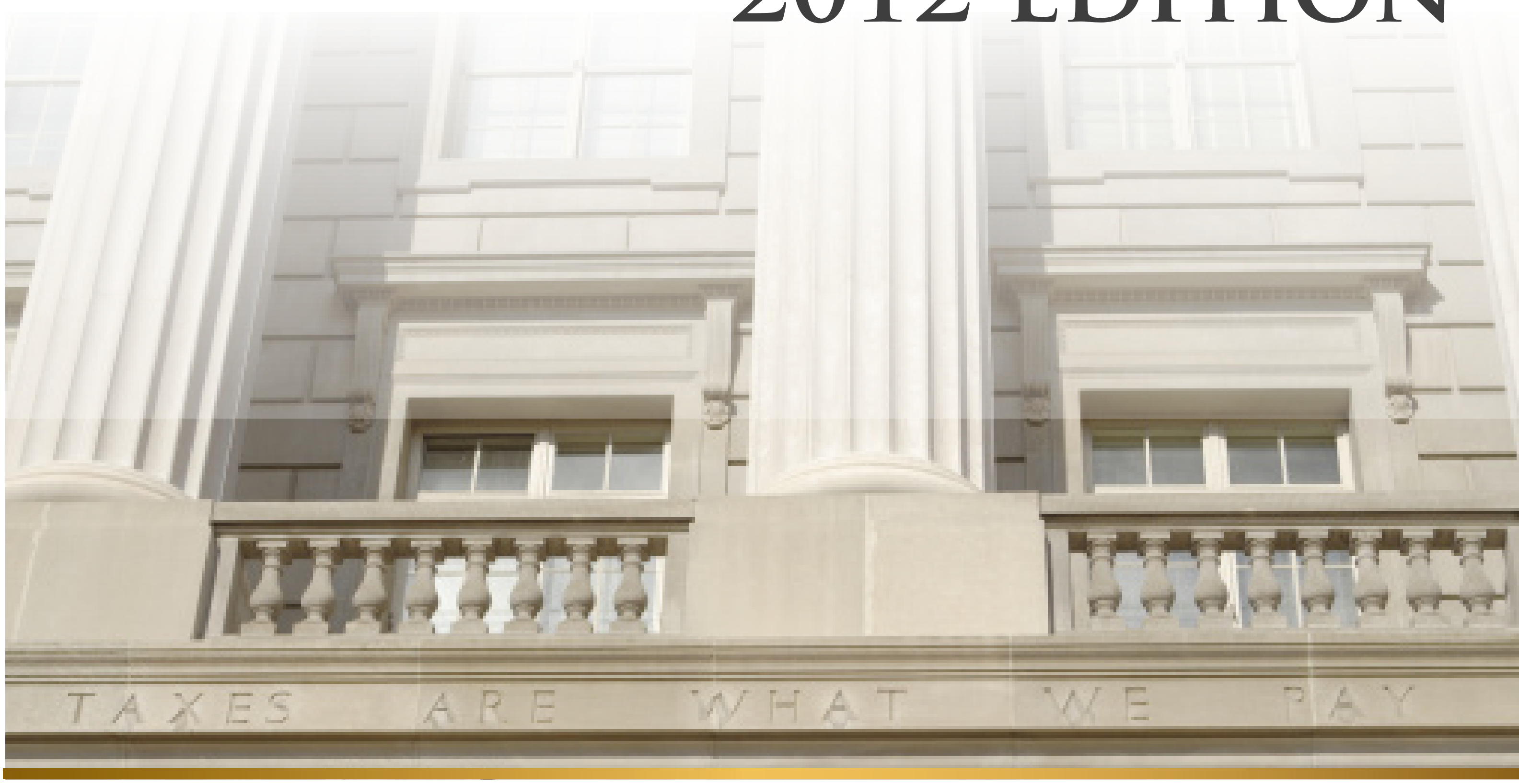
ExPat Tax Guide

2012 Edition



Premier Offshore Investor
Research, News, and Legal Services for the Offshore Entrepreneur

Premier Offshore Tax & Business Guide

2012 Edition

The Complete Guide to U.S. Taxes for the American
Living and Working Abroad

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December 2012 - This download version includes corporate and trust formation forms at the end of the book not found in other versions.

INTRODUCTION

The biggest challenge facing Americans living and/or working abroad is the United States Internal Revenue Service. The U.S. is one of the few countries that tax its citizens abroad, and the only one that regularly locks up its people up in prison cells for violations of the tax code.

The Service's hostility to foreign tax planning and attacks on international business has become legendary over the last five years. Criminal penalties aside, the financial risks for failing to file a report or form on time are extraordinary…some include penalties of up to $50,000 per year, per form. For this reason, many Americans are afraid to hold funds or assets abroad.

Even after determining what forms are required, an ever moving target, figuring your tax liability is like learning a foreign language. "IRS speak" is unique and convoluted…and a distant cousin to the business English you speak every day.

And, once you learn the lingo, applying that language to your situation requires advanced training in accounting and finance.

How much time will it take an average business person to learn the language, organize the accounting, and prepare the forms for a standard foreign corporation return? The IRS estimates you should spend 174 hours to complete Form 5471 and its schedules! That's about 22 days, working 8 hours per day, while completely ignoring your business, employees, and other obligations.

> Note: Time estimates are contained in the instructions for each form. For Form 5471, see page 14 of 17 at http://www.irs.gov/pub/irs-pdf/i5471.pdf

As few international entrepreneurs have the time or energy required to learn this language, some give up and stay onshore and others hand the entire mess over to their accountants and hope for the best. Those who really like to gamble, place their bets on off the shelf software costing anywhere from $25 to $150, with the expectation that the software will guide them through the maze and costly traps safely.

Think about that. Spending $25 to protect themselves from risks of $50,000+ is quite a gamble. Would you do that in any other area of your life or business?

> Note: The tax attorneys and enrolled agents at Premier Offshore, Inc. have decades of combined experience in international taxation and we spend about $5,000 per year for professional level tax software.

With that in mind, the objectives of this tax guide are to 1) give you the tools to maximize profits and minimize taxes while working and living abroad, 2) provide a road map to the U.S. forms and reporting requirements, and 3) to point out the landmines of international taxation – costs and risks of failing to keep up with tax compliance.

Armed with this manual, you will be able to structure your business and plan your life abroad to your advantage…and those advantages can be significant. For example, a business owner may be able to reduce or completely eliminate U.S. income tax on his ordinary income while taking a salary tax free of up to $97,600 for 2013. This means no Federal income taxes, no State income taxes, and no employment taxes (payroll, FICA, etc., which add up to 15% in the U.S.).

While you might not become a U.S. tax expert by the end of this guide, you will be better prepared to deal with your tax attorney, CPA or accountant. You will have an understanding of the options available, the forms required, and the questions that must be asked. You will be able to determine if your current preparer is capable of handling your new and more complex tax reporting and, by being better prepared, you should cut down on the time—and fees—spent with your advisor.

In addition to this guide, there are resources available on the IRS website at www.irs.gov. For example, IRS Publications 593 and 54 should be reviewed by all U.S. ExPats (anyone living and/or working outside of their home country). Publication 54 is a lengthy document, which goes into the nitty-gritty of overseas taxation—for a summary of the highlights, use Publication 593. Publication 593 can be viewed at http://www.irs.gov/publications/p593/index.html and Publication 54 is at http://www.irs.gov/publications/p54/index.html.

If you have been living abroad, or had an offshore account, for several years and not been filing your U.S. forms, this guide can help you get in to compliance. However, a complete analysis of your situation should be undertaken by a qualified tax attorney before you file any amended or delinquent tax returns or forms. I suggest you start with the section of this report entitled "2012 IRS Offshore Compliance Program," then review the IRS website at http://www.irs.gov/uac/2012-Offshore-Voluntary-Disclosure-Program for any new information. After you understand your options, read the rest of this guide to become familiar with your filing obligations and future planning options.

Finally, this guide is focused on your U.S. Federal Taxation issues. It is not meant to help you with (1) liability for state income taxes; (2) estate and probate matters; (3) local taxes of a foreign country; or (4) the community property laws of the U.S. states or foreign countries.

The Rules for Americans Overseas

Foreign Income Must be Reported

As an American citizen overseas—regardless of where you live or work—you are generally required to file a U.S. tax return, reporting any income generated abroad, in addition to your earnings on the U.S. side.

You are also subject to the same filing requirements that apply to U.S. citizens or residents living in the U.S. As long as you meet the gross income requirement, there's no escaping the IRS.

You are also eligible for just about all of the deductions. You can choose to take the standard deduction, or itemize on Schedule A. If you itemize, you may deduct mortgage interest, property tax, investment interest, etc. The only major issue is charitable contributions made to a non-U.S. church or organization.

In order for a charitable contribution to be deductible, it must be made to an IRS approved organization. In other words, the charity must qualify under Code Section 501(c)(3). Only the largest of international charities have gone through this approval process, thus, it is unlikely that a contribution to your local non-U.S. church or group is deductible on your U.S. tax return.

Certain deductions may also be reduced by the foreign housing exclusion for the foreign earned income exclusion. However, this is rare and you will need to consult with a tax professional for further guidance.

Even if you determine that your federal tax obligation is zero, you must still complete and file the forms. The IRS changes the filing thresholds slightly each year. In general, once you have the following gross income amounts for 2012, the law requires you to file a federal tax return with the IRS:

Single	$9,500
— 65 or older	$10,950
Head of household	$12,200
— 65 or older	$13,650
Married filing jointly	$19,000
— One spouse 65 or older	$20,150
— Both spouses 65 or older	$21,300
Married filing separately	$3,700
Qualifying widower	$15,300
— 65 or older	$16,450

To determine if you meet the gross income requirement for filing purposes, you must include all income you receive from foreign sources as well as your U.S. income.

This is true even if:

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

If you are self-employed, and generate more than $400 of net self-employment earnings in a single year, you must file a U.S. income tax return, regardless of your age. Net earnings from self-employment include the income earned both in a foreign country and in the U.S.

