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Tax Highlights for U.S. Citizens and Residents Going Abroad



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See *How To Get More Information* in this publication.

Introduction

This publication discusses in general terms some provisions of the U.S. federal income tax law that apply to U.S. citizens and resident aliens who live or work abroad and who expect to receive income from foreign sources.

As a U.S. citizen or resident alien, your worldwide income generally is subject to U.S. income tax regardless of where you are living. Also, you are subject to the same income tax return filing requirements that apply to U.S. citizens or residents living in the United States.

However, several income tax benefits might apply if you meet certain requirements while living abroad. You may be able to exclude from your income a limited amount of your foreign earned income. You also may be able either to exclude or to deduct from gross income your **housing amount** (defined later). To claim these benefits, you must file a tax return and attach Form 2555, *Foreign Earned Income*. If you are claiming the foreign earned income exclusion only, you may be able to use the shorter Form 2555-EZ, *Foreign Earned Income Exclusion*, rather than Form 2555.

You may, on your U.S. return, be able to claim a tax credit or an itemized deduction for the foreign income taxes that you pay. Also, under tax treaties or conventions that the United States has with many foreign countries, you may be able to reduce your foreign tax liability.

Publications 54, *Tax Guide for U.S. Citizens and Resident Aliens Abroad*, 514, *Foreign Tax Credit for Individuals*, and 901, *U.S. Tax Treaties*, discuss in detail the treatment of your foreign income, the foreign tax credit, and the general tax treaty benefits available to you.

Students or professors who receive income from teaching or while studying abroad should also get Publication 520, *Scholarships and Fellowships*.

See *How to Get More Information* near the end of this publication for information about getting publications and forms.

Filing Information

The U.S. filing requirements for U.S. citizens and resident aliens in foreign countries are generally the same as those for citizens and residents living in the United States.

Who must file. Your age, marital status, gross income, and whether you can be claimed as a dependent by another taxpayer determine whether you must file a U.S. federal income tax return. To determine if you meet the gross income requirement for filing purposes, you must include all income you receive from foreign sources as well as your U.S. income. It does not matter that:

- The income is paid in foreign money,
- The foreign country imposes an income tax on that income, or
- The income is excludable under the foreign earned income exclusion, discussed later.

Self-employed persons. You must file a U.S. income tax return if you had \$400 or more of net earnings from self-employment, regardless of your age. **You must pay self-employment tax on your self-employment income even if it is earned in a foreign country and is excludable as foreign earned income in figuring your income tax.** Net earnings from self-employment include the income earned both in a foreign country and in the United States.

When to file. If your tax year is the calendar year, the due date for filing your income tax return is usually April 15 of the following year.

Extensions of time to file. If you are a U.S. citizen or resident and both your tax home and your abode (the place where you regularly live) are outside the United States and Puerto Rico on the regular due date of your return, or you are in military or naval service on duty outside the United States and Puerto Rico, you are automatically granted an extension to June 15 to file your return and pay any tax due. You must pay interest on any unpaid tax from the regular due date to the date you pay the tax. You do not have to file a special form to receive this extension. You must, however, attach a statement to your tax return explaining what situation qualified you for the extension.

It may benefit you to file for an additional extension of time to file. You may benefit if, on the due date for filing, you have not yet met either the bona fide residence test or the physical presence test, but you expect to qualify after the automatic extension discussed above. To obtain an additional extension, file Form 2350, *Application for Extension of Time To File U.S. Individual Income Tax Return*, with the Internal Revenue Service Center in Philadelphia or your local IRS representative. You must file Form 2350 after the close of your tax year but before the end of the first extension. If an additional extension is granted, it will be to a date after you expect to meet the time requirements for the bona fide residence or the physical presence test.

Where to file. If any of the following situations apply to you, you should file your return with the Internal Revenue Service Center, Philadelphia, PA 19255-0002.

- 1) You claim the foreign earned income exclusion.
- 2) You claim the foreign housing exclusion or deduction.
- 3) You claim the exclusion of income for bona fide residents of American Samoa.
- 4) You live in a foreign country or U.S. possession and have no legal residence or principal place of business in the United States.

