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INTERNATIONAL EXECUTIVE SERVICES

U.S. Taxation of Americans Abroad

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The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

If you are a citizen or resident of the United States who lives or works abroad, this publication is designed to help you understand your U.S. income tax obligations.

Your tax situation may be especially challenging in the year that you move to or from the United States, and it is generally advisable to seek tax advice in both the U.S. and your host country before you move, if possible, thereby helping to prevent tax "surprises" in either country.

United States tax law is continually changing. This publication reflects U.S. income tax law as it applies to taxable years ending on or before December 31, 2012.

You may also be interested in our companion publication, *U.S. Taxation of Foreign Citizens*, which is available online at:

http://www.kpmg.com/US/en/IssuesAndInsights/ArticlesPublications/Pages/us-taxation-of-foreign-citizens.aspx

For further information, please contact your local KPMG International member firm's office. Our U.S. offices are listed in Appendix E of this publication.

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Chapter 1 – Taxation of Foreign Earnings and the Foreign Earned Income Exclusion

If you are a U.S. citizen or resident who lives and works outside the United States, you may qualify to exclude some or all of your foreign earned income from U.S. taxation. The "foreign earned income exclusion" ("FEIE") – often referred to as the "section 911 exclusion" in reference to its place in the Internal Revenue Code – allows a general exclusion of up to USD 95,100 in 2012 (USD 97,600 in 2013; the amount is adjusted annually for inflation). In addition to (or in lieu of) the foreign earned income exclusion, you may elect to exclude from income a housing cost amount based on your foreign housing expenses. To claim the FEIE, you must meet certain requirements.

Qualifying to Claim the Foreign Earned Income Exclusion

To qualify to claim the FEIE, you must have foreign earned income, your tax home must be in a foreign country, and you must meet one of two tests:

- The *bona fide residence test*, which requires that you be a "bona fide resident" of a foreign country or countries for an uninterrupted period that includes a full tax year; or
- The *physical presence test*, which requires that you be present in a foreign country or countries at least 330 full days during any period of 12 consecutive months.

If you are a U.S. citizen, you may qualify to claim the FEIE using either the bona fide residence or physical presence tests. If you are a U.S. resident alien (because you are a "green card" holder) who is working abroad, in general you should use the physical presence test to qualify to claim the FEIE; although if you are a citizen of a country that has a tax treaty with the United States, you may be able to use the bona fide residence test to qualify to claim the FEIE. The two tests are described in greater detail below.

Bona Fide Residence Test

Bona fide (Latin for "good faith") residence is determined based on your individual situation, including the nature of your international assignment and the length of your stay in the foreign country. Foreign residence may be established even though you intend to return to the United States when your international assignment is over. Bona fide residence is not the same as domicile, which is normally your permanent home that you plan to return to.

Determining your bona fide residence requires an analysis of all the relevant facts and circumstances. Factors that might indicate that you are a bona fide resident include:

- Your family accompanies you on the international assignment and makes their home in the foreign location;
- You purchase or lease a home in the foreign country;
- You intend to become involved in the social life and culture of the foreign country; and
- The nature of any conditions or limitations concerning your employment agreement, as well as the type and term of your visa or residence permit.

To use the bona fide residence test to qualify to claim the FEIE, your period of bona fide residence abroad (whether in one or more countries) must include one full calendar year. Once you meet the full-year requirement, you can apply the bona fide residence test to the partial years abroad at the beginning

and end of your assignment, as well. (In a partial year of residence abroad, the maximum FEIE is prorated.) Temporary visits to the United States generally will not disqualify you from claiming to be a bona fide resident of a foreign country, unless the visit to the United States is itself a period of residence in the United States.

Comment:

To claim the bona fide residence test on your U.S. income tax return, you cannot claim that you are a nonresident of the foreign country in order to avoid paying resident income tax in the foreign country.

Example 1

Darcy moves from the United States to London, England and establishes bona fide residence there on August 1, 2013. Assuming that the other requirements are met, she will qualify as a bona fide resident after December 31, 2014 (when she has been a resident of the United Kingdom for a full calendar year (2014)). As a result, she will qualify for the FEIE for all of 2014 and a prorated portion of 2013, commencing with her date of arrival. Her maximum exclusion for 2013 (before taking into consideration the additional exclusion for housing costs) would be USD 40,912 (153 days / 365 days x USD 97,600).

Physical Presence Test

If you use the physical presence test to qualify to claim the FEIE, you must be physically present in a foreign country (or countries) for at least 330 full days during any 12-month period. Unlike the bona fide residence test, the physical presence test does not depend on your particular facts and circumstances, or whether you intend to establish residence in a foreign country.

Your qualifying period for the physical presence test can be any period of 12 consecutive months, and the period does not have to start on the first day of the month. If you are claiming the FEIE for a full year of residence abroad, the qualifying period should be the calendar year; but for an arrival or departure year, any 12-month period that begins or ends during the tax year can be used. (In some cases, two or more overlapping 12-month periods may be used; usually this will be the case if two different international assignments occur during the same year.)

A day counts as a day outside the United States only if you were in a foreign country (or countries) for the entire 24-hour period commencing at midnight. For that reason, a day of departure or arrival in a foreign country generally will not count. Time spent over international waters – or in Antarctica – does not count as being present in a foreign country. However, if you spend less than 24 hours in the United States en route between two foreign countries, that will not be counted as presence in the United States.

It is important to keep careful records of your travel while on international assignment. Particularly in the year that your international assignment begins or ends, the physical presence test can result in a larger pro rata FEIE than the bona fide residence test, because of the way that the 330-day requirement is applied. It is easiest to explain how this works in an example.

Example 2

Assume the same facts as in example 1 above – Darcy begins her assignment in the United Kingdom on August 1, 2013. Assume further that she does not leave the U.K. for more than a year after that date. To maximize Darcy's pro rata FEIE, we should find the 12-month period that contains 330 days

abroad that begins the earliest in 2013. Since Darcy remained continuously in the U.K. after her first qualifying day of August 1, 2013, the 330th day of presence in the U.K. will be June 26, 2014. The 12-month period ending on June 26, 2014 begins on June 25, 2013, so Darcy's qualifying period for the physical presence test in 2013 is June 25 through December 31, a period of 190 days. Her maximum pro rata exclusion is USD 50,805 (190 days / 365 days x USD 97,600). Note that this is USD 9,893 more than if she had used the bona fide residence test.

Comment:

If you qualify to use both the bona fide residence test and the physical presence test, you may use whichever test allows the larger exclusion. As demonstrated in the two preceding examples, the physical presence test is often preferable in the year of your move abroad (as well as in the year that you end your international assignment), because it may result in a larger prorated maximum exclusion.

Exceptions to Minimum Time Requirements

If you are forced to end your international assignment early because of war, civil unrest, or similar adverse conditions which prevented you from conducting business, you may be allowed a prorated exclusion even though you did not meet the time requirements of the qualifying tests. Each year the Internal Revenue Service (IRS) releases a list of countries that met this exception in the prior year. The exception applies if you left one of those countries on or after the date specified by the IRS, and this departure prevented you from complying with the time requirements of either the bona fide residence test or the physical presence test, that you otherwise would have expected to meet. Please note the FEIE will be prorated only for the actual period of residence.

The following countries were allowed the exception for 2012:

Country	**Date of Departure (on or after)**
Central African Republic	December 28, 2012
Sudan	September 15, 2012
Tunisia	September 15, 2012

Example 3

Bill is a U.S. citizen who began his assignment to Sudan on November 1, 2011. Bill was in Sudan continuously beginning on that date, and established his bona fide residence there. On September 20, 2012, Bill ends his assignment early and returns to the United States due to the civil unrest in Sudan. Bill does not meet the bona fide residence test because his period of bona fide residence in Sudan did not include one full calendar year. He does not meet the physical presence test either because he was not present in a foreign country or countries for at least 330 full days in a 12-month period. However, Bill can apply the special exception and claim either of the two tests, because his departure from Sudan was after the date specified by the IRS.

Note that the exception does not apply if you leave before the date specified, or if you begin an assignment after the date specified and subsequently leave.

Foreign Tax Home

To qualify to claim the FEIE, your tax home must be in a foreign country throughout your period of bona fide residence or physical presence. The term "tax home" generally means the location of your regular or principal place of business, but you cannot claim that a foreign country is your tax home if your abode is in the United States. Temporary presence in the U.S., or maintaining a dwelling in the U.S., does not

necessarily mean you have an abode in the U.S., even if the dwelling is used by your spouse and dependents as their principal place of abode.

The IRS has issued guidelines (which can be found in Revenue Ruling 93-86) to help determine whether a work assignment away from one's regular place of employment is temporary (so that the tax home remains in place) or is indefinite (so that the tax home moves to the new location). If your expected or actual assignment exceeds one year in a single location, you will be considered to have given up your old tax home. If you realistically expect your assignment away from home to last for a year or less, the employment is considered temporary. Other guidelines establish three factors for determining an individual's place of abode, which also affects where his or her tax home is considered to be. These factors are:

- Whether the individual's family accompanies him or her to the new location;
- Whether the individual duplicates living expenses by maintaining his or her home; and
- Whether there is a preponderance of business contacts in the new location.

You do not necessarily have to meet all three of these conditions to be considered to have moved your abode to the new location.

Comment:

When you take an international assignment, it is very important for you to document the factors that indicate your intention to establish your tax home in the foreign country. Even if you meet the physical presence test, the IRS may not consider your tax home to have moved to the foreign location. On the other hand, if you satisfy the bona fide residence test, it is likely that the foreign location will be considered your tax home.

Foreign Earned Income and Foreign Housing Cost Exclusions

Once you have established that you have a tax home in a foreign country, and meet either the bona fide residence test or the physical presence test, you are entitled to claim the FEIE, which actually has two parts: the foreign earned income exclusion and the housing cost exclusion.

If you have more foreign earned income than the maximum allowable FEIE, the amount of your exclusion is limited to that maximum. On the other hand, if your foreign earned income is less than the maximum allowable exclusion, the excess exclusion can in some circumstances be used in the previous or following year (this is most likely to apply if you receive a bonus based on prior year performance, or a tax reimbursement that relates to the prior year's tax liability).

As explained above, the maximum amount of the FEIE for 2013 is USD 97,600. If your foreign earned income is more than that amount, you may also be able to claim the housing cost exclusion. The housing cost exclusion is available if your qualified housing costs exceed 16 percent of the maximum FEIE (USD 15,616 in 2013). The amount of your qualified housing costs that exceed that threshold can be taken as housing cost exclusion, up to maximum housing costs of 30 percent of the maximum FEIE (USD 29,280). In other words, up to USD 13,664 (in 2013) of housing costs can be taken to increase your maximum exclusion. The 30-percent ceiling amount is increased if you live in certain high-cost locations. The complete list of those locations can be found in the instructions to IRS Form 2555, *Foreign Earned*

Income. In a partial year abroad, the housing cost exclusion is prorated in the same manner as the foreign earned income exclusion.

(Housing costs are treated slightly differently if you are self-employed. See the discussion in Chapter 5.)

"Qualified housing costs" are the reasonable expenses you paid (or your employer paid on your behalf) for housing in a foreign country for yourself, your spouse, and your dependents. Qualified housing costs include rent, utilities (other than for telephone and cable television), insurance, occupancy taxes, rental of furniture and appliances, rental of parking, and household repairs. The cost of anything purchased (such as furniture) is not a qualified housing cost, nor is the cost of domestic labor. Mortgage interest and property tax are not considered qualified housing costs (though they remain itemized deductions even if paid for a foreign home).

Example 4

Scott, a U.S. citizen, works in Trinidad for all of 2013. His tax home and bona fide residence are in Trinidad. During 2013, he earns USD 100,000, all of which is foreign earned income. His qualified foreign housing costs in 2013 are USD 30,000, which exceeds the 30 percent ceiling on the housing cost deduction, meaning that he is eligible for the full housing exclusion of USD 13,664. The combined maximum FEIE and housing cost exclusion for 2013 is 111,264 (USD 97,600 + USD 13,664). Therefore, Scott can exclude his entire USD 100,000 of foreign earned income.

If Scott receives a bonus of USD 20,000 early in 2014 that relates to his performance in 2013, he will not be able to offset that bonus with his 2014 FEIE. However, because he had USD 11,264 of unused FEIE in 2013, he can take that amount as an exclusion against the bonus that is paid in 2014 but related to 2013.

Qualified Second Household

If you maintain a second foreign household for your family at a different location because the living conditions at your place of residence are dangerous, unhealthy, or otherwise adverse, you can claim the expenses for the second household as additional qualified housing cost. Examples of adverse living conditions include a state of warfare or conditions under which it is not feasible to provide family housing (for instance, remote construction sites).

Two-Earner Families

If you are married, both you and your spouse can claim the FEIE, but each of you must qualify separately, and you cannot use any unused exclusion of your spouse. If you come from a community property state, community property law is generally disregarded in determining the amount of your foreign earned income. If you and your spouse live together, housing costs can be shared by the two of you, or allocated all to one or the other, whichever is more beneficial.

Example 5

Jacqueline and John are a married couple who are both on international assignment for all of 2013. Jacqueline's foreign earned income for 2013 is USD 120,000 (which includes reimbursed housing expenses of USD 30,000), while John's is USD 80,000 (which does not include any reimbursed housing). Jacqueline's foreign earned income exceeds the maximum exclusion of USD 111,264 (USD 97,600 plus the housing exclusion of USD 13,664). After claiming the entire exclusion, USD 8,736 of compensation will be subject to U.S. tax (USD 120,000 less USD 111,264).

