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2022 Tax planning for US individuals living abroad

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Contents

Introduction

US citizens and resident aliens living abroad must file a US tax return and, with several important exceptions, must use the same forms and must compute tax by referring to the same tax rules as their stateside counterparts. The main exception is special rules that allow taxpayers to exclude all or part of their foreign earned income if they meet statutory foreign residence or physical presence abroad tests. While these provisions may allow significant tax benefits, it is important to remember that income earned abroad is frequently subject to foreign income taxes. In turn, credits or deductions for these foreign taxes may provide an additional measure of US tax relief.

This publication combines a general explanation of the rules with an analysis of the tax issues and decisions to consider in preparing for, and during the course of, a foreign assignment. It is not intended to answer all questions but only as an introduction to the many issues facing US taxpayers living abroad. When specific advice is necessary or appropriate, consultation with a professional adviser who specializes in expatriate taxation is strongly recommended.

Deloitte professionals in member firms throughout the world are prepared to help US taxpayers abroad plan for their specific US and foreign tax issues.

Ongoing COVID-19 Impact

- The economic disruption from COVID-19 has been profound. You maybe aware that former President Trump and President Biden signed into law several acts during 2020 and 2021 tax year, including Coronavirus Aid, Relief, and Economic Security Act (the CARES Act), the Consolidated Appropriations Act, and the American Rescue Plan (ARP) to assist impacted individuals and businesses. However, provisions affecting individuals primarily apply to tax years 2020 and 2021 and have expired for 2022 tax year.

Tax Cuts and Jobs Act of 2017 (Tax Reform)

On December 22, 2017, former President Trump signed into law U.S. tax reform legislation (P.L. 115-97, commonly referred to as the 2017 Tax Reform Act). This bill represented the largest change to the U.S. tax system in over 30 years. Though initially enacted in 2017, updates to this legislation are ongoing. Some key changes effective for tax years 2018-2025 consist of revisions to tax rates and brackets, repeal of personal exemptions, increase of standard deduction, revisions to itemized deductions including mortgage interest, state tax and foreign real property tax deduction, taxability of moving expenses and tax treatment for alimony payment.

Chapter 1 Filing requirements

Who Must File?

While residing in foreign countries, US citizens and aliens considered US residents must continue to follow the standard rules for filing US income tax returns. A single taxpayer must file if his or her gross income is in excess of the standard deduction, and married taxpayers who are entitled to file a joint return must file only if their combined gross income is at least as high as the value of the standard deduction for a married couple. A child who is claimed as a dependent on the parents' return must file his or her own return if the child's unearned or investment income exceeds certain amounts or if the child has any earned income. See Appendix A for the current year amounts. In determining these amounts, all compensation earned abroad is included in gross income; income that is excludable for other reasons, such as interest on tax-free municipal bonds, is not included in gross income. A tax return must be filed even when the taxpayer's foreign exclusions or deductions equal or exceed gross income or when credits, such as the foreign tax credit, completely eliminate US tax liability.

Tax Rates

There are seven tax brackets. For 2022, the tax brackets are: 10%, 12%, 22%, 24%, 32%, 35%, and 37%.

The brackets are applied at different levels of income to each of the four categories of taxpayers: single, married filing jointly, married filing separately, and head of household.

See Appendix A for current year amounts.

Joint Versus Separate Returns

A US citizen or resident alien may file a joint return with a spouse. If the spouse is a nonresident alien, however, the couple can elect to file a joint return only if the nonresident spouse agrees to be subject to US tax on his or her worldwide income for the entire year. The election to be treated as a US resident may be advantageous as long as the nonresident alien spouse has little or no income or has foreign-source income that is taxed at a higher rate overseas than in the United States. The use of a standard deduction for married individuals filing jointly may also make the election beneficial. This election can later be terminated by death, revocation, or separation. In considering this election, the nonresident spouse should also be aware that, as a US resident, US income tax treaty benefits that might otherwise be available could be lost.

If the election is made, the nonresident alien spouse is taxed on worldwide income and may be entitled to the special foreign earned income exclusions.

When to File

Tax returns for individuals are due on the fifteenth day of the fourth month following the close of the tax year (15 April for calendar-year taxpayers); however, taxpayers who are US citizens or residents and whose tax home and abode are outside the United States and Puerto Rico on the regular due date have an automatic extension of two months (to 15 June for calendar-year taxpayers) for filing. While no formal request for this additional time is necessary, the taxpayer's return must include a statement that his or her tax home and abode were outside the United States and Puerto Rico on the regular due date. If a joint return is filed, only one spouse must reside outside the United States in order to obtain the automatic two month extension. This postponement of the due date does not relieve taxpayers from paying any interest due on the unpaid portion of their ultimate tax liability. The tax liability is still due on 15 April, and interest is calculated from such date (without extension) until payment is received by the Internal Revenue Service (IRS).

An additional automatic extension of four months, to 15 October, is available by filing Form 4868, *Application for Automatic Extension of Time To File US Individual Income Tax Return*. This extension will not excuse the taxpayer from interest unless he or she has paid at least 100% of his or her ultimate US tax liability by the time the extension is filed.

If the due date for filing a return (including the automatic extension) falls on a Saturday, Sunday, or national holiday, the due date is the next business day. A federal return mailed from a foreign country will be accepted as filed on time if there is an official postmark dated on or before the last day for filing, including extensions. Tax returns filed by a private mail service must reach the IRS office by the required due date; however, returns filed with certain designated delivery services will be considered to have been filed when they are given to the delivery service. See Appendix A for a list of currently designated private delivery services.

If a return is mailed after its original or extended due date, it is not considered filed until actually received by the IRS.

Interest and Penalties on Balance Due

A properly filed extension relieves the taxpayer from a late filing penalty on the net tax due (4.5% per month for late filing plus .5% per month for late payment until the payment is made; the combined penalties may not exceed 25%). It does not, however, eliminate the liability for interest that is charged on any unpaid tax from the original due date (without extension).

Example 1:
Taxpayer B is living in the US as of 15 April 20X2. On 10 April 20X2, he files a valid Form 4868 extension for his 20X1 US income tax return. He then files the return on 15 September 20X2, and there is a $1,000 balance due.

Because B filed his return prior to the 15 October extended due date, there is no late filing penalty assessed. He will be subject to the late payment penalty and interest charges, calculated as follows (assume a 3% annual interest rate):

Late payment penalty: 0.5% x 5 months x $1,000 = $25
5 months counted from 15 April to 15 September
Interest: 3% x 154 days / 365 days x $1,000 = $13
154 days counted from 15 April to 15 September

Alternative First-Year Filing Procedures

Taxpayers who expect to qualify for the special foreign exclusions but are required to file a return before qualifying, may either obtain an additional extension to defer filing until they qualify or file the return without claiming any foreign exclusion, pay any tax due, and file an amended return to apply for a refund when the requirements are met. The IRS will grant an extension until thirty days after the date on which either the bona fide foreign residence test or physical presence test is expected to be met.

The extension application is filed using Form 2350, *Application for Extension of Time To File US Income Tax Return*, and may be filed with the IRS Center in Austin, TX, or with an IRS office located in a major US embassy in another country. A copy of the approved application should be attached to the return when it is filed to help reduce IRS processing delays.

Filing a US tax return without claiming the special foreign exclusions may require payment of US taxes, particularly when the taxpayer's compensation has not been subject to US tax withholding. Although all or a portion of these taxes may be refunded at a later date, it is usually advantageous to obtain the extension and file the return when the special foreign exclusions can be claimed.

A taxpayer who is already entitled to a refund may consider it worthwhile to file by the original due date and obtain a refund. At a later date, he or she may file an amended return (Form 1040X) to obtain an additional refund because of the special foreign exclusions. This situation may occur when a foreign assignment begins late in the year.

The exclusions may be elected on a return that has been filed by either its regular or properly extended due date, or on a timely filed amended return. They may also be elected on a late return, if the return is filed within one year of its original due date.

The exclusions may also be elected on a late return filed after one year of its original due date, provided one of the two following conditions is met:

- The taxpayer owes no federal income tax after taking into account the exclusion and files Form 1040 with Form 2555, *Foreign Earned Income*, attached before or after the IRS discovers that the taxpayer failed to elect the exclusion.
- The taxpayer owes federal income tax after taking into account the exclusion and files Form 1040 with Form 2555 attached before the IRS discovers that the taxpayer failed to elect the exclusion.

Taxpayers filing a late income tax return more than one year after its original due date under these rules must note this on page one of their Form 1040.

Estimated Tax

Estimated tax payments are required if the amount of taxes due with the return after withholding is expected to exceed $1,000. No estimated tax payments are required if there was no tax liability in the preceding year. See Appendix A for a schedule of current year payment due dates. If there is an underpayment of the estimated tax and none of the exceptions to the penalty applies (i.e., payments and withholding are greater than or equal to 90% of current year tax; payments and withholding are equal to 100% of last year's tax if adjusted gross income on last year's return was less than or equal to $150,000, or payments and withholding are equal to 110% of last year's tax if adjusted gross income is greater than $150,000), a penalty is imposed at the interest rate that applies to assessments of tax. This penalty is not generally deductible for income tax purposes. Interest is not charged for the late payment of estimated tax.

It is important to note that alternative minimum tax must also be paid by estimates. For a complete discussion of alternative minimum tax, see Chapter 5.

Foreign Bank Accounts and Specified Foreign Financial Assets

Foreign Bank Account Reporting (FBAR). The Department of the Treasury requires that every US citizen or resident alien with an interest in or signature authority over foreign bank accounts, securities, or other financial accounts that exceed $10,000 in aggregate value at any time during the calendar year must report that relationship. The original deadline to file the FBAR will align with that of the individual income tax return (that is, 18 April). An automatic six-month extension is provided for anyone who fails to meet the original deadline.

The report is made electronically on Form 114, *Report of Foreign Bank and Financial Accounts (FBAR)* and is filed online and separately from the income tax return through the BSA E-Filing System website. Form 114 is for disclosure purposes only and does not impact or serve to assess any amount of tax on the return. However, failure to file Form 114 may result in the imposition of civil and criminal penalties.

Specified Foreign Financial Asset Reporting. Additional reporting of specified foreign financial assets may be required as part of the individual's tax return by attaching Form 8938, *Statement of Specified Foreign Financial Assets*. Form 8938 applies to certain individuals holding an interest in specified foreign financial asset(s) over the applicable Form 8938 reporting threshold for the underlying tax-year.

"Certain individuals" generally include US citizens and green card holders, as well as US aliens filing a resident US income tax return. These individuals must attach Form 8938 to their US tax return when they hold an interest in specified foreign financial assets in excess of the applicable reporting threshold.

"Specified foreign financial assets" may include:

- any depository, custodial, or other financial account maintained by a foreign (non-US) financial institution,
- any stock, security, financial instrument or contract issued by a person other than a US person held outside of a financial institution, and,
- any separate interest in a foreign entity not held in a US institutional account

The table below summarizes the Form 8938 reporting threshold for each type of individual classified as a specified person and is based on the aggregate total value (in US dollars) of all specified foreign financial assets held on either the last day of the tax year, or at any time during the tax year:

When required, all accounts and financial assets located outside the US require disclosure on Form 8938.

	Not Living Abroad		Living Abroad	
	Not Filing Jointly	Filing Jointly	Not Filing Jointly	Filing Jointly
Last Day of Tax year	$50,000	$100,000	$200,000	$400,000
Any Time During Tax year	$75,000	$150,000	$300,000	$600,000

US Immigration Reporting

Passport applicants and green card applicants must affirm that they have properly filed required US returns. Failure to file this information carries a penalty. The purpose of this provision is to identify US persons who fail to file US tax returns during their period of foreign residence.

The U.S. State Department may revoke existing U.S. passports or deny U.S. passport applications or renewals for individuals with an outstanding tax debt in excess of $55,000 during 2022. The $55,000 threshold includes tax liabilities, interest, and penalties for which the Internal Revenue Service (IRS) has issued a notice of levy of lien for the debt. It does not include debt which is being paid through an installment plan or which is currently under due process hearing.

A US green card holder is generally subject to US income tax on worldwide income during the entire time he or she holds the green card, even if residing outside the US. Complex tax statutes govern individuals who abandon lawful permanent residence status. In general, revoking a green card subjects the individual to an expatriation exit tax regime which may serve to tax the individual on their net wealth. Consultation with a professional adviser specializing in this area is strongly recommended when considering potential tax consequences and other legal implications associated with surrendering a green card.

Chapter 2 Special foreign exclusions

Qualifying US taxpayers with a tax home outside the United States are entitled to elect two exclusions to reduce their US taxable income: the foreign earned income and the housing cost exclusions. The exclusions are available only if the taxpayer maintains a foreign tax home and meets either the bona fide residence or physical presence requirements explained on pages 9 – 12.

