2020 International Tax Guide:

Taxation of U.S. Expatriates

KLR International Tax Services Group

Introduction

The acceptance of a foreign assignment poses complex challenges for newly expatriated U.S. citizens and resident aliens. These issues include, but are not limited to: foreign earned income, residency issues, and increased taxable income. This guide is designed to help U.S. expats understand the tax obligations and options they will face during the course of a foreign assignment.

This e-book is only meant as a guide, as U.S. and foreign tax laws are always changing, and different rules apply depending on your assignment. We are always here to help—we can analyze the tax situation, ensure the minimization of tax liabilities, and compliance.

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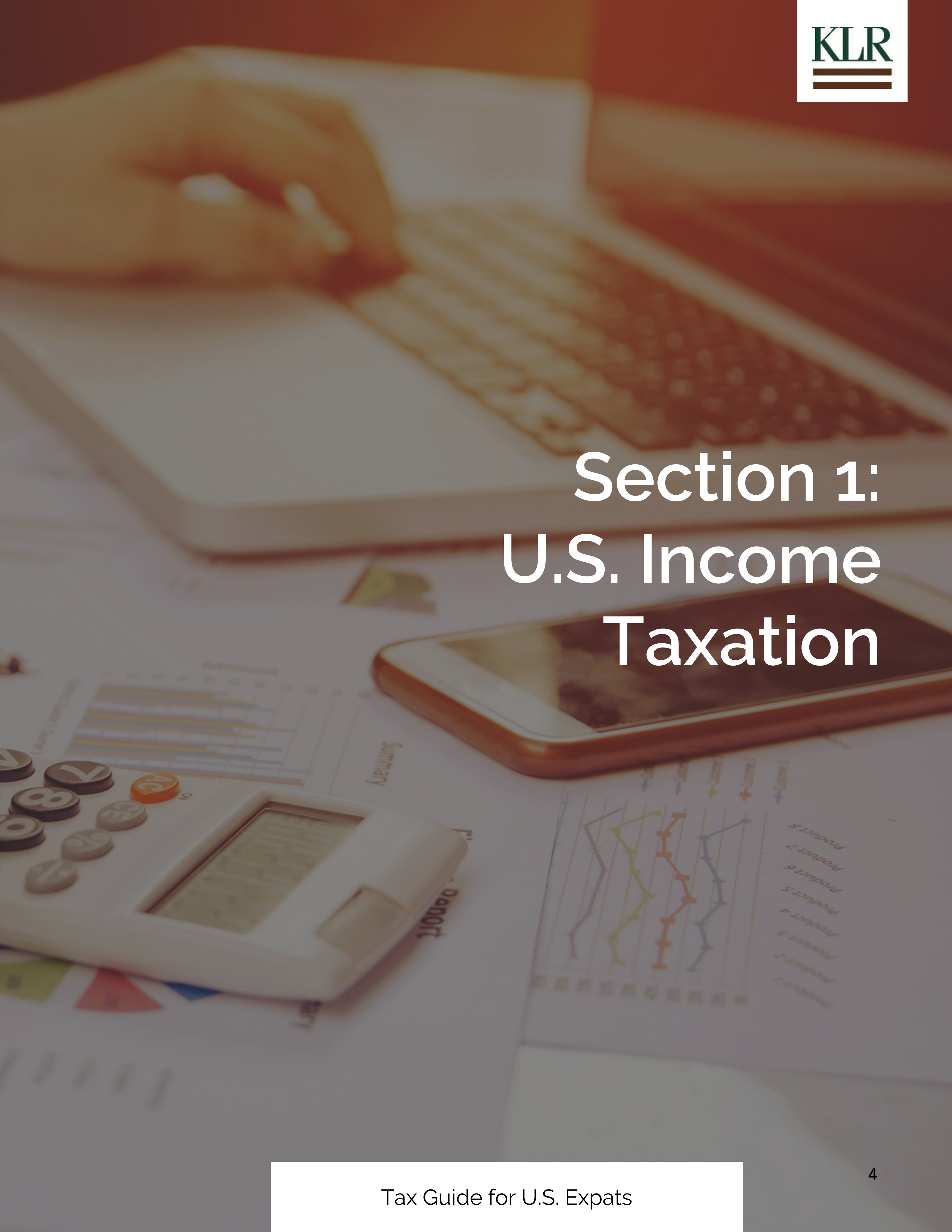


Section 1: U.S. Income Taxation

U.S. Income Taxation

What is a U.S. expatriate?

A U.S. expatriate (expat) is a citizen or resident alien of the U.S. who has permanently or temporarily moved out of the U.S. for more than one year. Those on business trips of one year or less are referred to as short-term assignees.

All U.S. citizens and residents are required to file a U.S. tax return if their gross income exceeds the standard deduction (indexed annually for inflation) based on their filing status. Adding the foreign assignment to the mix makes things more complex, but expats are generally required to file income tax returns, estate tax returns and gift tax returns and pay estimated tax the same way as those residing in the U.S. Irrespective of your residence, all worldwide income has to be reported.

Special related foreign exclusions

While residing in foreign countries, U.S. citizens and resident aliens are still subject to the standard rules for filing U.S. income tax returns. **There are various special tax provisions** available to reduce federal income tax liability and to prevent double taxation. The two most common are the **foreign tax credit** and the **foreign earned income and housing exclusions**.

U.S. Income Taxation

Foreign tax credit- A U.S. citizen or resident alien may either deduct foreign income taxes or claim foreign taxes as a credit against their U.S. income tax liability. In some cases, the credits can also help reduce state individual income tax liability.

Who can claim the foreign tax credit?
Anyone who meets the below four tests can qualify for the credit:

1. The tax must be a legal and actual foreign tax liability
2. The tax must be imposed on an individual claiming the credit
3. The tax must have paid or accrued, and
4. The tax must be an income tax (or a tax in lieu of an income tax)

Typically, only income taxes paid or accrued to a foreign country or a U.S. possession (Puerto Rico and American Samoa) will qualify for the foreign tax credit.

The complex mechanism of the foreign tax credit is designed to prevent taxpayers from claiming a credit in excess of the tax that would have been paid in the U.S. on the foreign income.