John's foreign earned income is less than the maximum exclusion of USD 97,600. (Since all of the housing costs were allocated to Jacqueline, John cannot use the housing cost exclusion.) John can claim an exclusion of USD 80,000, leaving USD 17,600 of unused exclusion. Jacqueline cannot use John's unused exclusion against her remaining foreign earned income. However, if in 2014 John receives a bonus that relates to 2013, he can use his unused 2013 exclusion to offset the bonus.

Foreign Earned Income

To claim the FEIE, you must have foreign earned income. This is compensation that you receive for services that you perform in a foreign country. Earned income includes not just wages but bonuses, commissions, lodging, foreign incentives and cost-of-living allowances, tax reimbursements, home leave and educational reimbursements or allowances, and moving expense reimbursements. An amount is considered income whether it is paid directly to you or paid on your behalf, and whether it is paid in cash or received as a benefit-in-kind. Earned income does not include passive income such as interest and dividends.

Only the location of the services provided determines whether earned income is considered to be foreign – the nationality of the employer, the currency paid, or the location of the bank account is not relevant. However, amounts paid by the United States or its agencies to government employees or members of the U.S. armed services are not considered to be foreign earned income. Likewise, income earned working in Puerto Rico or U.S. possessions is not considered to be foreign earned income (although that income may be eligible for other tax benefits that are outside the scope of this publication).

If you work in both the United States and a foreign country (or countries), your earned income has to be allocated by the number of days worked to determine how much is considered to be foreign source. (Certain types of income such as foreign housing allowances and foreign tax reimbursements may be considered to be exclusively foreign source.) It is also necessary to determine when foreign earned income was earned, as opposed to when it was received – for example, a bonus that is paid in 2013 may have been earned in 2012, because it relates to prior year performance. The FEIE is used to offset foreign earned income that was earned in the current year.

Example 6

Joan is a U.S. citizen who qualified as a bona fide resident of Bolivia for all of 2012 and 2013. In 2012, her total compensation was USD 90,000 (including reimbursed housing expenses of USD 28,000), all of which qualified as foreign earned income because she had no U.S. work days. In 2013, she received USD 95,000 (including reimbursed housing expenses of USD 28,500) of foreign earned income attributable to services performed in 2013, plus a USD 5,000 bonus and a USD 10,000 tax equalization payment related to 2012. Joan's earned income exclusions, both used and unused, for the two years are as shown on the next page.

2012	**USD**
Foreign earned income	90,000
Maximum exclusion	108,414
Exclusion used in 2012	(90,000)
Unused 2012 exclusion	18,414
2013	
Foreign earned income related to 2013	95,000
Foreign earned income related to 2012	15,000
Total income received in 2013	110,000
Total exclusions claimed in 2013 return:	
Related to 2013	95,000
Related to 2012	15,000
Total exclusion in 2013 return	110,000
Maximum 2013 exclusion	111,264
2013 exclusion used	(95,000)
Unused 2013 exclusion (available in 2014)	16,264

If you have unused exclusion in a year, it may be wise to consult with your employer to be sure that any payments related to that year are paid by the end of the following year, so that the unused exclusion can be used in that following year. (Generally this will be incentive compensation and assignment-related payments such as tax equalization settlements.)

Denial of Double Benefits

If you claim the foreign earned income and foreign housing cost exclusions, you cannot deduct or claim a credit for any expenses that are directly related to the excluded income. In such cases, a "scaledown" calculation is necessary to determine the portion of the credit or expense that is related to the excluded income.

This "denial of double benefits" rule is typically seen in the areas of deductible moving expenses and foreign tax credits, both of which are discussed in detail in later chapters.

Calculation of U.S. Tax Liability ("Stacking Rule")

If you claim the FEIE, your income tax is figured using a special calculation called the "stacking rule," which causes the exclusions to be less beneficial than other deductions or exclusions of the same amount would be.

Like many countries, the United States has "progressive" tax rates, which means that the higher a person's taxable income is, the higher his or her rate of tax. In the U.S., each level of tax is referred to as a bracket, with higher levels of income subject to higher tax rates or "brackets." The income in the lower brackets continues to be taxed at the lower rates. For example, in 2012, a single taxpayer with taxable income of USD 75,000 paid tax of 10 percent on the first USD 8,700 of income, 15 percent on income in excess of USD 8,700 up to USD 35,350, and 25 percent on income over USD 35,350. The taxpayer would be referred to as being in the 25-percent tax bracket, and he knew that his next dollar of income would be taxed at 25 percent. The same applies to deductions – if the taxpayer were to have an

additional deduction of USD 100, he knew that because he was in the 25-percent bracket, the benefit of that deduction would be to lower his tax by 25 percent of the deduction, or USD 25.

However, the stacking rule causes the FEIE to be unique in that it offsets income that is taxed in the lowest brackets, rather than in the highest brackets. In our example above, if the taxpayer had a deduction of USD 30,000, it would offset income that would be taxed at 25 percent. However, if the taxpayer had a FEIE of USD 30,000, it would shelter income that would be taxed at 10 and 15 percent.

The stacking rule is applied by figuring the tax on your taxable income without taking the foreign earned income and housing cost exclusions into account. Next, the tax is figured on the amount of your total foreign earned income and housing cost exclusions (at the appropriate graduated tax rates and with no other deductions taken into account). The difference (if any) between the two amounts is the taxpayer's actual U.S. tax liability for the year.

Electing and Revoking Exclusions

The FEIE is elective, which means that if you qualify to claim the exclusions, you can choose whether or not to do so. However, once you have claimed the exclusions in a tax return, you have effectively elected to claim the exclusions in all future years that you qualify to claim them. You can revoke the election – that is, choose not to claim the exclusions after having claimed them in an earlier year – but if you do so, you cannot make the election again for six years, unless you get special permission from the IRS. This permission is not routinely granted, so careful consideration should be made before revoking the election.

You make the election to claim the two exclusions by completing Form 2555, *Foreign Earned Income*, and attaching it to your tax return (Form 1040). The election should generally be made on a tax return that is not delinquent, but the IRS will accept the election on a late return that is filed within one year of the original due date (generally April 15). You can also make the election on an amended return (in other words, amend a previously filed return to claim the exclusions) if you are amending a return that was initially filed on time, within three years of the due date of the original return.

There are two other situations in which the IRS will accept late elections to claim the two foreign income exclusions. If you owe no federal income tax after taking the exclusions into account, you can file a Form 1040 (or amended Form 1040X) with a Form 2555 attached to it. However, if you owe federal income tax after taking the exclusions into account, you can claim the late exclusions only if the IRS has not discovered that you did not claim the exclusions. In certain cases, the IRS may allow a late election to claim the exclusions under other circumstances. It is important to consult a competent tax adviser to be sure that the special procedures to request IRS permission to make late elections are followed.

Making the Decision: To Elect or Not?

Because of the interaction between the stacking rule (described above) and the foreign tax credit (discussed in Chapter 4), it is sometimes more beneficial not to claim the foreign earned income exclusion. This is more likely to be the case if you are paying tax in a country that has higher tax rates than the United States. For this reason, it is important to do the complex calculations to determine whether it is more advantageous to claim the exclusions before making the election. On the other hand, once the election has been made, it may not be advisable to revoke it in a future year, even if revocation would result in a lower tax liability in that year, due to the impact that revocation might have on future tax

years. Whether to make, or revoke, the election, should be discussed with a qualified tax professional before proceeding.

Special Exclusion for Meals and Lodging Provided by Employer

It is common for employers who send their employees on international assignment to pay for the assignees' housing costs in the foreign location. The general rule is that housing costs reimbursed or paid on behalf of an employee are considered taxable income for the employee – that is part of the reason why the foreign housing cost exclusion (described above) exists. However, under certain circumstances, the value of meals and lodging furnished to you by your employer may be excluded from taxable income.

General Rule

You may exclude from your gross income the value of meals and lodging furnished to you by, or on behalf of, your employer if it is for the convenience of the employer. To qualify for exclusion, the meals and lodging must be provided on the business premises of the employer, and you must accept such lodging as a condition of employment. This general rule applies to employees in the United States, as well as to Americans overseas. Typical examples include prison guards who live on site at the penitentiary, and oil workers who reside at the drilling rig.

Foreign Camp Exclusion

In some cases, your employer can exclude housing costs from your wages if you do not live on the employer's premises, but live overseas in employer-provided housing that qualifies as a "camp."

To qualify as a camp, the following conditions must be met:

- The camp must be provided for the employer's convenience if the place of business is in a remote area where satisfactory housing on the open market is not otherwise available within a reasonable commuting distance of the work site;
- The camp must be located as near as practicable to the place of employment and be in a common area or enclave not available to the general public;
- The camp must normally accommodate 10 or more employees.

As with on-premises housing, you must accept the camp housing as a condition of your employment. Furthermore, you cannot have an option to accept additional compensation instead of housing and meals in-kind. You may qualify for the camp exclusion even if you do not qualify to claim the FEIE. Note that the excludible cost of camp housing and housing on the employer's premises cannot be treated as qualified housing expense when computing the foreign housing cost exclusion.

Chapter 2 – Employment-Related Deductions

Most U.S. citizens and residents have the option of claiming the standard deduction (which is a flat amount that is determined according to filing status), or claiming itemized deductions if they are higher than the standard deduction. Deductions reduce taxable income, resulting in a lower tax liability. Deductible items include medical expenses, state and local income taxes, property taxes, charitable contributions, and home mortgage interest, among others. (Many of these are subject to various limitations.) Taxpayers should consult with their tax advisers about whether itemizing deductions or claiming the standard deduction is more advantageous.

Certain other deductions can be claimed even if you choose to claim the standard deduction rather than itemized deductions. This category of deductions is referred to as "adjustments," and includes many employment-related deductions.

Moving Expenses

If your employer reimburses you for "qualified moving expenses," or pays those expenses on your behalf, those amounts can be excluded from gross income. Qualified moving expenses that are not reimbursed by your employer can be deducted as an "adjustment" as described above.

To be considered qualified moving expenses, the expenses must have been incurred in connection with moving to a new location for employment-related reasons, and are limited to the costs of moving household goods and personal effects to the new residence (including in-transit or foreign-move storage expenses), and travel and lodging costs during the move. The definition of "qualified moving expenses" does not include:

- Meal expenses;
- Expenses incurred while searching for a new home after obtaining employment;
- The costs of selling the old residence (or settling a lease) or purchasing (or acquiring a lease on) a new home;
- Temporary lodging at the new location after obtaining employment;
- Any part of the purchase price of the new home;
- Automobile registration;
- Driver's license;
- Expenses of obtaining or breaking a lease;
- Home improvements to help sell the house;
- Loss on the sale of the house;
- Losses from disposing of memberships in clubs;
- Mortgage penalties;
- Real estate taxes;

- Refitting of carpets and draperies;
- Security deposits (including any given up due to the move); or
- Storage charges except those incurred in-transit and for foreign moves.

Employer reimbursements of these items must be included in gross income. Also, qualified moving expense reimbursements are only excludible if the following two conditions apply:

- Your new job location is at least 50 miles farther from your old residence than that old residence was from your former place of employment.
- You are a full-time employee at the new location for at least 39 weeks during the 12-month period following the move, unless you are transferred, involuntarily terminated, become disabled, or die. If you are self-employed, you must work full time at the new location for at least 39 weeks during the first 12 months and a total of at least 78 weeks during the first 24 months following the move.

Special Rules

Although qualified moving expenses are generally deductible or excludible only if incurred in connection with beginning work in a new location, exceptions are provided in two situations for individuals who return to the United States from abroad. If you retire from your principal place of work and residence which are outside the United States, you may deduct the cost of moving to the United States upon retirement, even if you do not work in the new location. Also, the spouse and dependents of a person who dies, whose principal place of work at the time of death was outside the United States, may deduct the cost of returning to the United States. To be deductible in such circumstances, the move must begin within six months after the death of the decedent and must be from a former home outside the United States, assuming this home was the residence of both the surviving spouse and the decedent at the time of death. The surviving spouse needs not work in the new location.

Reasonable costs of storing household effects while on an international assignment are considered qualified moving expenses, even for years in which you reside abroad in a single location.

Allocation of Moving Expenses (Denial of Double Benefits)

As mentioned above in the discussion of the foreign earned income and foreign housing cost exclusions, expenses that are attributable to excluded income cannot be deducted. Qualified moving expenses connected to a move to a foreign work location are considered to be attributable to the foreign income earned there, so to the extent that some or all of the foreign earnings can be excluded from gross income, an equal proportion of unreimbursed qualified moving expenses cannot be deducted against gross income.

Travel Expenses

As discussed above, if your employer reimburses you for your housing and other living costs while you are working in a foreign location, or pays such expenses on your behalf, those amounts are generally includible in gross income, although some portion of the housing reimbursement may be excludible under the foreign housing cost exclusion. In general, you have to reside abroad for at least one year in order to qualify for the housing cost exclusion.

If your assignment is less than a year in length, although you probably will not qualify for the foreign earned income and foreign housing cost exclusions, you may qualify for a different exclusion that allows you not to include in gross income reimbursements for housing and other travel and living expenses.