You must pay self-employment tax on your net self-employment income, even if it is earned in a foreign country and is excludable as foreign earned income in figuring your income tax. This is an important point worth repeating: the foreign earned income exclusion helps reduce the income tax—not the self-employment tax. The only way to reduce self-employment tax is with ordinary business expenses incurred in the self-employment activity or to operate the business through a foreign corporation.

The Standard Deductions for tax year 2012 are as follows:

Married, Filing Joint Return	$11,900
Head of Household	$8,700
Unmarried (not S.S. or H.H.)	$5,950
Married, Filing Separate Return	$5,950

Tax Advantages for Americans Overseas

The good news is that you may be able to exclude from your income some or all of your foreign earned income. Earned income includes salary, wages, and self-employment earnings. You may also be able either to exclude or to deduct from gross income a "housing amount." And—depending on your situation—you may qualify for a foreign tax credit or deduction for the local taxes paid to a foreign country. Based on your own particular circumstances, these advantages may reduce—or sometimes eliminate—your federal tax liability.

While exclusions and credits can reduce your tax liability to Uncle Sam, the United States has concluded tax treaties—and other international agreements—with many foreign countries which may help reduce your foreign tax liability, as well.

In theory, the foreign earned income exclusion, the credit or deduction for foreign income taxes, and the application of tax treaty provisions are designed to prevent overseas Americans from paying taxes to both the U.S. and a foreign country on the same income. In other words, they are designed to avoid double taxation. If you are fortunate enough to live in a foreign country that—for one reason or another—doesn't tax your income, and your salary while abroad is less than or equal to the foreign earned income exclusion amount, this exclusion may allow you to escape income taxes altogether

Foreign Earned Income Exclusion

The most important tool in the expat's U.S. tax toolbox is the Foreign Earned Income Exclusion (FEIE or Exclusion). If you qualify, you can exclude up to $95,100 in 2012 of foreign earned income free from U.S. Federal income tax. If you are married, and both spouses qualify for the exclusion, your total exclusion may be $182,800.

Foreign Earned Income

As I said above, only income that is both foreign and earned can be excluded from Federal income tax. Income that is foreign is that which is earned while you are physically present outside of the United States. Income that is earned is wages, salaries, professional fees and other amounts received as compensation for personal services actually rendered when your tax home was located in a foreign country and you meet either the bona fide residence or physical presence test. Wages can come from a U.S. corporation or a foreign corporation, including an offshore corporation, and it does not matter that you are also a shareholder or owner of that corporation.

Earned Income does not include interest, dividends, or other investment or passive income.

To qualify for the exclusion, you must first prove that your "tax home" is outside of the United States. Second, you must meet the requirements of either the residency or 330 day tests.

Your tax home is where your principal place of business is located, regardless of where you maintain your residence. In most cases, if you live and work outside of the United States, your tax home is located there.

The concept of a tax home can become complicated in a few, specific instances, such as when someone works in Mexico and lives in the U.S. (ie. commutes from the U.S. to Mexico each day). In that circumstance, your tax home is the U.S. and the FEIE is not available.

In the vast majority of cases, one's tax home is not a major consideration, therefore, I will not go in to more detail here. For more information, contact a tax professional or see Code Section 911(d)(3) and the related regulations and examples.

Once you have established that your tax home is outside of the United States, you must meet the requirements of either the 330 day test or the residency test.

1. 330 Day Test: You must be outside of the United States for 330 out of any 365 day period. It does not matter if the 330 days is over two calendar years (example: between November 1, 2011 to October 31, 2012) and a special extension to file your tax return is available to give you time to meet this requirement.

2. Bona Fide Residency Test: Residency is achieved by moving to another country and making it your “home." You can intend to return to the United States in the future, but you must move to the foreign country for an “indefinite” or “extended” period of time, which must include one entire calendar year. This is discussed in detail below.

As you can see, the 330 day test is fact based, while the residency test turns on your intentions and is therefore more difficult to use and prove. I often recommend relying on the 330 day test in the first year you claim the Exclusion, and then moving to the residency test after applying for or gaining residency in your new home.

Also, the exclusion is computed on a daily basis. Therefore, the maximum limit must be reduced for each day during the calendar year that you do not qualify. The exclusion is also limited to the excess of your foreign earned income for the year over your foreign housing exclusion.

Bona Fide Residency Test

The bona fide residency test is one of the most misunderstood and misused sections of the tax code by those working and living abroad...especially by contractors on “temporary” assignments and those in combat zones.

You are a bona fide resident if you move to a foreign country and make it your home. You do this by filing and paying taxes in that country, moving there and planning to stay indefinitely, and generally becoming part of the local community.

The perfect example of a resident is someone who moves to a foreign country, does not intend to return to the U.S., files and pays taxes in that country, is on a long term visa that allows them to work in that country, applies for residency and/or citizenship if possible, sell their U.S. home and buys one in the foreign country, and if they are married or have children, those family members relocate with them.

The problem with the residency test is that very few cases are perfect. For example, a husband might move to France to work indefinitely, leaving his family in California, where he returns to visit for 40 days per year. He also plans on returning to California when it is financially possible. This taxpayer must use the residency test and convince the IRS that his tax home is in France, while his wife’s tax home is in the U.S. This can be a challenging tax issue.

Also, being out of the U.S. for one calendar year does not make you a resident of a foreign country. For example, if you go to a foreign country to work on a particular construction job for a specified period of time, say 14 months, you ordinarily will not be regarded as a bona fide resident of that country even though you work there for one tax year or longer. The length of your stay and the nature of your job are only some of the factors to be considered in determining whether you meet the bona fide residence test.

If the residency test is so complex, why use it? Because qualifying under this test, rather than physical presence, allows you to return to the U.S. for a few months each year rather than only 35 days. Second, once you qualify as a resident of a foreign country, you will remain a resident of that country for U.S. tax purposes until you give up your residency. With the 330 day test, you must be out of the country for 330 of each 365 day period.

Finally, with the residency test, you can qualify for all or part of a year. Here is an example:

Andy is a U.S. citizen who qualifies for the FEIE using the physical presence test by living in Costa Rica for all of 2011. He spent no days working in the United States and received $78,000 in salary. Assuming he claimed no foreign housing exclusion, Andy is able to exclude all of this salary from his gross income because it is less than the Foreign Earned Income Exclusion amount for 2011 of $92,900. Andy continues to work in Costa Rica until October 31, 2012, when his employer permanently reassigns him to the United States. During this time, Andy received a salary of $95,000 for his work in Costa Rica in 2012. Assuming he claimed no foreign housing exclusion, the maximum amount of foreign earned income he can exclude from his gross income in 2012 is $79,467 ($95,100 multiplied by ratio of the number of days he was working in Costa Rica (305/365)).

Perpetual Traveler

One major issue I see time and time again, especially with retiree’s living abroad, is the “perpetual traveler.” This is someone who is never in any one place long enough to lay down roots. They travel from place to place, possibly residing in one city for a few days, or a few months.

As stated above, the residency test is based on your intent to move to a particular place and make it your home. If you have no home base, or are not a part of any community in particular, you may not be eligible to use the residency test.

In my opinion, the perpetual traveler is forced to use the 330 day test. Therefore, they must be outside of the U.S. for 330 out of each 365 day period. This may limit the perpetual traveler’s ability to visit family or vacation in the States.

Simply gaining residency in a nation, such as Belize that only requires you to be in their country a few months each year, will not suffice for U.S. tax purposes. The residency test is based on a number of facts and circumstances, and having a residency permit is only one factor.

However, once you establish residency in one place, you will not lose that status in the U.S. tax system, until you give it up (also stated above). Therefore, if you move to a foreign country for a year or two, with the intent of making it your home, and then become a perpetual traveler, you should maintain your foreign residency status.

Travel Days

Since about 2008, it has been the IRS's position that travel days, and time spent in international waters or airspace are not days outside of the U.S. for the purposes of the FEIE. This argument has been supported by a few U.S. tax court cases.

What does this mean to you? If you are using the 330 day test, you must count days traveling to and from the U.S., as days in the U.S., and not foreign days.

If you are in a business, such as a ship captain or airline pilot, that requires you to spend time in international waters, then you have a problem. If you have no residency, and are required to use the 330 day test, you may not be eligible for the FEIE. If this applies to you, you should contact a tax professional.

Forced Out

Relief from either the residency or the 330 day test is available if you are forced to flee a foreign country because of civil unrest, war, or other adverse conditions. To qualify, you must have been a bona fide resident of, or present in, the foreign country on or before the date the IRS determines that adverse conditions exist. In addition, you must establish that you could reasonably be expected to have satisfied the residency requirements had the adverse conditions not arisen. The IRS publishes the names of countries for which this waiver is available annually.

I note that the adverse conditions must arise after you moved to the country in question. Each year I have contractors working in war zones ask if they can use this clause to get out of their contracts and still use the FEIE. Of course, the answer is no. Anyone who travels to a country on the list is on notice and the exception is not available.

Use it or Lose It

In a perfect world, all U.S. citizens file their U.S. tax returns on April 15 and make use of all the proper exclusions and deductions. Of course, that is not the case. In fact, the majority of returns I prepare for those living abroad are delinquent.

This can be extremely costly for those using the foreign earned income exclusion. If you file late, and you are audited by the IRS, you might lose the foreign earned income exclusion, and pay tax on 100% of your foreign earned income!

Generally, a qualifying individual's initial choice of the foreign earned income exclusion must be made with one of the following income tax returns:

- A return filed by the due date (including any extensions),
- A return amending a timely-filed return. Amended returns generally must be filed by the later of 3 years after the filing date of the original return or 2 years after the tax is paid, or
- A return filed within 1 year from the original due date of the return (determined without regard to any extensions)

An exception to this rule will be made provided that:

- You owe no federal tax after accounting for the exclusion, or
- Prior to the IRS discovering you failed to elect/utilize the exclusion.