Claiming the foreign tax credit?
The foreign tax credit is claimed only for foreign taxes imposed on income, war profits, excess profits, or taxes in lieu of those taxes. This excludes excise taxes, wealth taxes, VAT, and other non-income based taxes. Taxes actually paid or accrued create a 'creditable amount'. A complex formula establishes the credit limitation for the tax year. Creditable amounts in excess of the limitation are carried forward to future periods.

Individual taxpayer claim the credit on Form 1116. However, Form 1116 will not be required if all of the following conditions are met.

1. All foreign source gross income is passive income (e.g. interest and dividends);

2. All income and any foreign taxes paid thereon were reported on a qualified payee statement such as Form 1099;

3. The tax must have paid or accrued, and

4. The tax must be an income tax (or a tax in lieu of an income tax)

The ability to carryback or carryforward excess foreign tax credits is forfeited if Form 1116 is not used.

Foreign taxes paid or accrued?
A taxpayer elects either the paid or accrual method for claiming the foreign tax credits. Under the paid method, you claim the foreign taxes paid/withheld to the foreign country during the calendar year. Under the accrual method, you report the actual foreign tax liability at the end of the foreign tax year is used. Once the accrual method is elected, it is binding for all future tax years.

If the foreign tax year does not match the calendar year, using the accrual method will create a mismatch. The timing difference may cause a temporary cash flow problem as the taxpayer may have to pre-pay the U.S. income tax liability, without any credit offset, and later amend the return to carryback the foreign tax credits. Therefore, if you have different U.S. and foreign tax years you may find it more beneficial to remain in the paid method for foreign tax credits.

How does the Alternative Minimum Tax (AMT) fit in?
As a taxpayer you must prepare separate foreign tax credit calculations to determine the applicable credits for the AMT computation (a separate tax calculation designed to ensure that higher income taxpayers pay at least a minimum tax).

What happens to unused foreign tax credits?
In any year where the amount of foreign taxes paid or accrued exceeds the U.S. tax on foreign source earnings, it must be carried back to the previous tax year and then carried forward for up to ten years. A carryback claim of the foreign tax credits will require the amendment of a prior year income tax return. There is a ten-year window in which the amendment must occur.

U.S. Income Taxation

Can foreign taxes be deducted rather than credited?
You can elect to deduct foreign taxes paid as an itemized deduction rather than calculating the foreign tax credit, but keep in mind that the foreign tax credit is generally much more beneficial because it provides a dollar-for-dollar tax reduction.

What is the foreign tax disallowance?
Expats cannot claim a foreign tax credit or deduction for foreign taxes related to income that has been excluded as part of the foreign earned income exclusion (FEIE) or housing exclusion. To determine the disallowed amount, an apportionment of the foreign tax is calculated between your excluded foreign net earned income and the total foreign net earned income subject to the foreign tax.

2. Foreign earned income and housing exclusions -
A U.S. citizen or resident alien with a tax home located overseas may elect to claim the **foreign earned income exclusion** (FEIE) and/or the housing exclusion (or deduction depending upon employment status). Taxpayers must meet either the bona fide residence test or the physical presence test to qualify for either or both of these exclusions. Once either election is made, it is effective until revoked. Revocation can only occur if the FEIE has been claimed at least once; if a taxpayer qualifies for FEIE but chooses not to utilize that strategy, it is not considered a revocation.

Foreign earned income exclusion
Through the FEIE, you can claim an exclusion of foreign earned income up to the lesser of an inflation-indexed amount of $107,600 for 2020 or the individual's actual foreign earned income for such year. The FEIE is an adjustment, or deduction, from gross income and only foreign earned income (income that an individual earns performing services outside the U.S.) may be excluded. Income deferred for more than one year cannot be excluded.

In situations where compensation is partially related to services performed outside the U.S. and partially related to services performed in the U.S., the foreign earned income is determined through an allocation generally based on relative business days spent inside and outside the U.S. This is why tracking travel activity is crucial while on a foreign assignment.

U.S. Income Taxation

Foreign housing exclusion or deduction
Foreign housing costs (over a defined base amount) can be excluded through the **housing exclusion or deduction**. The exclusion is generally limited to 30% of the maximum foreign earned income exclusion ($32,280 for 2020 - 30% of $107,600). The housing expenses are limited to the smaller of the actual expenses or the maximum allowed for the location less the base housing amount of $17,216 for 2020. If you reside in a high-cost geographic area the limitation amount is adjusted. The total of the housing exclusion or deduction plus the FEIE cannot exceed your foreign earned income for the tax year.

Foreign housing exclusion vs. deduction
The housing exclusion applies only to amounts considered paid for with employer-provided amounts. The housing deduction applies only to amounts paid for with self-employment earnings (which will not reduce self-employment tax).

What kind of housing expenses are included?
Qualified housing costs include items such as rent, utilities, insurance, residential parking, and repairs, amongst others. The costs have to be reasonable expenses actually paid or incurred for housing in a foreign country for the taxpayer and any dependents. Only expenses for portions of the year in which the taxpayer qualifies for the exclusion or deduction should be used.

There are a few costs not included under applicable housing expenses, such as lavish or extravagant additions to the home, furniture, accessories, improvements, or other expenses that increase the value or "appreciably prolong" the life of the property. Also lodging expenses that have already been excluded from gross income, or deducted as moving expenses, cannot be included. Consequently, mortgage interest payments are not eligible since those can be itemized.

How to qualify for the exclusions
A foreign tax home must be established and either the bona fide residence test or the physical presence test must be satisfied.

U.S. Income Taxation

How to establish a tax home

The location where business is primarily conducted is considered your "tax home". If there is no principal place of business, the tax home is considered to be the taxpayer's regular abode. The location of an abode is based on where family, economic, and personal ties are maintained. For example, imagine a taxpayer commutes across the border each day to work in Mexico, but his/her family remains in Texas; his/her abode remains in the U.S. A new tax home is often established by exceeding one year at a new place of work. Temporary absences from a tax home in the U.S. on business, do not qualify for the foreign earned income exclusion.

What is the bona fide residence test (BFR)?

The BFR test is met if…

- The taxpayer is a U.S. citizen or resident alien who is a citizen or national of a country with which the U.S. has an income tax treaty in effect, and

- The taxpayer has set up residence in a foreign country and lived there for an uninterrupted period that includes an entire tax year (January 1st through December 31st for calendar year taxpayers).