When you are traveling away from home on business, you are allowed to deduct from (or not include in) gross income your reimbursed expenses for travel, meals and lodging, if the amounts are justified and reasonable. These amounts, called "temporarily-away-from-home expenses," must meet several requirements to qualify for exclusion. First, you must be temporarily away from your tax home (your tax home is generally your principal place of business; in contrast, to qualify for the foreign earned income and foreign housing cost exclusions, your tax home must move to the foreign location). Second, you must account to your employer for your reimbursed expenses by maintaining records and receipts (reimbursements in excess of accountable expenses are not excludible). Finally, you cannot be considered to be temporarily away from home if your assignment abroad is expected to last for more than a year, or if it actually lasts for longer than a year.

Example 1

Glendale is sent on a six-month assignment to Ireland. He retains his home in the United States. If documentation requirements are met, Glendale's employer-paid travel and lodging will be excludible from gross income. However, after he has been away for three months, his employer changes the terms of the assignment and determines that Glendale's assignment will be 15 months long; therefore, the reimbursed expenses will be excludible only for the initial three months. The reimbursements should be included in income beginning on the date that it is determined that the assignment will last for longer than a year.

Example 2

Bethany is sent on a 10-month assignment to Ireland. She retains her home in the United States. Although the expectation remains that she will be away for only 10 months, the project runs late and Bethany remains in Ireland for 13 months. Because the intent was always that the assignment should be less than a year in duration, reimbursed expenses are excludible from gross income for the first 12 months of the assignment. Reimbursed expenses after 12 months cannot be excluded.

Individual Retirement Accounts

Individual Retirement Accounts (IRAs) are a popular retirement savings plan that allow great flexibility over investment options. You can contribute up to USD 5,000 to an IRA (in 2012; the amount rises to USD 5,500 for 2013), if you have at least that much in compensation. (If you are married and do not have any compensation income, your ability to contribute to an IRA is based on how much compensation your spouse has.) If you are age 50 or older, you can contribute an extra USD 1,000 per year. In general, the amount contributed to an IRA can be taken as a deduction against gross income, but this benefit is phased out at higher levels of income (although you are still permitted to make non-deductible contributions to an IRA). Often, due to assignment-related allowances and reimbursements, your taxable income will be higher while you work abroad than it was when you were working in the United States. For that reason, you may find that your ability to claim deductions for IRA contributions is limited or lost while you are on assignment.

Roth IRAs

A popular alternative to an IRA is a Roth IRA. You can contribute the same amount to a Roth IRA as you can to a traditional IRA (but your contributions to both kinds of IRAs in a given year cannot together

exceed the limitation of USD 5,000 in 2012 or USD 5,500 in 2013). Contributions to Roth IRAs are never deductible, but, unlike with traditional IRAs, withdrawals from a Roth IRA upon retirement are not subject to tax. However, you are not allowed to contribute to a Roth IRA if your adjusted gross income is over a certain level, and as mentioned above, this is more likely to be the case if you are on an employer-sponsored international assignment. There may be ways to overcome this limitation – e.g., steps such as making a "back door contribution" to a Roth IRA – but it is suggested that you consult with a tax professional before taking any such step.

Business and Professional Expenses

In addition to away-from-home travel expenses, you are entitled to deduct certain employment – or professionally-related expenses as itemized deductions, subject to limitations. It should be noted that such expenses, if attributable to foreign earned income, will be partially disallowed under the denial of double benefits rules. Such deductions are generally more beneficial to individuals who have substantial U.S. source income from employment or self-employment, or whose income significantly exceeds the foreign exclusions.

Chapter 3 – Other Income, Credits, and Deductions

U.S. citizens and resident aliens are subject to U.S. tax on worldwide income. The rules for taxing such income, other than for compensation and related items, generally do not change by virtue of overseas residence. An exception to this general rule may occur where income is taxed in a foreign country of residence. In such cases, it is possible that U.S. tax rules may be changed due to an income tax treaty with the foreign country. Tax treaties (discussed in Chapter 6), therefore, should always be consulted when considering your tax status while working abroad.

Phased-Out Deductions and Credits

Although all items of income are still subject to taxation, and most deductions are generally allowed, tax planning considerations while residing abroad could very well be different than if you are living in the United States. This is due to various factors, including the FEIE, the foreign tax credit, and local country taxes. Also, many important tax credits and deductions are phased out (gradually limited until eliminated) at higher levels of income. As discussed in a previous chapter, if you are on an employer-sponsored international assignment, you may receive allowances and reimbursements that cause your income to be higher than it was when you were working in the United States, and this in turn may cause you to lose certain tax benefits, such as tuition credits (the American Opportunity Tax Credit, formerly Hope Credit, and Lifetime Learning Credit), deductions for student loan interest, and the child tax credit. Consulting with a tax professional before going on assignment may help you anticipate these changes in your tax situation.

Itemized Deductions

Itemized deductions are generally allowable under the same rules that apply to taxpayers residing in the United States and will not be reviewed here in detail. It should be noted that foreign sales taxes and value-added taxes are not deductible. Similarly, contributions to foreign charities are not deductible unless the organization has obtained U.S. tax-exempt status.

Miscellaneous itemized deductions are deductible only to the extent that, in the aggregate, they exceed 2 percent of adjusted gross income. This category of deduction includes unreimbursed business expenses and investment expenses. Since your adjusted gross income (AGI) may be higher while you are on assignment, it may take more of these deductions to get any benefit than it would if you were not on assignment.

Comment:

While you are on international assignment you may have itemized deductions lower than the standard deduction. Even if you are tax-equalized (see discussion at Chapter 8), this may mean that you do not get a tax benefit for certain items such as charitable contributions that might have benefited you before you went on assignment. Where deductible expenses can be postponed, it may be worthwhile to do so, though it would be appropriate to review your company's tax equalization policy with respect to itemized deductions, and consult with a tax professional, before reaching a conclusion.

Passive Investment Income

While you are living abroad, dividends and interest, as well as all other income, are subject to tax under the normal rules that would apply if you were a resident of the United States. Interest income is subject to tax unless it is from a qualified obligation of a state, county, city, or municipality in the United States

(these are commonly referred to as "muni bonds"). Interest or other earnings accumulating on IRAs or other qualified retirement plans are not subject to tax unless actually withdrawn from the plan.

Capital gains are taxed at different rates, depending upon the holding period and the nature of the asset. Short-term capital gains (assets held 12 months or less) are taxed at normal income tax rates. Long-term capital gains (assets held more than 12 months) are generally taxed at a maximum rate of 15 percent. However, long-term capital gains are taxed at 0 percent for individuals in the 10-percent and 15-percent tax brackets. Beginning in tax year 2013, the long-term capital gains rate for taxpayers in the highest income tax bracket will be 20 percent.

Capital losses are treated differently than ordinary losses. Capital losses are deductible in full against capital gains. If there is an overall net capital loss for a year, up to USD 3,000 of that net loss can be deducted against other income (USD 1,500 in a married, filing separately return). Net losses in excess of USD 3,000 may be carried forward for use against future capital gains or against other income (subject to the same USD 3,000 per year limitation).

"Qualified dividend income" received by U.S. citizens or residents is taxed at the same rates as long-term capital gains. Generally, qualified dividend income includes dividends received from U.S. corporations and certain qualified foreign corporations. Non-qualified dividends are taxed at normal income tax rates.

Residences

A primary consideration for any foreign move involves the tax implications of holding, renting, or selling your principal U.S. residence. The tax rules that you should consider are described briefly in the following paragraphs.

Sale of Principal Residence

The general rule is that gain on the sale of property is taxable, including any gain on the sale of one's home. However, individuals may qualify to exclude up to USD 250,000 (USD 500,000 for a married couple filing a joint return) of gain on the sale of their principal residence.

To qualify for the exclusion, the following requirements generally must be met:

1. You must have owned and used (occupied) the residence as your principal residence for at least two years during the five-year period prior to the sale or exchange (the two years do not have to be in one consecutive period); and
2. During the two-year period ending on the date of the sale, you have not excluded gain from the sale of another home.

However, in certain cases, even if you do not meet the requirements above, you may be entitled to claim a smaller exclusion if the primary reason you sold the home was because of a change in place of employment, health, or certain other unforeseen circumstances. If you meet one of these exceptions, you may qualify for a smaller maximum exclusion. You must still have owned and used the home as your primary residence for some period of time in the five-year period ending on the date of sale or exchange. If so, your maximum exclusion will be prorated by the ratio of the period that you did use the home as your primary residence to two years.

Example 1

Irwin purchased his home in Yonkers, New York, on January 1, 2013, and immediately moved in to use it as his primary residence. On June 30, 2014, he sold the home because his employer sent him on a long-term assignment to South Africa. Irwin's maximum exclusion for gain on the sale of this home will be USD 186,986 (546 days / 730 days x USD 250,000). If Irwin's gain is less than that amount, he can exclude the entire gain. If his gain is more than USD 186,986, the gain in excess of that amount will be taxed as capital gain.

In addition, if your home had any periods of "non-qualified use" after January 1, 2009, gain attributable to the non-qualified use cannot be offset by the exclusion. Non-qualified use is any period that you did not use the property as your principal residence, such as renting it out or using it as a vacation home – but only if you reoccupy the house as your primary residence afterwards.

Example 2

Rosemary purchased her home on January 1, 2010, for USD 300,000, and immediately moved in to use as her primary residence. Rosemary went on international assignment from January 1, 2012 through December 31, 2012, during which time she rented the home out to tenants. She moved back in on January 1, 2013, and sold the home on June 30, 2013, for USD 500,000, resulting in a gain of USD 200,000. Even though Rosemary meets the two-out-of-five-year-ownership-and-use requirement, the portion of the gain attributable to the period of non-qualified use is taxable. The taxable portion is figured as the ratio of the number of days of non-qualified use to the total number of days the property was owned. Therefore, USD 57,322 of the gain is taxable (366 days / 1,277 days x USD 200,000), while the remainder of USD 142,678 can be excluded.

Example 3

Assume the same facts as *Example 2* above, except that Rosemary did not reoccupy the home after the rental period, but sold it immediately after ending her international assignment. In this case, the rental period would not be considered non-qualified use, and the entire USD 200,000 gain could be excluded. (These examples do not take into account depreciation recapture – see *Example 4* below.)

There are two exceptions to the non-qualified use rule. First, periods of absence of up to 10 years in the aggregate during which you or your spouse are serving on qualified official duty as a member of the uniformed services, the U.S. foreign service, or the intelligence community will not count as non-qualified use. Also, periods of non-qualified use do not include any other period of absence (not to exceed two years in the aggregate) due to change in place of employment, health conditions, or certain other unforeseen circumstances.

Renting your home out while you are on assignment can create taxable gain on the sale of the home in another way, by creating "depreciation recapture." When you rent out your home, you must claim the rents received as income, but you can also deduct related expenses, including depreciation, which is a portion of the purchase price of the property. When you sell the property, the amount you originally paid for the property is decreased by the depreciation deductions you took, which increases the gain – the portion of the gain that is related to this depreciation adjustment is called depreciation recapture, and it cannot be offset by the exclusion for gain on the sale of a primary residence. Also, this depreciation recapture is taxed at 25 percent, rather than the 15-percent rate that applies to most long-term capital gains.

Example 4

Assume the same facts as *Example 3* above. During the rental period, Rosemary claimed depreciation deductions of USD 10,000. When she sells the home her original purchase price (called basis) of USD 300,000 will be adjusted by the depreciation deductions, resulting in an "adjusted basis" of USD 290,000. This means her gain will be USD 210,000, and the USD 10,000 depreciation recapture will be subject to tax even though Rosemary qualified to claim the exclusion for gain on sale of a primary residence.

Comment:

As discussed, to be eligible for the exclusion, you must have owned your residence and used it as your principal residence for at least two years during the five years prior to the sale or exchange. This requirement often causes problems for people on temporary assignment. When you are on assignment overseas, you will not be occupying your residence, and it is not unusual for a two- or three-year assignment to be extended. It is also common for a returning assignee to accept another position with his or her employer in a different location. In these situations, it is possible that you will not meet the two-out-of-five-years use requirement to exclude the gain on the sale of your home.

Furthermore, as noted earlier, if you go on international assignment you may rent your home out while you are away, in order to cover the expenses. This period of rental may create depreciation recapture, as well as a period of non-qualified use if you reoccupy the home when your assignment is over.

Limitations on Deduction of Rental Losses (Passive Activity Loss Limitation)

It is common to keep your home while you are on international assignment, and to rent the property in order to cover the carrying costs. In such cases, the rental income must be reported on your tax return, and you can claim certain deductions against that income. These deductions include items such as mortgage interest, property taxes, insurance, agency commissions, and other operating expenses of the property. Depreciation may also be allowed on the cost of the building, improvements, and furnishings left in the house, but not on the portion of the cost of the property that is attributable to land.

If rental income exceeds the tax deductions related to the property, the net rental income is included in taxable income. On the other hand, if the deductions exceed rental income, the net loss generally cannot be deducted against other ordinary income such as salary, interest, dividends, and active business income. Instead, they can only be deducted against income from other rental properties, and from other "passive activities" such as limited partnerships that you may derive income from. The non-deductible losses, called "suspended loss," are carried forward to the next tax year. In the year the property is disposed of, any remaining suspended loss becomes fully deductible.

However, a special rule allows you to deduct up to USD 25,000 of net rental loss against your ordinary income, if you "actively participate" in the management property. You actively participate if you or your spouse own at least 10 percent of the property, and you perform management functions such as approving new tenants, deciding on rental terms, and approving expenditures. The USD 25,000 amount is phased out if your AGI exceeds USD 100,000, and is fully disallowed if your AGI exceeds USD 150,000 (all these amounts are halved on married filing separate returns). For this purpose, AGI is generally determined without regard to net losses from passive activities and any IRA deductions, but after the reduction for the foreign earned income and housing exclusions.