All other taxpayers should see Publication 54 or the instructions for Form 1040.

Foreign bank and financial accounts. If you had any financial interest in, or signature or other authority over, a bank account, securities account, or other financial account in a foreign country at any time during the tax year, you may have to complete Treasury Department Form TD F 90-22.1, *Report of Foreign Bank and Financial Accounts*, and file it with the Department of the Treasury at the address listed on the form. You need not file this form if the combined assets in the account(s)

are \$10,000 or less during the entire year, or if the assets are with a U.S. military banking facility operated by a U.S. financial institution.

You can get Form TD F 90–22.1 from the offices listed at the end of this publication or from the IRS Forms Distribution Center, P.O. Box 25866, Richmond, VA 23286-8107.

Estate and gift taxes. Under certain conditions, you may have to file a federal estate or gift tax return. For more information, see Publication 950, *Introduction to Estate and Gift Taxes*.



You can also request additional information by writing to:

Internal Revenue Service
Assistant Commissioner (International)
Estate Tax Group
CP:IN:D:C:EX:HQ:1114
950 L'Enfant Plaza South, S.W.
Washington, DC 20024.

Income Earned Abroad

You may qualify for an exclusion from tax of a limited amount of income earned while working abroad. However, you must file a tax return to claim it. In general, foreign earned income is income received for services you perform in a foreign country. You also may be able to claim an exclusion or a deduction from gross income for your reasonable housing costs that are over a certain base amount. Generally, you will qualify for these benefits if your **tax home** (defined below) is in **a foreign country**, or countries, throughout your period of bona fide foreign residence or physical presence and you are one of the following:

- 1) A U.S. citizen who is a bona fide resident of a foreign country or countries for an uninterrupted period that includes a complete tax year, or
- 2) A U.S. resident alien who is a citizen or national of a country with which the United States has an income tax treaty in effect and who is a bona fide resident of a foreign country or countries for an uninterrupted period that includes an entire tax year, or
- 3) A U.S. citizen or a U.S. resident alien who is physically present in a foreign country or countries for at least 330 full days during any period of 12 consecutive months.

Tax home. Your tax home is the general area of your main place of business, employment, or post of duty where you are permanently or indefinitely engaged to work. You are not considered to have a tax home in a foreign country for any period during which your abode is in the United States. However, being temporarily present in the United States, or maintaining a dwelling there, does not necessarily mean that your abode is in the United States. For details, see Publication 54.

Foreign country. A foreign country, for this purpose, means any territory under the sovereignty of a government other than that of the United States, including territorial waters (determined under U.S. laws) and air space. A foreign country also includes the seabed and subsoil of those submarine areas which are adjacent to the territorial waters of the foreign country and over which it has exclusive rights under international law to explore and exploit natural resources. For this purpose, U.S. possessions or territories are not foreign countries.

Waiver of time requirements. You may not have to meet the minimum time requirements for bona fide residence or physical presence if you have to leave the foreign country because war, civil unrest, or similar adverse conditions in the country prevented you from conducting normal business. You must, however, be able to show that you reasonably could have expected to meet the minimum time requirements if the adverse conditions had not occurred. See Publication 54 for a list of foreign countries that individuals have had to leave due to these conditions.

Travel restrictions. If you violate U.S. travel restrictions, you will not be treated as being a bona fide resident of, or physically present in, a foreign country for any day during which you are present in a country in violation of the restrictions. (These restrictions generally prohibit U.S. citizens and residents from engaging in transactions related to travel to, from, or within certain countries.) Also, income that you earn from sources within such a country for services performed during a period of travel restrictions does not qualify as foreign earned income. Housing expenses that you incur within that country (or outside that country for housing your spouse or dependents) while you are in violation of travel restrictions cannot be included in figuring your foreign housing amount.

Currently, these travel restrictions apply to Cuba, Libya, and Iraq.

Exclusion of foreign earned income. If your tax home is in a foreign country and you meet either the bona fide residence test or the physical presence test, you can choose to exclude from gross income a limited amount of your foreign earned income. Your income must be for services performed in a foreign country during your period of foreign residence or presence, whichever applies. You cannot, however, exclude the pay you receive as an employee of the U.S. Government or its agencies. You cannot exclude pay you receive for services performed abroad for Armed Forces exchanges, officers' messes, etc., operated by the U.S. Army, Navy, or Air Force.

