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Tax and information reporting requirements for US taxpayers living abroad

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Introduction

The Foreign Account Tax Compliance Act (FATCA) requires non-US financial institutions, including investment entities, to report US account holders to the Internal Revenue Service (IRS). This reporting is causing US taxpayers living abroad to consider whether they have been adequately filing annually their income and information returns in the United States. In addition to non-US financial assets, US taxpayers living abroad may receive gifts from non-US family members, which can trigger US reporting. With the exchange of information provided under FATCA, the IRS will now be able to follow up with recalcitrant US taxpayers with regard to non-US financial accounts. On July 31 2015 President Obama signed the Surface Transportation and Veterans Healthcare Choice Improvement Act 2015, modifying certain filing dates.

Income tax reporting

US taxpayers (citizens and green-card holders) living outside the United States must file income tax returns and pay tax in generally the same way as taxpayers residing in the United States. A taxpayer's income, filing status and age determine whether an income tax return, Form 1040, must be filed. An income tax return is generally required if gross income from worldwide sources is equal to or greater than a specified annually adjusted amount for the relevant filing status (eg, \$10,300 for a single taxpayer under the age of 65 in 2015). Credits for taxes paid abroad and treaty agreements may mean that no actual tax is due, but nevertheless the return must be filed.

Due date of June 15

The due date for an individual's calendar year income tax return is April 15 of the following year. However, if the US taxpayer has a tax home and abode outside the United States or is on military duty outside the United States on that date, he or she is allowed an automatic two-month extension to file an income tax return and pay any amount due without the need to request an extension. Taxpayers must attach a statement to their tax return explaining which situation applies.

If the taxpayer cannot meet the June 15 automatic extension date, he or she can request an additional extension to October 15 by filing Form 4868 – Application for Automatic Extension of Time to File US Individual Income Tax Return before the automatic extension date. US taxpayers can electronically file their tax returns for free online at www.irs.gov using Free File if their adjusted gross income is within a specified threshold amount (currently \$60,000) or, if greater than the specified threshold, using Free File Fillable Forms or by purchasing commercial software.

US taxpayers with certain foreign financial assets must attach to their income tax return a Form 8938 – Statement of Specified Foreign Financial Assets, even if those assets do not affect the tax liability.

Foreign bank account report

Separate from their US income tax filings, US taxpayers must file Form 114, a foreign bank account report (FBAR), when:

- the taxpayer had a financial interest in or signature authority over at least one financial account located outside the United States; and

- the aggregate value of all foreign financial accounts exceeded \$10,000 at any time during the calendar year reported.

Instead of filing with the IRS, the FBAR is filed electronically with the Financial Crimes Enforcement Network (FinCEN) through its Bank Secrecy Act filing system at www.bsaefiling.fincen.treas.gov. The due date for this filing was previously June 30 and could not be extended.

Due date of April 15

As from the 2016 tax year, the FBAR due date will be changed to April 15 and will thus correspond with the income tax return due date for a taxpayer residing in the United States. In addition, the new due date can now be extended for a six-month period, ending on October 15. The automatic two-month income tax return extension available to US taxpayers living outside the United States applies to the due date of the FBAR and the taxpayer may request an extension to file the FBAR by October 15.

Pursuant to FATCA, non-US financial institutions have begun to report account balances for US reportable accounts held during tax year 2014. A US taxpayer's FBAR filing requirement should not be ignored. A taxpayer filing a late FBAR must select a reason for filing late. The 2015 act provides possible penalty relief for US taxpayers required to file an FBAR for the first time: any penalty for failure to timely request or file an extension may now be waived by the secretary.

Reporting receipt of distributions from trusts and gifts/bequests

Due date of April 15

US taxpayers must report the receipt of gifts and bequests from non-US persons that total more than \$100,000 in a calendar year, regardless of the fact that receipt of the gift or bequest is not subject to US tax. This includes a gift from a non-US citizen spouse. The report is made on Form 3520 – Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts. The due date for Form 3520 is April 15, with a maximum six-month extension to October 15.

The receipt of a distribution from a non-US trust, regardless of the amount, must also be reported on Form 3520. Some portion or all of the distribution may be subject to US income tax and so the beneficiary must obtain from the trustee a beneficiary reporting statement so that the amount and type of income can be reported on his or her income tax return if required. In

some cases an interest charge will also be due (for further details on the classification of trusts as foreign or domestic and undistributed net income please see the Overview (May 2013)).

Due date of March 15

If the settlor of the trust is a US person and that person is considered to be the owner of the trust income under the US grantor trust rules (for further details please see the Overview (May 2013)), Form 3520-A – Annual Information Return of a Foreign Trust with a United States Owner, is required. That form is generally due on March 15, with a maximum six-month extension to September 15.

Trustees of non-US trusts that are FATCA compliant as trustee-documented trusts, sponsored investment entities or registered reporting foreign financial institutions have begun reporting the amount of distributions made to US beneficiaries in 2014. If Form 3520 is not timely filed or if the information is incomplete or incorrect, penalties are generally imposed. The minimum penalty is \$10,000. However, no penalty will be imposed if the taxpayer can demonstrate that the failure to comply was due to reasonable cause and not wilful neglect.

Becoming US tax compliant

It is not an unusual situation for a US taxpayer living abroad to fail to timely file US federal income tax returns, FBARs or Form 3520s. Because the FATCA intergovernmental agreements require foreign financial institutions to look for US indicia that would require the financial institution to file a FATCA report, some US taxpayers have recently become aware of their filing obligations and are seeking to come into compliance with the law. These taxpayers may be able to file their delinquent returns using the IRS's so-called 'streamlined foreign offshore procedures', which are available to current non-resident taxpayers, including dual citizens who have not filed US income tax and information returns.

In some cases, a US taxpayer living abroad may be ready to relinquish his or her US citizenship. This should not be done before obtaining a new citizenship. The process for properly relinquishing US citizenship in order to be free to return to the United States as a visitor must be carefully followed. This process includes:

- becoming US tax compliant using the streamlined foreign offshore procedures or, if necessary, entering the IRS's Offshore Voluntary Disclosure Programme;
- calculating a possible exit tax when the taxpayer meets certain criteria, calculated as though the taxpayer had sold his or her assets on the day before the date of expatriation (for further details please see the Overview (May 2013));
- following the appropriate procedure for relinquishing a US passport outside the United States and signing the required declarations; and
- filing Form 8854 – Initial and Annual Expatriation Statement with the taxpayer's final income tax return.

Relinquishing US citizenship will not avoid the new worldwide exchange of tax information initiative, as an increasing number of countries sign on to the Organisation for Economic Cooperation and Development's common reporting standards. Declarations regarding where a person is tax resident are now required in order to move within the international financial community.

Comment

The US laws regarding tax reporting and expatriation have become increasingly complicated. US citizens living abroad would be well advised to utilise a tax accountant who knows the US rules. For international families that include US persons, US tax counsel should coordinate declarations made for FATCA purposes and ensure that US reporting is consistent with FATCA reports filed by non-US financial institutions and investment entities. In many cases, the succession planning structures utilised by such families will need to file those FATCA reports themselves. Advisers to families with no US members which own property and spend time in the United States will need to consider carefully where each family member is tax resident and domiciled.

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