Foreign Earned Income Exclusion

A qualifying taxpayer may elect to exclude foreign earned income up to certain thresholds. The exclusion amount is indexed for inflation (see Appendix A for current year limitations). The exclusion is allowed in full only if the taxpayer remains qualified during the entire tax year. Otherwise, the exclusion is reduced proportionately for the number of days during the tax year that the taxpayer does not qualify for the exclusion (see Example 3 on page 8). Also, to be excluded, the foreign earned income must be received no later than one year following the tax year in which it is earned. Income deferred for more than one tax year may not be excluded.

In the case of married persons who each earn foreign income, a full exclusion is available for each individual and is computed separately against each individual's foreign earned income. See Example 2. This procedure applies even if the income is earned in a foreign country that is a community property jurisdiction. If married individuals file separately, each may elect to take his or her foreign earned income exclusion on a separate return (see Example 2). (Also see "Foreign Earned Income" and "Foreign-Source Income," pages 12-14)

Housing Cost Exclusion

Qualifying taxpayers may make an additional election to exclude from their gross income an amount equal to certain housing costs, as long as these costs are not considered extravagant. A taxpayer is generally subject to US income tax on the value of accommodations, meals, and most other living expenses paid for or provided by the employer. However, if these items are supplied for the convenience of the employer and several other standards are met, they are excluded from income.

> ***Example 2:***
> Bill and Anne Smith are US citizens who qualify for the foreign earned income exclusion for all of 20X1. Assume the exclusion limitation for 20X1 is $100,000. Anne's 20X1 foreign earned income is $110,000 and Bill's is $50,000. In a joint return, the Smiths may exclude a total of $150,000: $100,000 of her earnings and the full $50,000 of his earnings. Anne is not allowed to use the unused portion of Bill's exclusion. If they file separately, each would report the exclusion on a separate return.

The election to exclude housing costs is available only to those who have received foreign earned income as an employee. Qualifying housing expenses **include** the following:

- Rent
- Fair rental value of housing provided in the foreign country by the employer
- Utilities (other than telephone charges)
- Real and personal property insurance
- Certain occupancy and personal property taxes
- Nonrefundable fees paid for securing the leasehold
- Rental of furniture and household accessories
- Household repairs
- Residential parking

Qualifying housing expenses **exclude** the following:

- Cost of a house purchase, improvements, and other costs considered capital expenditures
- Cost of purchased furniture or household accessories
- Domestic labor expenses (maids, gardeners, etc.)
- Mortgage payments (both principal and interest)
- Depreciation expenses
- The cost of a television pay subscription
- Telephone charges
- Certain other housing-related expenses claimed elsewhere on the return

In addition, if the taxpayer's family is required to reside in a separate abode overseas because the living conditions in the location where the taxpayer is employed are not safe or healthy for the family, the reasonable housing expenses of maintaining the second foreign household may be eligible for the housing cost exclusion.

The housing cost exclusion is equal to the excess of the "qualifying housing expenses" over a "base housing amount." The maximum housing expenses allowable are capped at 30 percent of the maximum foreign earned income exclusion limitation. The base housing amount is calculated as 16 percent of the maximum foreign earned income exclusion discussed above. Thus, the maximum housing exclusion allowable is the equivalent to 14 percent of the foreign earned income exclusion and will increase as the foreign earned income exclusion is adjusted upward for inflation.

If the housing expenses are incurred in a year in which the employee begins or completes the foreign assignment, the base housing amount is reduced proportionately. Also, assuming both exclusions have been elected, the housing cost exclusion must be calculated first (see Example 3).

Example 3:
Smith qualified for the foreign exclusions during 20X1 from 1 January through 31 May. His total foreign income earned during the qualifying period was $45,000, and he incurred $8,000 in qualified housing expenses. The number of days in the qualifying period during 20X1 is 151, and this number serves as the basis for the apportionment of the foreign earned income exclusion and the base-housing amount. Assume the foreign earned income exclusion limitation for 20X1 is $100,000.

Smith's foreign exclusions would be calculated as follows:

Qualified housing expenses	$8,000
Less: proportional base housing amount (151 / 365 × (100,000 * 16%))	$(6,619)
Housing cost exclusion	$1,381
Foreign earned income exclusion (151/365 x $100,000)	$41,370
Total foreign exclusions	$42,751

The IRS has provided for certain exceptions to the limitation on "qualifying housing expenses" for taxpayers living in high cost locations. Accordingly, in calculating the amount of foreign housing exclusion in a high cost location, an individual would (1) take the lower of their actual housing expenses or the high cost amount and (2) subtract the base housing amount discussed above. Appendix B provides a sample of housing exclusions for popular foreign assignment locations around the world. For a complete list, please contact a professional tax advisor. These amounts will be updated annually by the IRS and other locations may be added as cost of living data on those locations are evaluated by the IRS.

Married Taxpayers. Spouses residing together and filing joint returns may elect to compute their housing cost exclusion separately or jointly. If they elect to calculate the exclusion separately, they must use a separate base housing amount. They may allocate expenses to either spouse or divide them as they wish. Married persons filing separately must compute their housing cost amounts individually and file separate returns.

If they elect to compute the housing cost amount jointly, the spouses must also decide which spouse is to claim the exclusion. The spouse claiming the exclusion may aggregate the couple's housing expenses and subtract his or her base-housing amount. Generally, the joint election is more beneficial, since the qualified housing expenses are reduced by only one base housing amount.

Foreign Housing Expense Deduction

The foreign housing expense deduction is roughly equivalent to the foreign housing cost exclusion, except that its use is restricted to self-employed individuals. Under these circumstances, the qualifying taxpayer must deduct his or her housing cost amount. If the taxpayer has earned income during the year as an employee and as a self-employed individual, the housing cost amount is reported as an exclusion *and* as a deduction in proportion to the two income sources.

The deduction for the housing cost amount is limited to the excess of the taxpayer's foreign earned income for the year over the foreign exclusion. If part of the housing cost amount cannot be deducted due to this limitation, it may be carried forward to the succeeding tax year and deducted up to the amount of the limitation in that year. The expenses may be carried forward for only one year and may be taken into account only if the foreign earned income for the following year exceeds both the exclusion and the housing expenses incurred in that year (see Example 4).

Example 4:
Smith's 20X1 foreign earned income was $112,000, $21,000 of which is considered self-employment income. His qualified housing expenses were $35,000. Assume the foreign earned income exclusion limitation for 20X1 is $100,000. Smith's housing cost amount exclusion and housing cost amount deduction would be calculated as follows:

Qualified housing expenses (limited to 30% of FEIE)	$30,000
Less: base housing amount	(16,000)
Housing cost amount	$14,000

Housing cost amount exclusion:

Employment income / Total income	x	Housing cost amount	=	Excludable housing cost amount
$91,000 / $112,000	x	$14,000	=	$11,375

The housing cost deduction is $2,625 (the $14,000 housing cost amount less the $11,375 exclusion). However, since Smith's foreign earned income is exceeded by the combination of the $100,000 exclusion and the housing cost exclusion, a por¬tion of this housing cost deduction will be carried forward to 20X2.

Foreign earned income	$112,000
Less: housing cost exclusion	(11,375)
Less: foreign earned income exclusion	(100,000)
Housing cost deduction in 20X1	$625
Housing cost amount deduction carried forward to 20X2	$2,000

Qualifying for the Exclusions

A US citizen may qualify for the foreign earned income and housing exclusions in two ways:

1. By establishing himself or herself as a bona fide foreign resident (BFR) for an uninterrupted period that includes an entire calendar year, or
2. By qualifying for the physical presence test (PPT) by being physically present in one or more foreign countries for 330 full days in any consecutive twelve-month period.

In many cases, only PPT is available to US resident aliens ("green card" holders) since they are, by nature, bona fide residents of the United States. The IRS can waive the time requirement needed to quality for either of the two tests if it is determined that the individual had to leave a country because of a war or other adverse living conditions that existed in that country. The IRS publishes every year a list of countries for which this waiver applies. The list of countries to which this exception applies is strictly limited. A special provision denies the exclusions to individuals violating federal travel restrictions.

Foreign Tax Home

A prerequisite for either BFR or PPT is that the taxpayer must establish a foreign tax home. A person's tax home is generally defined as the location of his or her principal place of business, rather than his or her abode or residence. A tax home normally must be established and maintained solely for reasons of employment. If a person has no principal place of business, his or her tax home is considered to be his or her regular abode.

A taxpayer is not considered to have a foreign tax home for any period during which his or her abode remains in the United States. For example, a taxpayer who lives in Detroit but commutes daily to work in Windsor, Ontario, would ordinarily have his or her tax home in Windsor (principal place of business); however, because the abode continues to be located in the United States, he or she would be ineligible for the exclusions. The IRS considers a new tax home to have been established if the taxpayer actually stays at the new place of employment for at least one year.

Equally important as the establishment of a foreign tax home and foreign place of employment is the taxpayer's demonstration that he or she has established a foreign abode. The IRS, in Revenue Ruling 93-86, lists three factors for determining whether a taxpayer has established a foreign abode:

- the taxpayer's family accompanies him or her to live in the new home,
- living expenses are not being duplicated by maintaining an old home, and
- a preponderance of business contacts are now at the new location.

If a person meets the tests for establishing a foreign tax home and maintains his or her principal dwelling abroad, merely retaining ownership of the former US residence will not cause him/her to have a US abode for purposes of this rule. The result is generally the same even if the individual's spouse or dependents continue to reside in the US house. A final determination would depend on all other facts and circumstances.

It should be noted that once a foreign tax home has been established, any reimbursements for housing or living expenses in that location may not be treated as "away from home" business expenses. Therefore, it is not possible to claim the exclusions for a period of time in which housing or living expense reimbursements are taking place unless these reimbursements are included in the taxable compensation of the employee.

The lack of a precise definition of foreign tax home makes it very important that taxpayers document factors in their personal situation that support the establishment of a foreign tax home. As previously mentioned, a foreign tax home is absolutely necessary to qualify for the exclusions.

Foreign Country

The term *foreign country* for purposes of the physical presence and bona fide foreign residence tests includes any territory under the sovereignty of a government other than that of the United States. It includes the territorial waters of the foreign country, as they are defined under US laws, and the air space over the foreign country. US possessions and territories are not considered foreign countries, nor are international waters.

Bona Fide Foreign Residence Test

To qualify as a bona fide foreign resident, a US citizen must reside in a foreign country for at least an entire tax year—for a calendar-year taxpayer, one beginning before 1 January and ending after 31 December of the same year. For purposes of the BFR test, it is crucial that the taxpayer establish foreign residence before 1 January. Being on the foreign company's payroll is not sufficient; residency begins only when the taxpayer arrives in the foreign country with a genuine intent to establish a foreign residence (see Examples 5, 6, and 7).

The BFR test requires that the taxpayer have an intent to reside in a foreign country, as supported by the related facts and circumstances. A person who travels abroad for a temporary period of time for a specific purpose is not usually considered a BFR. Merely being in a foreign country for the required length of time is not sufficient; the required intent must exist. In determining a taxpayer's intent to establish a foreign residence, US courts have considered factors such as the duration and nature of the stay; whether the taxpayer's US house was sold, leased, or abandoned in favor of one in the foreign country; whether the taxpayer was accompanied by his or her family; the type of foreign visa obtained; the nature and degree of the taxpayer's participation in the foreign community; the taxpayer's command of the foreign language; and the location of the taxpayer's economic interests. The fact that a taxpayer intends to return to the United States when the foreign assignment is over does not prevent his or her qualification as a BFR (see Examples 6 and 7).

Example 5:
Smith, a calendar-year taxpayer, arrived in the United Kingdom on 19 January 20X1. He cannot qualify as a BFR for 20X1 because he is a UK resident for only part of 20X1. However if he remains a UK resident for all of 20X2, the benefits of BFR status can be retroactively applied starting from 20 January 20X1. Should Smith relinquish his UK residence at any time during 20X2, he will be unable to qualify for the exclusion under the BFR test for either year.

Example 6:
US citizen Smith moved to the UK with the intention of residing/working there for an indefinite period of time. He plans to return to the US after his assignment is done. He rented his home in the US and took his home furnishings with him to the UK. Smith has the intent necessary to qualify as a BFR.

Example 7:
Brown, a US citizen, leaves the United States to work in Belgium for thirteen months. She leaves her family in the United States. Brown may or may not qualify for BFR. Additional factors must be examined.

Being considered a nonresident under foreign tax laws should not preclude a taxpayer from applying the BFR test. Also, the possession of a tourist visa, with its implications that one is not a resident of the country under local immigration laws, does not in itself cause one to fail the BFR test.

An income tax exemption provided in a treaty or other international agreement will not in itself prevent a person from BFR status. Whether a treaty prevents a person from becoming BFR of a foreign country is determined under all provisions of the treaty, including specific provisions relating to residence or privileges and immunities.

Another determining factor may be the manner in which the taxpayer presents his or her status to the foreign tax authorities. If the taxpayer gives a statement to the foreign tax authorities seeking exemption from the foreign country's tax on the grounds that the taxpayer is not a resident of the foreign country, and if the tax authorities of the foreign country agree with the claim for exemption, then the taxpayer will not qualify under the BFR test.

