during a calendar year exceeds \$10,000 (more or less €7,830 at current exchange rates)**

FBAR – Who must file (continued)?

- ❖ The FBAR filing requirement includes financial accounts over which a U.S. citizen has signature authority even if the person has no beneficial interest in the account (e.g., a bank account of a company for which the person works)**

FBAR – Who must file (continued)?

- ❖ The FBAR regulations make it clear that even if the U.S. person is not the owner of record, if the owner of record is that person's agent or the U.S. person can control the account directly or indirectly, the financial account is to be reported**

FBAR – What is an account?

❖ Foreign financial accounts include:

- Bank (savings, checking or deposit) and securities accounts**
- Accounts from which cash can be withdrawn regardless of its description**
- Mutual funds and other funds in which the US person has an equity interest**
- Bonds, stock, promissory notes are NOT accounts**

FBAR – Filing Requirements

- ❖ **Each US person must file his/her own FBAR**
 - **Married couples can file a joint FBAR if all reportable accounts are jointly owned**
- ❖ **FinCEN Form 114 must be received by the IRS on or before June 30th each year for the prior year**

FBAR – Dealing with unfiled FBAR’s

- ❖ **FBAR’s are required to be filed every year**
- ❖ **The statute of limitations on unfiled FBAR’s is six years from when it should have been filed, i.e., FBAR’s that should have been filed for 2007 are now statute barred**
- ❖ **Compliance should begin with the FBAR for calendar year 2008**

FBAR – Penalties

- ❖ **Maximum penalty for “non-willful” failure to file is \$10,000 PER account PER year**
- ❖ **No penalty is owed if failure was not “willful”, taxpayer can establish “reasonable cause”, and each account is properly reported**

FBAR – Penalties

- ❖ **“Willful” means voluntary and intentional violation of a known legal duty**
- ❖ **Willfulness does not exist if a person had no knowledge of the FBAR filing requirement**
- ❖ **Burden of proof is on the IRS to prove “willfulness”**

FBAR – Penalties

- ❖ **Willfulness, if proved, can trigger significant civil and criminal sanctions**
- ❖ **Civil penalty can be the greater of \$100,000 or 50% of the high balance of each account for each year that an FBAR has not been filed**
- ❖ **Criminal penalties are even stiffer**

FBAR – Penalties

- ❖ Very few, if any, U.S. expats will face significant penalties if they file FBAR's for 2008 through 2013 soon**
- ❖ Reasonable cause based on “I did not know” is less credible as time passes**
- ❖ Filing FBAR's without filing tax returns is inviting serious trouble and vice versa**

FBAR – Quiet Disclosure

- ❖ Taxpayer files FBAR's and tax returns (or amended returns) for 2008-2013; includes a reasonable cause statement with FBAR's**
- ❖ Quiet disclosure suits taxpayers with genuine “reasonable cause” based on the facts and circumstances of their situations**

FBAR – Offshore Voluntary Disclosure Program (OVDP)

- ❖ IRS launched a Offshore Voluntary Disclosure Initiative (OVDI) in 2009 and another one in 2011; both have closed**
- ❖ In January 2012, the IRS announced a new version that is now a program and will be open indefinitely**

FBAR – OVDP

- ❖ **Participation in OVDP requires the taxpayer to concede that his/her non-filing was “willful”**
- ❖ **Penalties are capped at 27.5% of the highest balance of all offshore accounts during the unfiled years**

FBAR – OVDP

- ❖ **Participation in OVDP requires the taxpayer to concede that his/her non-filing was “willful”**
- ❖ **Penalties are capped at 27.5% of the highest balance of all offshore accounts during the unfiled years**
- ❖ **OVDP is for tax criminals; not for people with genuine reasonable cause**

FOREIGN ACCOUNT TAX COMPLIANCE ACT (FATCA)

- ❖ FATCA enacted by U.S. Congress in 2010 to address tax evasion by U.S. citizens using foreign accounts**
- ❖ Two fold approach: individual disclosure required on Form 8938 and foreign financial institutions required to disclose “U.S. accounts” to IRS**

FATCA – Form 8938

❖ Who has to file?