Credits and deductions. If you claim the exclusion, you cannot claim any credits or deductions that are related to the excluded income. Thus, you cannot claim a foreign tax credit or deduction for any foreign income tax paid on the excluded income. Nor can you claim the earned income credit if you claim the exclusion. Also, **for IRA purposes**, the excluded income is not considered compensation and, for figuring deductible contributions when you are covered by an employer retirement plan, the excluded income is included in your modified adjusted gross income.

Amount excludable. If your tax home is in a foreign country and you qualify under either the bona fide residence test or physical presence test for the entire tax year, you can exclude your foreign income earned during the year up to the maximum amount shown in the schedule below.

<u>Year</u>	<u>Maximum Exclusion</u>
1997	\$70,000
1998	\$72,000
1999	\$74,000
2000	\$76,000
2001	\$78,000
2002 and after	\$80,000

Beginning in 2008, the \$80,000 amount will be adjusted for inflation.

If you qualify under either test for only part of the year, you must reduce ratably the maximum amount based on the number of days within the tax year you qualified under one of the two tests.

Housing amount. If your tax home is in a foreign country and you meet either the bona fide residence test or the physical presence test, you may be able to claim an exclusion or a deduction from gross income for a housing amount.

A **housing amount** is the excess, if any, of your allowable housing expenses for the tax year over a **base amount**. Allowable housing expenses are the reasonable expenses (such as rent, utilities other than telephone charges, and real and personal property insurance) paid or incurred during the tax year by you, or on your behalf, for your foreign housing and that of your spouse and dependents if they lived with you. You can include the rental value of housing provided by your employer in return for your services. You can also include the allowable housing expenses of a second foreign household for your spouse and dependents if they did not live with you because of dangerous, unhealthy, or otherwise adverse living conditions at your tax home. Allowable housing expenses do not include the cost of home purchase or other capital items, wages of domestic servants, or deductible interest and taxes.

The **base amount** is 16% of the annual salary of a GS-14, step 1, U.S. Government employee, figured on a daily basis, times the number of days during the year that you meet the bona fide residence test or the physical presence test. The annual salary is determined on January 1 of the year in which your tax year begins. You figure the base amount on Form 2555.

Exclusion. You can exclude (up to the limits) your entire housing amount from income if it is considered paid for with employer-provided amounts. Employer-provided amounts are any amounts paid to or for you by your employer, including your salary, housing reimbursements, and the fair market value of pay given in the form of goods and services. If you have no self-employment income, your entire housing amount is considered paid for with employer-provided amounts.

If you claim the exclusion, you cannot claim any credits or deductions related to excluded income, including a credit or deduction for any foreign income tax paid on the excluded income.

Deduction. If you are self-employed and your housing amount is not provided by an employer, you can deduct it in arriving at your adjusted gross income. However, the deduction is limited to the amount your

foreign earned income for the tax year is more than the excluded foreign earned income and housing amount.

Carryover. If you cannot deduct all of your housing amount in a tax year because of the limit, you can carry over the unused part to the following year only. If you cannot deduct it in the following year, you cannot carry it over to any other year. You deduct the carryover in figuring adjusted gross income. The amount of carryover you can deduct is limited to your foreign earned income for the year of the carryover minus the total of your foreign earned income exclusion, housing exclusion, and housing deduction for that year.

Choosing the exclusion(s). You make separate choices to exclude foreign earned income and/or to exclude or deduct your foreign housing amount. If you choose to take both the foreign housing exclusion and the foreign earned income exclusion, you must figure your foreign housing exclusion first. Your foreign earned income exclusion is then limited to the smaller of (a) your annual exclusion limit or (b) the excess of your foreign earned income over your foreign housing exclusion.

Once you choose to exclude your foreign earned income or housing amount, that choice remains in effect for that year and all future years unless you revoke it. You can revoke your choice for any tax year. However, if you revoke your choice for a tax year, you cannot claim the exclusion again for your next 5 tax years without the approval of the IRS. For more information on revoking the exclusion, see Publication 54.