A change of foreign residence from one foreign country to another does not affect BFR status. However, even temporary residence in the United States between foreign assignments may terminate BFR status. Consequently, a taxpayer should maintain his or her foreign residence status until becoming a resident in a new foreign country. (Note, however, that a temporary period of US residence status does not revoke the election to exclude foreign earned income. If the taxpayer moves abroad again, the election remains in effect.)

The IRS frequently determines whether a taxpayer qualifies as a BFR on the basis of the facts reported on Form 2555 *Foreign Earned Income*. This form must be filed with each tax return for which the foreign exclusions are claimed.

Physical Presence Test

To qualify for the special foreign exclusion under the physical presence test, a US citizen or resident alien must be physically present in a foreign country for 330 full days within any consecutive twelve-month period. A full day is a twenty-four-hour period beginning at midnight. Also, the taxpayer must have established a foreign tax home and a foreign abode as of that day. The time spent on or over international waters is not considered when counting the days a taxpayer was physically present in a foreign country unless the points of departure and arrival are both foreign countries. During such a trip, a person may visit the United States and, provided that the US presence is for less than twenty-four hours, the day in the United States will still qualify as one of foreign physical presence.

The intent to establish a foreign residence is irrelevant for purposes of the physical presence test. All that is required is that the taxpayer actually be present on foreign soil and be able to claim that his or her tax home and abode are outside the United States during the time of foreign presence. An individual may qualify under the physical presence test regardless of whether he or she is subject to income tax in the foreign country.

Time spent in a foreign country in the employment of the US government will count toward satisfaction of the 330-day requirement. However, income earned from the US government may not be excluded.

A taxpayer qualifies for the exclusions in any twelve-month period in which he or she has been physically present outside the United States for at least 330 full days, and the taxpayer can select the period. The objective is to have as many days as possible in a tax year fall within a twelve-month qualifying period. The foreign tax home and abode need not have been established throughout the entire twelve-month period, but they do need to have been established for each day of the taxpayer's 330 foreign days within that period.

As a result, for the first year of physical presence, the qualifying period and amount of excludable earned income are maximized as follows: Count back twelve months from the 330th full day of physical presence abroad. Then count the number of days between the first day of that twelve-month period and the end of the first year of foreign physical presence (see Example 8).

Example 8:
Brown arrives in Belgium at 11:59 p.m. on 31 March 20X1. She remains there throughout 20X1 and 20X2. The earliest possible date which Brown can qualify for the foreign earned income exclusion is 330 days from the date of arrival, or 24 February 20X2:

1 April 20X1 + 330 foreign days = 24 Feb 20X2

Because Brown arrived in Belgium on 31 March 20X1 and remained outside the U.S. for the following 330 days the physical presence qualification test is met on 24 Feb 20X2.

There are 35 days remaining (i.e., 330 of 365) in the consecutive twelve month qualifying period which Brown can use to claim an earlier qualifying start date than 1 April 20X1 to maximize the number of qualifying days and the excludable amount in 20X1:

	←	1 April 20X1	→	24 Feb 20X2
25 Feb 20X1	35 U.S. Days	+	330 foreign days =	365 days

Brown's qualifying period during calendar-year 20X1 is 25 February 20X1 through 31 December 20X1, or 310 days.

The maximum amount of the 20X1 earned income exclusion available is therefore 310/365, or 85% of the total annual exclusion amount, even though Brown was physically present in Belgium only 275 days during calendar-year 20X1.

Similarly, in the year the taxpayer terminates his or her foreign assignment, the qualifying period may be extended beyond the date of repatriation (see Example 9).

Example 9:
Brown leaves Belgium on 1 July 20X2, having been physically present there for three consecutive years. To maximize the number of qualifying days and the excludable amount in 20X2, Brown performs the following calculation:
The date physical presence ended is 30 June 20X2. Because Brown was physically present outside the U.S. for 330 consecutive days prior to this date, the physical presence ending date may be deferred 35 days after Brown leaves to 4 August 20X2:

	←	30 June 20X2	→	4 Aug 20X2
5 Aug 20X1	330 foreign days	+	35 US days =	365 days

Brown's qualifying period during calendar-year 20X2 is from 1 January 20X2 through 4 August 20X2, or 216 days. The maximum amount of the 20X2 earned income exclusion available is therefore 216/365, or 59% of the total annual exclusion amount, even though Brown was physically present in Belgium for only 181 days during calendar-year 20X2.

In summary, the foreign exclusions may be increased in the first and last years of an overseas assignment in certain situations when the physical presence, not the BFR, rule is used. This is the only exception to the rule that taxpayers must maintain a foreign tax home throughout the period during which they qualify for the special foreign exclusions. Nevertheless, the foreign tax home must be maintained throughout the time the taxpayer counts as having been physically present outside the United States.

Foreign Camp Exclusion

A taxpayer is generally required to include as taxable income employer-provided housing and meals, as well as most other in-kind accommodations and allowances. One exception to this rule is that an employee may exclude from gross income the value of meals and lodging furnished by or on behalf of his or her employer and for the employer's convenience. This exclusion applies only if the meals are furnished on the employer's business premises. In the case of lodging, the employee is required to accept it on the business premise of his or her employer as a condition of employment. This exception applies to employees inside and outside the United States.

A second, more liberal exception applies to employees stationed overseas. This exception provides that if a taxpayer resides overseas in employer-provided housing qualifying as a camp, the "on the business premises of the employer" requirement for excluding the value of lodging and meals is waived.

There are detailed rules under which the meals and lodging must be provided in order for this exception to apply.

Electing the Exclusions

The exclusions for foreign earned income and for housing costs are elective by the taxpayer. These elections must be made on a tax return with Form 2555 attached that is filed no later than one year after the original due date. This due date will be determined without respect to the extension of time to file. As a result, a person may elect the exclusions for 20X1 on a 20X1 tax return filed no later than 15 April 20X3. This special-election deadline does not extend the return's due date or the time period for other provisions in the tax law.

Either of the elections may also be made on an amended tax return if the original return was filed on time. An amended tax return may be filed up to three years following the extended due date of the original return, as described on pages 3 to 4. Either election may also be made on a late return filed after one year of its original due date as described on page 4. A taxpayer must make separate elections for the first year he or she intends to exclude foreign earned income or qualified housing expenses. Each election may be made regardless of whether the other is made.

It may not always be to the taxpayer's advantage to elect one or both of the exclusions. However, once elected, the exclusions must be applied in all later years unless they are revoked. The taxpayer may revoke either election in the current tax year or use an amended return to revoke elections made in previous years. However, this will also revoke the exclusion claimed in any intermediate year.

If the taxpayer has never previously elected to claim the exclusions (e.g., first year on assignment), and chooses not to claim the exclusion, that is not considered a revocation.

Should the taxpayer return to the United States and become a US resident and then, a number of years later, move abroad again, the elections would remain in effect. Should he or she decide in a later year to revoke either election, the revocation would be binding for that year and at least five subsequent tax years. A taxpayer can, however, reelect either exclusion within this six-year period by obtaining the IRS' consent. In deciding whether to consent to a reelection, the IRS considers the period of the taxpayer's US residence, whether the individual moved from one foreign country to another with differing tax rates, and other relevant facts and circumstances. IRS consent is obtained by filing a request for a private letter ruling with the IRS National Office of Chief Counsel.

Foreign Earned Income

The basis for calculating the foreign exclusion is the taxpayer's foreign earned income for the year. Earned income generally includes all typical compensation items received by an employee in providing personal services to the employer. It includes all types of reimbursements, allowances, commissions, and in-kind payments associated with the provision of services, such as:

- Incentive payments relating to foreign assignments
- Cost-of-living and housing allowances
- Market value of employer-provided housing, automobiles, financial services, and so forth
- Tuition and home leave
- US, state, and foreign income tax allowances

When a taxpayer operates as a sole proprietor or professional, separate rules apply to determine the amount of earned income, depending on whether the income generated is the result of personal services only, or a combination of personal services and other capital investments. Where both are included, the taxpayer may consider up to 30% of the net profits as compensation for personal services qualifying for the exclusion. If capital is not a factor in producing the overall income, the total profit may be considered earned income. In all cases, the amount paid for personal services for a sole proprietor or professional must be considered reasonable, based on all of the circumstances of the situation.

Professional fees will generally constitute earned income, even if the taxpayer employs assistants who perform part or all of the services, provided that the patients or clients look to the taxpayer as the person responsible for the services rendered.

The IRS has ruled (contrary to at least one court case) that, when determining the earned income of a member of a foreign partnership, the foreign earned income exclusion is applied to the partner's share of the partnership's gross income, rather than to its net income. Furthermore, if the partner's income partly depends upon the services of the fellow partners and employees both inside and outside the United States, the partner's income qualifying for the exclusion is based on a ratio of the partnership's earned income from sources outside the United States to its total earned income. However, if the partnership agreement provides that a particular partner's share of partnership income is derived solely from the profits of the partnership's foreign branch, that partner can consider his or her

proportionate share of earned income to come from foreign sources.

"Guaranteed payments" received by a partner for services rendered outside the United States are considered separately as compensation for services performed outside the United States.

In the arts and sciences, distinguishing compensation for personal services from income and from the transfer of artistic property (for example, a painting, book, or copyright) has often been difficult. Since 1973, the IRS has agreed that, at least for purposes of the foreign earned income exclusion, a painter's income from the sale of his or her paintings is earned income eligible for the exclusion. Furthermore, the IRS has extended its analysis to writers who transfer the property rights to their works to a publisher, and to composers who transfer the copyrights to their musical compositions. Consequently, the income that authors and artists derive from transferring their work can be earned income for purposes of the earned income exclusion.

As a rule, employees of the US government are not eligible for the special foreign exclusions. They usually receive other exemptions for certain cost-of-living and foreign-area allowances.

Foreign earned income does not include pension or annuity income, income received as a "nonqualified annuity," or income received from a nonexempt trust.

Earned income qualifying for the exclusion is deemed to have been received, for purposes of applying the limitation, in the year in which the services were performed. The exclusion cannot be increased by deferring receipt of foreign earned income to a later year.

Also, to qualify for the exclusion, the income must not be received later than the end of the year following the year in which the services were performed. Consequently, payments for the employee's salary, expense reimbursements, or tax equalization will not qualify for the exclusion if paid later than one year after the year in which the services were performed (see Example 10).

Example 10:
Smith, who is entitled to the foreign earned income exclusion, earned $105,000 working outside the United States during 20X1. Smith received payment for these services over a three-year period: $60,000 in 20X1, $15,000 in 20X2, and the remaining $30,000 in 20X3. Assuming he reports on the cash basis, Smith would report the income in the year it is received. Assume the exclusion limitation for 20X1 is $100,000.

Since it was earned in 20X1, the maximum amount that may be excluded, provided that it is received no later than 31 December 20X2, is $100,000. Smith therefore would be allowed to exclude the $60,000 received in 20X1 and the $15,000 received in 20X2, since this total—$75,000—does not exceed the $100,000 exclusion allowed for 20X1. Smith cannot exclude any of the 20X1 income received in 20X3, even though an additional $25,000 ($100,000 - $60,000 - $15,000) could have been excluded had it been received in either 20X1 or 20X2.

Foreign-Source Income

To exclude the income, not only does it have to be earned income, the taxpayer must also establish that the income is from a foreign source. The source of compensation for the performance of personal services is determined on the basis of the place where the services are performed. Factors such as the place from which payment is made, the location of the employer, and the employee's home base are not relevant.

The IRS has issued regulations that address the proper method for determining the source of compensation for personal services performed inside and outside the United States. Generally, the regulations state that the source of compensation should be determined based on either a "time" or "geographical" basis.

The time basis requires all compensation other than certain listed fringe benefits (listed below) to be sourced based on days worked during the tax year. This category of income would include, among other items, salary, incentive compensation and taxable group term life insurance. This income would be sourced based on the ratio of foreign workdays over total workdays for the year.

Compensation related to prior or multiple tax years should be sourced on the time basis, applied to the entire period to which the compensation is attributable. For example, a bonus received in 20X2 related to 20X1 performance would be sourced based on 20X1 workdays. The IRS regulations prescribe that the time basis for stock option income is the time period between grant date and vesting date, rather than between the grant date and the exercise date.

The geographic basis sources income received in the form of certain fringe benefits based on the geographical work location for which it relates. The regulations list certain fringe benefits that should be sourced geographically, and set forth the following sourcing provisions:

- Housing — Sourced on the location of the individual's principal place of work;
- Education — Sourced on the location of the individual's principal place of work;
- Local transportation — Sourced on the location of the individual's principal place of work;
- Foreign tax reimbursements — Sourced on the location of the jurisdiction that imposed the tax;
- Hazardous or hardship duty pay — Sourced based on the duty zone for which the fringe benefit was paid;
- Moving expenses — Sourced on the location of the employee's new principal place of work, or if more appropriate based on specific facts, then the former place of work.

