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Tax Obligations of U.S. Individuals Living and Working Abroad

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**Welcome to Today’s
IRS Webinar**

**Tax Obligations of U.S.
Individuals Living and
Working Abroad**

The Information contained in this presentation is current as of the date it was presented. It should not be considered official guidance.

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Topics

- **Specify the U.S. income tax obligations of U.S. citizens and resident aliens abroad.**
- **List the requirements for claiming the foreign earned income exclusion.**
- **Summarize the U.S. employment tax obligations of U.S. citizens and resident aliens abroad.**

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**U.S. Citizen
Living and Working Abroad**

- **Must report and pay applicable federal taxes on ALL income, regardless of source, unless specifically exempt under the Internal Revenue Code or a tax treaty provision**
- **May be subject to employment taxes**
- **Must file Form 1040**

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**U.S. Resident Alien
Living and Working Abroad**

- Must report and pay applicable federal taxes on ALL income, regardless of source, unless specifically exempt under the Internal Revenue Code or a tax treaty provision
- May be subject to employment taxes
- Generally must file Form 1040

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Polling Question

U.S. citizens and resident aliens must report and pay applicable U.S. taxes on . . .

- a. Only their U.S. source income
- b. Only their foreign source income
- c. All of their income (both U.S. and foreign source) if living in the United States
- d. All of their income (both U.S. and foreign source) regardless of where they live

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Foreign Earned Income Exclusion

- Available to U.S. citizens and resident aliens who live and work in a foreign country and meet the requirements
- Maximum exclusion amount is indexed annually for inflation
- May also be able to exclude (if an employee) or deduct (if self-employed) the cost of foreign housing in excess of a base amount and subject to a limit

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**Foreign Earned Income Exclusion
Requirements**

To claim the foreign earned income exclusion, foreign housing exclusion, or foreign housing deduction, you must:

- have foreign earned income, and
- have a foreign tax home, and
- meet either the Bona Fide Residence Test or the Physical Presence Test, and
- make a valid election.

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Foreign Earned Income

- **Income for services performed in a foreign country**
 - U.S. territories are not foreign countries
 - Antarctica is not a foreign country
 - Neither is international waters or airspace
- **Does not include income paid by the United States or its agencies to government employees or to members of the U.S. armed forces, even if earned in a foreign country**

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Polling Question

Which of the following is not foreign earned income?

- a. Income earned in international airspace
- b. Income earned in a U.S. territory
- c. Wages paid by the U.S. government to a U.S. government employee working in a foreign country
- d. All of the above

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**Foreign Earned Income Exclusion
Foreign Tax Home**

- Regular or main place of business, employment or post of duty must be in a foreign country or countries, and
- Abode cannot be in the United States during the same period, unless – for tax years beginning after 12/31/17 – serving in support of the Armed Forces of the United States in an area designated as a combat zone
 - Location of economic, familial and personal ties determines abode

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**Foreign Earned Income Exclusion
Bona Fide Residence Test**

- **Must be either**
 - a U.S. citizen, or
 - a U.S. resident alien who is a citizen or national of a country with which the U.S. has an income tax treaty in effect
- **Must be a bona fide resident of a foreign country or countries for an uninterrupted period that includes an entire tax year (except for brief temporary visits to U.S. or elsewhere)**

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**Foreign Earned Income Exclusion
Bona Fide Residence Test (cont'd)**

- **Subjective test**
- **Determined by considering 11 factors, as set forth in *Sochurek v. Commissioner*, 300 F.2d 34 (7th Cir. 1962), including:**
 - Intent
 - Extent of assimilation into life and society of foreign country
 - Reasons for temporary absences

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**Foreign Earned Income Exclusion
Physical Presence Test**

- **Objective test**
- **Determined by counting the number of full days physically present in foreign country(s)**
 - A full day is 24 hours, from midnight to midnight
- **Must be physically present in foreign country(s) for 330 full days during any period of 12 consecutive months**

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Waiver of Time Requirements

- **The minimum time requirements for the bona fide residency and physical presence tests can be waived if an individual must leave a foreign country because of war, civil unrest, or other adverse conditions.**

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**Waiver of Time Requirements
(cont'd)**

- **The individual must show that:**
 - they had a tax home in the foreign country, and
 - on or before the beginning date of the waiver, they reasonably could have been expected to meet the time requirements as a bona fide resident or under the physical presence test except for the adverse conditions

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Waiver of Time Requirements
(cont'd)

- A list of countries which qualify for the waiver and the departure dates is published in the Internal Revenue Bulletin.

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Waiver of Time Requirements
(cont'd)

- Rev. Proc. 2020-27 waives the section 911(d)(1) time requirements for individuals who reasonably expected to meet the eligibility requirements during 2019 or 2020 but failed to do so because the individual departed a foreign country on or after a specified date due to the COVID-19 emergency.

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Foreign Earned Income Exclusion
Valid Election

- The election to exclude foreign earned income and the election to exclude the cost of foreign housing are separate elections.
- You may make one or both elections by attaching Form 2555, *Foreign Earned Income*, to the tax return for the first year for which it is effective.

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**Foreign Earned Income Exclusion
Valid Election (cont'd)**

- **Generally, the election(s) must be made with a:**
 - Timely filed return (including any extensions),
 - Return amending a timely filed return during the claim period under IRC § 6511(a), or
 - Late-filed return within one year from the original due date of the return (without regard to extensions)

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Polling Question

Which of the following requirements must be met in order to qualify for the foreign earned income exclusion?