Bona fide residence can be met if you make temporary visits back to the U.S., provided that there exists a clear intent to return to the foreign home or to a new foreign abode. Living overseas for one year doesn't necessarily imply qualification for BFR. Once bona fide residence is established, it begins with the first day and ends with the date the foreign residence is abandoned. Therefore, taxpayers can qualify for BFR for part of a year during the arrival and departure periods.

You *do not* meet the BFR test if a statement is made to the authorities of the foreign country that the taxpayer is not a resident of that country and the authorities hold that the taxpayer is not subject to their income tax laws as a resident.

U.S. Income Taxation

What is the physical presence test (PPT)?
The physical presence test is met when a taxpayer is physically present in one or more foreign countries for at least 330 full days during a 12 consecutive month period. The 330 days do not need to be consecutive. A full day is a period of 24 consecutive hours beginning and ending at midnight. Any time spent on or over international waters does not count as time in a foreign country when traveling to or from the U.S. For example, flying out of the U.S. for Spain on March 13 and arriving at 8:00 a.m. on March 14 would result in March 15 being considered the first full day in Spain.

PPT applies to U.S. citizens or U.S. resident aliens and is based on length of stay. Additionally, a foreign tax home must be established (see earlier discussion).

Electing the FEIE and/or housing exclusion
The exclusions are elective and available to each individual taxpayer. If a couple files a joint return, each person can claim an exclusion. A taxpayer can make a FEIE without the housing exclusion or can elect both.

The initial choice of the exclusion (s) must be made with:

- A timely filed return,
- An amended return, if the original return was filed on time, or
- A late-filed return, filed within one year from the original due date of the return.

Additionally, claiming an exclusion on a return filed outside of the above periods is possible, provided no federal income taxes are owed. If federal income taxes are owed after taking the exclusion into account, the return can still be filed after the periods described above, but special language will need to be included in a statement attached to the return.

If a U.S. expat has not met the BFR or PPT qualifications for a part-year period by the due date of the return, Form 2350 can be used to request an additional 30-day extension.

U.S. Income Taxation

How to avoid double benefits
There are a few calculations required regarding the FEIE and housing exclusion, to ensure no “double tax benefit” is received on the same item of income.

Picture this: Let’s say you claim the FEIE and housing exclusion and also pay creditable taxes to a foreign jurisdiction. Barring any adjustment, it would be possible to claim the foreign tax credit for taxes paid on income that is excluded from taxation under the FEIE. To prevent such double tax benefits, a portion of the credits applicable to the foreign income excluded must be disallowed.

What credits are disallowed?
The disallowance for the foreign taxes paid or accrued is calculated according to this formula:

$$\frac{\text{Foreign Income Excluded}}{\text{Total Foreign Earned Income}} \times \text{Foreign Taxes} = \text{Disallowed Foreign Taxes}$$

Expatriate allowances
In addition to normal compensation, if you participate in a corporate program you will often receive a number of expatriate allowances and/or expense reimbursements. Some of the most common include but are not limited to; host housing, cost-of-living allowance, home leave, foreign income tax payment, cultural training, relocation help, tax assistance and other benefits. As long as a personal benefit is provided, these fringe benefits are typically treated as taxable wages (regardless of whether the payments are made directly to you or to a vendor).

Generally, if you are ‘tax equalized’ (see section 6), usually your employer will deduct stay-at-home amounts (often referred to as “hypothetical”) withholding for housing and income taxes during the foreign assignment. The hypothetical withholding will reduce the taxable wages reported on Form W-2.

While on assignment, some of the fringe benefits will increase your Form W-2 taxable wages and your federal income tax withholdings may be completely shut off. It is imperative that you take the time to understand the differences!

U.S. Income Taxation

If you are not on a U.S. payroll, you will need to track the expatriate allowances received, because the foreign country may not consider them taxable income and you'll need the information for U.S. reporting purposes.

Moving expenses

Moving expenses will be included in gross income as taxable wages. Common taxable moving expense reimbursements include:

- Storage fees
- House hunting expenses
- Transportation of your household goods
- Travel expenses from an old residence to a new residence
- Temporary living expenses
- Cost of meals
- Cost of buying/selling home
- Reimbursement of loss on home sale
- Tax assistance or gross-up payments

Some companies will pay their employee a lump sum from which you must pay your own moving expenses (entire lump sum will be included in your taxable wages.)

What about other benefits?

Expats that go on assignment for a specific amount of time will generally remain employees of the U.S. Company. As a U.S. employee you can stay on the U.S. payroll during your foreign assignment as a result you can continue to participate in the company's:

- Health and dental plans
- 401(k) plans
- Pension plans
- Life insurance plans
- Stock option plans
- And any other benefits

U.S. Income Taxation

Home ownership and tax consequences
There are numerous tax effects attached to home ownership, including:

- Home mortgage interest deduction- To be deductible, the interest must be for a loan secured by your main home or your second home.

- Points paid on purchase of your home- Points are essentially charges paid by a borrower to obtain a mortgage loan. To qualify for this deduction, the loan must be secured by the principal residence, The payment of points must be an established practice in that geographical area, and the amount of points charged cannot be more than is generally charged in said area.

- Real Estate Taxes- State and local governments will sometimes charge an annual tax on the value of real property. A deduction is allowed if the taxes charged are at a uniform rate for all property in the taxing jurisdiction and if the property is in the U.S.

Gain on sale?
A tough decision for many expats is whether to sell your personal residence, rent it out, or retain the home without renting while on foreign assignment.

If a principal residence results in a gain, it may be possible to exclude up to $250,000 (per taxpayer, so $500,000 for a joint return) of that gain from income.

To qualify for this exclusion both the ownership test and the use test must be satisfied. Here are the specifics:

- The home has been owned for two of the last five years prior to the date of the sale,

- The home has been occupied as a primary residence for two of the last five years prior to the sale date, and

- Taxpayer and/or spouse has not claimed the exclusion on the sale of another home within two years prior to the date of the sale of the current home.

U.S. Income Taxation

If any of the above conditions are not met, a pro-rated amount of the maximum exclusion may still be available, under certain circumstances.

Loss on sale?

Losses from the sale of personal-use property such as a principal residence are not tax deductible. It is not eligible for the capital gains loss of up to $3,000 annually.

Rental of principal residence

The conversion of a U.S. principal residence into a rental property would result in the inclusion of any rental income on a U.S. income tax return; specifically on Schedule E.

