

Volume XXXVI

Number 2

September/October 2012

California Enrolled Agent

csea.org

Foreign Financial Accounts

Serving a Multi-National Tax Clientele

California Disaster Loss Treatment



**Don't Miss
Tax Boat 2013**

A Publication of the California Society of Enrolled Agents

“Foreign” Tax Issues

By Monica Haven, EA, JD, LLM

As the world shrinks, practitioners encounter “foreign” tax issues on a near-daily basis; whether serving immigrant clients or citizen taxpayers who live and work overseas or have foreign bank accounts and other non-U.S. assets. CSEA will host two digiTAX webinars (November 7 and December 5) that will provide practitioners with the tools needed to serve the multi-national clientele that has become today’s norm.

Topics will include the tax treatment of income and expenses for nonresident and dual-status aliens, as well as deductions and exemptions available to American clients with foreign earned income. And no class would be complete in today’s regulatory environment without a detailed look at foreign account reporting requirements. This article will offer a brief introduction to some of the topics that will be covered in depth during the upcoming seminars.

Nonresident Aliens

Unlike U.S. citizens and permanent residents, nonresident aliens (NRAs) are taxed only on U.S.-sourced, rather than worldwide, income. Thus, NRAs will frequently have less taxable income to report to U.S. tax authorities but will also not be entitled to favorable deductions, credits, exemptions, filing statuses, and preferential tax rates.

The NRA’s U.S.-sourced income may be “effectively connected” if it is derived from a U.S. trade or business or “not effectively connected” such as interest, dividends, rents, royalties and annuities. If connected, the income may be reduced by itemized deductions and taxed at graduated rates. Income that is not effectively connected is taxed at a flat rate of 30 percent.¹

An individual who is not a citizen or resident of the U.S. is deemed to be an NRA. Residency may be ascertained under one of two tests: (1) the “green card test” or (2) the substantial presence test (SPT).²

Green cards are issued to lawful permanent residents by the U.S. Citizenship and Immigration Services, but can be administratively or judicially revoked or voluntarily forfeited (abandoned) by the holder. Alternatively, residency may be established for tax purposes if the individual has been physically present in the U.S. for at least 31 days during the tax year and 183 days during the most recent three-year period, which is calculated as the sum of (a) all of the days in the current year plus (b) one-third of the days in the previous year plus (c) one-sixth of the days in the year prior to that.

Part-Year and Dual-Status Residents

Part-year residents are, by definition, deemed “dual-status” and must file as nonresidents for part of the year and as resident aliens for the other portion. The residency date begins on the first day that the taxpayer is present in the U.S. or is issued the green card. Thus, to accumulate the requisite 183 days for residency status, the immigrant must enter the U.S. on or before July 1.

An immigrant arriving on or after July 2 would not qualify under the SPT for residency until the following year but may elect to backdate his residency status to the previous year if he was present in the U.S. for at least 31 consecutive days in the previous year and meets the SPT for the current year. A married individual entering the U.S. for the first time and considered to be dual-status may opt to be treated as a resident for the entire year if he becomes a resident alien or citizen by year-end and is married to a U.S. citizen or resident alien who agrees to file a joint return.³ This is an once-in-a-lifetime election and cannot be made again upon separation, divorce, or remarriage.

While U.S. citizens and resident aliens may use Forms 1040, 1040A or 1040EZ, the NRA must use Form 1040NR. The dual-status alien must use:

- Form 1040 if he entered the U.S. during the year and is a resident *on December 31*; or
- Form 1040NR if he was a U.S. resident who left during the year and no longer resides in the U.S. *on December 31*.

U.S. Citizens Abroad

U.S. citizens and resident aliens living abroad have the same filing requirements as those living in the U.S. All amounts of income and expenses must be reported in U.S. dollars on the tax return. The prevailing exchange rate at the time the income was received or the expenses paid should be used.

