

KEY TAX INSIGHTS

U.S. Taxation of U.S. Citizens and U.S. Tax Residents Residing Overseas

U.S. citizens and U.S. tax residents (“**U.S. Persons**”) are taxed in the United States on their worldwide income no matter where in the world they reside. The U.S. taxes based on citizenship, which is different than almost all other countries in the world that tax based on residence.

This often catches U.S. Persons who have never lived in the U.S. or have lived abroad for a number years by surprise. Any U.S. Person living abroad with income for tax year 2022 above the following thresholds must file a U.S. tax return:

Filing Status	Under 65	65 or Older
Single	\$12,950	\$14,700
Married Filing Jointly	\$25,900	\$28,700
Married Filing Separately	\$5	\$5
Head of Household	\$19,400	\$21,150



Personal income includes: wages, salary, commissions, tips, consultancy fees, pension fund, alimony, U.S. and/or foreign social security, interest, dividends, capital gains, rental property, farm income, royalties, inheritance or payment in kind in the U.S. or abroad. A U.S. Person has a U.S. tax filing obligation even if the U.S. Person has never lived in the U.S. or left several years ago and their income is from foreign (non-U.S.) sources. The U.S. Person has a U.S. tax filing obligation even if some or all of the income was taxed at source or is going to be taxed by the resident foreign country.

Mitigation of Double Taxation:

There are two methods that a U.S. Person living abroad can reduce their U.S. tax liability. The two methods are the Foreign Earned Income Exclusion (“**FEIE**”) and the Foreign Tax Credit (“**FTC**”). Even if one of these methods were to eliminate the U.S. Person’s U.S. tax liability, the U.S. Person is still required to file their U.S. tax return if their income exceeds the filing thresholds provided above.

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For tax year 2022, the FEIE amount is \$112,100. It is important to note that the FEIE can only be claimed against foreign earned income such as wages and not passive types of income like interest, pension income, and dividends.

The FTC allows the U.S. Person a credit for taxes paid in the foreign country on income sourced to that country against their U.S. tax liability applicable to the foreign source income. The FTC can substantially reduce a U.S. Person's tax bill. It is important to note that the FTC cannot be claimed for foreign taxes paid on income excluded by the FEIE.

Tax Return Filing Deadlines:

The due date for a U.S. personal income tax return (**Form 1040**) is April 15 of each year. U.S. Persons living abroad receive an automatic extension of time to file the tax return and pay any taxes due without penalty until June 15. However, if there are taxes due, interest will be calculated starting on April 15.

A U.S. Person can receive an automatic extension of time allowing until October 15 to file their U.S. tax return. This extension does not extend the time to pay the tax due, so penalties and interest will be added for payments received after the tax filing deadline. U.S. Persons who are outside the U.S. can request a discretionary 2-month additional extension of time to file their U.S. tax return allowing until December 15 to file.

The deadline to file the Foreign Bank Account Report (**FinCEN Form 114**) is the same deadline to file U.S. income tax returns including extensions.

Foreign Bank Accounts:

The government does not annually tax wealth. However, the IRS wants to know about funds U.S. Persons have in foreign bank accounts. There are now two different reporting requirements for foreign bank accounts, the Foreign Bank Account Report ("**FBAR**") and the individual reporting requirement under the Foreign Account Tax Compliance Act ("**FATCA**").

The FBAR has been around since 1972 and is required to be filed if a U.S. Person's aggregate foreign holdings are \$10,000 or more at any time during the tax year, including signature authority accounts. The penalties for not filing the FBAR are significant.

The individual FATCA filing is made with the submission of the U.S. tax return. U.S. Persons living abroad, with filing status unmarried or married filing separately, must submit the individual FATCA filing if their foreign holdings are \$200,000 or more on the last day of the tax year or were more than \$300,000 at any time during the tax year. U.S. Persons living abroad, with filing status married filing jointly, must submit the individual FATCA filing if their foreign holdings are \$400,000 or more on the last day of the tax year or were more than \$600,000 at any time during the tax year. The penalties for not submitting the individual FATCA filing are significant.

Certain U.S. Tax Rules and Reporting Obligations:

For U.S. Persons with investments and income outside the U.S., the U.S. taxation can be unfavorable and there are enhanced informational reporting obligations. For example, a non-U.S. pension that is taxed deferred in the country where

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the U.S. Person is resident may or may not be taxed currently in the U.S. and the U.S. tax treatment will be based on U.S. pension rules. Also, the non-U.S. pension plan will likely be considered a foreign trust which could require additional informational reporting.

A U.S. Person who is a U.S. shareholder of a controlled foreign corporation (“**CFC**”) may or may not be able to defer U.S. taxation on income accrued and remaining in the CFC. Further, essentially a corporate tax return will be required to be filed as an informational filing with the U.S. Person’s U.S. tax return. There is an additional information filing that is required in the year that the CFC was formed.

Certain foreign investments, such as a non-U.S. mutual fund, are considered an interest in a passive foreign investment company (“**PFIC**”). The PFIC tax regime can be punitive and PFICs require extensive record keeping and reporting.