Ordinary and necessary expenses for managing, conserving, and keeping the rental property would be deductible from this income. Depending on the host country, the U.S. rental income may be includable on the foreign income tax return.

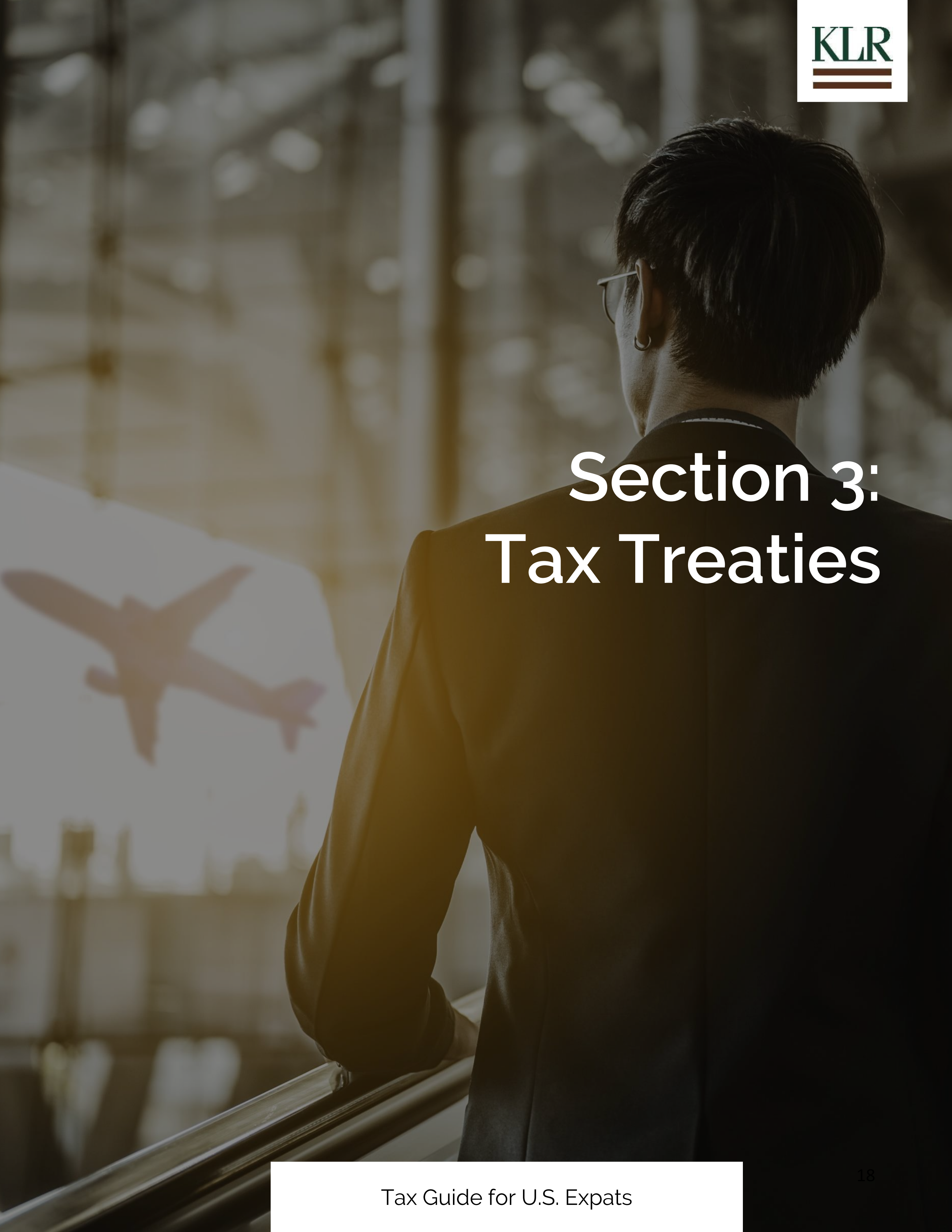
Section 2:
Social Security

Social Security

U.S. persons working for U.S. employers are subject to Social Security/Medicare taxes even while working abroad. A U.S. citizen or resident employed by a foreign employer may be able to remain on the U.S. Social Security/Medicare tax system if there is a totalization agreement (see discussion later) in place, otherwise, it would default to the foreign country's social security tax system.

Similarly, a self-employed taxpayer who is performing services in the U.S. is still subject to U.S. Social Security/Medicare taxes. A U.S. person that is self-employed and performing services overseas, the country to whom you have to pay social security taxes to will depend on the specific facts and circumstances.

Deciding to stay overseas would necessitate revisiting the long-term consequences of what country the Social Security taxes are being contributed to. In the U.S., a person becomes eligible to collect Social Security retirement benefits once he/she is 62. In addition, at least 40 credits are needed which is the equivalent of 10 years of work. Social Security contributions made to another country may count towards the credit requirement if the U.S. has a totalization agreement with the country.



Section 3: Tax Treaties

Tax Treaties

Totalization agreements

Currently, the U.S. has totalization agreements with many countries (see **IRS website** for a list) to avoid double taxation of income with respect to social security taxes as well as to determine benefits. The agreements provide that a taxpayer is subject to social security tax in only one of the two countries that are party to the agreement. Employees of a U.S. company sent on a temporary assignment will likely only be subject to U.S. social security tax while on the foreign assignment. There must be a request for a Certificate of Coverage from the U.S. Social Security Administration in order to remain subject to the U.S. Social Security/Medicare taxes under a totalization agreement. An added advantage of remaining subject to one country's social security tax system is that it provides continuity of benefits if you have worked in multiple countries.

Income tax treaties

The U.S. has income tax treaties with many countries around the world. The goal of an income tax treaty is to ensure that you, as a citizen or resident, are not taxed by two countries on the same income.

Tax Treaties

Under these treaties, if you are a resident of a foreign country you may be taxed at a reduced rate or exempt from U.S. taxes on certain items of income you receive from sources within the U.S. Each income tax treaty has its own set of regulations, thus, detailed review pertaining to a particular country/treaty is necessary to determine what is applicable. Additionally, most income tax treaties contain a "saving clause" which prevents you, a U.S. citizen or resident, from using provisions of a tax treaty to avoid taxation of U.S. source income.

States may or may not recognize the previsions of an income tax treaty provision, so further research will be warranted.

Most treaties count your number of physical presence days in a country to determine if you are a resident. Those who spend less than 183 days in a tax year, or over a 12 month period in the country, will likely be classified as a nonresident. Normally, nonresidents are taxed only on income earned within the foreign country.