Comment:

These "passive activity loss limitation" rules, which apply to rental property as well as to any other activities that you do not materially participate in, are very complex. You should seek advice from a tax professional to analyze the effects of these rules on an international assignment.

Vacation Home Rules

Other rules may apply to limit deductible losses if you use your rental property for personal purposes during the year. If you use the property for personal purposes for more than the greater of 14 days or 10 percent of the number of days the home is rented during the tax year, deductions related to the rental use (depreciation, insurance, maintenance, etc.) may be limited to the amount of rental income, meaning that no loss can be created either to be deducted in the current year, or to be carried forward to a future year. "Personal use" of a property includes occupancy by relatives. Losses may not be deducted from rental of a property unless a market rent is paid for use of the property. ("Personal use" does not include any period that the home is your principal residence.) If personal use does not exceed the 14 days/10-percent limitation, then the rental may instead be subject to the passive activity loss limitation rules described above.

Foreign Properties

The rules described above apply to personal residences and rental properties located in foreign countries, as well as those in the United States. However, special depreciation rules apply to foreign properties. These rules generally provide longer useful lives (resulting in a smaller annual deduction) than those allowed for domestic properties, and, therefore, they may make such investments less attractive from a tax standpoint.

Chapter 4 – Foreign Tax Credit

When you live and work in a foreign country, you may be subject to that country's income taxes because you are a resident. Even if you do not meet your host country's definition of a resident, you may still be taxed on the income you earn in that country. As a U.S. citizen or green card holder you will also be subject to U.S. income tax on your worldwide income, which means that while you are working abroad, some or all of your income could be subject to income tax in both countries. To reduce the possibility of being taxed twice on the same income ("double taxation"), the United States allows a credit for foreign tax paid on foreign source income. If you have U.S. source income that is being taxed in your host country, in many cases that country will allow a similar credit. The United States also has tax treaties with many countries, which help to coordinate the foreign tax credits allowed by the two countries. A list of treaty countries is provided in Appendix C.

The amount of foreign tax credit (FTC) that the United States will allow is the lesser of the amount of foreign tax paid, or the amount of U.S. tax on the foreign source income. As an alternative to claiming a FTC, you may deduct the foreign tax paid as an itemized deduction, which, under certain circumstances, can be more beneficial than claiming FTC. However, you cannot claim both a FTC and itemized deductions for foreign taxes in the same year.

Cash Versus Accrual Method

As a general rule, individuals are "cash basis" taxpayers. This means that you recognize income when it is received, not when it is earned, and claim deductions when the expenses are paid, not in the period that the expense relates to. However, in calculating the FTC, you may elect to instead use the "accrual" method, which means you will claim the credit in the period the taxes relate to, not in the year that the taxes are paid. Once you choose to use the accrual method for calculating the FTC, you must use that method in all subsequent years.

Example 1

Flo is a U.S. citizen who lives in France. In 2012, Flo is subject to both U.S. and French income tax on her salary of USD 100,000. No French income tax is withheld on her salary, so Flo pays the entire USD 30,000 of French tax in March 2013. As a cash basis taxpayer, Flo should claim the FTC for the French tax paid in 2013. However, if Flo elects to use the accrual method, she can claim the credit in 2012, because the tax paid relates to income earned in 2012. In Flo's case, the accrual method would be beneficial because it would enable her to claim the credit in the same year the U.S. tax is due on her French income.

Since the election to use the accrual method cannot be revoked, it should be made only after careful consideration and consultation with a tax adviser. In some situations, the accrual method is not beneficial, particularly if you pay tax in a country that does not use the calendar year as its tax year (for example, Australia, whose tax year runs from July 1 of one calendar year through June 30 of the following calendar year). This is because you are not allowed to claim an accrued FTC until the calendar year in which the other country's fiscal year ends.

Example 2

Marco is a U.S. citizen who lives and works in Australia. His salary for the year July 1, 2012 through June 30, 2013, is USD 10,000 per month. Marco's Australian tax is withheld from each paycheck at a rate of USD 3,000 per month. Marco previously lived in France, and elected to use the accrual method

for calculating his FTC while he lived there. He must continue to use the accrual method while he lives in Australia. This means that the entire USD 36,000 of Australian tax must be claimed as FTC in 2013, because that is the U.S. tax year in which the Australian tax year ends. Marco cannot switch back to the cash basis of calculating the FTC, but if he could, he would claim the USD 18,000 that was withheld from his salary during 2012 as FTC in his 2012 U.S. tax return.

Foreign Taxes Eligible for Credit

To claim a tax as a FTC, it must be an income tax, war profits tax, or excess profits tax, or a tax paid in lieu of one of those. Foreign social security taxes can be claimed as additional FTC for income tax purposes, unless they were paid to a country that the United States has a social security totalization agreement with (see Appendix C for a list of those countries). The tax must be paid to a foreign country or its political sub-divisions (*e.g.*, Canadian provinces or Swiss cantons), or to a U.S. possession. Other foreign taxes such as real estate tax, sales tax, value-added tax, turnover tax, luxury tax, wealth tax, or occupancy tax, cannot be claimed as foreign tax credit. It is not always clear whether a certain tax qualifies as a creditable tax, so it is a good idea to consult with a competent tax adviser if there is any question.

Disallowance of Credit Allocable to Exempt Income

As mentioned in Chapter 1, a denial of double benefits rule says that you cannot claim a FTC (or itemized deduction) for foreign taxes paid on income that is exempt from tax in the United States. The principal is that you should never get a benefit for expenses related to income that is not subject to tax. The amount disallowed is proportional to the amount of income that is not subject to tax.

Example 3

Jolene is a U.S. citizen who lives and works in Greece. In 2012, she earns USD 120,000, on which she pays USD 30,000 of Greek income tax. Jolene qualifies for the foreign earned income and foreign housing cost exclusions, which completely offset her earnings. Because none of her Greek salary is taxable in the United States, Jolene cannot claim any FTC for the Greek income tax she paid on her earnings.

Example 4

Same as above, except that Jolene has no qualified housing expenses, so she can claim the maximum foreign earned income exclusion of USD 95,100, but no foreign housing cost exclusion. The portion of Jolene's Greek income tax that relates to the excluded income, USD 23,775, cannot be claimed as FTC (95,100 / 120,000 x 30,000). The remainder, USD 6,225, can be claimed as FTC, or as an itemized deduction (30,000 – 23,775).

Comment:

As discussed in Chapter 1, in some cases it is more beneficial to forego the FEIE, and claim only the foreign tax credit. A qualified tax professional should be able to do a comparative calculation to determine which position would be better in a given year. However, if you determine that it would be better not to claim the FEIE, but you have claimed it in the past, you should weigh the current year benefit of revoking the FEIE against the possible disadvantages of being barred from re-electing the FEIE for the six following years.

Limitation on Credit

As noted above, the FTC is limited to the lesser of actual foreign taxes paid (or accrued), or U.S. tax on foreign source income. Form 1116, *Foreign Tax Credit*, is used to calculate what portion of one's U.S. tax liability is attributable to foreign source income. The calculation is complicated because some deductions are attributed only to U.S. source income, while others are apportioned between U.S. and foreign source income. Additional complications can arise if the individual has long-term capital gains or qualified dividend income, since these categories of income are taxed in the U.S. at special rates. Also, income must be separated into two categories, generally referred to as the "passive basket" and the "general basket." Foreign taxes paid on income in one basket cannot be used as a credit against U.S. tax on income in the other basket.

Example 5

Maria is a U.S. citizen and resident. Maria has foreign source investment income of USD 10,000, on which she paid USD 3,000 of foreign income tax. Maria also worked abroad for two months, and her salary related to the work abroad was USD 20,000. Due to a treaty provision, Maria did not pay foreign income tax on the salary earned abroad. Maria's effective U.S. income tax rate is 20 percent. Assuming that the U.S. income tax on Maria's investment income is USD 2,000, she will have USD 1,000 of excess FTC in the passive basket. Maria cannot use that excess FTC as a credit against the U.S. tax on her salary earned abroad, because compensation is in the general basket, and FTC in one basket cannot offset U.S. tax in the other basket.

Carryback and Carryover of Unused Credits

Individuals with FTCs that exceed the limitation for a year can carry those excess credits back to the prior year, and treat them as if they were credits generated in that year. If they cannot be used in the prior year, they can be carried forward for 10 years. If they are not used in the 10 years following the year in which they were generated, the excess credits expire. Note that because the excess credits were subjected to the denial of double benefits rule in the year they were generated, they are not subject to that rule again in the carryback or carryforward year.

Example 6

Arnold is a U.S. citizen who has several business trips abroad during 2012. His salary attributable to the foreign trips, USD 10,000, is treated as foreign source income. Arnold pays no foreign income taxes in 2012, but his U.S. tax on the foreign source income is USD 2,500.

In 2013, Arnold goes on international assignment. His foreign source earnings in 2013 are USD 120,000, and he pays foreign income tax of USD 40,000 on that amount. Arnold does not elect to claim the FEIE, but claims a FTC of USD 30,000 against the U.S. tax on his earnings, completely offsetting the U.S. tax. Arnold can carry the excess USD 10,000 to the prior year on an amended return, and claim a FTC of USD 2,500 against the U.S. tax on his foreign source income. The remaining USD 7,500 of unused credit will be reflected as carryforward credit in Arnold's 2014 U.S. tax return.

Planning for Use of Excess Credits

It is not uncommon to return to the United States after an international assignment with large FTC carryforwards. Although you may assume that these credits are useless once you are no longer living abroad, that is not always the case. As demonstrated above in the example of a FTC carryback, you only have to have foreign source income to utilize a FTC – it does not have to be foreign source income on

which you paid foreign taxes. So generating foreign source earnings after the end of your assignment may enable you to use your excess credits from prior years. Generating foreign source income that may not be subject to foreign income tax includes:

- Receiving taxable pension and profit-sharing distributions attributable to services that were performed abroad.
- Stock option income attributable to periods of international assignment or business travel.
- Business trips abroad, either before or after moving to the location of the international assignment. Income would be attributed to the work days abroad and would be considered foreign source income and possibly not taxed in a foreign country.
- Going on a second international assignment to a country with tax rates lower than U.S. rates.

Comment:

If you were subject to a tax reimbursement policy while you were on your international assignment, it is possible that your employer was paying your foreign taxes on your behalf. If that is the case, then any reductions in your post-assignment U.S. tax liability due to FTC carryforwards or carrybacks would be the result of credits that were financed by your employer, and your employer may expect you to surrender any refunds attributable to these FTCs. Many tax reimbursement policies address this issue and may require that you track your post-assignment overseas business trips, which may allow for some of the FTC carryforwards to reduce your tax bill even after you have returned from international assignment. This FTC carryforward may belong to your employer who could require that it be repaid.

Chapter 5 – Special Rules for Self-Employed Individuals

If you are self-employed and living abroad, you may find that the foreign earned income and foreign housing cost exclusions discussed in Chapter 1 are less advantageous and more complex than they are for employees.

Foreign Earned Income Exclusion (FEIE)

The principles of qualifying for the FEIE are the same whether you are self-employed or an employee. However, there may be a limitation on the amount that you can claim as foreign earned income. First of all, the FEIE is applied to your income before expenses (gross receipts). If your business is to provide personal services, such as a doctor or lawyer, all of your income is characterized as "earned." If not, the amount of your gross receipts that can be characterized as "earned" cannot exceed 30 percent of the net profits of your business. In many cases this may mean that the maximum allowable FEIE is less than the annual maximum (USD 95,100 for 2012, and USD 97,600 for 2013).

Disallowance of Business Expenses

As we discussed in Chapter 1, the denial of double benefits rule prevents you from claiming a deduction for expenses that relate to excluded income. If you are self-employed and claim the FEIE against some of your gross receipts, this means that a portion of your business expenses will be disallowed. Because the FEIE is applied to gross receipts rather than net income, it may be less beneficial to you than it would be to an employee.

Example 1

Peter, Paul, and Mary are U.S. citizens who live abroad and qualify for the FEIE for all of 2012. Peter is a salaried employee, Paul is a self-employed attorney, and Mary is a self-employed manufacturer.

(All figures USD)	Peter: Salaried Employee	Paul: Self-Employed Attorney	Mary: Self-Employed Manufacturer
Gross income	95,100	145,100	225,100
Business expenses	0	(50,000)	(130,000)
Net income	95,100	95,100	95,100
Earned income exclusion	95,100	95,100	28,530*
Disallowed expense:	0	(95,100 / 145,100 x 50,000) = 32,771	(28,530/ 225,100 x 130,000) = 16,477
Calculation of taxable earnings:			
Gross income	95,100	145,100	225,100
Earned income exclusion	(95,100)	(95,100)	(28,530)
Taxable gross income	0	50,000	196,570
Business expenses		50,000	130,000
Disallowed expenses		(32,771)	(16,477)
Allowable expenses		17,229	113,523
Net taxable earnings	0	32,771	83,047

* Limited to "reasonable earned income," up to a maximum of 30 percent of net income.