If you owe tax after taking the FEIE into account, and the IRS discovers your failure to use the FEIE, then you may request relief by requesting a private letter ruling under Income Tax Regulation 301.9100-3 and Revenue Procedure 2009-1.

Having handled several of these cases, I can tell you that negotiating a settlement, or securing a letter ruling, will be a very costly and time consuming battle. It is possible to have about $1 million in untaxed income at issue, where a husband and wife failed to file a return for 6 or 7 tax years and would have been eligible for the full FEIE.

What if I am not overseas for a full tax year?

If during a tax year, you are overseas for only part of one tax year, but not long enough to qualify for the exclusion based on either physical presence or bona fide residence, you have four options:

1. If you paid foreign income tax, claim the foreign tax credit if it means you can avoid paying any U.S. income tax. In general, this applies when the tax rate of your foreign country is higher than, or equal to the U.S. tax rate.

(Caution: This option should be made only with the advice of a tax professional. It is not entirely clear at this time whether claiming a foreign tax credit when you could have chosen the foreign earned income exclusion will automatically revoke your election to take the exclusion for the following five years without the approval of the IRS.)

2. File your tax return for the year without claiming the exclusion. Then, once the physical presence or bona fide residence qualifying period is reached in the following year, you can file an amended return to claim a pro-rated exclusion for the part-year.

3. Those who were overseas for the last three months of the year (let's say in 2010 for this example) and expect to be overseas for the first nine months of the following year, can file an IRS Form 4868 and if necessary the applicable state return filing extension request for automatic extensions to October 15. This will allow time to meet the 12 month physical presence test before the extended due dates of the returns. Once the 12 month period is reached, the 2010 tax returns can be filed claiming the partial exclusion for the time spent overseas in 2010.

4. File a Form 2350—a further application for extension of time to file beyond October 15. This allows you sufficient time to qualify under either of the two time requirements, plus 30 days to file the return for the year in which you qualified for only the part-year exclusion. In choosing your strategy, you need to consider the consequences involved. If financial concerns are paramount, then you should seek advice from a tax professional. If you have a considerable amount to pay on the original return—most of which you will recover on an amended return—you may prefer to wait out the qualification period and file one return.

Housing exclusion or deduction

If your tax home is in a foreign country—and you meet either the bona fide residence test or the physical presence test—you may be able to claim an exclusion or deduction from gross income for housing provided by your employer. Employees claim an exclusion, whereas a deduction is claimed by those who are self-employed.

For the exclusion, foreign housing is provided by an employer if any amount is paid or incurred by the employer on your behalf and included in your foreign earned income (for example, housing allowance or reimbursement).

A housing amount is determined as the excess, if any, of your allowable housing expenses for the tax year over a base amount which increases each year. For 2012 the qualifying daily rate is $36.47 or $13,314 for an entire year of qualifying days (this is 16% of the total FEIE). Allowable housing expenses are the "reasonable" expenses incurred by you and your family such as:

- Rent paid on your foreign property.
- Utility charges incurred (other than telephone charges).
- Real and personal property insurance for foreign housing.

Items that are not considered "allowable housing expenses" include:

- The cost of home purchase or other capital items.

- Wages of domestic servants.(Note: Under certain circumstances, such wages may qualify as "childcare expenses.")
- Deductible interest and taxes.

You can also include the allowable housing expenses of a second foreign household for your spouse and dependents if they did not live with you because of adverse living conditions at your tax home.

The base amount is figured on a daily basis. Your allowable housing amount is the IRS-determined base amount times the number of days during the year that you meet the bona fide residence or physical presence test. The base amount, which changes each year, is shown on each year's Form 2555. It is found on line 32 of the Form 2555 for 2011.

Determining your housing amount

You can exclude or deduct (within the lower and upper limits) your entire housing amount from income if it is considered paid for with employer-provided amounts. Employer-provided amounts are any amounts paid to you—or on your behalf—by your employer, including salary, housing reimbursements, and the fair market value of pay given in the form of goods and services.

If you have no self-employment income, your entire housing amount is considered paid for with employer-provided amounts. If you claim the exclusion, you cannot claim any credits or deductions related to excluded income, including a credit or deduction for any foreign income tax paid on the excluded income.

If you are self-employed—and your housing amount is not provided by an employer—you can deduct the housing amount to arrive at your adjusted gross income.

However, the deduction cannot be more than your foreign earned income for the tax year, minus the total of your excluded foreign earned income and the foreign housing deduction amounts.

If you are an overseas employee who also carries on an overseas self-employment activity, the rules are more complicated. To determine the net self-employment income for both income and self-employment tax purposes, you should consult a tax professional.

Second foreign household

Ordinarily, if you maintain two foreign households, your reasonable foreign housing expenses include only costs for the household that bears the closer relationship (not necessarily geographic) to your tax home. However, if you maintain a second, separate household outside the United States for your spouse or dependents because living conditions near your tax home are dangerous, unhealthful, or otherwise adverse, include the expenses for the second household in your reasonable foreign housing expenses.

You cannot include expenses for more than one second foreign household at the same time. If you maintain two households and you exclude the value of one because it is provided by your employer, you can still include the expenses for the second household in figuring a foreign housing exclusion or deduction.

Adverse living conditions include:

- A state of warfare or civil insurrection in the general area of your tax home.
- Conditions under which it is not feasible to provide family housing—for example, if you must live on a construction site or drilling rig.

What exclusion will I take?

You make separate choices to exclude foreign earned income and/or to exclude or deduct your foreign housing amount. If you choose to take both the foreign housing exclusion and the foreign earned income exclusion, you must figure your foreign housing exclusion first.

Your foreign earned income exclusion is then limited to the smaller of (a) your annual exclusion limit, or (b) the excess of your foreign earned income over your foreign housing exclusion. This limitation is automatically computed on the Form 2555.

It is often difficult to follow the interplay of the lines on tax forms because forms are generally designed by mathematicians whereas the rules are most often written by lawyers. A simpler way of looking at it is that your combined earned income exclusion and housing exclusion cannot exceed your total overseas earnings.

Once you choose to exclude your foreign earned income and/or housing amount, that choice remains in effect for that year and all future years unless you revoke it. You can revoke your choice for any tax year. However, if you revoke your choice in one tax year, you cannot claim the exclusion again for your next five tax years without the approval of the IRS. For more information on revoking the exclusion, see (1) Effect of Choosing the Exclusion and (2) Revoking the Exclusion, both of which are found on page 20 of the 2012 Publication 54.

After reading these two sections, you may reach the conclusion that simply taking a foreign tax credit when you could have chosen the exclusion will automatically disqualify you from claiming the exclusion for the next five years without the approval of the IRS.

If, in your case, a foreign tax credit would be far more beneficial than claiming the exclusion, you should discuss your situation with a tax professional.

For a free consultation, you can reach a U.S. licensed tax attorney or Enrolled Agent at Premier Offshore, Inc. at (619) 564-4062 or by email to info@premieroffshore.com.

Form 2555 or Form 2555EZ?

The Form 2555EZ is a shorter, simpler version of the Form 2555 but may be used only if you meet all of the following requirements:

- Total foreign earned income is $91,400 or less.
- The return being filed is for a full calendar year.
- You have no self-employment income.
- You have no business or moving expenses.
- You are not claiming the foreign housing exclusion or deduction.

There is no need to memorize the above conditions. They are printed on the top of page one of the Form 2555EZ.

Married couples claiming exclusions

If both you and your spouse are eligible for either the foreign earned income or housing exclusion, you can file separate Form 2555s (or 2555EZs) and claim separate exclusion amounts. For further details on married couples filing separate 2555s, see Chapter Four of Publication 54.

If you are married and residing either in a foreign country with community property laws or a domiciliary of a U.S state with community property laws, you need to consult a tax expert.

Waiver of time requirements

Disruption of the qualifying time period because of war, civil unrest, or similar adverse conditions in the foreign country would not preclude you from claiming at least part of the exclusion. However, there are special rules to determining a reduced amount of the exclusion. Here again, you should refer to Publication 593 or Publication 54, or consult with a tax professional.

Exclusion of employer-provided meals and lodging

If your work requires you to live in a camp in a foreign country that is provided by or for your employer, you can exclude the value of any meals and lodging furnished to you, your spouse, and your dependents. For more details, see Publication 593 or Publication 54.

Withholding income tax and social security tax

If you are an employee of a U.S. company overseas, your employer may withhold income and social security taxes from your pay. In certain circumstances, it may be to your advantage to have your employer discontinue withholding income tax from all or part of your wages. You might do this if you expect to qualify for the income exclusions under either the bona fide residence test or the physical presence test. See Publication 54 for more information on withholding income tax.

See the U.S. security taxes section below for the requirements for employer withholding of social security taxes.

If a U.S. employer does not withhold income taxes from your foreign wages—or if not enough tax is withheld—you may have to pay estimated tax. Your estimated tax is the total of your estimated income tax and self-employment tax for the year, minus your expected withholding for the year.

When estimating gross income, do not include the income that you expect to exclude. In figuring your estimated tax liability, you can subtract from income your estimated housing exclusion or deduction. However, if the actual exclusion or deduction is less than you expected, you may be subject to a penalty for underpayment. You can use Form 1040-ES (Estimated Tax for Individuals) to estimate your tax due for the year. The requirements for filing and paying estimated tax are generally the same as those you would follow if you were in the U.S.

Withholding from pension payments

U.S. payers of benefits from employer deferred compensation plans (such as employer pensions, annuities, or profit-sharing plans), individual retirement plans, and commercial annuities are generally required to withhold income tax from these payments or distributions. This will apply unless you choose an exemption from withholding.

To qualify for this withholding exemption, you must provide the payer of the benefits with a residence address in the U.S. (or U.S. possession), or certify to the payer that you are not a U.S. citizen, resident alien, or someone who left the United States with the principal purpose of avoiding U.S tax.

For rules that apply to non-periodic distributions from qualified employer plans and tax-sheltered annuity plans, refer to Publication 575 (“Pension and Annuity Income”).