Short-term business trips may provide for the exclusion of foreign earnings from foreign taxation. In most of these situations, it is necessary to be paid by a U.S. company and the salary cannot be charged to a foreign branch of the employer. Lastly, nonresident status is required to use this provision.

Section 4: U.S. Filing Requirements

U.S. Filing Requirements

U.S. income tax returns are required to be filed by all U.S. citizens and residents irrespective of where they live or work, provided the applicable filing thresholds are met. Even if tax liability is eliminated via benefits such as the Foreign Earned Income Exclusion and/or the Foreign Tax Credit, a return must be filed to document the use or election of these benefits.

It is important to understand that your income tax return will be more complex. An example of added complexity is translation of foreign currency amounts into U.S. dollars to report worldwide income and any applicable deductions. In addition, previously discussed positions will necessitate additional filings, such as Form 2555 (Foreign Earned Income Exclusion), Form 1116 (Foreign Tax Credit), Form **8938** (Statement of Specified Foreign Financial Assets- discussed later), and FinCEN Form 114 (**FBAR** – discussed later) amongst others.

When to file

Individuals are required to pay taxes based upon calendar years ending December 31. The due date for filing federal individual income tax return is generally April 15 of each year.

U.S. Filing Requirements

If you are a U.S. citizen or resident alien who has a tax home and abode outside of the U.S. and Puerto Rico, you qualify for an automatic two-month filing extension until June 15th. If further time is needed, an extension through October 15th is available by filing Form 4868 either by April 15th or June 15th. By sending a letter to the IRS, a taxpayer may be able to qualify for an additional two-month filing extension until December 15th if their tax home and abode continues to be outside of the U.S. and Puerto Rico.

Note that all taxes due must be paid by April 15 to avoid interest payments. The automatic two-month extension to June only prevents late filing penalties.

Summary of U.S. filing deadlines

2019 Tax Year	Deadline
• Filing and payment deadline • 1st estimated tax payment (form 1040-ES) • FinCEN Form 114 (FBAR)	April 15, 2020
• Filing deadline for qualifying expats • 2nd estimated tax payment	June 15, 2020
• Filing deadline by requesting extension • 3rd estimated tax payment • FinCEN Form 114 (FBAR) automatic extension	October 15, 2020
• Filing deadline for expats who requested a second extension on October 15	December 15, 2020
• 4th estimated tax payment	January 15, 2021
• Filing deadline for 1st year expats qualifying for FEIE with Form 2350 submission	January 30, 2021

REMINDER, all taxes must be paid by April 15, 2020, even if qualifying for the June 15th extension. Check out our ***tax deadline calendars here****.*

U.S. Filing Requirements

Income tax withholdings

All employers who pay wages to you as a U.S. citizen or resident are required to withhold federal income tax. However, your U.S. employer does not need to withhold U.S. income tax on foreign earned income if:

- The income is earned overseas and your employer must withhold foreign income taxes on such income.
- The income will be excluded under the foreign earned income exclusion and you provide a completed Form 673 to your employer.
- If the income is earned in Puerto Rico and you are or will become a bona fide resident of Puerto Rico.

But what about state and/or local income tax withholdings? Taxpayers continuing to reside in a state with an income tax should also continue regular state and local withholdings. Once state residency is broken, then the withholdings can stop. Nonetheless, if services are performed in a state(s) with an income tax, nonresident state income tax withholdings may be applicable.

Net investment income tax

In certain circumstances, you may be subject to the net investment income tax (NIIT) at a rate of 3.8%. This tax is applicable if you have net investment income such as interest, dividends, capital gains, rental and royalty income, non-qualified annuities, and others. Your modified adjusted gross income must exceed these thresholds based on filing status:

Filing Status	Threshold Amount
Married filing jointly	$250,000
Married filing separately	$125,000
Single	$200,000
Head of household (with qualifying person)	$200,000
Qualifying widow(er) with dependent child	$250,000

U.S. Filing Requirements

State Taxes

Expats often fail to adequately consider the impact of state taxes on their assignment. Most states do not provide the various mechanisms such as the foreign earned income exclusion and foreign tax credits to avoid ongoing taxation. Several states such as California, Connecticut, and New York do have rules that allow individuals on long-term assignments to be treated as non-residents during such periods, thus avoiding taxation of the foreign source income and benefits. Therefore, planning becomes an even more important issue in the context of state taxation. If a person takes an assignment overseas having no intention of returning to their state of residence, they may want to consider terminating their state residence. This can be a complex area since states typically have several layers of residency rules that must be considered in making this determination. Also if the person is tax equalized, their employer is bearing the burden of the additional tax so the incentive to make such a change is lessened.

Estimated tax payments

During a foreign assignment, estimated U.S. tax payments may still be required, if …

- At least $1,000 in tax after withholdings and refundable credits is expected to be owed, or
- Expected withholding and refundable credits will be less than the smaller of:
  - 90% of the tax shown on the current income tax return, or
  - 100% of the tax shown on the prior year income tax return, or
  - 110% of the tax shown on the prior year income tax return, if your 2019 adjusted gross income is more than $150,000 ($75,000 for married filing separately).

If these estimated tax payment(s) are not made, an underpayment penalty may be imposed.

U.S. Filing Requirements

Specified foreign financial assets

Reporting of specified foreign financial assets may be required on Form 8938 if you are a U.S. citizen and resident alien who meets the disclosure requirements. However, if an income tax return is not required due to the filing thresholds, then Form 8938 is not required. This form is submitted as part of the income tax return package.

In general terms, specified foreign financial assets include:

- Financial accounts you hold in a foreign financial institution
- Any stock, financial instrument, security, or contract issued by a person other than a U.S. person held outside of a financial institution, and
- Any interest in a foreign entity not held in a U.S. account.

Once the presence of an interest in a specified foreign financial asset is confirmed, the aggregate value reporting thresholds, based on location and filing status, are used to determine the requirement to file Form 8938.

Thresholds for taxpayers living in the U.S.:

- Unmarried individuals/married filing separately- The total value of specified foreign assets is more than $50,000 on the last day of the tax year or more than $75,000 at any time in the year.
- Married filing jointly- The total value of specified foreign assets is more than $100,000 on the last day of the tax year or more than $150,000 at any time in the year.

