



US citizens living abroad still face US tax and reporting obligations



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Anchor Introduction

Particularly since the US presidential election, some US citizens have moved abroad and others are considering such a move. Tax professionals and trust officers worldwide are fielding questions from these individuals. How to advise them depends on the particular individual's objectives. Does the US citizen want to live in another country for a limited number of years or to change domicile and resettle permanently? Will the individual be working abroad or living off savings and unearned income? Regardless of the length of time spent living outside the United States, the US citizen must be advised to continue all annual US tax reporting.

US tax and reporting obligations continue

Sometimes a US citizen is surprised to learn that he or she will continue to be subject to federal income tax on worldwide income, regardless of where in the world that citizen resides or for how long. Similarly, a US citizen is subject to US federal estate tax on the value of worldwide assets owned at death. In addition to US tax, while living abroad, the US citizen may also be taxed on income producing assets or activities in the foreign country.

Assume that a US citizen with a second passport which allows the US citizen to live in an EU country wants to leave the United States and live in England for four or more years. The individual's advisers or family office will want to hire a qualified accountant or accountants able to handle both US and UK tax filings. The US citizen and his or her financial advisers, used to a US calendar year reporting tax system, must now take into consideration that the UK tax year runs from April 6 to April 5 each year.

Extension of time to file

No matter where in the world a US citizen lives, the US citizen must still file US income tax returns. While living abroad full time, the US taxpayer receives an automatic two-month extension from the Internal Revenue Service (IRS) so that the

US income tax return is due on June 15 rather than April 15. Interest will accrue on any tax not paid by April 15, but no penalties are imposed. To minimise double taxation, the US citizen will be entitled to a credit for foreign tax paid when calculating US income tax liability.

Earned income and housing cost exclusions

The US tax rules provide for a foreign earned income exclusion and foreign housing cost exclusion, but only for US persons working abroad. The exclusions are unavailable to a US citizen living off savings and unearned dividend and interest income. Similarly, a US citizen receiving distributions from trusts of which the US citizen is a discretionary beneficiary cannot offset distributed income with these exclusions. In general, trusts will add another layer of consideration as regards tax and reporting, depending on the country where the US citizen decides to reside.

Reporting foreign financial assets

In addition to a US income tax return, since the US citizen will likely have a bank account in the other country, a foreign bank account report (FBAR) must be filed annually by April 15 if certain account balance thresholds are met. It may also be necessary for the US citizen to file Form 8938 – Statement of Specified Foreign Assets, with his or her US income tax return (for further details please see the "Overview (April 2017)").

Domicile

Although physically living abroad, the US citizen should consider maintaining a domicile in the United States. Domicile is generally recognised as a person's permanent home. Domicile and residence are separate for US tax purposes. The individual's residence status in the other country will determine how that other country taxes the individual's income. Non-residents generally pay tax only on income sourced within the other country and not on foreign source income. Residents, on the other hand, generally pay tax on worldwide income. In countries such as the United Kingdom there are special rules for UK residents whose permanent domicile is abroad. Therefore, consideration should be given as to whether the US citizen intends to maintain his or her US domicile. The US citizen will maintain a US domicile, provided that the facts and circumstances surrounding the move indicate that the individual intends to return to the United States after living temporarily in the other country.

Establishing residency

Whether a US citizen is considered to be tax resident in another country depends on the laws of that other country. For example, countries will often specify the number of days a year spent in that country that will trigger tax residency. Being present in that other country for a specified number of days (often 183 days) of the year will cause the US citizen to be considered a tax resident. For some countries the prescribed threshold is lower. For instance, an individual would be considered tax resident in Switzerland after residing there for just 90 consecutive days. Moreover, many countries, such as the United Kingdom, will look at the number of days that an individual has been present in his or her country over a three-year period in addition to just a single year. An intent to reside in a particular country may also cause tax residency even before a day-count test is met.

Even though a US citizen may want to live abroad and has the financial resources to do so, family advisers must consider where and by what process the US citizen and his or her family will be permitted to become resident in the foreign jurisdiction. There are few countries that allow an individual to become a permanent resident by merely moving there with the intent to remain. Most countries require an individual to obtain a visa in order to stay for more than a couple of months. The type of visa generally depends on whether the US citizen is planning to study or work in the foreign country or would be able to make a considerable investment in real estate or the economic development of that country. If the US citizen is hired as an employee of a company in the foreign country, obtaining a visa is relatively straightforward. Alternatively, if the US citizen is not planning on working, he or she may have to demonstrate sufficient assets for self-support, which can involve significant financial disclosure.

For wealthy clients, another option involves obtaining residency status or citizenship in exchange for investment in a foreign country. Several countries offer so-called 'investor visas' or residency permits for a minimum investment of a specified amount over a prescribed period of time and, in some cases, but not all, a minimum number of days spent

residing in the country. 'Investment' generally means debt or equity in local companies, government bonds, real estate, or some combination thereof. The amount of investment required can range from \$250,000 to several million dollars.