Alternatively, a "facts and circumstances" basis may be used if it can be shown to the satisfaction of the Commissioner that this basis is more appropriate. This may occur, for example, when an employee's compensation is tied to the performance of a specific action rather than earned ratably over a specific time period.

Some states have also published rules on sourcing which need to be considered in applying state income tax withholding rules and preparing state income tax returns.

Treaty re-sourcing of Compensation

Treaty re-sourcing provisions allow certain taxpayers to re-source US.-source income as foreign. Treaty re-sourcing provisions may be relied on for assignees on assignment to a treaty country that has a re-sourcing provision to ensure optimal sourcing of compensation, in cases in which such re-sourcing is applicable and the treaty provisions of the treaty are met. The treaty provisions generally require that the individual is a US citizen who is considered resident in the foreign country under the treaty.

Income Tax Calculation After Considering the Exclusions

The tax calculation with the exclusions requires the taxpayer to determine his or her taxable income after all deductions and exemptions and, before calculating the tax liability, the taxpayer must add back the amount of the exclusions, calculate the tax, and then subtract an amount of tax calculated as if the exclusion amount was the taxable income. An example of the tax calculation follows:

Example 11:

Married Filing Joint, No children Assume for 20X1 that the foreign earned income exclusion limitation for is $100,000, the maximum allowable housing exclusion is $14,000 and the standard deduction is $24,000.	20X1
Gross Income Including Wages	$150,000
Foreign Earned Income Exclusion	(100,000)
Housing Exclusion ($50,000 Qualified Housing Expenses)	(14,000)
Adjusted Gross Income	$36,000
Less:	
Standard/Itemized Deductions	(24,000)
Taxable Income	$12,000
Calculation of Tax	
Taxable Income	$ 12,000
Plus: Exclusions	114,000
Tax Base	$126,000
Tax Calculation	$18.945
Less: Tax on Exclusions	16,314
Net Tax Liability	$ 2,640

Chapter 3 Moving and travel expenses

Moving Expense Reimbursement

Moving expense reimbursements will be included in gross income as compensation for services. Moving expense reimbursements include any amount received, directly or indirectly, by an employee from an employer as a payment for, or a reimbursement of, expenses for a move.

Source of Moving Expense Reimbursements. A reimbursement for a move to a foreign country will generally be considered foreign-source income and will therefore qualify for the foreign earned income exclusion. A reimbursement for moving expenses incurred to return to the United States will generally be considered US-source income, since it is deemed to be paid for future services to be performed in the United States.

However, a reimbursement for the return move back to the United States will be considered foreign-source income if it is made under a written agreement prepared before the move to the foreign country as an inducement for the move. The agreement must state that the employer will reimburse the employee for moving expenses incurred in returning to the United States whether or not the employee continues to work for the same employer after returning to the United States.

Attributing Moving Expense Reimbursements. When an individual does not qualify for the foreign earned income exclusion for the entire tax year of the move, the portion of the moving expense reimbursement that qualifies for the exclusion in that year is based on the number of days the taxpayer resided abroad in the tax year of the move. However, the moving expense reimbursement is attributable entirely to the year of the move, as long as the individual has a qualifying period of at least 120 days in the year of the move.

If the individual does not have a qualifying period of at least 120 days, he or she must attribute the moving expense reimbursement both to the year of the move and to the succeeding year, on the basis of the following ratio:

$$\frac{\text{Number of qualifying days for year of move}}{\text{Total number of days in the year}}$$

Travel Expenses "Away from Home"

Deductions are allowed for un-reimbursed expenses of travel, lodging, and meals and entertainment, provided that the amounts are reasonable and necessary for the conduct of the taxpayer's business. The expenditures cannot be "lavish or extravagant" under the circumstances. Travel and lodging expenses are allowed only when the taxpayer is temporarily away from his or her tax home.

An employee's reimbursed expenses under a reimbursement or other expense allowance arrangement with his or her employer should not be included in compensation, if the employee is required to substantiate the expenses.

When a taxpayer's employment away from home is expected to last more than one year, the employment will be treated as indefinite, as opposed to temporary, and the related travel expenses will be nondeductible. If the employment away from home is expected to last one year or less and during this period it is determined that the assignment period will exceed one year, the "away from home" provisions no longer apply as soon as the intent to remain exceeds one year.

Thus, a person who works abroad but maintains a US tax home while on a temporary foreign assignment can claim deductions for the cost of travel and lodging, as well as 50% of the cost of meals and entertainment, related to his or her foreign (or US) business trips. By maintaining a US tax home, the person is not eligible for the special foreign exclusions.

If, on the other hand, the person maintains a foreign tax home (and maintains a foreign abode), he or she is eligible for the foreign exclusions and can, in addition, claim similar deductions for lodging, meals, and travel on business trips away from the foreign tax home. At times it may be advantageous for a taxpayer to arrange his or her affairs in such a way that he or she continues to maintain a US tax home (and forgo the foreign exclusions) to claim away from home deductions for foreign business trips. This arrangement may be beneficial if it prevents foreign residence status and the resulting obligation to pay foreign income tax.

Chapter 4 Principal residence

Selling the US Principal Residence

Unmarried taxpayers are allowed to exclude the gain on the sale of their principal residence to a maximum of $250,000, and $500,000 for married taxpayers filing joint returns, provided such taxpayer(s) meet certain qualifications. In general, to qualify for the exclusion, a taxpayer must have owned and occupied the residence as a primary residence for at least two of the five years preceding the sale. Taxpayers who fail to meet the two-year requirement because of a change in place of employment, health, or other unforeseen circumstances (described below) may be eligible for a portion of the exclusion based on the ratio of their own qualifying period to the two-year period. For example, a taxpayer who has owned and occupied a residence for one year and is then transferred abroad will be entitled to one-half of the exclusion (see *Partial Exclusion*, below, for more detail). In addition, the exclusion for gain does not apply if the principal residence was acquired in a like-kind exchange in which any gain was not recognized within the prior five years. The exclusion may be claimed once every two years.

Regulations help to define what is considered a sale by reason of unforeseen circumstances. The regulations state that a sale is by reason of unforeseen circumstances if the primary reason for the sale is the occurrence of an event that could not reasonably have been anticipated before purchasing and occupying the residence. Examples provided include the involuntary conversion of the residence, a natural or man-made disaster or acts of war or terrorism resulting in a casualty to the residence, or for the owner's death, cessation of employment for which the individual is eligible for unemployment compensation, a change in employment status so that the individual can no longer pay housing costs and reasonable basic living expenses, a divorce or legal separation, or multiple births from the same pregnancy. Preference for a different residence or an improvement in financial circumstances is not considered an unforeseen circumstance that would allow for the reduced maximum exclusion.

When a taxpayer sells a home on which depreciation has been claimed during a rental period, the depreciation is recaptured at the time of sale (assuming that the sale price exceeds the depreciated cost of the home) and taxed at a special rate of 25% (see Example 12). However, depreciation claimed before 7 May 1997 is not treated this way.

The exclusion is generally not available to individuals who are deemed to have expatriated to avoid US tax under Section 877 (i.e., former long-term residents or former US citizens).

Partial Exclusion. If a taxpayer has owned and occupied a residence as a primary residence for fewer than two of the five years preceding sale, but has sold the residence because of a change of place of employment or health or other unforeseen circumstances, the taxpayer is entitled to a pro-rata portion of the exclusion (see Example 13)

For sales or exchanges occurring after 31 December 2008, gain attributable to a period of **nonqualified** use by a taxpayer is not excludable from gross income. The amount of gain allocated to a period of nonqualified use is the total amount of the gain multiplied by a fraction, the numerator of which is the total period of nonqualified use during the entire period the property was owned, and the denominator of which is the total period the property was owned.

A period of nonqualified use is defined as any period (not including any period prior to 1 January 2009) during which the property is not used by the taxpayer, the taxpayer's spouse or former spouse as a principal residence. Three exceptions apply to this definition:

- Any period of the five-year period after the last day the property is used as a principal residence of the taxpayer or spouse

Example 12:
Smith purchases a home on 1 September 20X1 for $100,000 and sells it on 1 September 20X9 for $200,000. During the period of ownership, the home was rented for a brief period and depreciation of $3,000 was claimed, so that the depreciated cost of the home is $97,000. The gain realized on the sale is $103,000 ($200,000 – [($100,000 - $3,000)]. The first $3,000 of realized gain is recaptured depreciation subject to the special 25% tax, and the remaining $100,000 is eligible for the exclusion (assuming there is no applicable nonqualified use, see examples 14 & 15).

Example 13:
Smith purchases a residence on 1 September 20X1 for $100,000. On 1 June 20X2 Smith sells the residence for $150,000, as a result of taking up a foreign assignment. Smith is entitled to 9/24ths of the maximum exclusion ($250,000 * (9/24) = $93,750), since he has owned and occupied the house as his principal residence for nine months of the required twenty-four-month total period and the house was sold as a result of a change in place of employment. Since his total gain of $50,000 ($150,000 - $100,000) is less than the maximum exclusion available ($93,750), the full amount of the gain is excluded.

- Any period, up to 10 years, during which the taxpayer or spouse is on extended duty with the military, Foreign Service, or the intelligence community, and
- Any period, up to two years, during which the taxpayer is temporarily absent by reason of change of employment, health conditions or other unforeseen circumstances

See Examples 14 and 15 for application of these new changes.

Example 14:
Brown buys a principal residence on 1 May 20X1 and moves out of his principal residence on 1 August 20X3 to work abroad. While living abroad, Brown rents out his home. Brown does not reoccupy this home and he sells the property on 1 June 20X6 for a gain of $100,000. Brown owned and used the property as his principal residence for at least two of the last five years (1 June 20X1 through 31 July 20X3), so he meets the two-of-five year test, and even though he rented the property, he still meets the first exception above, in that the rental period is considered a period after the last day the property was used as his principal residence. Therefore, this period is not considered a period of nonqualified use. Brown is therefore entitled to the full exclusion of $250,000, subject to the depreciation from the rental period being taxable.

Implications of the Sale of Home Rules for Foreign Assignments. Employees who will take, or have taken, a foreign assignment should consider the possible effects of these rules on gains that they might realize from their US residences. There are numerous possibilities.

- An employee who cannot yet meet the two-year ownership and use requirements might attempt to delay the foreign assignment until the requirements are met.
- An employee who has owned and occupied the house for the two years immediately preceding foreign assignment will have a foreign assignment "window" of three years at the end of which the employee would still be entitled to the full exclusion, since at that point (but not beyond it) the employee will have owned and occupied the residence for precisely two of the preceding five years.
- An employee who is uncertain whether the foreign assignment may extend sufficiently to impair access to the full exclusion, or who is uncertain about repatriating to the same US location at the conclusion of the foreign assignment, may want to sell the residence before taking up the assignment.
- An employee who, as a result of a foreign assignment, will at the conclusion of that assignment not meet the two-year test may wish to avoid repatriating to a different US location, so that the residence may be reoccupied and re-qualified for the exclusion.

As there are a great many more possibilities, along with issues involving marriage, ownership, and the assignment, it is strongly recommended that planning be carried out with the assistance of tax advisers.

Purchasing a Foreign Residence

The law does not restrict the exclusion to gain from the sale of a principal residence in the United States; a foreign principal residence may also qualify. There are, however, several issues that should be considered before a foreign residence is purchased.

First, the purchase of a residence in the foreign location may affect the taxpayer's status under the tax laws of the foreign country. A number of countries maintain special tax regimes for expatriates assigned temporarily, and the purchase of a residence may jeopardize a taxpayer's opportunity to take advantage of such a regime.

Second, a taxpayer who rents a home abroad may be entitled to a housing cost exclusion (see Chapter 2, *Special Foreign Exclusions*). The exclusion is not available for costs associated with a home that is purchased abroad.

Third, foreign real property taxes on a personal property are not deductible in the United States.

Example 15:
Smith buys a principal residence on 1 May 20X1 and is sent abroad by her employer on 1 May 20X3, leaving the property vacant. She returns to live in the residence on 1 May 20X6 and sells the property on 1 May 20X8 for a gain of $200,000. Smith meets the two-of-five year test so she is eligible to exclude a full $250,000 of the gain. However, a portion of this gain is related to a period of nonqualified use so the exclusion is limited, as follows:

- 1 May 20X1 – 30 April 20X3 – 2 years in which the property was used by Smith
- 1 May 20X3 – 30 April 20X6 – 3 years property was not used. However, per the third exception above, she is entitled to a 2-year absence by reason of change of employment. Therefore, only one year is considered nonqualified use.
- 1 May 20X6 – 30 April 20X8 – 2 years in which the property was used by Smith

Accordingly, one out of her seven years of ownership is considered a period of nonqualified use. Therefore, one seventh of the gain is not eligible for the exclusion, or $28,571 ($200,000 gain * 1/7), and is included in gross income in the year of sale. The remaining gain of $171,429 is less than the $250,000 exclusion so it is fully excluded from gross income.