Thresholds for taxpayers living abroad:

- Unmarried individuals/married filing separately- The total value of specified foreign assets is more than $200,000 on the last day of the tax year or more than $300,000 at any time in the year.
- Married filing jointly- The total value of specified foreign assets is more than $400,000 on the last day of the tax year or more than $600,000 at any time during the year.

U.S. Filing Requirements

Report of Foreign Bank and Financial Accounts (FBAR)
Under the Bank Secrecy Act, most U.S. citizens and resident aliens must report specific foreign financial accounts to the Treasury Department by April 15th or at the latest by October 15th with the automatic extension. The accounts are reported by electronically filing a Report of Foreign Bank and Financial Accounts (FBAR) on FinCEN Form 114.

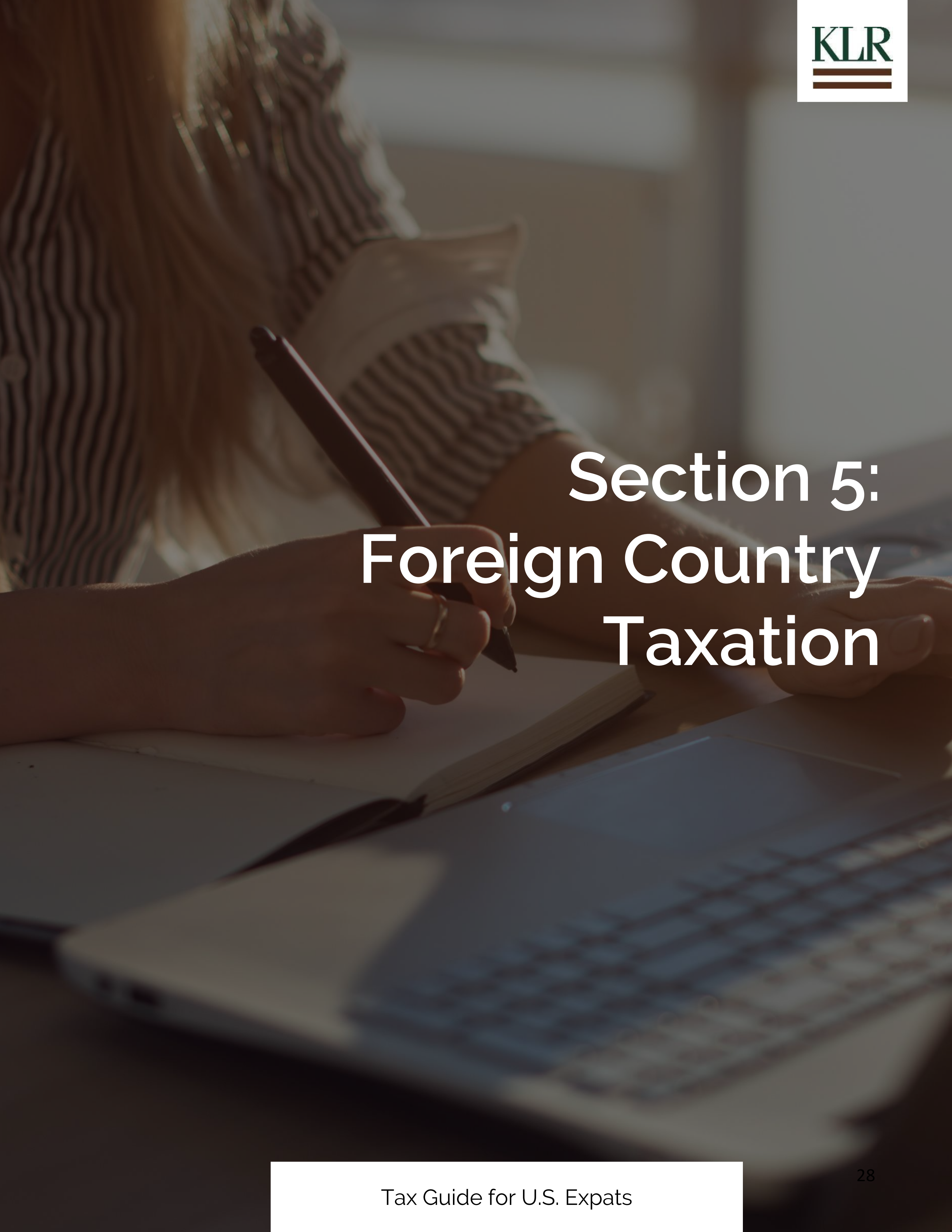
FBAR filing requirements exist for taxpayers who have:

- A financial interest or signature authority over financial accounts located outside of the U.S. and

- The aggregate value of those foreign financial accounts exceed $10,000 at any time during the calendar year.

The FBAR and Form 8938 seem to be redundant, but the information is sent to different authorities. The FBAR is filed with the Treasury Department, while Form 8938 is filed with the IRS. The filing of either form does not relieve the filing requirement for the other form. Some of the foreign assets may be disclosed twice once on Form 8938 and the second time on the FBAR. Secondly, if you move the same cash from one foreign account to another foreign account the amount has to be considered twice since they are separate accounts.

Failure to file the FBAR may be subject to civil and/or criminal penalties. Thus, taxpayers who have not complied with FBAR filings should consult a tax adviser as soon as possible to rectify their situation.



Section 5: Foreign Country Taxation

Foreign Country Taxation

As discussed, a U.S. expat continues to be responsible for U.S. income taxes. Whether or not a second, or multiple country filing requirement exists, will depend on the country (ies) involved. While moving to, and living in, a country with no income tax would simplify worldwide taxes, most countries have an income tax. Thus, it is important to get an understanding of the foreign country's tax system to find ways to minimize worldwide taxation.

Foreign tax planning

Taxpayers overseas should explore the following techniques with a foreign tax adviser to ensure the lowest foreign tax possible:

- Length of assignment - Some countries offer an optimal tax position if time in-country is limited.

- Arrival and Departure dates- Multiple tax year filings can be avoided by shifting the entry and departure dates.