Although the U.S. Social Security Administration (SSA) is not required to withhold federal income tax on benefit payments to American recipients residing in the U.S. or overseas, benefit recipients may request voluntary income tax withholding. Based on rules too complicated to discuss here, some of the benefit payments may be subject to U.S. income tax and the recipients may prefer to have the income tax withheld. You should check with a tax expert to determine if any of your benefit payments will be subject to U.S. income tax and whether or not it is advisable to have the tax withheld by the SSA.

Note: Some foreign countries may tax your benefit payments in spite of the fact the payments are also subject to U.S. tax. Although the many U.S. income tax treaties provide for taxation of certain income by the U.S. alone, you will need to be familiar with the laws of the foreign country in which you reside.

U.S. Social Security taxes

Under certain circumstances, you may be required to pay social security taxes to both the U.S. and a foreign country on the same income. For example, when Bob, an employee of a U.S. company, moves overseas on a foreign assignment, the employer is liable for the employer's share and Bob is liable for his share of U.S. social security taxes on his wages. At the same time, the foreign tax laws may require that Bob's employer pay the foreign social security taxes on the wages paid to Bob while he is living in that country.

Unless certain arrangements are made with the SSA, the same situation would occur if the U.S. company assigns Bob to work for a foreign subsidiary of which the American company is a principal owner.

The SSA is responsible for administering "totalization agreements," which are similar to the U.S. tax treaties.

At time of writing, the U.S. has totalization agreements with the following nations: Australia, Austria, Belgium, Canada, Chile, Finland, France, Germany, Greece, Ireland, Italy, Japan, Korea (South), Luxembourg, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the United Kingdom.

An agreement is under discussion with Poland. Agreements with the Czech Republic, Denmark, and Mexico have been signed but have not yet come into force. (See Appendix C for full details.)

On the other hand, if you have the option of working overseas for employers other than U.S. companies—or principally owned foreign subsidiaries of U.S. companies—you will avoid any double taxation on the social security side because you will no longer be liable for the U.S. social security taxes.

If you or your employer needs more information, contact the Social Security Administration online at www.ssa.gov. Its welcome page has a "Contact Us" link that provides a variety of means of getting in touch with a representative.

Credits and Deductions on Foreign Income Taxes

In filing your U.S. returns, you can take either a credit or a deduction for income taxes imposed on you by a foreign country. Taken as a deduction, foreign income taxes reduce your taxable income. Taken as a credit, foreign income taxes reduce your tax liability.

There is no rule to determine which approach is better. Generally, it is to your advantage to take the credit, which is subtracted directly from your U.S. tax liability. Your credit cannot be more than the part of your U.S. income tax liability allocable to taxable foreign income. In other words, if you have no U.S. income tax liability, or if all your foreign income is excludable, you will not be able to claim a foreign tax credit.

If foreign income taxes were imposed at a high rate, and the proportion of foreign income to U.S. income is small, a lower final tax may result from taking the foreign income tax deduction. You must treat all foreign income taxes in the same way—you generally cannot deduct some taxes and take a credit for others.

If you choose to credit foreign taxes against your tax liability, you will need to complete Form 1116 (unless you meet the requirements outlined below), and attach it to your U.S. income tax return.

Caution: Do not include the foreign taxes paid or accrued as withheld taxes on the second page of the 2012 Form 1040 at line 63.

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

You will not be subject to this limit, and may be able to claim the credit without using Form 1116, if the following requirements are met:

1. You are filing as an individual.
2. Your only foreign source income for the tax year is passive income coming from sources such as dividends, interest, and royalties, which are reported to you on a payee statement such as a Form 1099-DIV or 1099-INT.
3. Your qualified foreign taxes for the tax year are not more than $300 ($600 if filing a joint return) and are reported on a payee statement.
4. You elect this procedure for the tax year. (If you make this election, you cannot carry back or carry over any unused foreign tax to or from this tax year.)

If you choose to deduct all foreign income taxes on your U.S. income tax return, you need to itemize the deduction on Form 1040 Schedule A.

The foreign tax credit and deduction, their limits, and the carry back and carry over provisions are discussed in detail in IRS Publication 514.

Foreign Currency: The foreign income, expenses, and credits must be converted from foreign currency using an appropriate exchange rate and reported on the U.S. return in U.S. dollars.

Claiming a Deduction for Relocation Expenses

If you incur expenses when relocating overseas, you may qualify for a deduction of "reasonable" moving expenses. Keep in mind that moving expenses relate to the income earned after the move and you cannot claim expenses attributed to excluded income. For example, if you are an employee and move overseas, your unreimbursed moving expenses are generally deductible. However, if you are able to exclude all of your overseas earnings in the year of the move, the following year you cannot claim any of the unreimbursed moving expenses regardless of whether or not they are reasonable. See Publication 54 for more details.

Avoiding Double Taxation

If you have paid foreign taxes on the earnings that qualify for the earned income exclusion, you will have to make a choice of taking the exclusion, taking the tax credit/deduction, or taking a combination of the two.

A good tax software program should allow you to prepare a complete return claiming the income exclusion, housing exclusion/deduction, and the foreign tax credit. Once the return is prepared, the program should allow you to easily produce two duplicate computer copies. These can be produced individually using the other two options for comparison to figure out which option produces the best results. As mentioned earlier, you need to do the math.

If you claim the exclusion, you cannot claim any credits or deductions that are related to the excluded income—the concept being that you can't get a double benefit. Nor can you claim the earned income credit, which is to benefit low income earners. In other words, someone who earned $100,000 overseas and excluded $91,400 is not the same as an individual whose total earnings are only $8,600.

Also, for Individual Retirement Account (IRA) purposes, the excluded income is not considered compensation and, for figuring deductible contributions when you are covered by an employer retirement plan, the excluded income is included in your modified adjusted gross income.

Double Taxation Treaties

If a "double taxation" treaty exists between the United States and the country in which a U.S. citizen resides, then the tax treaty supersedes the Internal Revenue Code (IRC), and the language of the treaty governs. As a general rule, tax treaties allow you to offset foreign tax paid against what your federal tax liability would have been.

This means that if your foreign taxes are higher than your U.S. federal tax, no U.S. tax is due. If your foreign taxes are lower, then the difference would generally still be due to Uncle Sam, unless it was exempted under the rules for foreign earned income exclusion.

Treaties generally provide U.S. students, teachers, and trainees with special exemptions from the foreign treaty country's income tax.

Publication 901 contains detailed information on tax treaties and tells you where you can get copies of them. Click here for additional information: http://www.irs.gov/publications/p901/index.html

Foreign Bank Accounts Must be Reported

If you had any financial interest in, or signature or other authority over a bank account, securities account, or other financial account in a foreign country at any time during the tax year, you may have to complete Form 90-22.1 and file it with the Department of the Treasury. You need not file this form if the combined assets in the account(s) are $10,000 or less during the entire year, or if the assets are with a U.S. military banking facility operated by a U.S. financial institution. The deadline for filing is June 30 of each calendar year.

There are no extensions and an extension to file the federal income tax return does not extend the deadline for filing the Form 90-22.1. If you have a foreign account, you must also file a Form 1040 Schedule B and complete Part III regarding foreign bank accounts—regardless of whether you are required to file a Form 90-22.1, or have any interest or dividend income to report on the Schedule B.

This requirement to report your foreign bank account is one of the most important obligations you have as a U.S. citizen living abroad. The law imposes a civil penalty for not disclosing an offshore bank account or offshore credit card up to $25,000 or the greatest of 50% of the balance in the account at the time of the violation or $100,000. Criminal penalties for willful failure to file an FBAR can also apply in certain situations. Note that these penalties can be imposed for each year.

In addition to the FBAR penalties above, intentionally failing to check the box on Schedule B to report a foreign account is a Felony. It is possible for a single violation to result in 6 to 12 months in prison!

I have personally handled many FBAR and Schedule B related cases and can tell you with certainly that the IRS is very aggressive in prosecuting these matters. For example, in one case in 2010 a client plead guilty to a single count of failing to check the box on Schedule B, and was given 6 months of confinement. In addition to the criminal case, the IRS initiated a civil audit which, when taxes, fines, interest and penalties were calculated, the client was wiped out financially. Finally, to add insult to injury, the State of California came in with their taxes, interest, and penalties.

The Schedule B rules and the FBAR are no joke, and they are not just used against money launders and drug dealers. Prosecutions and civil fines have become a major revenue sources for the IRS.

Filing Deadlines, Extensions, and Penalties

If your tax year is the calendar year, the due date for filing your income tax return is April 15 of the following year—unless that date falls on a weekend day or holiday, which would allow you an additional day or two.

Automatic two-month extension for Americans overseas

The good news is that overseas Americans are automatically granted a two-month extension to June 15 to file (and pay their tax).You don't have to request this extension in advance. When the time comes to file, simply attach a statement to your return explaining that you were either:

1) Living outside the U.S. and Puerto Rico and that your main place of business or post of duty was outside the U.S. and Puerto Rico; or

2) In the military or naval service on duty outside the U.S. or Puerto Rico.

Note: If you are filing electronically (I'll discuss this later), you will need to check your software instructions or check with your software provider on how to electronically file the extension form or to add the required statement to the return.

What to do if you need more time

Better still is the Form 4868 ("Application for Automatic Extension of Time to File U.S. Individual Income Tax Return"). This form will get you a full six-month extension.

No signature and no reason will be required for the six-month extension to October 15 (or the alternate date under the weekend and holiday rule).

Time to pay tax due on a return

With the exception of the automatic two-month extension for overseas Americans, an extension of time to file does not mean an extension of time to pay the tax. Although you will be required to pay interest on any payment made after April 15, you will not be required to pay the late payment penalty (see below) for the period April 15 to June 15.

Where to file

If you claim the foreign earned income exclusion or the foreign housing exclusion or deduction on a paper tax return, you should file your return with the Internal Revenue Service, Austin, Texas 73301-0215.

Electronic filing has its own set of filing rules that are not treated here. A good software program with the electronic filing feature allows you to send the federal and, if applicable, the state income tax return to the relevant processing center.

