

# GRAHAM

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# TAX SOLUTIONS

## Overview of International Tax Issues for Individuals

By Susan H. Graham, E.A.



# Objectives:

The participants will:

1. Be aware of international issues and reporting requirements for both IRS and Treasury.
2. Be able to advise clients with international issues in both planning and problem solving, and
3. Have reference information and access to resources for international information, treaties and guidelines.



## What is “international”?

- Is it US citizens living and/or working outside of the US?
- Is it foreign persons living and/or working in the US?
- Is it US citizens investing outside the US?
- Is it foreign persons investing in the US?



## International Defined

**Webster says:** “common to or affecting two or more nations; of, relating to or constituting a group having members in two or more nations.”

**IRS says:** anything and everything that we can tax or gather information about to share with treaty partners or in a G4-8 conference. (Not really—this is my opinion!)

# Critical Information!!!

- Determination of **Residency**
- Determination of **Citizenship**
- **Types** of Income--Earned or Unearned
- **Source** of Income
- Type and location of **ALL** Investments/**Assets**
- What countries and what business--**Treaty**
- Historical **Compliance** and Future Planning



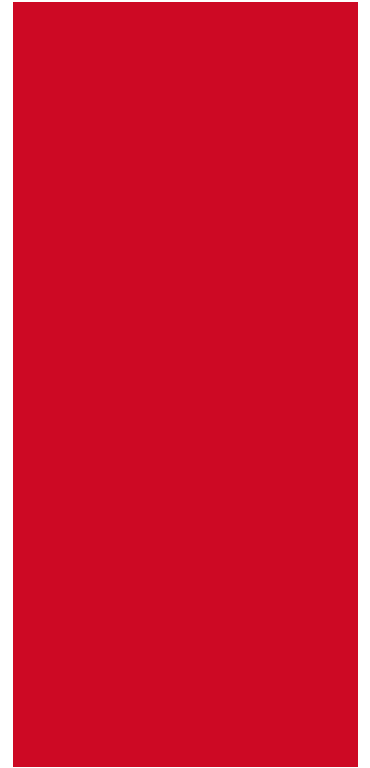
# Residency

- Resident vs. Non-Resident—in the US and the World—universal concept.
- How do you determine?

# Resident or Non-Resident

In the US there are two primary tests:

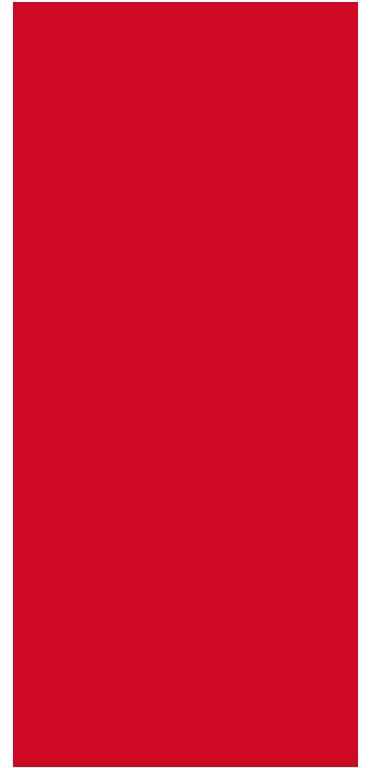
- Green-card Test—do they have one? If yes, they are considered a resident.
- Substantive Presence Test—here comes the math test! If they are in the country  $>183$  days on a temporary visa in one year or if they are present in the current year 31 days and  $1/3$  plus  $1/6$  of the days present in the two previous years  $\geq 183$  days they are considered a resident.
- Dual Status—in the year of the change from non-resident to resident or vice versa the person can have dual status. Possibly a tax savings to split the year between a 1040 and a 1040NR.



# Citizenship

- ❖ Not necessarily an easy answer and possibly not an accurate answer.
- ❖ Ask to see their passport, ask to see their visa, green card, etc.





## Source

Foreign or domestic source?

Effectively connected to US business?

# Where did the money originate?

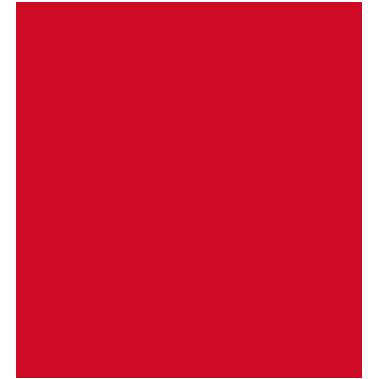
- The source of income is very important.
- Basically is it foreign source or US source?
- Have machinations been used to disguise the true source?
- Is it foreign income that is Effectively Connected to a US source?
- Is it fixed, determinable, annual or periodic (FDAP)?
- All countries tax laws have some reference to the source of the funds.



# Treaty or No Treaty?

- There are 68 treaties currently in existence.
- There are treaties for a large variety of provisions.
- Do you know how to read them and what to do with them?
- What about the 24 totalization agreements?

# Let's Make a Deal: aka Treaties and other Agreements



- Tax treaties exist with 68 countries and many are quite old. That means they have been amended and interpreted several times in most cases.
- When studying a treaty—read the original and then the next update (usually named a Technical Explanation or a Protocol) and so on until current.
- If it is about Social Security tax—look for a totalization agreement—24 of these.
- Then check to see if there is a Competent Authority Agreement on your issue.



## Earned or Unearned Income

You know this one--active vs. passive!

Add the international twist and the answer is “maybe”. Check your treaty.