Foreign Country Taxation

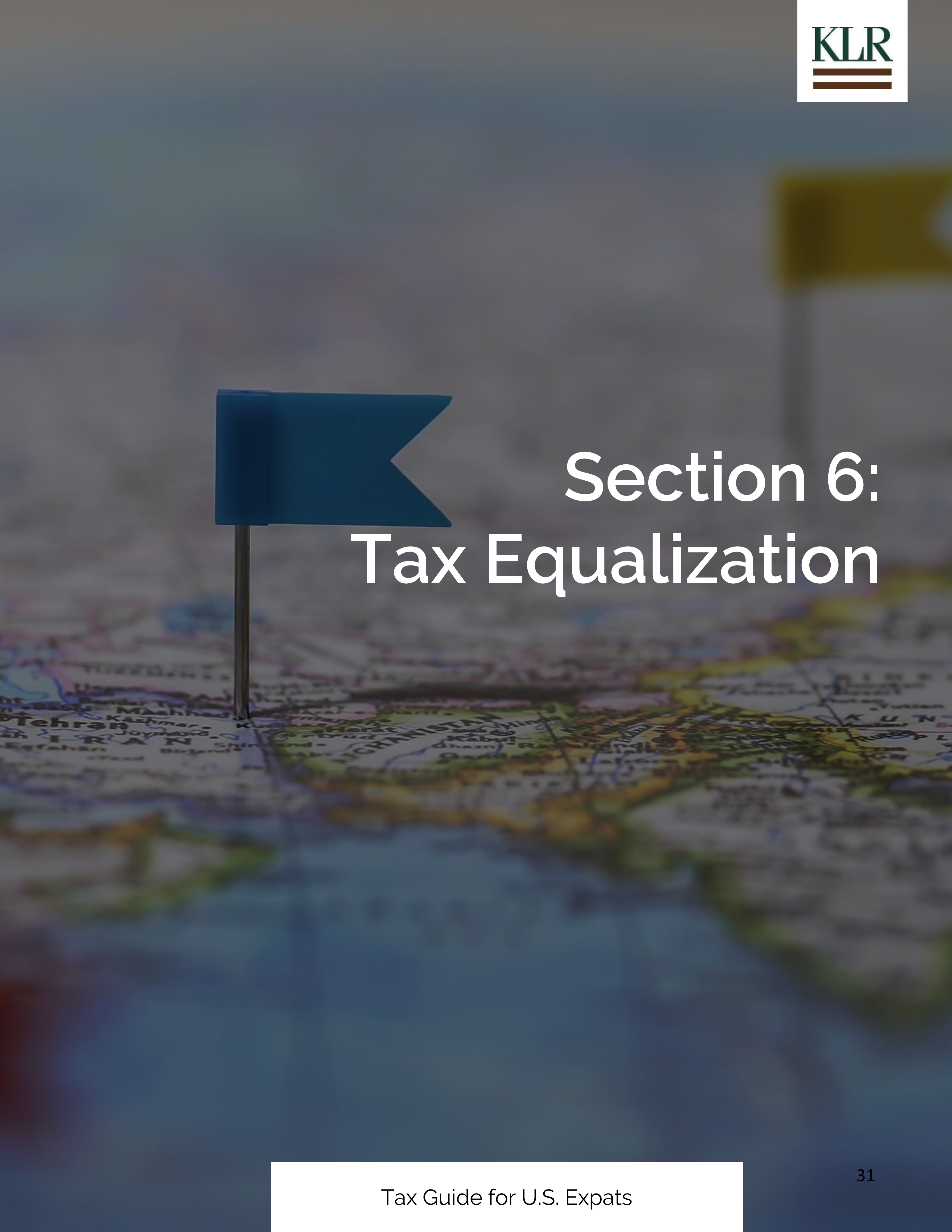
- Income tax treaty provisions - The number of days spent in-country will determine qualification for income tax treaty provisions to offset income taxes. Do possibilities exist for other reduced rates relative to certain income categories?

- Workdays outside of the foreign country- Can workdays outside of the foreign country be excluded for tax purposes?

- Assignment benefits- Which of your benefits are considered taxable and nontaxable in the foreign country? Is there any partial exclusion for the taxable benefits?

- Stock options- Does the foreign country tax stock options at grant, vest, or exercise? This may create a timing mismatch with the U.S. income tax return if the options are taxed at different periods. Is there a possibility to make an election to tax the stocks at the same time as the U.S. if taxing periods differ?

Planning for equity taxation is imperative while on foreign assignment because the grant, vest, and/or exercise may create taxable income in the foreign country.



Section 6: Tax Equalization

Tax Equalization

Often times, tax equalizations, which are a contractual arrangement, are offered to an employee by their employer as an incentive to go on an international assignment. As part of the arrangement, the employee may be offered various allowances such as housing, cost of living allowance, tax preparation services, and automobile (amongst others).

If the employee is offered a 'home-based' approach, the purpose of the tax equalization is to make relocation "tax neutral" for the employee. Tax neutrality ensures the employee is only responsible for the annual tax cost that is equivalent to the income tax that they would have paid had they remained at home and not taken the assignment. Employees will pay no more, or no less in income tax.

During the assignment, as part of the agreement, an amount is withheld through the employee's payroll (categorized as hypothetical taxes) which replace the traditional payroll income tax withholdings. An annual reconciliation is generated to determine if the employee overpaid or underpaid their at-home tax responsibility.

Tax Equalization

If the tax equalization settlement reflects an overpayment, this may be recuperated by the employee through a combination of a reimbursements from the employer and any potential U.S. income tax refund(s). If there was a shortage, the employee agrees to pay the additional balance due to the employer.