Electronic filing is the way to go

If you have the option, paperless filing is the way to go. All you need is a computer, tax preparation software with the electronic filing feature, and Internet access. You complete your return (and with some software programs the Form 4868 as well), send it over the wires, and await confirmation from the IRS or a state tax department that your return was accepted. If rejected, you should receive an error message that either tells how to correct the error(s) for resubmission or a statement of why the return cannot be accepted for electronic filing. The deadline for electronic filing is April 15, or October 15 (or the alternate date under the weekend and holiday rule) if you file an extension. You may not file a late return electronically.

The rules that relate to formatting, what information must be included on the return, and what forms or schedules if included in the return forms will disqualify the return from electronic filing, are mind-boggling. However, as with any good software program, the computer does most of the analytical work. And, if you mess up, the programs are generally designed to alert you to your mistakes or provide other reminders to help you through the process.

Most software programs allow you to complete the state tax return along with the federal return, saving time spent on duplicating data entries. The state return in most cases is produced automatically as an offshoot of the 1040. Part-year return (or even a non-resident return), if your situation warrants one, takes a little extra time because there are additional data entry steps. You will be required to allocate the annual income taxable on the federal return to the lesser amount taxable by a state for part-year residency or non-residency.

An additional benefit of tax preparation software is that, once you go through the process for the first year, most of the routine—and often tedious—data entries that apply year after year are carried forward to save you time in future years.

You’ll find a variety of good tax preparation software programs on the market. Two of the most popular are TurboTax and TaxCut.

I’d recommend that you do some research on the Internet to compare prices and availability. And make sure that whichever software program you purchase has the electronic filing capability. There are also some companies offering to prepare your taxes online, through their website, without your downloading and installing their programs. These include Intuit and H&R Block.

Foreign post marks and electronic filing

Generally, the IRS treats payments made—and tax returns filed—as received by the IRS on the date they are received by the U.S. Postal Service or a domestic courier service. Penalties could be applied by the IRS on late payments and, if applicable, late filed returns under certain circumstances including those received from overseas.

Consult a tax professional if sending tax documents from countries whose mail or courier systems are subject to lengthy delays. You should keep in mind that electronic filing is one means of avoiding mailing delays and possible penalties resulting from such delays. I generally recommend the electronic filing method to my clients overseas.

Interest and penalties

If you are late in filing your taxes, avoid filing altogether, or underpay taxes—whether intentionally or unintentionally—the IRS may impose a penalty. If the 1040 has no tax due, there are generally no penalties whether you filed or did not file.

Even if there are penalties, the IRS may waive them if the delay is due to "reasonable cause." The IRS doesn't like to pin itself down by trying to define the term reasonable cause—you have to write in with an explanation and hope for the best! The instructions for requesting elimination of a penalty for reasonable cause are found in Notice 433 on the IRS website.

The two more common penalties are the late filing and the late payment penalties. The penalty for late filing (or failing to file) a tax return is a percentage of the tax due but unpaid, unless the reason for the late filing or failure to file is due to reasonable cause. The penalty is 5% of the underpayment per month, or any part of the month, up to the maximum of 25%. If the return is not filed within 60 days of the due date (considering extensions), there is a minimum penalty which is the lesser of $100 or the tax due on the return. There is an interaction of the late filing penalty and the late payment penalty discussed below.

The late payment penalty is 0.5% for each month, or any part of a month, the tax due on a return remains unpaid. The maximum penalty is 25%.

The interaction between these two penalties in effect limits both penalties combined to the 25% maximum. For each month that both penalties apply, the late filing penalty is reduced to 4.5%.

Consequently, a return filed four months and one day late is subject to the late filing penalty of 4.5% times 5 (22.5%), and a late payment penalty of 0.5% times 5 (2.5%), for a total of 25% (the maximum).

However, if the return is filed on time but there is tax due, the late payment penalty is 0.5 per month of any fraction thereof until paid. These penalties are in addition to the interest charged for unpaid taxes. The IRS is required to determine the interest rate quarterly. For the latest information on interest rates, check with the IRS or a tax professional.

U.S. State Taxation of Foreign Income

If you have a choice of where to live and work overseas, it is important to understand how your last state of residency, the U.S., and your new home country will tax your income. High state or foreign tax rates, or lack of tax exemptions for income earned inside and outside of a new home country, can easily negate any tax advantages provided to overseas Americans under the U.S. federal tax laws.

Before we delve into state income taxes, it is important to understand the distinction between residency and domicile—although most states use these terms interchangeably. For tax purposes, your residence is generally where you currently live and work. Your domicile on the other hand may be the place you presently live, or previously lived and have a definite intention to return after living elsewhere.

Your domicile may also be a state in which you formerly lived, but failed to fulfill the conditions to abandon domicile when you moved elsewhere. For most of us, we are residents and domicile of the same state regardless of whether that state is a U.S. state or a foreign country.

Residence and domicile are important distinctions for those states that subject both their residents and their domiciliaries to state income tax. For example you may have moved to another state and established residency in that new state, but still have to file tax returns in your former state (where you are officially domiciled).

Different states…different rules

Liability for state income taxes is a complicated matter. There are 51 jurisdictions including the 50 states and the District of Columbia and consequently 51 different sets of rules.

If you move from one of the more popular non-taxing states such as Florida and Texas, you needn’t ordinarily worry about liability for state income taxes while living overseas.

Other states such as Oregon, New York, and Missouri to name a few will not tax an individual who is otherwise considered a domiciliary of the state, but maintains a permanent residence elsewhere (in the U.S. or overseas) and spends less than 30 days a year in the state. Also, New Hampshire and Tennessee only tax interest and dividend income.

Then there are those states desperate for money, like California. This state has no foreign earned income exclusion, is aggressive in determining “residency” for those abroad, and, when one spouse is abroad and one is in California, this state will tax the international spouse’s income under a "community property" argument. If you live in an aggressive state, and you can first move to a non-taxing state, and then move abroad, I strongly recommend you do so.

Finding a complete listing of states who do not tax domiciliaries living outside the state is beyond the purpose of this guide. A good starting point is a very comprehensive website for finding all kinds of information on taxation. Try www.taxsites.com and click on "state links" in the tax column to check out your state of interest.

Don't be misled by the advice that you can make a quick trip to one of the non-taxing states, set up a local address, get a driver's license, and register to vote thereby establishing residency and domicile in that state. It doesn't work that way. The fact that many have done exactly that without being questioned is a matter of inadequate enforcement by state tax authorities, rather than a good faith compliance with the rules for establishing and abandoning state residency.

If you think you may be taxed by a former state as a domiciliary, you need to be aware of what elements that state will look at to determine your liability for its income taxes. Some of the most important are as follows:

- Where you live.
- Where and how you vote.
- What state driver's license you carry.
- Where your bank accounts are located.
- The location of any real property you own.
- Where your family is living if not with you.
- Whether or not you have a fixed intention of returning to a particular state if you are living elsewhere at the present time.

There is no magic formula for determining what combination of the above listed items will prompt your former state to subject your income to taxation. Some combinations are more important than others. Where you live; whether you vote in national but not state elections; which driver's license you carry; and where your real property (if any) is located are often very critical elements. However, the most important and critical is the final point. A fixed intention to return to a particular state will always subject you to that state's income taxes, in those states that tax as residents not only those who physically reside within the state but also its domiciliaries.

What if I don't know which U.S. state I will return to?

Unlike in foreign countries, there is no such thing as a national U.S. residency or domicile. Residency and domicile apply to states only. So, if you don't have the fixed or definite intention to return to a particular state, but do have a fixed or definite intention to return to the U.S., you may still be able to abandon domicile in a particular state.

This is an important distinction when it comes to voting in U.S. elections. However, the Overseas Citizens Voting Rights Act allows U.S. citizens living outside the country who are presently not residents or domiciliaries of any U.S. state to vote in the federal elections (see U.S. Code 42, 1973ff).

To obtain the specific instructions and to download the form to request an absentee ballot, go to www.fvap.gov. On the opening web page you will see a large white block with the heading The Basic Absentee Voting Process. Just follow the simple instructions.

Expatriation – The Final Solution

Each month I get one or two inquiries from U.S. citizens who have had enough and want to give up their U.S. citizenship. While it is rare for someone to take such drastic steps, especially after they learn how to manage their U.S. tax obligations while living abroad, it is an important subject. Here are the facts:

Individuals who give up their U.S. citizenship, or long-term residents who give up their residency status after June 16, 2008 are subject to a mark-to-market tax regime under which they are taxed on the unrealized gain in their property to the extent it exceeds $651,000 for 2012.

To calculate gain, the IRS assumes the all of your assets were sold at fair market value on the day before you expatriated. If the net gain from these deemed sales exceed $651,000, you pay tax on that difference.

These rules apply to any U.S. citizen who relinquishes citizenship or any long-term resident who ceases to be a lawful permanent resident of the United States, and the individual who has:

1. An average annual net income tax liability for the five preceding years of more than $145,000,
2. A net worth of $2 million or more on the expatriation date, or
3. Fails to certify under penalty of perjury that he or she has complied with all U.S. tax obligations for the preceding five years or fails to submit evidence of compliance required by the IRS.

Of course, paying tax on assets you do not sell can cause a problem, for which the IRS has graciously made allowances: You may elect to defer this tax so long as you provide adequate security, as required by the IRS, to ensure payment and you give up any treaty rights that would preclude assessment or collection of the tax in the future.

In addition to any other requirement, an expatriate must also file an information return on Form 8854 in each tax year they are subject to the rules above. This form can be found at http://www.irs.gov/pub/irs-pdf/f8854.pdf

There are a lot of contingencies and complexities to the rules above. For example, special rules apply to deferred compensation items, interests in non-grantor trusts, special gift and inheritance rules, etc. Anyone considering expatriation should consult a tax expert.

U.S. licensed tax and expatriation experts are available to speak with you. Feel free to phone us at (619) 564-4062or send an email to info@premieroffshore.com for a free and confidential consultation.