- U.S. citizens and permanent residents based on reporting thresholds

❖ Adds to, does not replace, FBAR filing requirement

❖ Form must be filed with U.S. tax return (Form 1040)

❖ Form first required with 2011 tax returns

FATCA – Form 8938

- ❖ **Filing status and residence governs filing thresholds**
 - **Filing Status = Single or Married filing separately living outside the U.S. (must meet the residence requirements that apply to FEIE)**
 - **Total value of all “foreign financial assets” exceeds \$200,000 on last day of the year or \$300,000 at any time during the year**

FATCA – Form 8938

- ❖ **Filing Status = Married filing jointly living outside the U.S. (must meet the residence requirements that apply to FEIE)**
- **Total value of all “foreign financial assets” exceeds \$400,000 on last day of the year or \$600,000 at any time during the year**

FATCA – Foreign Financial Assets

- ❖ **Accounts at foreign financial institutions, defined broadly to include insurance companies, private equity funds and other investment entities and vehicles, not commonly thought of as financial institutions**
- ❖ **Bank accounts (all kinds)**

FATCA – Foreign Financial Assets

- ❖ **Stock in foreign companies held through a foreign financial institution**
- ❖ **Stock in private foreign companies**
- ❖ **Interests in foreign partnerships**
- ❖ **Foreign mutual funds**
- ❖ **Precious metals held indirectly through exchange traded funds**

FATCA – Foreign Financial Assets

❖ Do NOT include

- Personal property (e.g., artwork)
- Precious metals, jewelry owned directly
- Real estate held directly
- Social benefits (e.g., like social security) provided by foreign governments

FATCA – Form 8938

❖ Failure to File Penalties

- **\$10,000 penalty, plus**
 - **An additional \$10,000 penalty if Form 8938 not filed within 90 days of being notified of initial penalty**
 - **Incremental \$10,000 penalties accrue every 30 days to a maximum of \$50,000**
 - **Total could equal \$60,000 if all penalties are imposed**

FATCA – Foreign Bank Disclosures

- ❖ **FATCA imposes a 30% tax on all U.S. transactions of foreign financial institutions (FFI) that do not agree to share account information**
- ❖ **The 30% tax effectively locks FFI's out of U.S. banking system**
- ❖ **Most FFI's are cooperating**

FATCA – Foreign Bank Disclosures

- ❖ **U.S. is negotiating FATCA Intergovernmental Agreements (IGA's)**
- ❖ **As of April 9, 2013 U.S. Treasury was negotiating with more than 75 countries**
- ❖ **U.S. has signed IGA's with 20 countries; Greece is not one of them**

FATCA – Foreign Bank Disclosures

- ❖ **U.S. has developed two models for IGA's**
 - **Model 1: FFI's report accounts to their own governments which pass account information to the IRS**
 - **Model 2: FFI's report accounts directly to the IRS**

FATCA – Foreign Bank Disclosures

❖ How will an FFI know who is a U.S. person?

- FFI's must conduct due diligence (not well defined), but will generally gather and retain enough data about account holders to determine if the holder is a U.S. person
- U.S. birthplace, passport, address, employer, etc. are indicators

FATCA – Foreign Bank Disclosures

❖ What will be disclosed?

- **Under U.S.-Mexico IGA, Mexico will provide annually to the IRS**
 - **Name, address, US SSN/TIN of each U.S. person who is an account holder**
 - **Same information for entities controlled by U.S. persons**
 - **Account numbers**
 - **Name and identification of FFI's where accounts are held**

FATCA – Foreign Bank Disclosures

❖ U.S.-Mexico IGA (continued)

- Average monthly balance/value during the year
- Gross amount of interest paid on depository accounts
- Gross amounts credited or paid to non-depository accounts, including redemptions

FATCA – Key Implementation Dates

- ❖ April/June 15, 2012 – Form 8938 should have been filed with Form 1040
- ❖ July 1, 2014 – FFI's must implement procedures to determine U.S. status of new accounts
- ❖ March 31, 2015 – FFI's must file first FATCA reports
- ❖ See IRS Notice 2013-43 for key FATCA Implementation Dates

FATCA – Key Implementation Dates

- ❖ December 31, 2014 – FFI's must document owners of pre-existing high value accounts (\$1 million or more)**
- ❖ December 31, 2015 – FFI's must review all pre-existing accounts with balances above \$50,000 to determine if any are U.S. accounts**

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