Foreign Housing Cost Deduction

If you are self-employed, you are not allowed to claim the foreign housing cost exclusion. Instead, you can claim a deduction that is calculated the same way as the foreign housing cost exclusion. This foreign housing cost deduction is limited to the amount of foreign earned income that you have in excess of the foreign earned income exclusion. Because of the way that the stacking rule (see Chapter 1) and the denial of double benefits rule work, in some cases this foreign housing cost deduction may be more advantageous than the foreign housing cost exclusion that you would be entitled to if you were an employee.

Self-Employment Tax

As a U.S. self-employed taxpayer, you must continue to pay self-employment tax (which is social security tax for self-employed people) even when you are living abroad, and even if you are also paying social security tax in your country of residence. The self-employment tax rate is 13.3 percent of net earnings up to a base amount in 2012, and 15.3 percent of net earnings up to a base amount in 2013. The base amounts are USD 110,100 in 2012 and USD 113,700 in 2013. Earnings in excess of these wage limits are taxed at 2.9 percent, while earnings in excess of USD 200,000 (USD 250,000 for a married couple filing jointly) are taxed at 3.8 percent (due to an additional 0.9-percent tax on high-wage earners). Net earnings subject to self-employment tax are figured without taking the FEIE into account.

These rates are higher than the FICA* tax that is withheld from an employee's wages, because when you are subject to FICA, your employer pays additional FICA related to your wages. (See Chapter 6 for a discussion of FICA, which is the social security tax for employees.) When you are self-employed, you are effectively paying both the employer and employee taxes, so in 2012 you are allowed a deduction for 0.596 of the 13.3-percent tax, and half of the 2.9-percent tax. In 2013 this will change to one-half of the 15.3-percent and 2.9-percent taxes, but none of the 0.9-percent tax.

* Federal Insurance Contributions Act, or FICA, refers to U.S. social security and Medicare taxation

Social Security Totalization Agreements

If you are self-employed and working in a country that has a Social Security Totalization Agreement with the United States, you may be exempt from self-employment tax. (See Appendix C for a list of countries that have such agreements.) See the United States Social Security Administration Web site (www.ssa.gov/international) for more information regarding how to determine if one of these agreements applies to you.

Partnerships

If you are a service partner in a service partnership (such as a law firm), you are considered to be self-employed for U.S. tax purposes, which means that you are subject to self-employment tax, and your FEIE is calculated as described in this chapter. Also, when determining the portion of your partnership income that can be considered foreign earned income, in general you must look not to what proportion of your services were provided outside the United States, but rather what proportion of the partnership income as a whole was earned outside the United States. This means that even if you are a partner who works exclusively outside the United States, but your partnership earns income in the U.S., a portion of your partnership income will not be eligible for the foreign earned income exclusion. However, the rules may be different if you receive a "guaranteed payment," or if you receive a special allocation of overseas profits, from the partnership. These rules are very complex and therefore you should consult with a tax

professional who is familiar with the rules before commencing an international assignment as a partner in a partnership.

Partners in Foreign Partnerships

If you are a partner in a foreign partnership, the rules regarding taxation of your partnership income are the same as described above. However, there are special reporting requirements for U.S. partners of foreign partnerships, so be sure to discuss your situation with a qualified tax professional.

Chapter 6 – Other Tax Considerations of Overseas Residents

Treaties

If you are a resident of a country that shares a tax treaty with the United States, or if you receive income from one of those countries, you may be able to claim benefits allowed by the treaty to lower your overall tax burden. In most cases, treaties limit individuals' exposure to foreign income tax, but allow their U.S. income tax to remain what it would be without the application of a treaty. If you are able to claim the benefit or a treaty to lower your U.S. tax, you may have to disclose that fact by attaching Form 8833, *Treaty-Based Return Position Disclosure*, to your U.S. income tax return. You can find a list of countries that have tax treaties with the United States in Appendix C.

Social Security Taxes

When you are working abroad for an American employer, you may be subject to both U.S. and foreign social security taxes. However, if you are employed by a foreign employer, including a foreign subsidiary of a U.S. company, in most cases you will not be subject to U.S. social security and Medicare tax (often called "FICA" tax). Special exceptions apply if the U.S. parent company has elected to continue FICA coverage while you work abroad (this is unusual), or if you work for a foreign employer that is controlled by a U.S. company and you are providing services in connection with a U.S. government contract.

In general, FICA tax is imposed at 7.65 percent on compensation up to an annual maximum (the "OASDI wage base"), and 1.45 percent on compensation over the OASDI wage base. Your employer also pays a payroll tax at the same rate. (The OASDI wage base is USD 110,100 in 2012, and USD 113,700 in 2013.) For 2011 and 2012 only, the employee tax on compensation up to the OASDI wage base was lowered to 5.65 percent (the employer tax remained at 7.65 percent). Compensation in excess of USD 200,000 (combined compensation of USD 250,000 for a married couple filing jointly) is subject to an additional 0.9-percent tax. Your employer is required to withhold FICA tax from your wages. The FEIE (discussed in Chapter 1) cannot be claimed against your compensation when calculating your FICA tax.

Although income tax treaties do not address the possibility of being double taxed (*i.e.*, taxed in two countries on the same income) for social security purposes, 24 countries have special agreements called Social Security Totalization Agreements (SSTAs) that help prevent double social security tax. (See Appendix C for a list of countries that have SSTAs with the United States.) For individuals who are working in a country that has a SSTA with the United States, the default rule is that they will be subject only to the host country social security tax, and will be exempt from FICA. However, if you were sent on temporary assignment to the other country by your current employer, you may qualify under an exception in the SSTA that makes you exempt from the host country social security tax, and allows you to continue to pay FICA tax instead. If this exception is available, your employer should do the necessary paperwork on your behalf.

If you are working abroad in a country that does not have a SSTA with the United States, you can generally claim the foreign country's social security tax as an addition to your FTC (see Chapter 4 for a discussion). However, you cannot claim a credit for social security tax paid against your FICA tax liability.

Foreign Currency Exchange Rules

You must report your income and deductions on your United States tax returns in U.S. dollars (USD). Income received and expenses paid in a foreign currency should generally be converted to U.S. dollars using the exchange rate at the date of receipt or the date of payment, although under some specific

circumstances it may be appropriate to use an average exchange rate for the year. When calculating your capital gains and losses, you must use historical exchange rates, which means that you could have a gain or loss in USD even though you did not in the foreign currency.

Example 1

Paul purchased 100 shares of stock in a British corporation for GBP 10 per share, when the exchange rate was GBP 1.00 = USD 1.90. Two years later, he sold the stock for GBP 11 per share, at a time when the exchange rate was GBP 1.00 = USD 1.60. Paul received GBP 1,100 for shares he had paid GBP 1,000 for, a gain of GBP 100. However, for U.S. tax purposes, Paul will be treated as having received USD 1,600 for shares he had paid USD 1,900 for, realizing a capital loss of USD 300.

Example 2

Art purchased 100 shares of stock in a Canadian corporation for CAD 10 per share, when the exchange rate was CAD 1.00 = USD 0.85. Two years later, he sold the stock for CAD 10 per share, at a time when the exchange rate was CAD 1.00 = USD 0.98. Although Art had no gain or loss when measured in Canadian dollars, for U.S. tax purposes, he will be treated as having received USD 980 for shares he had paid USD 850 for, realizing a capital gain of USD 130.

Community Property Rules

Some U.S. states* impose "community property" rules which provide that most marital income and assets are the property of both spouses, regardless of which spouse earned the income. Community property rules generally have no impact on a married couple that files a joint return. However, the impact on the tax liability of married couples that file separate returns, can be significant. Community property rules are not applied to earned income of a married couple if either spouse is a nonresident alien, or when calculating the foreign earned income exclusion. Community property provisions and restrictions on such reporting are complex. If you live in, or are on assignment from, a community property state, you should consult a tax adviser regarding how the rules may apply to you.

* Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin. Community property rules may also apply to some same-sex couples, although because they are not considered married for federal tax purposes, the rules are applied somewhat differently.

Alternative Minimum Tax and Minimum Tax Credit

If you have a relatively high level of income and have high levels of deductions or tax credits, you may be subject to the alternative minimum tax (AMT), which was put in place so that the taxpayers at higher income levels pay at least a minimum amount of tax. AMT is calculated by disallowing many tax deductions, including those for state income tax and property tax, and applying a large flat exemption amount (see Appendix D for the exemption amounts). The resulting AMT income is taxed at 26 percent on the first USD 175,000 in 2012 (28 percent for AMT income over USD 175,000 in 2012 and USD 179,500 in 2013; half those amounts for a married taxpayer filing separately). If the resulting AMT is higher than your regular tax liability, you must pay the higher amount. The FTC as well as most other common tax credits are also allowed against alternative minimum tax.

If you are subject to AMT in a given tax year, this may result in a special tax credit called the minimum tax credit (MTC) in a subsequent year. Paying AMT does not automatically result in a MTC – you are entitled to a MTC if part of your AMT liability was generated for specific reasons, such as having

exercised incentive stock options, or having claimed depreciation deductions on business or rental property. You are allowed to claim the MTC in a year that you are not subject to AMT, and you cannot use the MTC to lower your regular tax liability to below what your AMT would be.

Comment:

Because of assignment-related allowances and reimbursements, you may be subject to AMT while you are on international assignment, even though you have never paid AMT before. Calculating the AMT, the AMT foreign tax credit, and the MTC, are quite complex, and it is recommended that you consult your tax adviser if you are, or ever have been, subject to the AMT.

Net Investment Income Tax

Beginning in tax year 2013, a new Net Investment Income Tax (NIIT) will apply to the net unearned income of certain taxpayers. Net unearned income is an individual's investment income, plus other passive income such as rental income, reduced by directly-related expenses. The NIIT tax rate is 3.8 percent and applies to the lesser of an individual's net unearned income, or the excess of his or her modified AGI over a threshold amount. The threshold amount is USD 250,000 for married taxpayers filing jointly, USD 125,000 for married taxpayers filing separately, and USD 200,000 for all others. If you are on an international assignment, you may find yourself liable for this tax, due to the extra taxable assignment-related allowances you may receive.

State Income Taxes

Depending on the state you live in, the length of your international assignment, and the connections you maintain with the state in your absence, including whether you maintain a residence there, you may continue to be subject to state income tax while you are living abroad. Tax law varies greatly from state to state, so to determine whether you will be subject to state income tax while you are on assignment, it is important to review your particular set of circumstances with your tax adviser. If you are subject to state income tax, be aware that many states do not allow the FEIE or the FTC that you might qualify for at the federal level.

Expatriation

People who give up U.S. citizenship or who give up their green card (this is known as "expatriation") may be subject to a special exit tax. Green card holders are covered only if they are considered to be a "long-term permanent resident," which is the case if they have had green card status in eight years during the 15-year period ending in the year of expatriation. If you are a long-term green card holder but choose to be treated as a nonresident of the United States under a tax treaty, you will be treated as if you gave up your green card.

The exit tax applies if you give up your citizenship or green card, on or after June 17, 2008, but only if you meet one of the following conditions:

- Your average annual U.S. net income tax liability over the five years before the year of expatriation is greater than USD 151,000 in 2012 or USD 155,000 in 2013;
- Your net worth is USD 2 million or more on the date of expatriation (this amount is not indexed for inflation); or
- You fail to certify that you have complied with U.S. tax laws for the five preceding tax years.

Narrow exceptions apply to certain U.S. citizens with dual nationality.

If you are subject to the exit tax, you are known as a "covered expatriate" and treated as if you have sold all your property at its fair market value on the day before your date of expatriation. Any resulting gains in excess of an exclusion amount (USD 651,000 for 2012; USD 668,000 for 2013) are subject to income tax. For the purposes of calculating this "deemed gain" on property that you owned when you first became a U.S. resident, you are treated as if you acquired that property for its fair market value on the date that you became a U.S. resident, if that amount is higher than the actual cost of acquisition.

Special rules apply to items of deferred compensation, certain tax-deferred accounts, and any interest in a nongrantor trust. An election is available to postpone payment of the exit tax on a given asset until that asset is actually sold, by posting adequate security and paying interest.

Estate and Gift Taxation

If you give someone a large gift, or if you leave property to someone when you die, the value of those transfers of property may be subject to the U.S. gift and estate tax, a tax that is payable by you as the person who gives the property, rather than by the person who receives it. In addition, some U.S. states also impose an estate or inheritance tax.

If you are a U.S. citizen, or if you are domiciled in the United States, the gift and estate taxes are coordinated in one unified system. "Domicile" is different from residency – you are considered to be domiciled in the United States if you reside in the U.S. and intend to remain there indefinitely. If you have a green card, you will probably be considered to be domiciled in the United States.

As a U.S. citizen or domiciliary, you are allowed to give up to USD 13,000 in 2012 and USD 14,000 in 2013 tax-free, to each separate person you give gifts. If you are married, you and your spouse can together give up to twice those amounts to each person you give gifts, if you and your spouse are both either U.S. citizens or domiciled in the United States. (In that case you and your spouse are considered to have split the gift evenly.) The concept of domicile is similar to residency, but you may be domiciled in the U.S. even if you are a nonresident alien, if you intend to return to the United States and consider it to be your permanent home. You are also allowed unlimited gifts to your spouse, if your spouse is a U.S. citizen. Otherwise, you are allowed to make gifts to your spouse of up to USD 139,000 per year in 2012, and USD 143,000 in 2013.

If you make any gifts in excess of these annual limits, the excess is defined as "taxable gifts," which you must track and report on an annual gift tax return. When your cumulative taxable gifts exceed a lifetime maximum of USD 5,120,000 in 2012 or USD 5,250,000 in 2013, the excess is subject to gift tax at a maximum rate of 35 percent in 2012 and 40 percent in 2013.