Taxation of Foreign Real Estate Investments

When it comes to investing in property overseas, there is often little difference than if you were investing in U.S. property. Three situations bear investigation:

1. The first is the **purchase of raw land or a building for speculation**. In this scenario, the investor buys a property overseas and plans on holding it for a period of time to later sell for a profit. The result is a capital gain taxed by both the U.S. government and, in some cases, the state of domicile of the taxpayer. The U.S. has favorable tax rates (currently 15%) if the holding period is over one year. There may also be a capital gains tax in the country that the property is located in. If this is the case, a credit can be used to offset U.S. taxes.

In this situation, there is no difference in how the U.S. taxes the sale of an investment property in the U.S. and one outside of the U.S.

2. Let's look at the same scenario, except this time, instead of selling the property outright you want to **exchange it into another property**. This can be accomplished by using the provisions of section 1031 of the IRS code. Under this section, you can defer some or all of the gain from the sale of one property by simultaneously purchasing another property of "like kind." Here again, there is no difference in the taxation of property inside the U.S. and outside the U.S.

What we must look at in this situation is the exact definition of "like kind." When dealing with real property, the government gives quite a bit of latitude in what is considered "like kind." Examples are raw land, a single family house, a condo, an apartment building, a restraint, etc. As long as you're selling real estate to buy real estate, you will generally be allowed to perform a 1031 exchange.

The main thing to be aware of is that foreign real property and U.S. real property is not considered to be like kind. For instance, you cannot exchange a rental property in California into a rental property in France or to raw land in Costa Rica (or vice versa).You could however exchange the rental property in France into raw land in Costa Rica. What this boils down to for you, the investor, is that, if you want to move an investment back into the U.S. you will have to pay taxes on any gains you made.

If a property qualifies as "like kind" then you must also qualify the exchange. There are complexities involved with this type of transaction, and you should hire a tax consultant to facilitate the transaction and make sure that you don't do anything to disqualify the non-recognition of gain. Another critical point is that your new property needs to be more expensive and have a larger note on it. Otherwise a portion of the gain will be recognized and taxable. For more information, see the "Nontaxable Exchanges" section of IRS Publication 544 Sale or Other Dispositions of Assets available at *www.irs.gov/pub/irs-pdf/p544.pdf*.

3. The third consideration is when you have a rental property overseas. In this case, it is much the same as a rental situation within the U.S. The main consideration is that rental activities are considered passive. This means that losses from your passive rental activities can only offset income from other passive sources. If you do not have any other passive income, the losses are suspended until such time that you have passive income or you sell the property—at which time the losses are released and can offset other types of income.

An exception to this rule applies to active participants in the management of real property. As an "active participant," you must share in the management decisions for the property, arranging for others to provide services like repairs, etc. Owning property in a foreign country makes it more difficult, but not impossible, to qualify as an active participant. If you meet this requirement, you can deduct the losses from your rental property against your other income (like wages, self-employment, interest, and dividends).

Besides the need to qualify as an active participant you must also meet these additional requirements:

- You must own more than 10% of the property.
- You cannot be a limited partner.
- You must be an active participant in the year of the loss and the year that the loss is deducted. The benefit phases out at an adjusted gross income of between $100,000 and $150,000.

Finally, you will only be allowed straight line depreciation on property outside of the U.S. You are not eligible for the various accelerated depreciation methods.

Implications of Your "Tax Home"

If you only have one tax home regardless of whether you reside in the U.S. or overseas, there are few, if any, complications.

For people with multiple homes or multiple business ventures at which they spend varying amounts of time, it gets trickier. These situations are decided on a case-by-case basis, according to individual circumstances. Some of the facts that will be looked at are:

- Total business time spent at the different locations.
- The amount of business activity that is carried on at each location.
- The significance of the business activity to the taxpayer's return (where is more money made and what percentage of the total income does it represent?)

Let's look at some examples of how the tax home concept can affect the taxes of the international real estate investor.

Example 1—Bob and Jane live in the United States and work close to their home. They own some real estate outside the U.S.

In this case, their tax home is their residence and all expenses they incur when visiting their real estate (whether rental property or investment property) are deductible against the income from that property.

Example 2—Bob and Jane live in the United States and work close to their home. They spend part of the year at their foreign property—a small house in France with a vineyard.

In this case, whether they can deduct all their living expenses (travel, meals, utilities, incidentals) as “away-from-home” expenses in pursuit of a business is dependent on the facts. Which home do they spend more time at? Where do they make more of their money? How much of their time at the foreign home is devoted to the vineyard business?

If it is determined that more time is spent at the foreign location, the deductions will not be allowed. This is exactly what happened in the case of Bowles v. United States. The taxpayers claimed away-from-home expenses for their grape-growing business, but the IRS and then the courts ruled that, since more of the couple’s time was spent at the vineyard, the vineyard was their tax home and the deductions weren’t allowed.

Example 3—Bob and Jane live in the United States and work close to their home. They own a seasonal B&B in Europe, which they spend the summer operating.

In this case, if Bob and Jane can prove that their tax home is in the United States, all of their living expenses can be deducted as away-from-home expenses (in any case the direct expenses of operating the business are allowed).

What is important to note is that you need to plan your actions beforehand. If you are going to operate a business, or own real estate overseas, and you want to deduct your overseas living expenses as away-from-home expenses, you need to make sure that you create a fact pattern consistent with a tax home in the U.S. Direct expenses of the business or investment are always deductible and are not dependent on where your tax home is.

Note: There is an important distinction in the concept of “tax home” for purposes of deducting away-from-home expenses and qualifying for the foreign earned income exclusion. Multiple homes may cause the loss of the away-from-home expenses but, as long as they are all overseas, you may still qualify for the earned income exclusion and the housing exclusion.

U.S. Tax for Business Owners & Self Employed

This section is an introduction to the benefits of an offshore corporation for U.S. citizens living and working abroad. It is not meant for those living abroad on their pension (retirees) or those with passive investment income.

Most Expats know that the U.S. taxes its citizens on their worldwide income and that all U.S. citizens must file a U.S. tax return every year. What most do not know is that a foreign corporation, in a zero tax jurisdiction, can legally and legitimately be used to reduce, defer or eliminate U.S. tax on their business income.

As discussed in Section one, your first line of defense is the Foreign Earned Income Exclusion (FEIE or exclusion). This exclusion was covered in detail in Section One, and can be summarized for our purpose here as follows: The FEIE excludes from your U.S. income tax the first $95,100 for 2012 of wage or self-employment income earned by a U.S. citizen who is a "resident" of another country or who was outside of the U.S. for at least 330 of any 365 day period.

The FEIE can be used to reduce or eliminate U.S. Federal income tax on wages paid to you by a U.S. corporation or a foreign corporation. It does not matter if you are the owner of the corporation…the FEIE still applies as long as you are an employee of that company drawing a salary.

The exclusion can also be used to reduce federal income tax on self-employment income paid to you while you are living and working abroad. "Self-employed" generally refers to someone operating a small business without the protection of a corporation.

Now, that you have become an expert on the FEIE by reading this book, let's look at the practical applications to the employee and the self-employed person.

Employees

Let's say you are the employee of a U.S. corporation and live outside of the U.S. You receive a Form W-2, and may have had reduced withholding of your federal income tax, or will file a claim for a refund with the IRS because of the exclusion. However, the exclusion only applies to income tax, thus you still get to pay Medicare, Social Security, and FICA tax…which, for our purposes, I will estimate at about 7.5%, or $6,855 on a salary of $95,100. In addition, your employer is required to match your Medicare, Social Security and FICA contributions, which is a cost to him of about 7.5%. Therefore, the total cost is about 15%. Again, these numbers are rounded off for this example.

Now, let's say you are an employee of foreign corporation, rather than a U.S. corporation. This foreign corporation can be owned by you, or be a subsidiary of your U.S. employer. In that case, you would not have a Form W-2 sent to the IRS, might not have any U.S. withholding, and may not be required to contribute to the U.S. Medicare, Social Security, or FICA programs (unless the foreign corporation opted in to the U.S. system).

In addition to the benefits to the employee, the employer incorporated offshore is not required to pay in to these U.S. programs, thereby resulting in a total savings of about 15%.

Please note that I have assumed that the foreign entity is incorporated in an offshore jurisdiction that will not tax its income or levy a Social Security tax. Also note that I assume it is a corporation, and not a partnership or Limited Liability Company.

Self-Employed

Now for the self-employed person operating without a corporation: The IRS and the entrepreneur will (or should) receive a Form 1099 from each payment over $500 done for a U.S. company or person. Presumably, there will be no report for work done for non-US businesses, though this does not impact your tax obligations. You then report your business income and expenses on Schedule C and use the foreign earned income exclusion to reduce your federal income tax…and that is where things go horribly wrong.

First, the FEIE does not reduce self-employment tax, which is about 15%, similar to the tax charged to the employee and employer above. Unfortunately for the self-employed person, he must pay the entire tax, rather than only half, as he would as an employee.

Second, the exclusion is reduced in proportion to your Schedule C business expenses. This roughly means that, if your gross income is $182,800, and your business expenses are $95,100, your exclusion is reduced by about 50% to $45,700. Thus you are paying federal income tax on $45,700, or about 50% of your net business income, in addition to paying 15% self-employment tax on $95,100.

Ok, so that is rough, but the IRS is not done with you yet! Since January 1, 2006, when the Tax Increase Prevention and Reconciliation Act of 2005 came into effect, taxpayers claiming the foreign earned income exclusion have been paying tax at the tax rates that would apply had they not claimed the exclusion. That means, instead of having your income taxed starting at the 10% rate, most expatriates are taxed starting at the 25% tax bracket.

Therefore, if you have a Schedule C business operating at a 50% net profit margin with sales of $182,800 your tax bill might be $24,835 ($91,400 x 15% + $45,700 x 25%). This is a very rough, back of the envelope, example, but you get the idea.

If a husband and wife both operate the same business, and sales are doubled, with the same 50% margin, the cost of reporting the business on Schedule C, rather than through a properly structured offshore corporation, could be around $49,000.