Exclusion of employer–provided meals and lodging.

If as a condition of employment you are required to live in a camp in a foreign country that is provided by or for your employer, you can exclude the value of any meals and lodging furnished to you, your spouse, and your dependents. For this exclusion, a camp is lodging that is:

- 1) Provided for your employer's convenience because the place where you work is in a remote area where satisfactory housing is not available to you on the open market within a reasonable commuting distance,
- 2) Located as close as practicable in the area where you work, and
- 3) Provided in a common area or enclave that is not available to the public for lodging or accommodations and that normally houses at least 10 employees.

Tax Withholding and Estimated Tax

Generally, you must pay U.S. tax on the income earned abroad in the same way you pay the tax on income earned in the United States. If you are an employee, your employer probably withholds income tax from your pay. If income tax is not withheld or if not enough tax is withheld, you might have to pay estimated tax.

Withholding tax. You may be able to have your employer discontinue withholding income tax from all or a part of your wages. You can do this if you expect to qualify for the income exclusions under either the bona fide residence test or the physical presence test. See Publication 54 for information.

Withholding from pension payments. U.S. payers of benefits from employer deferred compensation plans (such as employer pension, annuity, or profit-sharing plans), individual retirement plans, and commercial annuities generally must withhold income tax from the payments or distributions. Withholding will apply unless you choose exemption from withholding. You cannot choose exemption unless you provide the payer of the benefits with a residence address in the United States or a U.S. possession or unless you certify to the payer that you are not a U.S. citizen or resident alien or someone who left the United States to avoid tax.

For rules that apply to nonperiodic distributions from qualified employer plans and tax-sheltered annuity plans, get Publication 575, *Pension and Annuity Income*.

Estimated tax. If you are working abroad for a foreign employer, you may have to pay estimated tax, since not all foreign employers withhold U.S. tax from your wages.

Your estimated tax is the total of your estimated income tax and self-employment tax for the year minus your expected withholding for the year.

When you estimate your gross income, do not include the income that you expect to exclude. You can subtract from income your estimated housing deduction in figuring your estimated tax liability. However, if the actual exclusion or deduction is less than you expected, you may be subject to a penalty on the underpayment.

Use Form 1040-ES, *Estimated Tax for Individuals*, to estimate your tax. The requirements for filing and paying estimated tax are generally the same as those you would follow if you were in the United States.

Foreign Income Taxes

A limited amount of the foreign income tax you pay can be credited against your U.S. tax liability or deducted in figuring taxable income on your U.S. income tax return. It is usually to your advantage to claim a credit for foreign taxes rather than to deduct them. A credit reduces your U.S. tax liability, and any excess can be carried back and carried forward to other years. A deduction only reduces your taxable income and can be taken only in the current year. You must treat all foreign income taxes in the same way. You generally cannot deduct some foreign income taxes and take a credit for others.

Tax credit. If you choose to credit foreign taxes against your tax liability, complete Form 1116, *Foreign Tax Credit, (Individual, Estate, Trust, or Nonresident Alien Individual)*, and attach it to your U.S. income tax return. Do not include the foreign taxes paid or accrued as withheld income taxes on Form 1040.

Limit. Your credit cannot be more than the part of your U.S. income tax liability allocable to your taxable income from sources outside the United States. So, if you have no U.S. income tax liability, or if all your foreign income is excludable, you will not be able to claim a foreign tax credit.

If the foreign taxes you paid or incurred during the year exceed the limit on your credit for the current year, you can carry back the unused foreign taxes as credits to the 2 previous tax years and then carry forward any remaining unused foreign taxes to the next 5 tax years.



For tax years beginning after 1997, you will not be subject to this limit and may be able to claim the credit without using Form 1116 if the following requirements are met.

- 1) *You are an individual.*
- 2) *Your only foreign source income for the tax year is passive income (dividends, interest, royalties, etc.) that is reported to you on a payee statement (such as a Form 1099-DIV or 1099-INT).*
- 3) *Your qualified foreign taxes for the tax year are not more than \$300 (\$600 if filing a joint return) and are reported on a payee statement.*
- 4) *You elect this procedure for the tax year.*



If you make this election, you cannot carryback or carryover any unused foreign tax to or from this tax year.