At death, the estate tax may apply. The taxable value of your estate (*i.e.*, the property you leave) is the value of all your property at the date of your death, reduced by liabilities, transfers to your spouse who is a U.S. citizen, and bequests to U.S. charitable organizations. Your taxable estate is then reduced by any portion of the USD 5,120,000 / USD 5,250,000 exclusion that has not already been claimed against taxable gifts, and the remainder is taxed at a maximum rate of 35 percent in 2012 or 40 percent in 2013.

As mentioned above, any property you leave to your spouse is not subject to the estate tax *if* your spouse is a U.S. citizen (or becomes one soon after you die). Generally, no deduction is allowed for property that is left to a spouse who is not a U.S. citizen. Careful estate planning can help to mitigate this

advantage. If you are concerned about the taxation of your estate, you are highly advised to consult with a professional who specializes in this area.

Foreign Tax Planning

Individual income tax rates vary widely from country to country, and in many locations are higher than those in the United States. Marginal rates (*i.e.*, being in the "28-percent bracket") are only part of the story – many countries allow fewer deductions than U.S. taxpayers are accustomed to, and in most countries, a taxpayer finds himself/herself paying the highest rate of tax at a much lower level of income than in the United States. For these reasons, planning in advance for the impact of foreign taxes can have a significant effect on the cost of an international assignment. Even if your employer reimburses you for foreign taxes on your wages, it is necessary to be aware of how your investment and other income will be treated. (See Chapter 8 for a discussion of tax reimbursement.)

Often the timing of a transaction will determine whether it is subject to tax in your host country. Many countries apply the same principle as the United States to resident taxation: residents are taxed on all income from all sources, while nonresidents are taxed only on income from within that country. It is very important, therefore, to determine when you become a resident of your host country, and to know in advance how those rules work.

Example 3

Roger is a U.S. citizen who is selected by his employer to go on assignment to Spain. He decides to sell his home in Chicago, rather than retain it while he is living in Spain. He puts his home on the market immediately, but does not close the sale until two weeks after he establishes residence in Spain. Roger realizes a gain of USD 200,000 on the sale of the home, which qualifies for the special exclusion for gain on sale of a primary residence (see Chapter 3), making the sale tax-free in the United States. However, because the sale is concluded after Roger has become a resident of Spain, the sale is taxable there. If Roger had been able to time his assignment so that his resident status in Spain did not begin until after the sale of his home had been completed, the gain on the sale would not have been taxable in Spain.

You may also find that your employer structures the delivery of certain allowances and reimbursements in ways that are most tax effective in the host country. For example, in the United States, if your employer pays for your housing, the same amount will be included in your income regardless of whether you are reimbursed as opposed to the employer paying your landlord directly, and regardless of in whose name the lease is. In some countries, though, these facts can result in very different results. Sometimes these tax planning considerations may require some action on the employee's part, which is one reason why a pre-assignment meeting with a tax professional can be an important element in potentially lowering the overall cost of the international assignment.

Chapter 7 – Procedural Aspects

As a U.S. citizen or permanent resident ("green card" holder), you are subject to U.S. tax law even if you live outside the United States. This means that you may have a U.S. tax liability, and that you may have to file U.S. tax returns even if you do not have any tax to pay. However, many of the procedural rules regarding filing your tax return are different when you live abroad.

Tax Return Filing

Where to File

If you are claiming the FEIE or the foreign housing cost exclusion, or if you live outside the United States, you may be required to mail your tax return to a different address than you used previously. These addresses can change from year to year, so check the tax return instructions or follow the instructions of your tax return preparer.

The IRS has offices in a number of U.S. embassies abroad, and those offices often accept filing of U.S. income tax returns. If you plan to file your return at a U.S. embassy or consulate, you should ascertain in advance that the one you intend to use has an IRS office that accepts U.S. tax returns.

Due Dates and Extensions

U.S. citizens and residents must generally file their tax returns by April 15, but if you are residing abroad on that date, you get an automatic two-month extension to June 15. (Any due date that falls on a Saturday, Sunday, or holiday is also extended to the next weekday that is not a holiday.) If you qualify for this automatic extension, there is no special form to file, but you should attach a statement to your tax return explaining that you qualify for the automatic two-month extension. Be aware that tax return extensions are not extensions of time to pay your tax – any tax paid after April 15 will be subject to interest, and possibly penalties, even if the return has been extended.

If more time is needed to prepare your tax return, you can get an automatic extension to October 15 by filing Form 4868, *Application for Automatic Extension of Time to File U.S. Individual Income Tax Return.* For the extension to be valid, you must file Form 4868 by the tax return due date (generally April 15 or June 15 as discussed above), and you must make a reasonable estimate of your tax liability. If you anticipate owing tax with your tax return, you should pay it by April 15 to avoid interest and penalty charges.

If your tax return was due on June 15 because you were residing abroad on April 15, and you still need more time to finish your return after October 15, you can request an additional extension to December 15 by sending a letter to the IRS explaining why you need additional time. The IRS can approve or reject this request at its discretion.

Finally, a special extension past December 15 is available if more time is needed to meet the time requirements necessary to claim the foreign earned income and foreign housing cost exclusions (see Chapter 1 for a discussion of these time requirements). You are not allowed to claim these exclusions in your tax return until you actually qualify for them, and in many cases this means waiting a full year to file your tax return. In such cases, you should file Form 2350, *Application for Extension of Time to File U.S. Income Tax Return*, by the original due date of the return. The IRS will respond with a reply regarding whether the extension has been granted. In most cases the latest date the tax return can be extended to is January 30 of the year following the original due date.

Example

Patricia is a U.S. citizen who begins her international assignment during 2012. Due to frequent trips back to the United States, she will not be able to use the physical presence test to qualify for the foreign earned income exclusion. Patricia has established her bona fide residence in Brazil, but she cannot claim the bona fide residence test to qualify for the FEIE until her period of bona fide residence abroad includes one full calendar year. In Patricia's case, that means that she cannot claim the FEIE in her tax return until after the end of 2013. If Patricia files Form 2350 by April 15, 2013, her 2012 tax return filing due date can be extended to January 30, 2014.

No matter what kind of tax return extension is applied for, the extension request should be mailed to the same IRS office where you expect to file your return. To be considered as filed on time, the tax return should be postmarked by the due date of the return. Foreign postmarks are acceptable for this purpose. You can also ship the return by the due date via a private delivery service such as UPS, DHL, or FedEx, but the IRS does not accept all delivery modes offered by such vendors. If you plan to use a private delivery service, you should check the tax return instructions to see which services are acceptable.

Filing Status and Requirements

U.S. citizens and green card holders must file a U.S. tax return if their gross income (without taking into account the FEIE) exceeds a certain level (see Appendix D for 2012 and 2013 minimum filing requirements). If you are married* and both you and your spouse are U.S. citizens or residents for the entire year, you have the choice of filing jointly, or filing separate returns. (In many cases, filing jointly is more advantageous, however, you may wish to consult with a tax adviser regarding your filing status.) If you are not married, you must file as single, unless you support a dependent who lives with you (or supply a home for your dependent parent), in which case you may qualify for the more advantageous "head of household" status.

If you are married and either one of you is a nonresident alien at any point during the year, then in general you must file your return using "married filing separate" status. However, you may be able to make a special election to be treated as if you were full-year residents, enabling you to file your tax return jointly. In general, this election is made because filing jointly can be more beneficial than filing separately. Please note, making the election may cause some income to be subject to U.S. income tax that otherwise would not have been, the election can be made only once, and in some cases the election is binding in all future years. Therefore, whether or not to elect this treatment should be considered carefully with the advice of a qualified tax adviser.

If you are married to a nonresident alien who has no U.S. tax filing obligation, you may qualify to claim "head of household" status, as mentioned above. Note that to claim someone as your dependent, that person must be either a U.S. citizen, or a resident of the United States, Canada, or Mexico.

* The U.S. government does not recognize same-sex marriage, so if you are married to a person of the same sex, you cannot file as married at the federal level (although you may in some U.S. states) and therefore each of you must file as single.

Interest and Late Filing Penalties

If you pay any part of your tax liability after the unextended deadline of the tax return, the IRS will charge interest on that amount. Extensions of time to file the return do not prevent this interest charge.

In some cases, you may also be assessed a penalty for paying your tax after the due date. If assessed, this penalty runs at 0.5 percent of the amount due per month. As noted above, if you file an extension of time to file your return, you should estimate the amount that will be due with your return, and pay that amount with the extension. However, even if you cannot pay, you should still file the extension, because the penalty for filing a return late is much higher than the penalty for paying your tax late – the late filing penalty is 5 percent of the amount due per month. (In a month that you are subject to both penalties, you pay 5 percent a month, and the two penalties together cannot exceed 25 percent.)

There is one other reason to be sure you request an extension if you will not be able to file your return by April 15: filing late may jeopardize your ability to claim the foreign earned income and foreign housing cost exclusions.

Estimated Tax Payments

Another penalty for under-payment of estimated taxes applies if you do not pay at least 90 percent of your tax liability over the course of the year, where the amount due with your tax return is more than USD 1,000. You can also avoid the penalty if the amount of tax paid during the year is at least as much as your prior year tax liability. (If your AGI is over USD 150,000, or USD 75,000 if you are married filing separately, then you must pay at least 110 percent of the prior year's tax liability to qualify for this exception.) To avoid the penalty by paying the prior year's tax liability, you must have filed a tax return in the prior year, as either a U.S. citizen or a full-year U.S. resident.

If the income tax withheld by your employer is not sufficient to avoid this penalty, you should make additional estimated tax installment payments. These payments should be made with Form 1040-ES, *Estimated Tax for Individuals*, and are due on April 15, June 15, and September 15 of the tax year, and January 15 of the following year.

Comment:

Many taxpayers adjust their income tax withholding to cover their entire tax liability. In many cases, employer withholding is reduced or eliminated while a person is on international assignment, so it is important to determine whether you should be making estimated tax payments while you are on assignment, even if you have never made them before.

U.S. Withholding Taxes

While you are working abroad, you may continue to be subject to U.S. income tax withholding. If you want your employer to stop withholding income tax, either because you expect to claim the benefit of the FEIE, or because you will be able to claim FTCs, you may be able to lower or eliminate your tax withholding, for one of several reasons:

- If your earnings are subject to mandatory foreign income tax withholding, your employer is not required to withhold U.S. income tax.
- If you expect to qualify for the FEIE, you can provide your employer with Form 673, *Statement for Claiming Exemption from Withholding on Foreign Earned Income Eligible for the Exclusion(s) Provided by Section 911*, which allows the employer to stop withholding on the portion of your earnings that will be covered by the exclusions.

- If you expect to offset some or all of your U.S. income tax with FTC, you can provide your employer with Form W-4, *Employee's Withholding Allowance Certificate*, indicating sufficient withholding allowances to reduce your tax to the appropriate level.

Determining whether your U.S. income tax withholding should be reduced or eliminated while you are on international assignment can be a very complicated calculation, particularly if you have investment or business income to consider. Additional complexity is introduced if you are subject to an employer tax reimbursement policy (see Chapter 8 for a discussion of this topic). It is strongly suggested that you have a tax professional assist you with making these calculations.

Amended Returns

Being on an international assignment (or previously having been on one) makes it much more likely that at some point you will need to amend a tax return. The complexities of international payroll may result in your receiving an amended Form W-2 (Form W-2c), and you may have excess FTC that can be carried back to the prior year, or subsequent payments of foreign tax may change the amount of a previously-claimed foreign tax credit.

Although the form for filing an amended tax return, Form 1040X, is simple, the supporting calculations can be complex, and may require the assistance of a tax professional. You should file your amended return with the same IRS office where the original return was filed, generally within three years of the due date of the original return, although changes to your FTC are allowed for 10 years from the due date of the original return.

Foreign Bank and Financial Asset Reporting

You must file Form TD F 90-22.1, *Report of Foreign Bank and Financial Accounts* (often referred to as the "FBAR"), if you have a financial interest in or signature authority over foreign bank, securities, or other financial accounts, both business and personal, that exceed USD 10,000 in aggregate value at any time during the calendar year. The report is filed separately from your income tax return, and must be received by the IRS no later than June 30 of the year following the tax year. Significant penalties may be assessed for failure to file.

In addition, a special report must be attached to your tax return if the value of your foreign financial assets exceeds certain thresholds that vary depending on marital status and whether you live in the United States or abroad. Foreign financial assets include (but are not limited to) bank accounts, investments, and pensions. This report, Form 8938, *Statement of Specified Foreign Financial Assets*, is required in addition to Form TD F 90-22.1, mentioned above.

Creation of or Transfers to Certain Foreign Trusts

If you are a U.S. citizen or resident and you create a foreign trust, or transfer property to a foreign trust, you are required to file an information return, Form 3520, *Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts*, within 90 days of the creation or transfer. Failure to file may result in civil penalties unless reasonable cause can be established.

Foreign Corporations and Other Foreign Entities – Owners, Officers, and Directors

If you are a U.S. citizen or resident who is an owner, officer, or director of a foreign corporation, it is important to be aware that you may have to include a special information report with your tax return – Form 5471, *Information Return of U.S. Persons with Respect to Certain Foreign Corporations*. The form

applies to several categories of individuals, and the information that must be reported varies depending on which category you are in. Other special information reports apply if you are a partner in a foreign partnership, if you receive a large gift or inheritance from a foreign source, if you give money to or are a beneficiary of a foreign trust, or if you own stock in a "passive foreign investment corporation" (such as a foreign mutual fund).