Tax Benefits of Incorporating

If you are self-employed and living and working abroad you do have options.

For example, had the same self-employed person above operated through a properly domiciled and structured offshore corporation, he or she may have eliminated just about all of the tax on net active business profits of $95,100…to say nothing of the benefits of limited liability. This is accomplished as follows:

First, form an offshore corporation in a zero tax jurisdiction, open a foreign bank account, and resister that company with the IRS.

Second, draw a salary of up to $95,100 for 2012 from that foreign corporation. As long as you qualify for the FEIE and the company's income is derived from active, not passive business, there will be no federal income tax on this income.

Third, the properly registered and domiciled foreign corporation is not responsible for Medicare, Social Security, or FICA taxes.

Fourth, you are not considered self-employed; you are an employee of your offshore corporation, and not subject to self-employment tax.

Fifth, the expenses of the offshore corporation do not reduce your foreign earned income exclusion.

Sixth, you might be able to retain some or all of the offshore corporation's earnings in excess of the exclusion. Careful planning in this area might allow the deferral of U.S. income tax on active business income inside the corporation.

Therefore, the use of an offshore corporation by an international business with net profits of $95,100 and one employee saves about $24,000 in U.S. taxes. If the corporation's net profits are $190,200, and there are two employees, such as a husband and wife, the total savings might be as high as $48,000.

When planning an international business, be it large or small, you should consult with a qualified U.S. licensed tax attorney experienced in forming and advising international businesses.

OVERSEAS TAX FAQ #1: How can an offshore corporation be used to reduce U.S. taxation?

If you live in the United States while you do your work, you will pay U.S. tax on the income you earn. Using a foreign corporation while you are physically present in the U.S. does not affect your U.S. tax situation.

If you retire to a foreign country and your only income is from a pension, investments, Social Security, etc., you will continue to pay tax in the States. There is no tax benefit to retiring abroad.

If you live abroad, work for either a U.S. company or a foreign employer, and meet the foreign earned income exclusion requirements, up to US$95,100 in wage income (for 2012; the amount is adjusted upward each year) will be free of U.S. federal income tax.

If you run a business or are self-employed, live and work abroad, meet the foreign earned income exclusion requirements, and operate through an offshore corporation, you could be able to reduce or even eliminate all U.S. tax on your ordinary income.

If you operate a business from and reside in a country that does not tax foreign-source income, and your clients are outside that country, you could be able to operate free of tax in that country as well, meaning it could be possible for you to live completely income tax free.

OVERSEAS TAX FAQ #2: What if I set up an offshore corporation but continue living in the United States? Could I have foreign clients wire money to my offshore corporation, then pay U.S. tax on that income only when it is brought into the States?

No. This is one of the most common types of tax fraud…a strategy for going to prison.

If you are present in the United States while you work, all income you earn is taxable in the United States when received. When money is sent to an offshore corporation that you own or control, it is deemed received. It does not matter if you use nominee directors or add some other layer of complexity.

Of course, there are legitimate benefits to incorporating offshore. For example, you could have access to better or more diverse investment options, you could enjoy better asset protection than available in a domestic vehicle, and your customers could prefer to do business with a non-U.S. entity.

I am asked this question all the time by people seeking tax advice. Typically, they are looking for honest counsel and have no intention of breaking the law. However, you must understand that, when you call an offshore attorney or an online incorporator, you often receive no guidance and often can be given misleading information.

OVERSEAS TAX FAQ #3: If I retire overseas, will I owe income on my retirement or pension income?

U.S. retirement and pension income was earned while you were working in the United States. In many cases, you were allowed to defer income on the pension component of your wages.

Now that you are ready to take that income, it is taxable in the country where it was earned. The foreign earned income excision and other international tax tools do not apply.

The same is true of most types of investment income. Income from stocks sold, dividends received, rental income, and bank interest does not qualify for the foreign earned income exclusion and is taxed as if you were living in the United States.

OVERSEAS TAX FAQ #4: Living overseas, must I still pay Social Security, Medicare, and FICA?

If you live abroad but work for a U.S. corporation, you qualify for the foreign earned income exclusion and can exclude up to US$95,100 in wage income (for 2012) from federal income tax.

However, you still must pay Social Security, Medicare, and FICA. This usually amounts to 7.5% paid by you and 7.5% paid by your employer. For the purposes of this conversation, I'm ignoring Social Security treaties, which are country-specific.

Also, you could still be required to pay state tax if your spouse is living in the United States while you are working abroad. For example, if your spouse lives in California, which does not have the foreign earned income exclusion, the state would tax 50% of your income under a community property tax rule.

If you are employed by a non-U.S. corporation, the foreign earned income exclusion rules are as I've described, but you do not pay U.S. Social Security, Medicare, or FICA taxes. This is the case even if the foreign corporation is a subsidiary of a U.S. company (unless that subsidiary elects into the U.S. social tax system, which is extremely rare).

OVERSEAS TAX FAQ #5: What is my U.S. tax obligation operating a business or being self-employed outside the States?

If you are self-employed or operate a business outside the United States and qualify for the foreign earned income exclusion, you can use that exclusion to reduce the amount of federal income tax you owe. If you operate your business without a corporation or through a single-member LLC that does not file an election with the IRS, you must pay U.S. self-employment tax on your income. This amounts to about 15% tax of your income.

Making things worse, your business is reported to the IRS on the "Schedule C" form, and your business expenses proportionately reduce your foreign earned income exclusion. For example, if your total sales for 2012 were US$300,000 and your expenses were US$150,000, your foreign earned income exclusion is reduced by 50%. Thus, you can reduce your income for the purposes of figuring the tax you owe by only US$95,100 divided by 2, or US$47,550.

Adding insult to injury, you must pay U.S. income tax on the amount over the allowed foreign earned income exclusion. In our example, that is US$150,000 of net income, minus the remaining FEIE of US$47,550 equals US$102,450 of taxable income.

All three of these problems can be managed by operating your business through a foreign corporation.

First, operating this way, you are a non-U.S. corporation and not required to pay Social Security, Medicare, or FICA taxes.

Second, you can draw a salary from your corporation of US$95,100, avoiding the issue of a reduced exclusion because of business expenses.

Third, you may be able to retain net profits in excess of the foreign earned income exclusion and pay U.S. income tax on that money only when you take it out of the corporation.

OVERSEAS TAX FAQ #6: If I operate a business in a foreign jurisdiction (such as Panama), what is my local tax obligation?

Several countries, including Panama, do not tax foreign source income. These jurisdictions tax only domestic income (profits you make by selling to people in that country).

Therefore, you can mitigate income tax in your country of residence if you sell to people or businesses outside that nation. For example, from a base in Panama, you could offer products or services over the Internet to clients in the United States. If you don't take orders from people in Panama, this is foreign-source income in Panama and not taxable by that country.

Note: Selling to customers in the United States does not affect your foreign earned income exclusion or your ability to retain earnings in your corporation. These tax rules require only that you live outside the United States and otherwise qualify for the foreign earned income exclusion.

As discussed above, you must take a salary from your foreign corporation to maximize the benefits of living and operating a business abroad. If you draw a salary from your Panama corporation while you are living in Panama, you could be subject to Panama's various income, payroll, and social taxes.

You can comply with your U.S. obligations by selling through a second foreign corporation, such as one incorporated in Cayman or Nevis, drawing a salary from that entity, and then passing funds sufficient to pay business expenses in Panama up to your Panama company.

In this way, you mitigate tax in Panama on your salary, and your domestic (Panamanian) entity breaks even for domestic tax purposes.

As long as you report both entities and all non-U.S. bank accounts to the U.S. government, you remain in compliance with your U.S. tax obligations. If you take a salary less than or equal to the foreign earned income exclusion, and retain the balance in your offshore structure, you could eliminate or defer U.S. tax on up to 100% of your revenues.

Where to Incorporate

Once you have decided to incorporate your business offshore, the next big issue is where. Here are my suggestions.

The first step in the process is to decide if you want to focus on privacy, transparency, or on a country that will make a good impression on those who contract with your business. There are several good choices available for each of these three focal points, but I tend to limit my formations to countries where I have experience, have personal relationships, and where I have spent time researching and debating their business, tax, and privacy laws.

With that said, if the primary component is privacy, I typically suggest a Nevis or Cook Islands corporation or limited liability company (LLC). Both of these countries have exceptional privacy laws, well tested legal systems, and a long history in the asset protection industry. Again, there are other jurisdictions, but these two work well, so I do not see a need to search further.

I expect most readers are familiar with Nevis, so I will say a few words about the Cook Islands (CI). The CI have long been a leader in international asset protection trusts, and just recently passed the "The Cook Islands International Limited Liability Companies Act 2008." This Act, modeled after Nevis, integrates CI's long standing trust and creditor laws, and their corresponding lack of a bankruptcy statute, into an LLC statute which maximizes both privacy and asset protection.

Other clients, especially those who are officers or directors of large U.S. based businesses, or who will operate an offshore hedge fund with U.S. investments, require a country that is fully compliant with the U.S. Fyi…compliant generally means that the IRS and SEC can easily find the beneficial owner and gain access the company's books, records, and foreign bank accounts.

Where transparency is required, I prefer Cayman Islands corporations and licensed hedge funds. This jurisdiction is more expensive than its competitor, the British Virgin Islands, but I believe that the availability of quality legal and accounting professionals on Grand Cayman is worth the cost. Since most clients seeking such transparency are operating significant businesses or investment portfolios, cost should not be a primary factor.

The third category, a country that will make a good impression on those who contract with your business, is harder to define. After all, beauty is in the eye of the beholder. With that in mind, here are three suggestions:

If money is no object, and image is everything, I suggest a Swiss holding company with Cayman or BVI subsidiaries. This generally allows you to operate from Switzerland, hold yourself out as a Swiss company, and contract through offshore subsidiaries, without incurring Swiss tax on international (holding company) profits.