Foreign taxes paid on excluded income. You cannot claim a credit for foreign taxes paid on amounts excluded from gross income under the foreign earned income exclusion or the housing amount exclusion, discussed earlier.

Deduction. If you choose to deduct all foreign income taxes on your U.S. income tax return, itemize the deduction on Schedule A (Form 1040). You cannot deduct foreign taxes paid on income you exclude from your U.S. income tax return.

More information. The foreign tax credit and deduction, their limits, and the carryback and carryover provisions are discussed in detail in Publication 514.

Tax Treaty Benefits

U.S. tax treaties or conventions with many foreign countries entitle U.S. residents to certain credits, deductions, exemptions, and reduced foreign tax rates. In this way, you may be able to pay less tax to those countries.

For example, most tax treaties allow U.S. residents to exempt part or all of their income for personal services from the treaty country's income tax if they are in the treaty country for a limited number of days.

Treaties also generally provide U.S. students, teachers, and trainees with special exemptions from the foreign treaty country's income tax. Publication 901 contains detailed information on tax treaties and tells you where you can get copies of them.

How To Get More Information

You can get help from the IRS in several ways. The IRS has combined special forms and instructions as well as Publication 54 in Package 1040-7 for U.S. citizens and residents living abroad.



You can get the package and additional assistance by writing to:

Internal Revenue Service
 Assistant Commissioner (International)
 Attn: CP:IN:D:CS
 950 L'Enfant Plaza South, S.W.
 Washington, DC 20024

During the filing period, you can also get the necessary federal income tax forms and publications from U.S. embassies and consulates.

You can also call your nearest U.S. embassy or consulate, or the IRS office numbers listed below, to find out when and where assistance will be available. These IRS telephone numbers include the country and city codes required if you are outside the local dialing area.

Bonn, Germany	(49) (228)	339-2119
London, England	(44) (171)	408-8077
Mexico City, Mexico	(52) (5)	211-0042
		Ext. 3557 or 3559
Nassau, Bahamas	(800)	829-1040
	or (809)	759-5100
Paris, France	(33) (1)	4312-2555
Rome, Italy	(39) (6)	4674-2560
Santiago, Chile	(56) (2)	330-3424
Singapore	(65)	476-9413
Sydney, Australia	(61) (2)	9373-9194
Tokyo, Japan	(81) (3)	3224-5466

If you have access to a personal computer and a modem, you can also get many forms and publications electronically. They are available through IRIS, the Internal Revenue Information Services, on FedWorld, a government bulletin board. IRIS is accessible directly by calling 703-321-8020. On the Internet, you can telnet to iris.irs.ustreas.gov or, for file transfer protocol services, connect to ftp.irs.ustreas.gov. If you are using the World Wide Web, connect to www.irs.ustreas.gov.

Within the United States. To order free publications and forms, call 1-800-TAX-FORM (1-800-829-3676). Your local library or post office also may have the items you need.

For a list of free tax publications, order Publication 910, *Guide to Free Tax Services*. It also contains an index of tax free topics and related publications and describes other free tax information services available from IRS, including tax education and assistance programs.

Tax questions. You can call the IRS with your tax questions. Check your telephone book for the local number, or you can call 1-800-829-1040.

TTY/TDD equipment. If you have access to TTY/TDD equipment, you can call 1-800-829-4059 to ask tax questions or to order forms and publications.

Evaluating the quality of our telephone services. To ensure that IRS representatives give accurate, courteous, and professional answers, we evaluate the quality of our "800 number" telephone services in several ways.

- A second IRS representative sometimes monitors live telephone calls. That person only evaluates the IRS assistor and does not keep a record of any taxpayer's name or tax identification number.

- We sometimes record telephone calls to evaluate IRS assistors objectively. We hold these recordings no longer than one week and use them only to measure the quality of assistance.
- We value our customers' opinions. Throughout this year, we will be surveying our customers for their opinions on our service.