The penalties for failing to file any of these reports can be quite high, so it is important that you consult with your tax adviser about any foreign investments you may have.

Passive Foreign Investment Companies

If you invest in a passive foreign investment company (PFIC), such as a foreign mutual fund, you must pay tax and an interest charge on any gain derived from the sale of the investment or on an excess distribution from the PFIC. However, you can elect to treat the PFIC as a "qualified electing fund." If you do this, you will generally be taxed on your share of the PFIC's annual undistributed earnings unless you elect to defer the tax. However, as part of the election, the PFIC must agree to disclose certain information on ownership and earnings to the IRS. Before investing in a PFIC, you should consult a U.S. tax adviser. Investment in a PFIC is reported on Form 8621, *Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund*.

In addition, new rules require that taxpayers who have an ownership interest in a PFIC must report this annually with their tax return on Form 8621. The Form 8621 has recently been revised, but the section relating to the new reporting rules is still reserved until further guidance is issued.

Foreign Partnerships

If you are a partner in a foreign partnership, you must disclose certain information on Form 8865, *Return of U.S. Persons with Respect to Certain Foreign Partnerships*. In addition, certain foreign partnerships with U.S. partners or U.S. operations must file U.S. partnership returns. Failure to file can result in the disallowance of losses and credits to the U.S. partners, including resident aliens.

Currency Restrictions and Reporting

The United States imposes no restrictions on bringing money into or out of the country. However, if you transport or receive more than USD 10,000 of cash or monetary instruments in or out of the U.S., you must report it within 15 days. "Transportation" includes physically carrying currency as well as mailing, shipping, or causing currency to be carried, mailed, or shipped. The report is made on FinCEN Form 105, *Report of International Transportation of Currency or Monetary Instruments*, which must be filed in accordance with the instructions on the Form.

An exception to the filing requirements applies to funds transferred through normal banking procedures if no physical transportation of currency or monetary instruments is involved.

Chapter 8 – Employer Tax Reimbursement Policies

If you are an American who moves abroad to take a job with a foreign employer, or if you already live abroad, you probably participate fully in the local economy, with a salary in local currency, paying taxes in that country as any other employee there would. On the other hand, if your U.S. employer sends you on an international assignment that is not open-ended, your finances may be more complicated. You may receive your compensation in a combination of U.S. dollars and local currency, and your employer may provide special incentives and allowances to help you cope with differences in the cost of housing and other living expenses. These special items generally must be included in your taxable compensation, and that fact combined with the higher tax rates imposed by many countries mean that your annual tax bill may be higher than it was before you went on assignment.

For this reason, many multinational employers have in place a tax reimbursement policy. Every company's policy is different, but broadly stated, the goal of such a program is to lower an assignee's exposure to higher tax rates and taxes on assignment-related allowances. Most such policies can be grouped into one of two types: tax equalization and tax protection. This chapter will discuss how these programs generally work.

Tax Equalization

The idea behind tax equalization is that taxes should be a neutral factor in assignees' compensation packages when they go on international assignment. In other words, you should continue to have a tax burden equal to what you would have had at the same level of compensation if you had remained in the United States. This should remain true whether the host country tax burden is higher or lower than that in the United States. Tax equalization helps remove the burden of taxes from the assignee with respect to assignment-related elements of compensation, such as cost-of-living allowance, education and travel reimbursements, etc., because the employer pays the tax on these items on behalf of the assignee.

Tax equalization can be complicated to administer, since responsibility for the employee's taxes is split between the employee and the employer. However, there are potential advantages for both the employer and the employee. For the employer, tax equalization can lower the overall cost of an international assignment program, if assignees are employed in both high- and low-tax countries. For you as the assignee, tax equalization means that your tax burden is more predictable and can make your cash flow more even than it might be under tax protection, or if you are responsible for paying your own foreign taxes.

Tax Protection

The concept of tax protection is that you as the assignee will be reimbursed if your overall combined foreign and U.S. tax burden is higher than what you would have paid on the same level of income if you were not on assignment. On the other hand, if the combined tax burden is lower than it would have been if you were not on assignment (generally because the foreign tax rate is low and you are able to claim the FEIE), under tax protection you would be entitled to retain the financial benefit.

From the employer's standpoint, tax protection can be problematic because it may detrimentally influence employee mobility – if you are offered identical assignments in Saudi Arabia (with no income tax) and Belgium (with a high income tax rate), tax rates might enter into your willingness to accept one assignment or the other, in a way that they would not if your employer utilized tax equalization. Similarly, if the host country's tax laws change to increase taxation during an employee's assignment, the loss of

the former "benefit" may cause economic difficulties to the employees and create morale problems, even though, in theory, they are no worse off than in the United States. In addition, tax protection is often administered in a way that requires you to pay your own foreign and U.S. taxes through the year, and then "true up" with your employer after your tax returns are prepared. This can have a significant impact on your cash flow, and means that you may have to deal with the foreign tax system more than you would under tax equalization.

Comment:

Tax protection is most often used by employers that have only a small number of international assignees, who do not go on serial assignments from one country to another. In this case, the possibility of benefiting from a lower overall tax burden can become part of the incentive for accepting the international assignment.

Hypothetical / Theoretical Taxes

Whether your employer applies tax protection or tax equalization, a key element is the determination of the amount of tax that you as the assignee would have paid on your level of compensation if you had remained in the United States. This is generally referred to as hypothetical or theoretical tax. (Some employers use the terms interchangeably, while others use the term "hypothetical tax" to refer to the amount that is withheld from an assignee's paycheck, and "theoretical tax" refers to the final year-end tax liability calculated as if you had not been on assignment.)

Because your circumstances are different while you are on assignment, the precise amount that you would have paid if you had not been on assignment generally cannot be determined. Instead, the tax reimbursement policy may address certain items to help provide greater certainty and predictability. As one example, while you are on assignment, you may no longer have itemized deductions because you may no longer own a home and may no longer be paying state income tax, yet determining what your "stay-at-home" tax would have been necessitates making an assumption about your hypothetical itemized deductions. Your employer's tax reimbursement policy may spell out what assumptions to make in this and similar situations.

Another important determination a tax reimbursement policy may set forth is whether the assignee will be subject to hypothetical state income tax while he or she is working abroad. Some employers charge the state tax of the employee's home state, while others may charge the tax of the company headquarters state, or may charge state tax only if the employee continues to be subject to actual state income tax while he or she is working abroad. Since tax reimbursement is a company policy, and is not governed by any law, your company's policy will likely have been designed with reference to your company's industry, its competitors, and what makes sense in the context of the company's business and corporate culture.

Comment:

If your company's tax reimbursement policy sets the amount of hypothetical itemized deductions according to a formula that does not take your actual expenses into account, you may find it more beneficial to postpone discretionary deductible expenditures such as charitable contributions until after your assignment is over and you are no longer subject to your employer's tax reimbursement policy.

Personal Income and Losses

The primary objective of many employer tax reimbursement plans is to relieve excessive taxation on employment income, including expatriate allowances. Many tax equalization and protection plans, therefore, cover only taxes on employment-related income.

However, many countries tax residents on their worldwide income, including personal income, at rates that, in many cases, are higher than in the United States. For that reason, if you have significant personal income (*e.g.*, income from investments or rental properties), you may pay a higher tax rate on that income by virtue of being on an international assignment. To address this problem, many companies' tax reimbursement policies cover personal income, either in full or subject to limits.

Administration of Tax Equalization/Protection Plans

Many complex tax calculations are required to properly administer tax reimbursement policies for international assignees. Hypothetical taxes must be calculated, and actual foreign and U.S. taxes, either on company income or total income, must be verified. Exchange rates for conversion into dollars may vary when foreign taxes are finally paid, and foreign tax assessments may be incorrect and subject to challenge to prevent over-payment.

To help determine that taxes are not over-paid and to preserve the confidentiality of employees' personal tax information, many employers use independent tax accountants to prepare tax returns and calculate final tax equalization or protection payments.

Chapter 9 – Personal Planning for a Transfer Overseas

When you transfer overseas, there are many things to be considered. There are several factors that can help a transfer to be successful and rewarding. An organized approach can smooth your transition, reduce surprises, and help realize both your and your employer's objectives for the international assignment.

These important factors can generally be categorized as follows:

- Compensation factors;
- Pre-departure activities;
- Vital documents;
- Adjustment to the host country;
- Repatriation.

Following is a brief overview of each of the above points. Check-lists are included in Appendix A and Appendix B to help you and your employer to plan a successful transfer.

Compensation Factors

If your employer has an international assignment policy that discusses compensation, be sure that you understand how it applies to you before the assignment begins. Many such policies provide for various allowances and other benefits that affect your total compensation. A variety of things can significantly alter the actual value of compensation: different costs of living in different locations; different health, medical, pension, and life insurance benefits; different education costs for children; relocation costs; and different tax burdens.

Pre-departure Activities

Pre-departure "activities" outlined in the check-lists in Appendix A can help prepare you and your family for leaving home and for your stay in a foreign country. Among other things, these activities can help clear the way for convenient financial transactions in your host country, such as establishing lines of credit, credit cards, and insurance policies, and can help you acclimate to your new position and life-style.

Vital Documents

An important part of pre-departure activities is the preparation of vital documents, such as visas, wills, powers of attorney, and property deeds. This can help assure that concerns regarding legal status at home and in the host country are properly handled, including the status of your possessions, guardians for your children in case of emergency, and many other vital matters. While this preparation can be difficult, it may help protect you if unexpected circumstances arise. (See Appendix B.)

Adjustment to the Host Country

Prior to departure from the United States, you may find it helpful to obtain information on the host country company, as well as the city where you will work and live. Local magazines and guidebooks, government literature, and Web sites may be useful. Your employer in the foreign location may prepare receptions and meetings, some of an informal nature, at which you (the executive) and your family are introduced to your peers. The employer may even assign a local contact or "point person" to serve as a

source of helpful information and guidance for you. Sometimes the everyday activities that you take for granted at home can be unfamiliar and cause confusion and lost time when you arrive in the host location. Asking for references to local resources can save time and prevent stress – for example, doctors, insurance providers, newspaper delivery, telephone, utility, cable television and Internet providers, tipping guidelines, sales tax, local banks, retail shops, and so forth.

Repatriation

The best time to plan for your return to the United States is before your international assignment begins; that is when you should discuss the goals for the assignment itself as well as for after the assignment is over. Being sure that you and your employer understand each other's objectives is an important element of success and satisfaction, and should help in the repatriation process. These basic objectives should include the expected contribution that you will make to your department, specifically, and the company, generally, after the international assignment.

During the assignment, lines of communication between you and the U.S. company should remain open with respect to (1) larger corporate issues, as well as (2) your personal and professional development in areas that could prove valuable to the U.S. company. Moreover, changes at the U.S. company that could affect you should be routinely communicated. It may be useful for you to keep and provide status/progress reports to the U.S. company so that, where appropriate, revisions to original plans and goals can be made.

Appendix A – Pre-departure Activities Check-list

Action required:

1. Formulate a list of objectives for the international assignment.
2. Have a complete medical examination and receive required inoculations a month before departure.
3. Obtain required tests/inoculations and papers required to transport pet(s) to the host location.
4. Obtain medical and dental records for you and your family.
5. Attend language courses, if necessary.
6. Complete resource reading on the host country and reading of company orientation material.
7. Investigate host location climate to determine suitable clothing.
8. Secure and familiarize yourself and family members with samples of local currency.
9. Review guidance for visitors regarding local customs and take appropriate action.
10. Draw up, or update, a will. (Determine whether a will in the host location is advisable.)
11. Make arrangements for a power-of-attorney.
12. Choose a legal guardian for children, and complete the necessary formalities. In the case of your and your spouse's unexpected deaths, the legal guardian may be the only person permitted to take your child/children back to your home country.
13. Have any necessary adjustments made in insurance policies.
14. Notify local credit card and charge accounts of address change or have them canceled.
15. Notify local post office of mailing address change and provide six to eight weeks notice of change of address for journals/periodicals to which you are subscribed.
16. Once departure date is known, inform home delivery services, utilities, etc.
17. Obtain original or certified copies (translated) of your university diploma(s) and transcripts (record of grades). Certification can be done by bringing your original documents to any host country consulate. These documents will be required if you plan to attend a local university.
18. Make arrangements for support obligations of family members remaining in the United States.
19. Record vital documents on a check-list (see Appendix B). Give a copy of the check-list of vital documents to a home country relative or friend, and place a copy in your safe deposit box – or other "safe-keeping" place – with originals or copies of the documents.
20. Arrange for your sending office/ company to send pertinent publications and communications to you on a timely basis.
21. Receive tax counseling from an experienced international tax adviser with host country knowledge and experience.
22. Communicate with your receiving office as to your exact date of arrival in the host country and your employment starting date.