## Foreign Tax Credit or Deduction

Basically a simple concept—if a person pays income tax in more than one country they should not be taxed on that income in another country. The US taxes worldwide income and therefore US residents who pay tax on that same income in another country can choose to take an itemized deduction or credit.

# Basic Foreign Tax Credit (FTC)

- Start with Form 1116 and its instructions.
- Determine the source of all income and whether it is earned/general or unearned/passive.
- Determine the amount of foreign tax paid or accrued.
- Calculate the ratio of foreign source income to US source income and apply the ratio to the income categories to determine the credit amount.
- Excess credit may be carried back one year and forward ten years.
- Deduction may be taken in lieu of the credit.

# Foreign Earned Income/ Housing Exclusion:

- Foreign earned income and housing can be excluded from US income tax up to \$97,600 for 2013, if requirements are met.
- Tests again—Bona Fide Residence Test and/or Physical Presence Test. Choose one that works.
- Must omit excluded amount from FTC calculation—cannot have both on the excluded amount.
- This exclusion is an election to be made with the tax return by filing Form 2555 or 2555EZ. It can be revoked but then prohibited for next 5 years without IRS permission.
- Many considerations—tax rates, funding IRAs, etc.



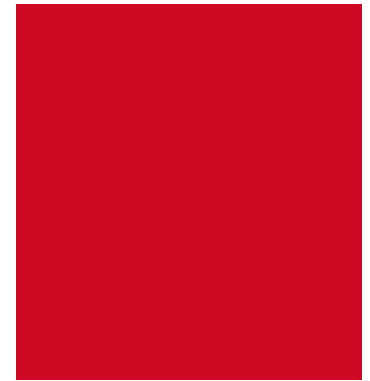


## Foreign Bank Accounts & Assets:

- What do you have to report?
- Where do you have to report it?
- How do you determine the amount?

# FBAR (TD F 90-22.1) and Form 8938:

- Determine if your client needs to file either or both. See comparison chart in handout.
- FBAR→Foreign financial accounts >\$10,000 in the aggregate at any time in the year. Must be e-*filed* in 2014. Report the highest balance.
- Form 8938→Total value of all specified foreign assets. Reporting threshold varies, \$50,000 is lowest.
- Convert foreign currency to US\$ using 12/31 exchange rates and report in US\$--use Treasury exchange rate table.



## Form 5471 vs. 5472:



**Form 5471** is filed by “US persons” meeting one of four categories.

Generally, to report  $\geq 10\%$  US ownership in a foreign corporation (cat 2 & 3) or control for  $\geq 30$  days of a corporation or CFC (cat 4 & 5)—often a US officer or director.

**Form 5472** is filed to report “foreign person” ownership of  $\geq 25\%$  (direct or indirect) of a US corporation or a foreign corporation engaged in a trade or business in the US or having effectively connected income (ECI) with a US trade or business.

This one is to be filed by a “reporting corporation” if it has a “reportable transaction”. Normally, this will refer to any monetary or non-monetary transactions between the parties.



## Withholding:

Effectively Connected Income (ECI) is subject to withholding as are all payments to foreign persons.

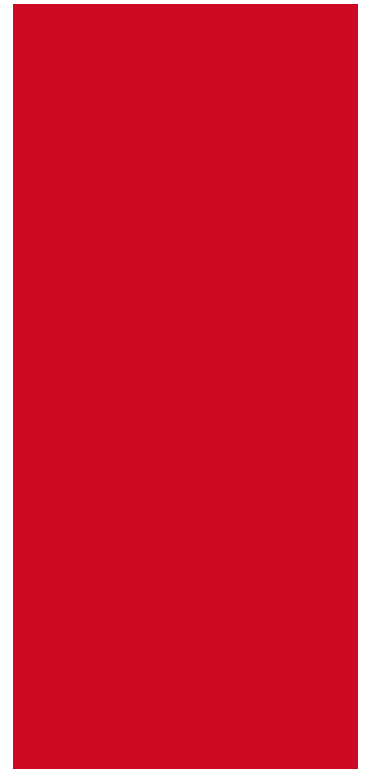
But as is true in all aspects of international taxation there are exceptions, exclusions, and exemptions from ECI and from withholding.

FIRPTA created 10% withholding on sales of real estate by foreign owners.

- You must withhold tax on payments of income unless a reduced rate or exemption is authorized under a tax treaty.
- The President can raise the tax rates on persons of a foreign country that imposes discriminatory taxes on US persons.
- The standard rate for withholding on foreign payments barring other provisions or treaties is 30%. It can be as much as 40%.

# Miscellaneous:

- Exchange Rates—any questions on this?
- Filing Status differences if US living abroad.
- Tax Treaty Tie Breaker Rules-dual residency
- US Pension/Annuity paid to foreign country, file W-8 to be exempt from withholding.
- Competent Authority-arbitration for treaties.
- Office of International Operations—audit/collection of non-resident US citizens.
- Foreign Trust with at least one US owner must file Form 3520-A.
- IRS Tax Map



Questions???



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# Resources:

- [www.irs.gov](http://www.irs.gov)
- <http://taxmap.ntis.gov>
- [www.irs.gov/FATCA](http://www.irs.gov/FATCA)
- <https://bsaefiling1.fincen.treas.gov>
- [www.fms.treas.gov/intl.html](http://www.fms.treas.gov/intl.html)
- [www.x-rates.com](http://www.x-rates.com)
- **Susan H. Graham, EA**
- Cell 210-865-2588
- Fax 210-493-8972
- [susan@grahamtaxsolutions.com](mailto:susan@grahamtaxsolutions.com)