Finally, the purchase of a home abroad may give rise to a foreign currency exchange gain when the home is sold and a mortgage retired because of a change in the exchange rate between the time of purchase/mortgage acquisition and sale/mortgage retirement. In fact, it is possible that the sale of a foreign home will give rise to a nondeductible personal loss on the sale of the home itself, and at the same time a taxable exchange rate gain on the retirement of the mortgage (see Example 16).

Example 16:
Brown purchases a home in Germany on 1 May 20X1 for €300,000, when the exchange rate is € 1 = US$1.4802. The purchase is effected by a down payment of € 60,000, and a mortgage of € 240,000. On 1 May 20X4, Brown sells the home for € 300,000, when the value of the Euro against the US dollar has changed to € 1 = US$1.3832. In the interval, € 10,000 of the mortgage has been paid off, so that the remaining mortgage is € 230,000.
In Euro, there has been neither a gain nor a loss on the house sale. However, in US currency the value of the home has declined from US$444,060 to US$414,960. The loss of US$29,100 is a nondeductible personal loss. Moreover, there has been a gain on the retirement of the mortgage. The remaining mortgage of € 230,000 was valued at US$340,446 at the time it was issued, but at only US$318,136 at the time it was retired. In other words, the debt is settled for US$22,310 less than its value at issue, and this $22,310 represents a taxable gain that cannot be offset by the loss suffered on the sale of the home itself.

Renting the US Residence

If a taxpayer rents the former principal residence during the period of a foreign assignment, the net rental income or loss is reported on the US income tax return. Expenses considered necessary for earning the income are deducted in determining the net amount. If the taxpayer intends to return to the US residence, renting it will not necessarily disqualify any later gain on its sale from the exclusion, although the taxpayer will still have to meet the ownership and use requirements for the exclusion.

Deductibility of rental losses may be restricted in several ways. First, if a taxpayer's adjusted gross income does not exceed $100,000, the taxpayer can deduct up to $25,000 of annual losses, but the deductible loss is phased out by fifty cents on the dollar as adjusted gross income exceeds $100,000, so that at $150,000 there will no longer be a deductible loss. Second, if a taxpayer uses the residence for personal purposes for the greater of fourteen days or 10% of the number of days during which the house is rented during a given year, no loss may be deducted. This loss restriction, however, does not apply to mortgage interest or real estate tax charges. If personal use does not exceed the limits, a deduction is allowable for a proportionate share of other expenses, including depreciation, attributable to rental of the unit.

If a taxpayer rents the US residence during the foreign assignment period but does not return to live in it, there may be some risk that the US residence will be considered to have been converted to business or income property. Case law indicates that this conversion will not be considered to have occurred if the taxpayer can demonstrate that the rental activity was temporary, was necessary owing to a difficult real estate market, coincided with sales efforts, or arose owing to uncertainties concerning future employment plans.

Conclusion

The rules regarding the exclusion on the gain from the sale of a principal residence in general provide stronger incentives to sell a residence before taking up a foreign assignment, especially if the length of the assignment is uncertain. The longer the assignment continues, the risk that access to the exclusion may be reduced or eliminated increases. Given the risks associated with rental of the US residence, and with purchase of a foreign residence, many employees taking a foreign assignment may wish to sell the US residence before or just after departure and rent a residence in the foreign location for the duration of the assignment. While certain factors may exist that could prevent this tax planning from being universally beneficial, special consideration should be given to the treatment of a person's principal residence.

Chapter 5 Alternative minimum tax

The alternative minimum tax (AMT) is intended to prevent a taxpayer with substantial economic income from avoiding all tax liability by using excessive deductions, exemptions, and credits. Essentially, AMT is a separate tax imposed on certain types of income and deductions. A taxpayer must pay AMT if it exceeds the regular tax. AMT is calculated in the same manner for expatriates as it is for domestic US taxpayers.

AMT is especially impactful to US taxpayers who earn foreign income that exceeds the exclusion amounts and is subject to foreign income tax at a rate greater than US rates. The foreign tax credit may help decrease the US tax (see Chapter 6 for an explanation of the foreign tax credit); taxpayers are allowed to claim the foreign tax credit as re-calculated for AMT purposes.

AMT Credit

Once paid, AMT may be allowed as a credit against the regular tax in later years. The AMT credit can be carried forward indefinitely; it cannot be carried back.

Carryovers are created only from deferral preferences and adjustments, not from AMT that may arise for exclusion preferences and adjustments (see below). The reasoning is that deferral preferences and adjustments provide the taxpayer with only temporary relief from the regular tax.

The preferences and adjustments that are exclusion items include the standard deduction, medical and dental expenses, taxes, depletion in excess of the basis, and private activity bond interest.

There may be little or no tax benefit from the above deductions, which are considered exclusion adjustments or preferences. For example, the deduction for state income taxes paid in a year when the taxpayer is subject to AMT may never provide a tax benefit since this deduction is ignored in the AMT calculation. Since the same rule applies to a deduction for foreign income taxes, the taxpayer may want to elect the foreign tax credit (vs. taking a deduction for foreign taxes) in years he or she is subject to AMT.

As with the regular tax, AMT must be paid either by withholding or by making quarterly estimated payments. If these payments are inadequate, the penalty due for underpayment of income taxes is not deductible in calculating AMT. Therefore, taxpayers living abroad are urged to estimate both their regular tax and their AMT periodically to confirm that tax payments are adequate.

Chapter 6 Foreign tax credit

A US citizen or resident alien may either deduct foreign income taxes in arriving at taxable income or claim them as a credit against US income tax. The use of a foreign tax credit often results in lower taxes than does the deduction of foreign income taxes since it permits a dollar-for-dollar offset of foreign income taxes against US income taxes.

A US taxpayer can credit taxes imposed by a foreign country, its political subdivisions, or a US possession, such as Puerto Rico. Income, war profits, and excess profits taxes, as well as taxes paid in lieu of income taxes, can be claimed as foreign tax credits. Some foreign social security taxes are creditable. Social security taxes paid to a foreign country that has a "totalization agreement" with the United States are not creditable or deductible.

Each year, an individual must either deduct all foreign income taxes or take a credit for them. Switching between deductions and credits from year to year is permitted and may enable a taxpayer to further reduce his or her income tax. Once the taxpayer makes the election to deduct or credit foreign taxes, he or she may revoke the election any time before the period to file a claim for a refund expires (usually three years from the due date or date of filing, if the time for filing was properly extended beyond the original due date).

IRS official Foreign Tax Credit Regulations

The IRS on January 4, 2022 formally published a tranche of final regulations relating to the foreign tax credit. The rules, which finalize portions of a November 2020 proposal, address a variety of topics relating to the foreign tax credit, including definitions, allocation and apportionment issues, and timing for claims. Two elections that are available to individuals with the published regulartions include:

Section 905(a) election In general, a §905(a) election is a one-time, irrevocable election. A taxpayer who uses the cash method of accounting for income may elect to take the foreign tax credit in the taxable year in which the taxes accrues. The election is irrevocable, and once made, must be followed in all subsequent years. The election cannot be made on an amended return. However, the election can be made on an amended return only by a taxpayer that has never previously claimed a FTC. Taxpayer can also elect the accrued method on the amended return. The election is binding in the election year and all subsequent taxable years in which the taxpayer claims a foreign tax credit. 1.905-1(e)(2). This regulation applies to foreign income taxes paid or accrued in taxable years beginning on or after Dec. 28, 2021. 1.905-1(h).

Election to claim a provisional FTC for contested taxes A contested foreign income tax liability cannot be claimed until both the contest is resolved and the tax is considered paid, even if the contested liability (or portion thereof) has previously been remitted to the foreign country. Once the contest is resolved and the foreign income tax liability is finally determined and paid, the tax liability accrues, and is considered to accrue in the relation-back year for purposes of FTC. 1.905-1(d)(3). However, taxpayers may elect to claim FTC before the contest is resolved if the contested taxes: (1)are paid to the foreign tax authority; and (2)relate to a taxable year in which the taxpayer has claimed FTC for foreign income taxes that accrue in such year. 1.905-1(d)(4). The election may be made with respect to contested tax that are remitted in taxable years beginning on or after Dec. 28, 2021 and that relate to a taxable year beginning before Dec. 28, 2021. 1.905-1(h).

Scaleback (Disallowance) of the Foreign Tax Credit

Foreign income taxes are scaled back (disallowed) as credits to the extent that the taxes relate to earned income excluded under the special foreign exclusions. A taxpayer may therefore decide not to elect the foreign earned income or housing cost exclusions for the years that he or she is subject to foreign taxes on earned income. Forgoing the exclusions may be reasonable to consider in a year in which the foreign income tax rate exceeds the taxpayer's US tax rate. The excess foreign tax credits may be used to reduce US tax on certain other foreign-sourced income or be carried to another year.

A decision to revoke a foreign exclusion election may also be advisable in a year in which the taxpayer moves from a foreign country with low income tax rates to one with high income tax rates. Remember that if a taxpayer revokes a foreign exclusion election, he or she is barred from reelecting that exclusion for the five successive tax years following the revocation, unless the IRS consents to the reelection. Any decision to revoke a foreign exclusion election should be discussed with a tax advisor specializing in this area of taxation.

If foreign taxes are considered related to excluded earned income, they are permanently disallowed as foreign tax credits (or as deductions). To determine the amount disallowed, an apportionment of the foreign tax is made between the excluded foreign net earned income and the total foreign net earned income subject to the foreign tax, as illustrated in Example 17. (If the foreign tax is imposed on earned income and some other income, and the taxes on the other amount cannot be segregated, then the denominator equals all amounts subject to tax less allocated deductions.) When foreign net income is calculated, foreign income is decreased by

Example 17:
Smith began working in the United Kingdom on 1 January 20X1, earning $10,000 a month. For the first three months of 20X1, he earned $30,000. On his UK tax return for the fiscal year ending 5 April 20X1, Smith was subject to UK tax of $6,000.

For the fiscal year ending 5 April 20X2, Smith reported UK earned income of $120,000 and was subject to a UK tax of $40,000, of which $30,000a was attributed to the nine months from 6 April through 31 December 20X1. Smith incurred allowable foreign housing costs that exceeded the base-housing amount by $3,000.

The UK tax subject to disallowance for the 20X1 calendar year would be $36,000: the $6,000 for his foreign tax year ending on 5 April of that year, plus the $30,000 attributable to 20X1 from his foreign tax year ending on 5 April 20X2.

Assume the foreign earned income exclusion limitation is $100,000 for 20X1.

Based on these facts, the disallowance of the foreign tax credit attributable to 20X1 would be $30,900

$$36{,}000 \times \frac{\$100{,}000 + \$3{,}000}{\$120{,}000} = 30{,}900$$

Consequently, $5,100 ($36,000 less $30,900) would be the maximum amount eligible for the credit.
a.The $30,000 is determined by apportioning the $40,000 tax for the nine months in 20X1. This calculation is simplified because Smith received an equal amount each month. If he had received $1,000 a month more starting in 20X2, causing him to have a UK tax of $42,000 for the year ending 5 April 20X2, the UK tax attributed to 20X1 would have been $36,732: the $6,000 accrued through 5 April 20X1, plus $30,732, calculated as follows:

$$42{,}000 \times \frac{\$90{,}000\ [\$10{,}000/\text{month for 9 months}]}{\$123{,}000\ [\$10{,}000/\text{month for 9 months} + \$11{,}000/\text{month for 3 months}]} = 30{,}732$$

any expenses considered directly related to that income (such as employee business expenses). Furthermore, if the housing cost amount is taken as a deduction, it is treated as related to foreign earned income that is not excluded (that is, it reduces the denominator, not the numerator). This rule causes a higher disallowance of the foreign tax credit than might have been anticipated (see Example 17).

The calculation for disallowing the foreign tax credit assumes that foreign taxes on earned income accrue ratably as the income is earned. Once a foreign tax is deemed disallowed, it is then traced to the year in which the credit was taken. As a result, a foreign country's different tax year or the taxpayer's election to claim the credit on either the cash or accrual method will not affect a foreign credit disallowance.

Limitation

The amount of foreign income taxes that may be credited in a particular year is again limited to the lesser of (a) the allowable foreign taxes paid or accrued or (b) the amount of the applicable limitation.

The limitation is that part of the gross US tax (before the foreign tax credit) that applies to the taxable income from foreign sources. The following formula is used to calculate the limitation:

$$\frac{\text{Foreign taxable income}}{\text{Total taxable income}} \times \text{Gross US tax} = \text{Credit limitation}$$

If the taxpayer has received foreign income If the taxpayer has received foreign income from more than one country, the income and taxes are combined from all foreign sources, and one calculation is made to determine the foreign tax credit limitation for taxes paid to different countries. The limitation formula is based on foreign-source and US-source taxable income. To increase the foreign tax credit, the taxpayer's income that is considered foreign-source taxable income must also increase. Only the foreign- and US-source income subject to US tax is included in the limitation fraction.