If, while living abroad, the U.S. citizen or resident alien has foreign *earned* income, he may be eligible for the Foreign Earned Income Exclusion or Deduction. He must have a tax home in the foreign country and satisfy either the Bona Fide Residence Test by residing in the foreign country for one full calendar year or the Physical Presence Test by being physically present in the foreign country for at least 330 days during any consecutive 12-month period. A “foreign country” is defined as any territory under the sovereignty of a government other than that of the United States.⁴

continued on p. 19

continued from p. 18

The maximum exclusion for 2012 is \$95,100/year; if both spouses work in a foreign country and meet the qualifications for the exclusion, up to \$190,200 of foreign earned income may be excluded. If the exclusion is claimed, the taxpayer may not take the Foreign Tax Credit for taxes paid on the excluded income and is ineligible to claim the Earned Income Credit.

Amounts received for employer-provided housing are eligible for the Foreign Housing Exclusion. Housing expenses include rent, repairs, utilities, real and personal property insurance, occupancy taxes, furniture rental, and residential parking. In 2012, only housing costs in excess of \$41.69/day and less than \$78.16/day are excludable – resulting in a maximum exclusion of \$13,312.

The Housing Exclusion must be elected before the Income Exclusion since the latter is reduced by the amount of Housing Exclusion claimed. Although amounts excluded under the Income and Housing exclusions are not taxed, they are nevertheless added back when computing regular and alternative minimum tax liabilities; thereby bumping taxable income into higher marginal tax brackets.

The Foreign Housing Deduction is *available only to the self-employed* because these individuals do not receive employer-provided housing and are ineligible for the Housing Exclusion from which wages earners may benefit. The Deduction is limited to foreign earned income (less any Income and/or Housing exclusions claimed) but is claimed as an adjustment to gross income. As a result, the taxpayer may actually exclude more from his taxable income than might otherwise be allowed by the Income and Housing Exclusions alone.

A taxpayer may also claim the Foreign Tax Credit for income taxes paid to a foreign government but should note that the credit is disallowed for foreign income taxes paid on earnings excluded under the Foreign Earned Income or Foreign Housing Exclusions. The credit is limited to the lesser of the U.S. tax that would be attributable to the foreign income had it been taxed by the U.S. or the actual foreign tax paid.



Monica Haven, EA, JD, LLM has a Masters in Taxation and decades-long experience as a solo practitioner with a burgeoning practice in Southern California. She is an alum and former faculty member of the National Tax Practice Institute, a recognized speaker on the “professional” circuit, and a guest lecturer on college campuses. Monica is also part-owner of an investment advisory firm and a practicing investment consultant. Always eager to share her expertise, Monica may be contacted at mhaven@pobox.com. Find out more about Monica at www.mhaven.net.

Copyright © 2012 Monica Haven, EA, JD, LLM.

Do not distribute without written permission of the author.

¹ IRC § 871(a).

² IRC § 7701(b)(1).

³ IRC § 6013(h).

⁴ Treas. Reg. 1.911-2(h).

PAID ADVERTISEMENT

NEGOTIATE TAX DEBTS WITH THE IRS

FOR PROFESSIONALS ONLY

A “HOW TO” MANUAL BY A FORMER IRS TAX COLLECTION MANAGER

LEARN WHAT 30 YEARS OF
EXPERIENCE CAN SHOW YOU....
EVERYTHING YOU NEED TO KNOW
TO RESOLVE YOUR CLIENTS’
TAX PROBLEMS

TAXNEGOTIATORGUIDE.COM

Spotlight on Member Benefits

Special CSEA Member Discounted Rates on Merchant Credit Card Processing

Choosing the right payments partner can be critical to your bottom line. CSEA and BancCard invite you to take advantage of the special discounted rates available to CSEA Members.

- Use your existing equipment – BancCard can reprogram most terminals
- Seasonal processing available (no fees when not processing)
- Latest technology for terminal, PC and web-based products, wireless options, gift cards, electronic check services, recurring payments and mobile solutions

Call your dedicated BancCard representative for a free rate comparison:

Adam Fox

888/741-2262, Ext. 148

afox@bancard.com