Secure the following:

1. Keep with your passport (and your family's passports) a written record of all immunizations and vaccinations with dates and physicians' signatures. School and local health authorities often require this information.
2. Separate passports for each family member.
3. Visa (obtained at the host country embassy or consulate), as applicable.
4. Birth certificates.
5. Marriage license.
6. Children's school records.
7. Letters of reference, credit rating, and competence.
8. An international driver's license, although in most jurisdictions you will be required to take a local driving test within two to three months of arrival.
9. Letter from current auto insurer referring to your driving record and insurance history.
10. Universally-accepted credit cards that can be transferred to a dollar-based account.
11. Travelers checks (in U.S. and host country currency).
12. Critical financial records, including tax returns for prior three years.
13. An account in a bank that has host country branches or an open transactional relationship with a host country bank.
14. Safe deposit box.
15. Copy of your most recent prescriptions for glasses, contact lenses, and medicines.
16. Spare pair of glasses/contact lenses.
17. Supply of prescription medicines adequate until local medical contacts can be established in your host location.

Appendix B – Vital Documents Check-list

	Identification Number (Where Applicable)	Location	Date
Your Will			
Spouse's Will			
Guardianship Agreements			
Trust Agreements			
Mortgages			
Property Deeds			
Car Titles			
Stock Certificates			
Stock Purchase Agreements			
Bonds			
Checking Account			
Savings Account			
Other Financial/Brokerage Account			
Life Insurance Policies			
Other Insurance Policies			
Contracts			
Set of Last Instructions			
Retirement Agreements			
Pension or Profit Sharing Plans			
Birth Certificates			
Marriage Licenses			
Divorce and Settlement Papers			
Notes Receivable			
Employment Contracts			
Income Tax Returns (Last 3 Years)			
Military Discharge and Documents			
Recurring Bills/Statements			
Credit Cards/Other Cards			
Frequent Flyer Program(s)			
Personal Computer Log-on Name/Password			
Personal e-mail Account and Password			
Driver's License			
Passport(s)			

Attorney:

Name: _____

Address: _____

Phone Number: _____

Personal/Family Physician:

Name: _____

Address: _____

Phone Number: _____

Relative / Other Individual in the United States (to contact in case of emergency):

Name: _____

Address: _____

Phone Number: _____

Appendix C – United States Tax Agreements

List of U.S. Tax Treaty Countries

Information as of December 31, 2012.

For treaty withholding tax rates, see IRS Publication 901, *U.S. Tax Treaties* (http://www.irs.gov/pub/irs-pdf/p901.pdf).

Armenia*
Australia
Austria
Azerbaijan*
Bangladesh
Barbados
Belarus*
Belgium
Bulgaria
Canada
China, People's Republic of
Cyprus
Czech Republic
Denmark
Egypt
Estonia
Finland
France
Georgia*
Germany
Greece
Hungary
Iceland
India
Indonesia
Ireland
Israel
Italy
Jamaica
Japan
Kazakhstan
Kyrgyzstan*
Latvia
Lithuania
Luxembourg
Malta
Mexico
Moldova*
Morocco
Netherlands
New Zealand
Norway
Pakistan
Philippines
Poland
Portugal
Romania
Russia
Slovak Republic
Slovenia
South Africa
South Korea
Spain
Sri Lanka
Sweden
Switzerland
Tajikistan*
Thailand
Trinidad and Tobago
Tunisia
Turkey
Turkmenistan*
Ukraine
United Kingdom
Uzbekistan*
Venezuela

* Former republic of the U.S.S.R. and member of the Commonwealth of Independent States, covered by the U.S.-U.S.S.R. income tax treaty signed June 20, 1973.

List of U.S. Social Security Totalization Agreement Countries

Information as of December 31, 2012. For text and description of each agreement, see U.S. Social Security Web site (http://www.ssa.gov/international/totalization_agreements.html).

Australia
Austria
Belgium
Canada
Chile
Czech Republic
Denmark
Finland
France
Germany
Greece
Ireland
Italy
Japan
Luxembourg
Netherlands
Norway
Poland
Portugal
South Korea
Spain
Sweden
Switzerland
United Kingdom

Appendix D – U.S. Individual Income Tax Figures 2012 & 2013

2012 Tax Tables

Married Individuals Filing Joint Returns and Surviving Spouses	
If taxable income is:	**The tax is:**
Not Over $17,400	10% of the taxable income
Over $17,400 but not over $70,700	$1,740 plus 15% of the excess over $17,400
Over $70,700 but not over $142,700	$9,735 plus 25% of the excess over $70,700
Over $142,700 but not over $217,450	$27,735 plus 28% of the excess over $142,700
Over $217,450 but not over $388,350	$48,665 plus 33% of the excess over $217,450
Over $388,350	$105,062 plus 35% of the excess over $388,350
Heads of Households	
Not Over $12,400	10% of the taxable income
Over $12,400 but not over $47,350	$1,240 plus 15% of the excess over $12,400
Over $47,350 but not over $122,300	$6,482.50 plus 25% of the excess over $47,350
Over $122,300 but not over $198,050	$25,220 plus 28% of the excess over $122,300
Over $198,050 but not over $388,350	$46,430 plus 33% of the excess over $198,050
Over $388,350	$109,229 plus 35% of the excess over $388,350
Unmarried Individuals (other than Surviving Spouse and Heads of Households)	
Not Over $8,700	10% of the taxable income
Over $8,700 but not over $35,350	$870 plus 15% of the excess over $8,700
Over $35,350 but not over $85,650	$4,867.50 plus 25% of the excess over $35,350
Over $85,650 but not over $178,650	$17,442.50 plus 28% of the excess over $85,650
Over $178,650 but not over $388,350	$43,482.50 plus 33% of the excess over $178,650
Over $388,350	$112,683.50 plus 35% of the excess over $388,350
Married Individuals Filing Separate Returns	
Not Over $8,700	10% of the taxable income
Over $8,700 but not over $35,350	$870 plus 15% of the excess over $8,700
Over $35,350 but not over $71,350	$4,867.50 plus 25% of the excess over $35,350
Over $71,350 but not over $108,725	$13,867.50 plus 28% of the excess over $71,350
Over $108,725 but not over $194,175	$24,332.50 plus 33% of the excess over $108,725
Over $194,175	$52,531 plus 35% of the excess over $194,175

Married Individuals Filing Joint Returns and Surviving Spouses	
If taxable income is:	**The tax is:**
Not Over $17,850	10% of the taxable income
Over $17,850 but not over $72,500	$1,785 plus 15% of the excess over $17,850
Over $72,500 but not over $146,400	$9,982.50 plus 25% of the excess over $72,500
Over $146,400 but not over $223,050	$28,457.50 plus 28% of the excess over $146,400
Over $223,050 but not over $398,350	$49,919.50 plus 33% of the excess over $223,050
Over $398,350 but not over $450,000	$107,768.50 plus 35% of the excess over $398,350
Over $450,000	$125,846 plus 39.6% of the excess over $450,000
Heads of Households	
Not Over $12,750	10% of the taxable income
Over $12,750 but not over $48,600	$1,275 plus 15% of the excess over $12,750
Over $48,600 but not over $125,450	$6,652.50 plus 25% of the excess over $48,600
Over $125,450 but not over $203,150	$25,865 plus 28% of the excess over $125,450
Over $203,150 but not over $398,350	$47,621 plus 33% of the excess over $203,150
Over $398,350 but not over $425,000	$112,037 plus 35% of the excess over $398,350
Over $425,000	$121,364.50 plus 39.6% of the excess over $425,000
Unmarried Individuals (other than Surviving Spouse and Heads of Households)	
Not Over $8,925	10% of the taxable income
Over $8,925 but not over $36,250	$892.50 plus 15% of the excess over $8,925
Over $36,250 but not over $87,850	$4,991.25 plus 25% of the excess over $36,250
Over $87,850 but not over $183,250	$17,891.25 plus 28% of the excess over $87,850
Over $183,250 but not over $398,350	$44,603.25 plus 33% of the excess over $183,250
Over $398,350 but not over $400,000	$115,586.25 plus 35% of the excess over $398,350
Over $400,000	$116,163.75 plus 39.6% of the excess over $400,000
Married Individuals Filing Separate Returns	
Not Over $8,925	10% of the taxable income
Over $8,925 but not over $36,250	$892.50 plus 15% of the excess over $8,925
Over $36,250 but not over $73,200	$4,991.25 plus 25% of the excess over $36,250
Over $73,200 but not over $111,525	$14,228.75 plus 28% of the excess over $73,200
Over $111,525 but not over $199,175	$24,959.75 plus 33% of the excess over $111,525
Over $199,175 but not over $225,000	$53,884.25 plus 35% of the excess over $199,175
Over $225,000	$62,923 plus 39.6% of the excess over $225,000

Standard Deduction

	2012	2013
Single	$5,950	$6,100
Married filing joint return and surviving spouse	$11,900	$12,200
Married filing separate return	$5,950	$6,100
Head of household	$8,700	$8,950

If you can be claimed as a dependent on another person's return, your standard deduction for 2012 cannot exceed the greater of $950 or your earned income plus $300 (for 2013 these amounts are $1,000 and $350).

If you are age 65 or over, or if you are blind, you are entitled to an additional standard deduction. The additional standard deduction amount for married taxpayers and surviving spouses is $1,150 for 2012 and $1,200 for 2013. For a single taxpayer or head of household, the additional standard deduction is $1,450 for 2012 and $1,500 for 2013. If you are both 65 or older *and* blind, the additional standard deduction amount is doubled.

Personal Exemptions

	2012	2013
Personal and dependent exemption amount	$3,800	$3,900

Alternative Minimum Tax

AMT Exemption Amounts

	2012	2013
Single or head of household	$50,600	$51,900
Married filing joint return and surviving spouse	$78,750	$80,800
Married filing separate return	$39,375	$40,400

The AMT exemption is reduced by 25 percent of the amount by which your alternative minimum taxable income exceeds a certain amount. These threshold amounts are as shown below.

AMT Exemption Phase-Out Thresholds

	2012	2013
Single or head of household	$112,500	$115,400
Married filing joint return and surviving spouse	$150,000	$153,900
Married filing separate return	$75,000	$76,950

Minimum Filing Requirements

Taxpayers under age 65 are required to file a U.S. income tax return if their gross income, disregarding the foreign earned income and housing costs exclusions, exceeds the following amounts:

Type of Return Filed	2012	2013
Joint Return	$19,500	$20,000
Head of Household	$12,500	$12,850
Single	$9,750	$10,000
Married Filing Separate	$3,800	$3,900

These amounts are increased for taxpayers who are age 65 or older, and for taxpayers who are legally blind.

Children and other dependents are required to file a U.S. income tax return if their gross income exceeds any of the following amounts:

	2012	2013
If taxpayer has only unearned income (interest, dividends, etc.) –	$950	$1,000
Earned income plus $300 in 2012 of $350 in 2013, up to a maximum of –	$5,950	$6,100

Social Security and Self-Employment Tax Wage Base Amount

	2012	2013
Old Age, Survivors, and Disability Insurance maximum wage base	$110,100	$113,700

Capital Gains Tax Rates

Assets Held Not More than One Year (Short-Term Capital Gain) – The special capital gain tax rate applies only to assets that you have owned for more than one year. Gain on assets that you have owned for one year or less is taxed at your normal marginal tax rate, with a maximum of 35 percent in 2012 and 39.6 percent in 2013.

Assets Held More than One Year (Long-Term Capital Gain) – In 2012, gains on assets held for more than one year are taxed at a maximum rate of 15 percent. If you are in the 10- or 15-percent marginal income tax bracket, your long-term capital gains are taxed at zero percent. In 2013, the same rules apply, unless you are in the highest (39.6 percent) income tax bracket. In that case, your long-term capital gain tax rate is 20 percent.

Depreciation Recapture – If you own real property (such as a building) that is used as business or rental property, you are entitled to take depreciation deductions for that property (however, no depreciation deduction is allowed for land). When you sell that property, the amount of the gain is increased by the depreciation that was taken (or that you were allowed to take, even if you did not claim it). The portion of the gain that is related to depreciation is referred to as "depreciation recapture" and is taxed at 25 percent.

Qualified Dividends – Qualified dividends are taxed at the same rate as long-term capital gains. In general, qualified dividends are many dividends on U.S. stock, and many dividends on foreign stock paid from countries that have a tax treaty with the United States.

Appendix E – List of KPMG IES Offices in the United States

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Billings MT 59101
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Fax. +1 (406) 245-9738

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Boston MA 02111
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Fax. +1 (617) 507-8321

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Charlotte NC 28202-4214
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Fax. +1 (704) 335-5377

Chicago
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Aon Center
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Fax. +1 (214) 840-2297

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Fax. +1 (212) 758-9819

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Fax. +1 (703) 286-8010

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Fax. +1 (949) 885-5410

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Philadelphia PA 19103-2499
Tel. +1 (267) 256-7000
Fax. +1 (267) 256-7200

Phoenix/Tempe
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Tempe AZ 85281-9102
Tel. +1 (480) 459-3500
Fax. +1 (480) 459-3550

Portland
KPMG LLP
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1300 SW Fifth Avenue
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Richmond
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Fax. +1 (858) 750-7101

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Fax. +1 (415) 963-8100

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KPMG LLP
Mission Towers 1
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3975 Freedom Circle Drive
Santa Clara CA 95054
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Fax. +1 (408) 877-3034

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KPMG LLP
Suite 2900
1918 Eighth Avenue
Seattle WA 98101
Tel. +1 (206) 913-4000
Fax. +1 (206) 913-4444

Short Hills
KPMG LLP
51 John F Kennedy Parkway
Short Hills NJ 07078
Tel. +1 (973) 467-9650
Fax. +1 (973) 467-7930

Stamford
KPMG LLP
Stamford Square
3001 Summer Street
Stamford CT 06905-4317
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Fax. +1 (203) 352-200

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