Since the foreign tax credit could be increased by simply shifting the source of investment income from US to foreign sources, thus increasing the numerator of the limitation formula, separate credit limitations apply for different types (or "baskets") of income. There are three baskets of income that typically apply to individual taxpayers. The two primary baskets are the passive income category and general income category. The passive income category includes dividends, rents, royalties, gains from the sale of non-inventory property, annuities, interest subject to withholding of less than 5%, and several other kinds of passive income. Individual taxpayers must calculate separate foreign tax credit limitations for interest subject to withholding taxes of 5% or greater and for dividends received from a foreign corporation that is between 10% and 50% owned by US shareholders. The general income category is defined as all income other than passive income and generally consists of wages or self-employment income. Certain passive income may be reclassified into the general limitation basket if subject to foreign taxes above a certain level.

Legislation enacted in 2010 added a third basket of income for "certain income re-sourced by treaty." The foreign tax credit is calculated separately with regards to any income that, without regard to the treaty, would be treated as US-source income and is being re-sourced as foreign for purposes of calculating the foreign tax credit. Previously, taxpayers must report the treaty re-sourced income and foreign tax credit associated with it in a separate basket on Form 1116 Foreign Tax Credit. Recent regulatory changes have provided an exception to this rule. For tax years starting in 2018 and onward, U.S. citizens who are residents of the foreign country and whose income is re-sourced for relief from double taxation under the rules of a U.S. income tax treaty are not required to report the re-sourced income and foreign tax credit associated with it in a separate basket on Form 1116. Instead, the general limitation category may be used.

The calculation of foreign taxable income requires that foreign-source gross income be reduced by (a) special foreign income exclusions and deductions, (b) expenses directly related to the foreign income, and (c) a ratable portion of other deductions.

In addition to the special foreign exclusions and deductions, items deducted in arriving at adjusted gross income generally relate to a specific item of income. Consequently, there is usually little question as to whether the item should be allocated to US or foreign income.

Itemized deductions that do not generally relate to a specific source of income, such as medical expenses and qualified residential interest, are ratably apportioned to US- and foreign-source income on the basis of gross income. Certain interest incurred to acquire passive or portfolio assets is apportioned according to the adjusted basis of the taxpayer's US and foreign assets. This apportionment of interest is not required, however, if the individual's foreign-source income does not exceed $5,000. Charitable contributions are allocated only to US source income.

Taxpayers who do not itemize their deductions must apportion their standard deductions on the basis of gross income.

A calculation of the foreign tax credit limitation is given in Example 18.

Example 18:

The facts are the same as in the previous example, except that Smith, who is unmarried, made visits to the United States that added $10,000 to his total earnings, and he received $5,000 in US-source interest income. Smith also had $13,500 of regular itemized deductions. Assume the foreign earned income exclusion limitation is $100,000.

He would compute his 20X1 US income tax and foreign tax credit as follows:

	Total	US	Foreign
Earned income	$130,000	$ 10,000	$ 120,000
Interest income	5,000	5,000	—
Gross income	$ 135,000	$ 15,000	$ 120,000
Gross income percentage	100%	11.11%	88.89%
Foreign earned income exclusion	(100,000)	—	(100,000)
Housing cost deduction	(9,000)	—	(3,000)
Adjusted gross income	$ 26,000	$ 15,000	$ 17,000
Less: itemized deductions apportioned on the basis of the gross income percentage)	(13,500)	(1,500)	(12,000)
Taxable income	$ 12,500	$ 13,500	$ 5,000
US income tax	$ 3,000		

Based on these calculations, the 20X1 foreign tax credit limitation is as follows:

$$\frac{\text{Foreign taxable income}}{\text{Total taxable income}} \times \text{Gross US tax} = \text{Credit limitation}$$

$$\frac{\$\ 5{,}000}{\$\ 12{,}500} \times \$\ 3{,}000 = \$\ 1{,}200$$

Shown below is the taxpayer's US income tax, after reduction for the foreign tax credit:

Gross income tax	$ 3,000
Less: foreign tax credit	(1,200)
Net US income tax	$ 1,800

Carryovers

The decision to elect or revoke the foreign exclusions becomes more complex because of the foreign tax credit carryover rules. Foreign income taxes that cannot be credited in a particular year because they exceed the applicable limitation may be carried back one year and forward ten. They are subject, of course, to the limitation formula for the year to which they are carried. In Examples 17 and 18, Smith was allowed a credit of only $1,200 in 20X1, although he had foreign taxes of $5,100 eligible for credit. His foreign tax credit carryover would be $3,900.

Use of Credits

US taxpayers living abroad may incur substantially more foreign income taxes than can be used to offset US income taxes. To the extent that the excess can be used as a credit against the tax on other foreign income in the same basket, it will decrease US income taxes otherwise payable. The more income considered "sourced" foreign on a tax return, the higher the potential exists to use foreign tax credits or credit carryforwards.

For example, many US taxpayers who once lived abroad and have unused foreign tax credits are required to make business trips abroad after their return from a foreign assignment.

Determination of the source of income from the performance of personal services is based on the place the services are performed.

Therefore, the salary earned while on business trips abroad is foreign source income and is available to use up the otherwise unusable excess credits attributable to previous years when the taxpayer lived abroad.

Cash or Accrual Option

Most individuals use the cash basis to file income tax returns and would thus normally credit foreign taxes in the year in which they were paid or withheld. Taxpayers may, however, credit foreign taxes on the accrual basis even though they use the cash basis for all other purposes. Once the accrual method is elected, it must be used in future years.

Taxpayers sometimes find it advantageous to accrue foreign income taxes. Using the accrual method for foreign taxes may accelerate the use of a tax credit when foreign taxes accruing to a given year have not been fully paid prior to 31 December of that year.

If the accrual method is chosen, the foreign tax is deemed to have been paid at the end of the foreign tax year. If the foreign tax year does not end on the same date as does the taxpayer's US tax year (for most taxpayers the US tax year is the calendar year), the use of the accrual method may create timing differences. Although the foreign tax credit carryover rules will solve most problems created by these timing differences, a taxpayer may nonetheless experience temporary cash flow problems and be required to file amended tax returns. Because of these issues, a taxpayer with different US and foreign tax years may find it more convenient to be on the cash method for foreign tax credit purposes (see Example 19).

Foreign Tax Credit and the AMT

If the AMT applies, a taxpayer must calculate a supplementary foreign tax credit limitation under a separate formula. Basically, the foreign tax credit is limited to the extent that the taxpayer's gross AMT is attributable to foreign-source alternative minimum taxable income (AMTI):

$$\text{Gross AMT} \times \frac{\text{Foreign-source AMTI}}{\text{Worldwide AMTI}} = \text{Foreign tax credit limitation under the AMT}$$

Additional adjustments are then necessary to allocate this foreign tax credit between the regular tax and the AMT.

Example 19:
Brown goes to the United Kingdom on 30 April 20X1. Her wages are subject to UK withholding, and, by 31 December 20X1, $10,000 has been withheld. Brown's UK income tax year ends on 5 April 20X2 (as required by UK law). Her UK income tax liability for that year is $15,000, of which $14,000 is satisfied by withholding and $1,000 by a check sent to the UK HMRC in November 20X2.

Brown's US income tax liability for 20X1 (before credits) is $20,000. Brown does not elect to benefit from the foreign earned income and housing cost exclusions. Thus, none of Brown's eligible foreign income tax is disallowed. If she uses the cash method to calculate her foreign tax credit, the $10,000 withheld in 20X1 would be considered eligible for the credit. The regular limitation formula would determine the amount actually creditable for 20X1.

However, if Brown elects to use the accrual method to account for the foreign tax credit, no foreign tax would be eligible for the credit since her first accrual date for UK tax is not until 5 April 20X2. Some or all of Brown's foreign tax credits for her 5 April 20X2 UK tax liability of $15,000 may, however, be carried back to 20X1 on an amended tax return, resulting in a refund of 20X1 US income tax.

Example 20:
Jones begins an assignment to Singapore on 1 June 20X1. There are no tax payments made during the 20X1 calendar year. Jones' 20X1 Singapore tax liability is $20,000, as calculated on the 20X1 Singapore income tax return, and this payment is made in 20X3.
If Jones elects to use the accrual method to account for the foreign tax credit, he can claim a credit for the $20,000 accrued liability when he files his 20X1 US tax return.

However, if Jones elects to use the cash method to account for the foreign tax credit, there is no credit to claim in 20X1 as there are no foreign taxes paid in that year. The $20,000 can be claimed as a credit in 20X3 when the taxes are paid and any excess credit may be carried back to 20X2. The carryback is limited to one prior year and, as a result, there is no foreign tax credit for 20X1.

Chapter 7 Tax equalization policies

Tax rates vary greatly throughout the world. In Germany, for example, the top rate for individuals is over 40%, while in Nigeria the overall rate may never exceed 25%. A few countries, such as Saudi Arabia, have no personal income tax. A US citizen or permanent resident considering whether to accept a foreign assignment may be unfamiliar with the tax laws of the foreign country and may hesitate to move abroad if he or she were unsure of the tax consequences.

For this reason, many US companies with operations abroad have adopted tax equalization policies for US employees on foreign assignment. Under tax equalization, the employer assumes responsibility for the employee's US and foreign income taxes (and, in most cases, foreign social security taxes, where applicable). In exchange, the employee pays the company a hypothetical tax equal to the amount the employee would have paid in federal, state, and local income tax had he or she not gone on foreign assignment. Normally, an amount similar to what the employee had withheld for income taxes is deducted from his or her paycheck. After the actual income tax returns are prepared, a final computation is made to adjust the final hypothetical tax on the basis of the figures in the actual return.

Most expatriates receive extra allowances from their employers when going overseas, and these allowances are generally provided tax-free to the employee. An illustration of a tax equalization is provided in Example 21.

Hypothetical Obligation

The hypothetical tax obligation is intended to approximate the amount that an employee would have paid if he or she had continued working in the United States. A number of issues arise when determining the itemized deductions in arriving at an employee's hypothetical taxable income.

State and Local Taxes. If an employee going overseas for several years takes the necessary steps to break residency in his or her home state, he or she will generally not be subject to state and local income tax after departure (unless he or she has sufficient income from that state to be required to file a nonresident return). Therefore, the federal return will often have no deduction for state and local income taxes. If the company charges the employee a hypothetical state or local income tax, the amount charged is normally allowed as a deduction in the hypothetical calculation subject to the $10,000 cap ($5,000 if married filing separate).

Mortgage Interest. Most employees on overseas assignments do not purchase homes abroad. If they retain their US residences, they may rent them out and receive the mortgage interest deduction as a rental expense on Schedule E. Therefore, many expatriates do not have a mortgage interest deduction on Schedule A. However, since many companies charge their employees a home housing equivalent as part of the overseas allowances, effectively offsetting a portion of the rent expense in the foreign country, a reasonable interest and real estate tax deduction may be allowed in the hypothetical tax computation.

Example 21:
Smith, a plant manager, is sent to Germany on assignment for two years, be¬ginning 1 January 20X1. His base salary is $120,000, and he receives a foreign service premium of $12,000, which is provided to him tax-free. Smith has $2,000 of interest income. He is married with one child; his wife is not employed. Smith is a resident of Pittsburgh, Pennsylvania. Assume Pennsylvania has a 3.07% income tax with almost no deductions allowed; Pittsburgh has a tax on earned income of 3.00%. For simplicity, we will ignore alternative minimum tax. We also assume Smith will be able to break state and local tax residency during his assignment.a

Smith's employer engages a tax provider to prepare an estimate of his hypothetical tax liability for 20X1. The provider calculates that Smith's hypothetical tax liability will be approximately $22,000 for 20X1 and this amount is withheld from Smith by the employer throughout the year.

Assume the following amounts are applicable for 20X1: foreign earned income exclusion limitation of $100,000 and standard deduction of $24,000 for a married couple.

His actual and hypothetical 20X1 taxes under the tax equalization policy of his company are shown below:

Example 21 (cont.):

	Hypothetical	Actual
Base salary	$ 120,000	$ 120,000
Foreign allowances not subject to hypothetical tax	—	12,000
Outside income	2,000	2,000
Hypothetical tax withheld		(22,000)
German taxes paid by employer on Smith's behalf	—	50,000
Less: foreign earned income exclusion	—	(100,000)
Total income	$ 122,000	$ 62,000
Less: standard deduction	(24,000)	(24,000)
Taxable income	$ 98,000	$ 38,000
Federal tax (joint filing assumed)	$ 12,794	$ 8,360
State tax (3.07% of $122,000 income)	3,745	—a
Local tax (3.0% of $120,000 wages)	3,600	—a
Total	$ 20,139	$ 8,360
Foreign tax credit	—	(7,920)
Net tax payable	$ 20,139	$ 440

By contrast, if Smith were not under equalization, but received the allow¬ances shown above, he would be liable for all domestic and foreign taxes, as illustrated below:

	Actual
Base salary	$ 120,000
Foreign allowances	12,000
Outside income	2,000
Gross income	$134,000
Less: foreign earned income exclusion	(100,000)
Less: standard deduction	(24,000)
Taxable income	$ 10,000
Tax	$ 2,200
Foreign tax credit	(1,760)
Net US tax	$ 440

Due to the exclusion, Smith owes very little US tax and no state or local tax. However, without equalization, he would have had to pay the German tax on his income, which would in almost every case be higher than his US liability would have been had he remained at home.

a. An employee going on assignment for two years may be able to terminate state and local residency and therefore no longer be liable for tax, depending on the facts and circumstances of the individual. See discussion of state and local taxes.