Treaty country versus low tax jurisdiction

From a US tax perspective, the most cost-effective approaches to residing outside the United States are for a US citizen to move to a foreign country that:

- has an income tax treaty with the United States; or
- imposes little or no income tax on its residents.

Moving to treaty country

As stated above, a US citizen will be subject to tax on worldwide income. However, in cases where the United States has a treaty with a foreign country, the treaty can limit the extent to which an individual may be subject to tax by the treaty partner country. In particular, the treaty will govern the determination of the individual's tax residency and the extent to which the foreign country will tax a US citizen and provide relief from double taxation. In general, if the individual is considered a resident of the treaty partner country, that country will have the authority to tax the individual on income from sources both within and outside that country.

If a US citizen moves to a treaty partner country and spends most of the year in that country (as opposed to a third country), the US citizen could be considered a resident of that country. Where a US citizen is deemed to be a resident of both the United States and the treaty partner country according to each country's residency laws, a series of tie-breaker tests will apply to determine which country will be deemed the individual's country of residence under the treaty. If the individual is considered a resident of the treaty partner country, the treaty would stipulate a reduced withholding rate for certain types of income and will provide for a US tax credit for income taxes paid to the other country on the same income.

For example, a US citizen tax resident in Spain is subject to US tax on worldwide income, including income sourced to Spain. In addition, the US citizen is also taxed as a Spanish resident on income derived from sources outside Spain. The tax treaty between the two countries provides that the US citizen will receive a US tax credit for taxes paid to Spain that were not otherwise sourced to Spain, but such credit is limited to the amount of US tax applicable to such income. Accordingly, in the case of a US citizen who is deemed resident of a treaty partner country, the treaty will not provide relief from US income tax liability, but it can reduce a US citizen's overall tax liability by providing tax credits for at least a portion of the tax paid to the other country.

Moving to country with little or no income tax

Since a US citizen will continue to pay US income tax on worldwide income, he or she may opt to move to a country that does not impose its own income tax. For example, a US citizen can become a resident and work in Bermuda by obtaining one of several types of work permit. Alternatively, the US citizen can obtain residential status in Bermuda by applying for a residential certificate, provided that he or she:

- is over the age of 18;
- is of good character and conduct;
- possesses valid health insurance coverage;
- is free of tuberculosis; and
- can provide evidence of self-support.

Bermuda has no income tax, capital gains tax or capital transfer tax, although there is a payroll tax, a land tax on property owners and a stamp duty on conveyances of real and personal property in Bermuda.

Other considerations

Regardless of where the US citizen ultimately decides to reside, he or she will want to ensure that adequate health insurance coverage is available. This is often a prerequisite for a long-term stay in many countries. An entrepreneur who plans to continue working after leaving the United States will want to consider whether he or she will be considered to be

doing business in the foreign country. If so, it could mean additional taxes on business income and local business regulations in the foreign country.

FATCA

Residing in another country generally means that the US citizen will have a bank or other financial account in that country. The United States has negotiated intergovernmental agreements with more than 110 countries requiring financial institutions in those countries to report US account holders under the Foreign Account Tax Compliance Act (FATCA). A FATCA report will alert the IRS that the US person has foreign financial assets. The IRS will then determine whether the US taxpayer has filed an FBAR, a Form 8938 and other forms which collect data on assets and income sources outside the United States. US citizens residing in a country where the US citizen has family must also be aware that receiving gifts from non-US persons or distributions from foreign trusts will trigger US reporting regardless of the fact that the gift was received outside of the United States (for further details on reporting threshold amounts please see the "Overview (April 2017)").

Retaining US citizenship

If the US citizen decides to obtain citizenship in the country of residence, the United States does not require the individual to relinquish US citizenship. However, if obtaining citizenship in another country is being done as a step toward expatriation, the individual should carefully consider the consequences of expatriating first before seeking to obtain citizenship in the other country. Advice from US and local counsel should be sought to determine how long the US citizen may live abroad and under what circumstances.

Comment

Tax professionals and trust officers advising US citizens wishing to live outside the United States during the next few years should:

- explore the various choices;
- consult local counsel in the foreign country regarding obtaining resident status; and
- engage an accountant who can navigate the income tax and additional reporting obligations of both the US and foreign jurisdiction.

For further information on this topic please contact Jennie Cherry or Stanley A Barg at Kozusko Harris Duncan's New York office by telephone (+1 212 980 0010) or email (jcherry@kozlaw.com or sbarg@kozlaw.com). Alternatively, contact Olivia S Brennan or Andrew P Stone at Kozusko Harris Duncan's Chicago office by telephone (+1 312 580 4949) or email (obrennan@kozlaw.com or astone@kozlaw.com). The Kozusko Harris Duncan website can be accessed at www.kozlaw.com.

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Jennie Cherry Stanley A Barg Olivia Brennan Andrew P Stone