In addition, as with the FBAR and FATCA, the failure to properly file the required informational forms can result in significant penalties.

Penalties for Failure to File U.S. Tax Forms:

Below is a table with the potential penalties for failing to file certain U.S. informational filings that are pertinent to U.S. Persons living abroad:

Form	Penalty
FBAR (FinCEN 114)	Non-willful non-filing penalty up to \$10,000 per year. Willful non-filing can be as high as the greater of \$100,000 or 50 percent total balance of each foreign financial account per year. Criminal penalties may also be applicable for willful non-filing.

Potential penalties for failing to file certain U.S. informational filings that are pertinent to U.S. Persons living abroad table (continued):

FATCA (Form 8938)	The penalty for failure to submit a FATCA filing is \$10,000, with an additional \$10,000 added for each month the failure continues beginning 90 days after the taxpayer is notified of the delinquency, up to a maximum of \$50,000 per return.
Foreign Trust Report – Pension (Form 3520)	The penalty for failure to submit Form 3520 is the greater of \$10,000 or 35 percent of the gross reportable amount.
Foreign Trust Report – Pension (Form 3520A)	The penalty for failure to file form 3520A is the greater of \$10,000 or 5 percent of the gross value of the trust assets determined to be owned by a U.S. Person.
Form 5471 (CFC and other foreign corporations)	The penalty for failure to file Form 5471 is \$10,000, with an additional \$10,000 added for each month the failure continues beginning 90 days after the taxpayer is notified of the delinquency, up to a maximum of \$50,000.
Form 926 (Return by a U.S. Transferor of Property to a Foreign Corporation)	The penalty for failure to file Form 926 is 10 percent of the value of the property transferred, up to a maximum of \$100,000, with no limit if the failure to report was intentional.
Form 8865 (Reporting for Foreign Partnerships)	The penalty for failure to file Form 8865 is \$10,000, with an additional \$10,000 added for each month the failure continues beginning 90 days after the taxpayer is notified of the delinquency, up to a maximum of \$50,000, and 10 percent of the value of any transferred property that is not reported, subject to a \$100,000 limit.

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Procedures to Mitigate Penalties for U.S. Persons Not Current with their U.S. Tax Reporting Obligations:

There are a number of filing procedures for a U.S. Person who is not current with their U.S. tax filing obligations to become current at reduced or no penalties. The appropriate procedure for a U.S. Person will depend on whether the non-reporting was willful, where the U.S. Person is residing, and whether any income was omitted from a U.S. tax return. Below is a brief description of the various procedures:

Procedure	Description
Streamlined Domestic Offshore Procedures (SDOP)	<ul style="list-style-type: none"> This procedure is for U.S. Persons who do not need criminal protection. This procedure is for U.S. Persons residing in the U.S.. Under the SDOP, the U.S. Person files 3 years of U.S. tax returns and 6 years of FBARs. There is a 5% penalty on the max balance of the foreign accounts during the covered period.
Streamlined Foreign Offshore Procedures (SFOP)	<ul style="list-style-type: none"> This procedure is for U.S. Persons who do not need criminal protection and who meet the non-residency requirement for 1 year in the covered period. Under the SFOP, the U.S. Person files 3 years of U.S. tax returns and 6 years of FBARs. There are no penalties under the SFOP.
Delinquent International Information Return Submission Procedures	<ul style="list-style-type: none"> For U.S. Persons who do not need to use the SDOP or SFOP to file delinquent or amended tax returns to report and pay any additional tax, but who:

<p>Delinquent International Information Return Submission Procedures (<i>continued</i>)</p>	<ol style="list-style-type: none"> Have not filed one or more required international information returns; Have reasonable cause for not timely filing the information returns; Are not under a civil examination or a criminal investigation by the IRS; and Have not already been contacted by the IRS about the delinquent information returns. <ul style="list-style-type: none"> Procedure is to file amended returns attaching the delinquent informational returns with a statement of all facts establishing reasonable cause for the failure to file. If reasonable cause statement is accepted, no penalties will be applied to the delinquent filing of the international information returns.
<p>Delinquent FBAR Filing Procedure</p>	<ul style="list-style-type: none"> For U.S. Persons who do not need to use the SDOP or SFOP to file delinquent or amended tax returns to report and pay any additional tax, but who: <ol style="list-style-type: none"> Have not filed a required FBAR; Are not under civil examination or a criminal investigation by the IRS; and Have not already been contacted by the IRS about the delinquent FBARs. <ul style="list-style-type: none"> File delinquent FBARs for up to 6 years. No penalties are imposed on the delinquent FBARs through this procedure.

Conclusion:

U.S. tax filings for U.S. Persons residing abroad are complex and require numerous informational filings. The failure to file an informational filing carries significant penalties. For U.S. Persons who are not in compliance with their U.S. tax filing requirements, there are a number of procedures to bring them into compliance. *Please contact us if you have questions or if we can be of help.*