Partial Equalization Policies

Some employers do not want to reimburse actual US or foreign tax on an employee's personal (non-company) income. Therefore, they apply equalization to company income only, which is an alternative to full equalization. Under this policy, the company withholds a hypothetical tax on company income only, calculated as though the employee had no other income, and pays the US and foreign tax only on that income. Outside income, such as a spouse's wages, interest and dividends, are excluded from the calculation, and the employee is responsible for paying US and foreign taxes on this income.

Final Computations

Under most equalization policies, the hypothetical tax withheld is not a final determination of the employee's tax obligation. After the employee's tax return is prepared (often by an independent accounting firm so that confidentiality is protected), a final reconciliation is prepared. At that point, the employee receives or pays any discrepancy between the amounts owed and those already paid, just as he or she would have had an actual refund or balance due on the actual return if the employee had stayed in the US.

Foreign Tax Credits

When an employee is subject to equalization, the employer generally pays the foreign taxes. Some portion of those taxes can frequently be claimed as a credit on the US return. Because the employee did not in fact pay the foreign taxes, he or she is not generally entitled to any benefit from them in the hypothetical tax calculation.

Chapter 8 Payroll taxes and special situations

Relief from Income Tax Withholding

Generally, a US employer is required to withhold US income taxes from US citizens and residents regardless of where the services are performed. However, a US employer is not required to withhold US income tax on foreign earned income under the following circumstances:

1. If the income is earned by a US Citizen in a foreign country or US possession and, under the law of that country or US possession, the employer must withhold foreign income taxes on that income.
2. To the extent that it may be reasonably anticipated that the income will be excluded under the special foreign exclusion rules.
3. If the income was earned in Puerto Rico and it is reasonable to expect that the employee, who is a US citizen, will be considered a bona fide resident of Puerto Rico during the calendar year.
4. If it is reasonable to expect that at least 80% of the remuneration paid to a US citizen during the calendar year will be for services performed in a US possession. (For this purpose, Puerto Rico is not considered a possession.)

Under the second exception listed above, an employer may presume that an employee will meet the physical presence or bona fide foreign residence test if the employee submits a statement to the employer and the employer has no cause to believe that the employee will not satisfy the relevant test. The statement must, according to IRS regulations, contain certain factual representations and commitments and contain a declaration that the statement is made under penalty of perjury (either Form 673 (see Appendix E) or the taxpayer's own statement may be used).

US income tax withholding is required to the extent that a taxpayer's compensation is not covered by any of the above exceptions. This will happen, for example, if the employee's foreign earned income exceeds the allowable foreign income exclusion or if he or she rendered services in the United States. The total withholding for the year may be estimated and withheld ratably throughout the year.

In calculating the tax to be withheld, the employee may take into consideration anticipated deductions, such as interest, contributions, losses, as well as credits, such as the foreign tax credit. Determination of the tax to be withheld is made on Form W-4 *Employee's Withholding Certificate*.

Social Security Taxes

The social security program is financed primarily from taxes paid by employers, employees, and the self-employed under the provisions of the Federal Insurance Contributions Act (FICA) and the Self-Employment Contributions Act (SECA). A US citizen or resident alien employed by a US employer is covered by social security and subject to social security tax, whether working in this country or abroad. While US taxpayers employed by foreign employers are usually not eligible for social security coverage, special rules for US taxpayers employed by foreign affiliates of US corporations may provide for the employee to be covered by US social security.

Self-employed individuals who reside abroad are subject to SECA taxes as though they had remained in the United States. US citizens working abroad must compute their earnings from self-employment without respect to any amount qualifying for the foreign earned income exclusions. (US taxpayers abroad who are not covered by social security and are not self-employed cannot cover themselves for social security purposes merely by paying SECA taxes.) FICA and SECA tax rates are split between old-age, survivors, and disability insurance (OASDI or "Social Security") and hospital insurance (HI or "Medicare"). The base for OASDI is adjusted annually for inflation and the HI base is unlimited. Accordingly, all wages will be subject to HI. The tax rates and limitations for the current year are shown in Appendix A.

An additional Medicare tax of 0.9% is imposed on employment wages for certain higher-income taxpayers (income of more than $250,000 for married couples filing jointly or surviving spouse, $125,000 for married couples filing separately, and $200,000 for all other taxpayers). Employers have an obligation to withhold this additional tax for any employee whose wages exceed $200,000, regardless of the filing status of that individual. An overpayment is reconciled on the actual tax return if the individual is subject to additional Medicare withholding in excess of the correct threshold confirmed by the actual tax return filing status. For example, if too much additional Medicare tax was withheld from the employee during the year, the excess is credited back to the individual on their tax return. Conversely, if a deficiency exists, an additional payment is charged on the tax return to account for any shortfall.

Additional Medicare applies only to the employee, not to the employer. However, as noted, the employer has an obligation to withhold amounts of excess Medicare tax from the employee's wages. This tax applies for any employee who is otherwise subject to US social security tax, including nonresident aliens covered by the US social security program. Employees on assignment in the United States who are exempt from US social security tax due to a totalization agreement between the United States and their home country are also exempt from this additional Medicare tax if a valid certificate of coverage is in place with the employer.

Totalization Agreements

The United States has entered into totalization agreements (social security treaties) with many countries (See Appendix F for a complete list) that eliminate dual social security coverage and dual taxation for individuals who work in the United States and in those foreign countries. Both the employer's and the employee's contributions come within a totalization agreement, when one applies.

Totalization agreements are bilateral agreements covering social security. They have provisions that deal not only with the tax on employers and employees but also with the way an employee who has worked in two countries can qualify for benefits. These agreements:

- Determine which country's social security tax applies in normal foreign assignments
- Determine where a person qualifies for benefits when he or she has worked in both countries and paid tax to both social security systems
- Provide for a continuation of US social security coverage in some cases
- Provide administrative rules, such as automatic applications for foreign pensions when the US employee applies for social security

Totalization agreements let US employees who work overseas keep US social security coverage on most temporary foreign assignments (usually less than five years long). But they eliminate only dual coverage; they do not grant total exemptions from social security. If an employee is not subject to US coverage, he or she cannot be exempt from foreign coverage under a totalization agreement. In fact, totalization agreements go to some lengths to confirm that an employee will be covered by at least one system.

Totalization agreements usually apply only to pension or disability coverage, not medical insurance. However, the foreign country often will exempt a US employee from medical coverage. This practice can make medical insurance for a foreign assignment worth investigating

To obtain a US exemption, an employer or a self-employed individual must obtain specific information from an authorized official of the foreign country. A self-employed individual must attach the information to his or her US tax return; an employer must keep the information in its files. Foreign procedural rules about exemptions from foreign social secu-rity taxes must be reviewed. Some residual double taxation may occur, depending on how the foreign social security system works.

Unemployment Tax

Generally, payments under the Federal Unemployment Tax Act (FUTA) are required for US taxpayers working for a US employer outside the United States.
A US employer for FUTA purposes, however, does not include the US government or its instrumentalities. Furthermore, services performed by a US taxpayer for a US employer in Canada need not be covered for FUTA purposes. There is no FUTA equivalent of the extension of FICA coverage to employees of foreign affiliates of American corporations. Therefore, while these companies are able to extend FICA coverage to their employees, they are not subject to FUTA coverage for the otherwise uncovered employees of their foreign affiliates.

Each state should be reviewed for determining the applica¬tion of the State Unemployment Tax Act (SUTA). Some states request that the employer continue to contribute to its state unemployment fund if the employee's last US location was within that state. Other states require that the employer contribute to that state's fund for all employees on foreign assignment if the company's US headquarters are within that state. This requirement applies regardless of where the employee had been last working or to which state the employer was contributing before the employee took the assignment.

Qualified Retirement Plans

A US citizen or resident who is an employee of a foreign subsidiary of a US parent company may continue to participate in most US employee benefit plans.
The contributions will not be taxable to the employee for US tax purposes.

Estate and Gift Taxes

US citizens and US resident aliens living abroad are generally subject to estate and gift taxes under the same rules that apply to those living in the United States and should therefore undertake estate planning to limit potential tax consequences related to wealth transfer. US citizens married to non-US citizens should pay particular attention to this area due to tax laws that severely limit the availability of marital deductions when property passes to a non-citizen spouse.
In addition to US and state laws affecting estates and gifts, foreign country laws imposing estate and gift taxes may affect US taxpayers residing there. Although the United States has concluded several treaties providing for relief from double taxation of estates and gifts (see Appendix F), in some cases, both US and foreign estate taxes will apply. Double taxation can sometimes be avoided or minimized by appropriate planning, but tax and legal advisers should be consulted before any action is taken in this area.

State and Local Taxes

An individual residing abroad may still be subject to state income taxes. Such liability can occur when the person returns to work in that state on business trips, continues to maintain a home in that state, or, under some state laws, is considered by the state to retain his or her residence there. In the last case, the individual may be considered a resident if he or she retains an intent to return to the home state on completing an assignment. Finally, some states tax the gain on the sale of a residence even if the seller is considered a resident abroad. Certain local jurisdictions may follow similar rules with respect to determining residence. As each state has its own unique set of rules for determining residency, the state residency position should be reviewed on an individual basis prior to the start of the foreign assignment.

Net Investment Income Tax

Certain US taxpayers may be subject to an additional net investment income tax (NII). The tax is in addition to regular federal income tax and intended to reach certain higher income taxpayers' unearned income. For individuals subject to tax on NII, tax is imposed at 3.8% on the lesser of:

- the individual's net investment income for the tax year, or
- the excess of the individual's Modified Adjusted Gross Income over the threshold amount (the MAGI threshold amount is $250,000 for individuals filing a joint return, $125,000 for married taxpayers filing a separate return and $200,000 for all other individuals).

Modified Adjusted Gross Income (MAGI) generally means Adjusted Gross Income as adjusted (increased) for the allocable amount of foreign earned income exclusion recognized on the return.

An individual's Net Investment Income includes three general categories of income: (1) gross income from interest, dividends, annuities, rents and royalties; (2) income derived from a passive activity or a trade or business of trading financial instruments or commodities; and (3) net gain recognized on dispositions of property.

The rules regarding the NII are detailed and complex. A taxpayer should consult with a tax adviser specializing in this area if their income is higher than the above thresholds and the taxpayer would like to discuss planning opportunities regarding this tax.

Affordable Care Act

As part of the Patient Protection and Affordable Care Act (ACA), individuals and their dependents are required to maintain minimum essential healthcare coverage throughout the year. Failure to maintain coverage will result in a penalty known as a shared responsibility payment, which is calculated on the individual income tax return. Medical insurance provided through a US employer will generally qualify as minimum essential coverage. In addition, there are specific exceptions from this requirement for individuals residing outside of the US or for gaps in the period of coverage of less than three months. A taxpayer should consult with a tax adviser specializing in this area for further details regarding the ACA healthcare requirements and exceptions.

After December 31, 2018 there will be no penalty imposed for failing to maintain minimum essential coverage.

Passive Foreign Investment Company

A US individual who owns stock in a company classified as a passive foreign investment company (PFIC) may be subject to an interest charge on "excess" distributions from the company. In general, a foreign company is a PFIC if 75% or more of its income consists of passive income or 50% or more of its assets produce passive income. An excess distribution is, in general, the amount of deemed distributions occurring during the US reporting period (generally the calendar-year) that exceeds 125% of the average amount of deemed distributions on that stock in the preceding three calendar years. It may be advantageous to make a special election to report the shareholder's current share of earnings to avoid the interest charge and complexity associated with excess distributions.

Further, distributions occurring within the fund need not be paid or received to be taxable. Foreign mutual funds paying dividends automatically reinvested are considered a distribution and subject to tax under the PFIC regime, regardless of the right to receive cash in lieu of the automatic reinvest. A sale of a PFIC fund during US residency, in most instances, is deemed an excess distribution and also subject to tax and interest under the PFIC excess distribution regime. Additional considerations outside the US tax cost associated with holding PFICs also merit attention. The administrative burden of gathering the necessary information for US compliance reporting can be burdensome. The non-US financial institution or entity where the PFIC is maintained may not provide readily available access to the specific fund information on a calendar-year basis. This burden is amplified when multiple funds are maintained in a single account because each require separate disclosure on the US return irrespective of whether tax may be assessed.