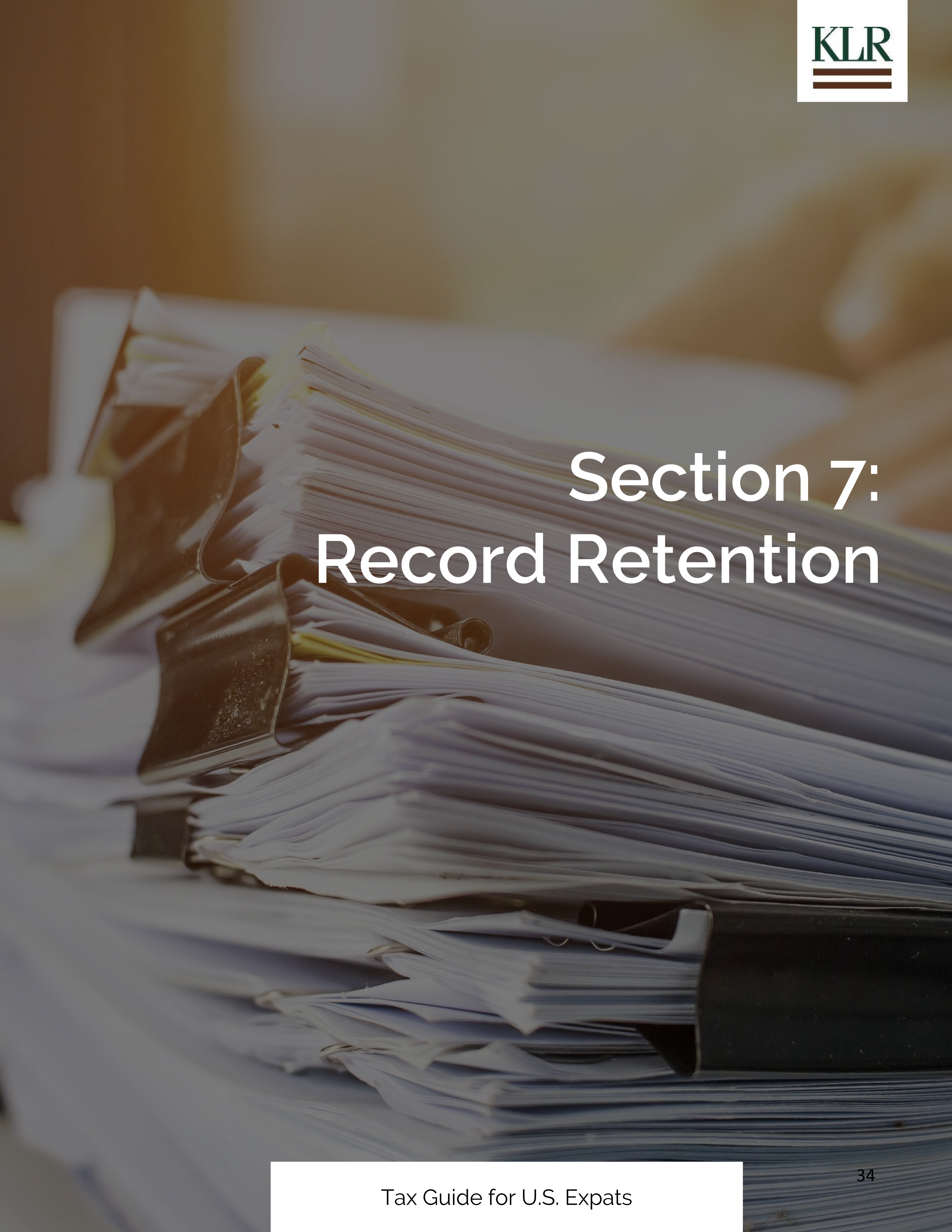
Typically, the employer will pay a service provider for the cost of preparing the employee's U.S. (home) and host (assignment) country income tax returns for the duration of their assignment. As part of the employee's assignment package, the service provider will also prepare the tax equalization settlement in conjunction. The tax equalization settlement cannot be effectively prepared without the home and host country income tax returns.

It is important to understand that this process will have payroll consequences. Typically, the employer may offer a training to the employee on the process, as it is a complex area that causes confusion.

Tax gross-up

The employer may offer a tax gross-up in lieu of tax equalization. A tax "gross-up" occurs when the employer covers the income tax withholding that will be due on a specific benefit amount. This is achieved by increasing the total payment reported via payroll to allow the net payment to equal the benefit amount taken home by the employee.

When a U.S. expat returns from an international assignment, a final tax gross-up may be calculated. This represents the final tax settlement between the employee and the employer to settle the taxes due on the taxable fringe benefits related to the assignment. The marginal rates used in the gross-up should be high enough to offset the effective income tax rates at which the assignment benefits are taxed.



Section 7: Record Retention

Record Retention

There exists a requirement to **retain tax records** for three years from the later of the date that tax returns were filed, or the due date of the returns.

In addition, there are other items to track during a foreign assignment:

- Travel dates during/after the foreign assignment (business and vacation)*
- Expense receipts for foreign housing costs (rent, utilities, maintenance, parking fees, etc.)
- Proof of foreign income taxes, social security taxes and real estate taxes paid (receipts)
- Information on income or deductible expenses earned or paid in a foreign currency (amount, currency, and date)
- Record of foreign bank accounts, financial accounts and assets for the annual disclosure requirements, if applicable.

Record Retention

It is crucial to track the time during a foreign assignment because many of the U.S. expat tax calculations and benefits are based upon location during each day of the assignment and the classification of that day as work, vacation, or non-work day.

What tax information should be brought on assignment?
Reference to certain tax documents will be necessary when on an international assignment, including:

- Copies of Federal and State income tax returns
- Copies of legal documents
- Purchase and closing settlement statements upon disposal of a home in the U.S.
- Purchase price and improvement amounts for a home if converted to a rental property
- Any cost basis information for assets that may be sold during the assignment

Section 8: Before Leaving

Before Leaving

Matters to be considered prior to leaving on an international assignment:

- Should a new Form W-4 be submitted to the employer?
- Completion of Form 673 to stop or reduce Federal income tax withholdings, if necessary
- Review state income tax residency and withholding requirements
- Will a Social Security Certificate of Coverage be required? Help should be available through the employer and/or a U.S. tax adviser.
- Discussion of U.S. and foreign pre-planning tax opportunities with both U.S. and foreign tax advisers.
- Gain an understanding of the tax system of the foreign country (e.g. filing deadlines, tax rates, income subject to taxation, etc.)

Ready To Talk?

WRAP UP

Tax laws vary significantly from country to country. While this guide provides a basic overview of a portion of the U.S. tax concepts that are common for expatriates around the world, most taxpayers do not have the time, desire, or patience to become experts in these matters. Our team specializes in the analysis and minimization of worldwide income tax obligations. **Contact us today**.

ABOUT THE AUTHOR

Francheska Pimentel, CPA is a Senior Tax Manager in KLR's International Tax Services Group. Francheska joined the firm in 2015 and is well versed in the U.S. tax implications of expatriates and nonresident aliens. She brings a unique perspective as she was also an expat that worked and lived in Belgium. Francheska has in-depth knowledge in the management of all aspects of the international assignment life cycle from implementation and tax planning, to tax return and payroll compliance. Francheska has extensive experience working with multinational large-scale, mid-size, and small global mobility programs.

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