- a. Foreign earned income
- b. Foreign tax home
- c. Meet the Bona Fide Residence or Physical Presence Test
- d. Valid election
- e. All of the above

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**Foreign Earned Income Exclusion
Filing Requirements**

- The foreign earned income exclusion is claimed on Form 2555 which is attached to Form 1040, *Individual Income Tax Return*.
- See instructions for Form 1040 and complete the Foreign Earned Income Tax Worksheet to figure tax on any income that is not excluded.
- An individual must file a return even if there is no tax liability after claiming the exclusion.

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Employment Taxes

- **The Federal Insurance Contributions Act (FICA) is a tax on wages from employment which is comprised of:**
 - (1) old-age, survivors, and disability insurance (known as the Social Security Tax), and
 - (2) hospital insurance tax (known as the Medicare tax).

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Employment Taxes (cont'd)

- **FICA taxes are payable on the wages of U.S. citizens and resident aliens working abroad for:**
 - an American employer,
 - a foreign person treated as an American employer under IRC § 3121(z), or
 - in certain instances, the foreign affiliate of an American employer.

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Self-Employment Taxes

- **The Self-Employment Contributions Act (SECA) provides for taxes on self-employed individuals, similar to the FICA taxes that must be paid by wage earners.**

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Self-Employment Taxes (cont'd)

- **Self-employed U.S. citizens and resident aliens are responsible for paying self-employment tax if net earnings from self-employment equal or exceed \$400, regardless of:**
 - where the self-employment activities occur,
 - where the individual resides during the period of self-employment, and
 - whether the individual is claiming the foreign earned income exclusion.

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Polling Question

Self-employed U.S. citizens and resident aliens who live and work abroad must report and pay self-employment tax if they have net earnings from self-employment of at least \$_____.

- a. \$100
- b. \$400
- c. \$1,000
- d. N/A – they do not have to pay self-employment tax

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Totalization Agreements

- **Totalization agreements are entered into between the United States and some foreign countries to prevent the payment of social security taxes to two jurisdictions on the same wage or self-employment income.**
- **If the U.S. has entered into a totalization agreement with the foreign country in which the wages or net earnings from self-employment were earned, the terms of that agreement will govern whether FICA or SECA taxes must be paid to the United States.**

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Totalization Agreements: Employee

- Either the employer or employee should obtain a certificate of coverage or similar statement from the authorized official or agency of the foreign country verifying that wages are subject to social security coverage in that country.
- If the authorities of the foreign country will not issue such a certificate or statement, obtain one from the U.S. Social Security Administration.
- A copy of the certificate or statement should be retained in the employer's files.

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Totalization Agreements: Self-Employed

- Request a certificate of coverage or similar statement from the appropriate agency of the foreign country.
- If unable to obtain a certificate or statement from the foreign country, request one from the U.S. Social Security Administration.
- For each applicable year, attach the certificate or statement to the tax return and print "Exempt, see attached statement" on the line on the tax return for self-employment tax.

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Polling Question

Under the terms of a totalization agreement, a U.S. citizen or resident alien may not have to pay what type of tax?

- a. FICA taxes
- b. SECA taxes
- c. U.S. income tax
- d. Both a and b
- e. All of the above

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Resources

- Publication 54, *Tax Guide for U.S. Citizens and Resident Aliens Abroad*
- <https://www.irs.gov/Individuals/International-taxpayers>
- Link to Totalization Agreements
https://www.ssa.gov/international/agreement_descriptions.html#texts
- Taxpayer Assistance: 1-800-829-1040
- Taxpayer Assistance Outside the United States: 00-1-267-941-1000

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Practice Units

Available at:
<https://www.irs.gov/businesses/corporations/practice-units>

- Tax Home for Purposes of IRC Section 911
- Physical Presence Test for Purposes of Qualifying for IRC 911 Tax Benefits
- Bona Fide Residence Test for Purposes of Qualifying for IRC 911 Tax Benefits

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Practice Units (cont'd)

- Calculating the Foreign Earned Income Exclusion – Employee
- Calculating the Foreign Earned Income Exclusion – Self-Employed Individual
- Calculating the Foreign Earned Income Exclusion – Partner in a Partnership with Foreign Earned Income

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Practice Units (cont'd)

- IRC 911 Election and Revocation
- Foreign Housing Exclusion
- Foreign Housing Deduction
- Employee Share of Employment Taxes – U.S. Citizens and Resident Aliens Working Abroad
- Self-Employment Taxes – U.S. Citizens and Resident Aliens Working Abroad

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Key Points

- The U.S. generally taxes its citizens and residents on worldwide income.
- U.S. citizens and resident aliens who live and work in a foreign country and meet the requirements of IRC § 911 may be able to exclude some or all of their foreign earned income.

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Key Points (cont'd)

- U.S. citizens and resident aliens working abroad may be subject to employment tax (FICA).
- Self-employed U.S. citizens and resident aliens are responsible for paying self-employment tax (SECA) if net earnings from self-employment equal or exceed \$400, regardless of where they live and work.

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Key Points (cont'd)

- If the U.S. has entered into a totalization agreement with the foreign country in which the wages or net earnings from self-employment were earned, the terms of that agreement will govern whether FICA or SECA taxes must be paid to the United States.

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THANK YOU!

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