Non-U.S. Trusts and Additional Reporting Requirements

Under U.S. tax law, certain types of foreign accounts or entities are classified as non-U.S. trusts. If a U.S. citizen or resident is considered the beneficiary, trustee, or owner of one of these trusts, they may be required to file certain information reporting forms with respect to the trust. These information reporting forms are filed separately from an individual's personal tax return and may have separate filing deadlines. Applicable penalties and interest may be due for failure to file timely any required forms. In recent years the IRS has increased scrutiny around timely and accurate filing of these forms, so care should be taken to proactively identify any applicable filing requirements for foreign accounts considered non-U.S. trusts.

A few common types of foreign accounts or entities that are classified as non-U.S. trusts are some Canadian Tax-Free Savings Account (TFSA), Canadian Registered Education Savings Plan (RESP), some family trusts and certain Superannuation funds, though many other accounts could also be considered a non-US trust. Determination of what is classified as a non-U.S. trust should be made based on the full facts and circumstances of each account or entity. It is possible for an entity to be classified as a trust for U.S. tax purposes when it is classified differently in the foreign jurisdiction. Classificiation under U.S. tax law will drive the U.S. filing requirements, even if it is inconsistent with the requirements in the non-U.S. jurisdiction.

Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts, is filed annually by an owner of a non-U.S. trust to report ownership of the trust. In addition, the form must be filed by an individual for the year they make a contribution or loan to a foreign trust, receive a distribution or loan from a foreign trust, or receive gifts over a certain value from non-U.S. persons or entities. The form must be filed by the due date, including any extensions, of the individual's tax return.

Form 3520-A, Annual Information Return of Foreign Trust with a U.S. Owner, is filed annually by the trustee of a foreign trust with a U.S. owner. In contrast to the Form 3520, the original due date of the Form 3520-A is generally March 15th for a calendar year trust. A six-month extension may be requested by March 15th to extend the due date of the form.

Appendix A – Key figures

1. Standard deduction

Filing Status	2022
Single	12,950
Married filing jointly	25,900
Married filing separately	12,950
Head of household	19,400

2. Kiddie Tax

- For children under age 19 (or certain full-time students under age 24) with unearned income consisting solely of interest, dividends and capital gain distributions, the child's income may be reported on the parent's return using Form 8814, provided the child's gross income is less than $11,500 in 2022.
- If the child files their own return, the first $1,150 of unearned income has no tax applied. The next $1,150 of unearned income it taxed at the child's marginal rate. Unearned income in excess of $2,300 will be taxed according to the parents' individual tax rate.

3. Private Delivery Services

The following private delivery services are currently designated by the IRS, as of this publication:

- Federal Express (FedEx): FedEx First Overnight, FedEx Priority Overnight, FedEx Standard Overnight, FedEx 2 Day, FedEx International First Next Flight Out, FedEx International Priority, FedEx International First, and FedEx International Economy; and
- United Parcel Service (UPS): UPS Next Day Air Early AM, UPS Next Day Air, UPS Next Day Air Saver, UPS 2nd Day Air, UPS 2nd Air A.M., UPS Worldwide Express Plus, and UPS Worldwide Express; and,
- DHL Express: DHL Express 9:00, DHL Express 10:30, DHL Express 12:00, DHL Express Worldwide, DHL Express Envelope, DHL Import Express 10:30, DHL Import Express 12:00, DHL Import Express Worldwide.

4. Estimated Tax Payments

Payment dates for 2022 are 18 April, 15 June, 15 September 2022 and 16 January 2023.

5. Foreign Earned Income Exclusion & Housing Cost Exclusion

- A qualifying taxpayer may elect to exclude foreign earned income up to $112,000 for 2022.
- The maximum housing expenses allowable are capped at 30 percent of the maximum foreign earned income exclusion limitation for 2022, $33,600 ($112,000 x 30%)).
- The base housing amount is calculated as 16 percent of the maximum foreign earned income exclusion discussed above. For 2022, the base housing amount is $17,920 ($112,000 x 16%) ($49.10 per day).
- As a result, the maximum 2022 housing exclusion allowable will be capped at $15,680 ($33,600– 17,920).

6. Income Bases for OASDI and HI

2022

	Income Subject to OASDI		Income Subject to HI[c]	
Tax	Rate	Maximum[a]	Rate	Maximum
FICA (employee)	6.2%	$9,114	1.45%	Unlimited
SECA (self-employed)	12.4%	$18,228[b]	2.9%	Unlimited

a. OASDI wage base = $147,000; $147,000 x 6.2% = $9,114; $147,000 x 12.4% = $18,228.
b. Self-employed taxpayers are allowed a deduction equal to one-half of their SECA tax liability when computing adjusted gross income.
c. Subject to additional 0.9% medicare tax on income in excess of predefined amounts.

An individual is liable for Additional Medicare Tax of 0.9% if the individual's wages, compensation or self-employment income (together with that of his or her spouse if filing a joint return) exceed the threshold amount for the individuals filing status for 2022:

Filing Status	Threshold Amount
Married filing Joint	$250,000
Married filing separate	$125,000
Single	$200,000
Head of Household	$200,000

Appendix B – Sample of the Increased Section 911 Housing Exclusions that have been published by the IRS

The table below provides a sample of the increased section 911 housing exclusions that have been published by the IRS for the 2022 tax year. The IRS published Notice 2022-10 which listed over 100 locations in which increased housing exclusions are allowed.
We have provided a sample of cities around the world.

City	Country	2022 Amount
Buenos Aires	Argentina	56,500
Sydney	Australia	70,800
Rio de Janeiro	Brazil	35,100
Montreal	Canada	55,500
Beijing	China	76,400
Paris	France	71,000
Frankfurt	Germany	36,300
Hong Kong	Hong Kong	114,300
New Delhi	India	56,124
Tel Aviv	Israel	50,800
Rome	Italy	47,300
Tokyo	Japan	92,400
Mexico City	Mexico	47,900
Amsterdam	Netherlands	52,900
Auckland	New Zealand	35,700
Singapore	Singapore	82,300
Dubai	UAE	57,174
London	U.K.	69,500

Appendix C – 2022 US Federal rates

Single

From	To	Amount	Excess
$0	10,275	$0	10.00%
10,275	41,775	1,028	12.00%
41,775	89,075	4,808	22.00%
89,075	170,050	15,214	24.00%
170,050	215,950	34,648	32.00%
215,950	539,900	49,336	35.00%
539,900		162,718	37.00%

Head of Household

From	To	Amount	Excess
$0	14,650	$0	10.00%
14,650	55,900	1,465	12.00%
55,900	89,050	6,415	22.00%
89,050	170,050	13,708	24.00%
170,050	215,950	33,148	32.00%
215,950	539,900	47,836	35.00%
539,900		161,219	37.00%

Married Filing Joint

From	To	Amount	Excess
$0	$20,550	$0-	10.00%
20,550	83,550	2,055	12.00%
83,550	178,150	9,615	22.00%
178,150	340,100	30,427	24.00%
340,100	431,900	69,295	32.00%
431,900	647,850	98,671	35.00%
647,850	And Above	174,254	37.00%

Married Filing Separate

From	To	Amount	Excess
$0	$10,275	$0	10.00%
10,275	41,775	1,028	12.00%
41,775	89,075	4,808	22.00%
89,075	170,050	15,214	24.00%
170,050	215,950	34,648	32.00%
215,950	323,925	49,336	35.00%
323,925		87,127	37.00%

Estates and Trusts

From	To	Amount	Excess
$0	$2,750	$0	10.00%
2,750	9,850	275	24.00%
9,850	13,450	1,979	35.00%
13,450		3,239	37.00%

2022 Long Term Capital Gain and Qualified Dividends Rates for Taxpayers with taxable income in the specified ranges

Married Filing Joint

$0	$83,350	0.00%
83,351	517,200	15.00%
517,200		20.00%

Single

$0	$41,675	0.00%
41,675	459,750	15.00%
459,750		20.00%

Married Filing Separate

$0	$41,675	0.00%
41,676	258,600	15.00%
258,600		20.00%

Head of Household

$0	$55,800	0.00%
55,801	488,500	15.00%
488,500		20.00%

Estate and Trusts

$0	$2,800	0.00%
2,801	13,700	15.00%
13,700		20.00%

Additional 3.8% tax imposed on the lesser of the individual's net investment income or the excess of the individuals modified gross income over certain thresholds ($250,000 for married couples filing jointly or surviving spouse, $125,000 for married couples filing separately, and $200,000 for all other taxpayers).

Appendix D – Decisions checklist

	Page
To obtain *filing extensions*, taxpayers outside the United States must file Form 4868 (an automatic four-month extension) or Form 2350 (an extension based on expectation of qualifying for the exclusions) by 15 June.	2
Cash flow may be enhanced if the taxpayer files an initial return before qualifying for the foreign income exclusions and subsequently claims them in an amended return.	3
Important exceptions to the US withholding tax requirements apply to expatriates. However, expatriates may be required to make *US estimated tax payments*.	3
Foreign financial accounts create additional filing requirements.	3
The *foreign earned income exclusion* and the *housing cost exclusion* are each elective, and spouses filing joint returns can compute the housing amount separately or jointly.	6
To qualify for the foreign earned income or housing cost exclusion, the taxpayer must have a *foreign tax home* (and abode).	7
A taxpayer meets the *bona fide residence test* only if he or she has established a foreign residence for at least an entire tax year.	7
The *physical presence test* may be more beneficial in the first and last years of a foreign assignment.	8
The *foreign camp exclusion* may prevent taxation on the value of meals and lodging provided by the employer.	10
Taxpayers receiving *deferred income* have options for purposes of the exclusions. But to qualify for the exclusions, the foreign earned income must be received no later than the year after it is earned.	11
Under some circumstances, it may be advantageous for a taxpayer to maintain a *US tax home* and forgo the exclusion in exchange for claiming "away from home" deductions for foreign business trips.	13
A taxpayer must review the tax consequences of any decision relating to his or her *personal residence* (for example, buying or renting a foreign residence, selling or renting the US residence, or converting the US residence to income-producing investment property).	14
A taxpayer with significant foreign tax payments or with foreign tax credit carryovers *may not want to elect* one or both of the *foreign exclusions*, so as to avoid or decrease the disallowance of the foreign tax credit.	18
Even after returning from a foreign assignment, a taxpayer may use *foreign tax credit carryovers* by increasing foreign earnings and certain other forms of foreign-source income.	21
If *foreign tax credits* are claimed, either the cash or accrual method could prove more beneficial.	21

Appendix E – Forms and statements location information

The current versions of all forms can be obtained from the IRS website:

http://www.irs.gov/

Appendix F – US Income tax, Estate tax, and social security treaties and agreements

Income Tax Treaties (as of February 2022)

Armenia[1]	Iceland	Philippines
Australia	India	Poland
Austria	Indonesia	Portugal
Azerbaijan[1]	Ireland	Romania
Bangladesh	Israel	Russia
Barbados	Italy	Slovak Republic
Belarus[1]	Jamaica	Slovenia
Belgium	Japan	South Africa
Bulgaria	Kazakhstan	Spain
Canada	Korea (Republic of)	Sri Lanka
China (People's Republic of)[2]	Kyrgyzstan[1]	Sweden
Cyprus	Latvia	Switzerland
Czech Republic	Lithuania	Tajikistan[1]
Denmark	Luxembourg	Thailand
Egypt	Malta	Trinidad and Tobago
Estonia	Mexico	Tunisia
Finland	Moldova[1]	Turkey
France	Morocco	Turkmenistan[1]
Georgia[1]	Netherlands	Ukraine
Germany	New Zealand	United Kingdom
Greece	Norway	Uzbekistan[1]
Hungary	Pakistan	Venezuela

1. The Department of the Treasury announced that the income tax treaty with the Soviet Union will continue in effect for these countries until separate agreements are concluded and come into effect; this position was confirmed in the 2016 IRS Publication 901. However in practice the convention is not consistently applied between all countries.
2. The U.S.– China income tax treaty does not apply to Hong Kong.
3. Although the United States and Canada do not have a separate estate tax treaty, taxes upon death are covered within the provisions of the U.S.–Canada income tax treaty.

Estate Tax Treaties

Estate and Gift Tax Treaties

Country	Type of Treaty
Australia	Separate estate and gift
Austria	Combined estate and gift
Canada[3]	Estate only
Denmark	Combined estate and gift
Finland	Estate only
France	Combined estate and gift
Germany	Combined estate and gift
Greece	Estate only
Ireland	Estate only
Italy	Estate only
Japan	Combined estate and gift
Netherlands	Estate only
South Africa	Estate only
Switzerland	Estate only
United Kingdom	Combined estate and gift

Social Security Agreements (Totalization Agreements) – as of February 2022

Australia	Germany	Norway
Austria	Greece	Poland
Belgium	Hungary	Portugal
Brazil	Iceland	Slovak Republic
Canada	Ireland	Slovenia
Chile	Italy	Spain
Czech Republic	Japan	Sweden
Denmark	Korea (Republic of)	Switzerland
Finland	Luxembourg	United Kingdom
France	Netherlands	Uruguay

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