Unfortunately, operating in Switzerland can be expensive. The typical annual maintenance of a Swiss holding company, including a Swiss director, is $10,000+, compared to about $850 for a Nevis IBC or LLC without a foreign director. In addition, a lot of planning and complex structuring is required to work through the dividend withholding section of the Swiss tax code.

For those on a budget, I recommend Hong Kong or Panama. Hong Kong is an excellent place for a holding company, has a wealth of qualified legal and accounting professionals, balances privacy and business image well, allows for nominee directors, and most banks are comfortable with corporations domiciled in Hong Kong.

The drawbacks of Hong Kong are that the directors monitor the company's activities closely, which results in higher than average annual bills, the time difference with the U.S. often delays communications and transactions by about 24 hours, and you must travel to Honk Kong in order to open a bank account there. If you prefer not to travel, an account can be opened in the Isle of Man. Also, while the directors are active, they are typically well qualified and handle your business in a professional manner.

Finally, I believe Panama is the best jurisdiction for someone who will operate a business outside of the U.S. with employees, an office, and business assets. The Panamanian economy is strong, qualified labor is relatively inexpensive, the costs of firing an employee are minimal compared to Europe, telephone and internet services are cost effective and of a high quality (certainly superior to all Caribbean islands and most Latin American countries), several local banks provide reasonable service and do not have branches in the United States, and Panama's primary currency is the U.S. dollar, so your Panamanian bank can accept checks from U.S. clients.

In addition to the business benefits above, from a privacy standpoint, Panama allows for nominee directors and shareholders. Also, the shares in a Panama company can be held by a Panama foundation, thereby maximizing asset protection.

Shelf Companies

I am frequently asked about the use of offshore "shelf" corporations in international business. Some claim they are useless, while others market them as the greatest invention since the numbered bank account. I would like to take this opportunity to put my two cents worth in to the debate.

Bottom Line: I believe offshore shelf corporations can be helpful if you are marketing a business because they improve your image. Since this can be accomplished without backdating any documents, or doing anything improper, I support shelf companies.

First, what is a shelf company? It is a corporation formed months or years ago that has been sitting on the incorporator's shelf, unused. Because it has no history of operation, no bank account, and no creditors, there should be no risk in purchasing a shelf company.

The legitimate benefits of an offshore shelf corporation are:

1. The company is ready to use off the shelf. You do not need to wait for the company to be formed, the name to be approved, or for the directors to be assigned.
2. You can market the name and age of the shelf company. For example, your letterhead and marketing materials can refer to "International Marketing Services (Panama), S.A., Established 2006," if you bought a corporation by that name formed in Panama in October of 2006.

Of course, the abuses of shelf companies are well documented. Many purchase these entities and then ask the director to sign back dated documents. While you can find some less scrupulous directors who are willing to provide this service, such a practice is obviously improper.

Because of the nature of the industry, it is difficult to find a shelf company older than about 14 months. This is because these companies are usually formed by the incorporator on behalf of a particular client. The client does not pay the incorporation fee, so the entity sits on the shelf to be sold to someone else. After 12 months, the annual dues must be paid, which the incorporator is not willing to do. Around the 14th to 16th month, the company is closed by the government registrar.

The only significant exception that I have found is in Switzerland. There, it is possible to purchase a company formed many years ago, revive that company in the government registry, let it sit on the shelf for about 2 years to eliminate any potential creditors and then file for a tax clearance. The result is a clean shell with the original incorporation date attached.

So, while a shelf company may help in marketing your business, it has no tax benefit.

International Foundations

Many offshore promoters are pushing Liechtenstein Foundations on the very wealthy and Panamanian Foundations on the rest of us.

Note: Foundations are more commonly used in asset protection, but some operate offshore businesses under them, thus their inclusion in this book.

Many are taken in by the term "foundation," hoping or believing that it makes the structure a charitable foundation which is tax exempt. This is simply not true. For an entity to be tax exempt, it must be registered with the IRS as such, under IRC §501(c)(3)., and this applies to both foreign and domestic entities.

Tax tip: Only donations to charities licensed by the U.S. are deductable on your personal tax return. You can donate money to any charity or group around the world, but, if they do not have the IRS's blessing, you are not entitled to a deduction.

Adding to the confusion, Foundations typically have multiple levels of nominee directors and boards which allegedly control the Foundation's assets. Some promoters' claim that, because you gave up control of your assets, you are not taxed on the interest, dividends, and earnings of the foundation. Again, this is not true. You remain the beneficial owner and have indirect control, which equals ownership in the U.S. tax code.

Most accept that a simple foreign corporation with a nominee director, or an offshore trust with a foreign trustee, does not reduce U.S. tax on earnings. But, change the ending from Inc. to foundation; add a few layers of directors, and many are willing to believe the impossible.

Taking it one step further, some foreign attorneys will issue an option stating that the Foundation is not a grantor trust under the U.S. rules. I do not see anything inherently incorrect in this statement. It seems possible that the Foundation can be classified as something other than a grantor trust. However, these statements are often used to confuse and mislead the U.S. client in to believing that there is some tax benefit to such a classification.

All of the opinions I have read say something like this: "The design and structure of the Foundation is to achieve an entity classification as other than a trust such as a partnership, corporation or disregarded entity for U.S. tax purposes."

Keeping in mind that the U.S. citizen is taxed on his or her worldwide income, and if we agree that the foundation is not some magical tax exempt structure, the classification does not make a tax difference. Under all options, income to the foundation will be taxed in the U.S. as earned, transfers to the entity will be reportable events, and (most) transfers of appreciated property will be deemed sales.

Some opinions also have the following clause: “Furthermore, there is the option of seeking a private letter ruling from the Internal Revenue Service confirming the proper entity classification of the Foundation.” Such a statement should cause alarm...it means that the IRS has not classified the Panamanian or Lichtenstein Foundation and that U.S. citizens have no certainty regarding when, what, and how to file returns for a foundation.

What would happen if you assumed the foundation was a corporation, filed foreign corporate returns, and then it was classified as a trust? I have no idea, but I would not want to find out! In my opinion, Panamanian and Lichtenstein Foundations are potential options and competitors of the offshore Asset Protection Trust. However, I will not recommend them until the IRS provides some clarity on their status and filing requirements.

I am a big fan of Panama as a country in which to operate an international business and I hope these issues are resolved, and that promoters take a more realistic view of U.S. taxation, so that Panamanian Foundations can become legitimate Asset Protection tools.

Offshore Filing Requirements

One of the most misunderstood areas of living, investing or operating a business abroad are the U.S. tax filing and reporting requirements. The purpose of this summary is to review the basic requirements and I recommend that you consult an international tax expert as to how they fit your particular situation.

One of the foundations of the United States tax system is that U.S. citizens and residents are taxed on their worldwide income. When handled properly, an active business, conducted outside of the United States, may have significant tax deferral and savings opportunities.

International Bank and Brokerage Accounts

One of the most critical filing requirements is the Report of Foreign Bank and Financial Accounts. Anyone who is a signor or beneficial owner of a foreign bank or brokerage account(s) with more than $10,000 must disclose these accounts to the U.S. Treasury.

The law imposes a civil penalty for not disclosing an offshore bank account or offshore credit card up to $25,000 or the greatest of 50% of the balance in the account at the time of the violation or $100,000. Criminal penalties for willful failure to file an FBAR can also apply in certain situations. Note that these penalties can be imposed for each year.

In addition to filing the Foreign Bank Account form, the offshore account must be disclosed on your personal income tax return, Form 1040, Schedule B.

Corporate and Trust Filing Requirements

There are a number of filing requirements for IBCs and International Trusts. Failure to file the required returns may result in civil and criminal penalties and may extend the statute of limitations for assessment and collection of the related taxes.

- ✓ Form 5471 - Information Return of U.S. Persons With Respect to Certain Foreign Corporations must be filed by U.S. persons (which includes individuals, partnerships, corporations, estates and trusts) who owns a certain proportion of the stock of a foreign corporation or are officers, directors or shareholders in Controlled Foreign Corporation (CFC). If you prefer not to be treated as a foreign corporation for U.S. tax reporting, you may be eligible to use Forms 8832 and 8858 below. http://www.irs.gov/pub/irs-pdf/f5471.pdf

- ✓ A foreign corporation or limited liability company should review the default classifications in Form 8832, Entity Classification Election and decide whether or not to make an election to be treated as a corporation, partnership, or disregarded entity. Making an election is optional and must be done on or before March 15 (i.e. 75 days after the end of the first taxable year). http://www.irs.gov/pub/irs-pdf/f8832.pdf

- ✓ Form 8858 – Information Return of U.S. Persons with Respect to Foreign Disregarded Entities was introduced in 2004 and is to be filed with your personal income tax return if making the election on Form 8832. A $10,000 penalty is imposed for each year this form is not filed. http://www.irs.gov/pub/irs-pdf/f8858.pdf

- ✓ Form 3520 - Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts is required when a U.S. person:

    1. Creates or transfers money or property to a foreign trust,
    2. Receives (directly or indirectly) any distributions from a foreign trust, or
    3. Receives certain gifts or bequests from foreign entities. http://www.irs.gov/pub/irs-pdf/f3520.pdf

- ✓ Form 3520-A – Annual Information Return of Foreign Trust is required of any foreign trust with a U.S. Owner (Grantor). Failure to file this form can result in a penalty of 5% of the gross value of the U.S. person's portion of the trust. http://www.irs.gov/pub/irs-pdf/f3520a.pdf

- ✓ Form 5472 - Information Return of a 25% Foreign-Owned U.S. Corporation is required to be filed by a "reporting corporation" that has "reportable transactions" with foreign or domestic related parties. A reporting corporation is either a U.S. corporation that is a 25% foreign-owned or a foreign corporation engaged in a trade or business within the United States. A corporation is 25% foreign-owned if it has at least one direct or indirect 25% foreign shareholder at any time during the tax year. http://www.irs.gov/pub/irs-pdf/f5472.pdf

- ✓ Form 926 - Return by a U.S. Transferor of Property to a Foreign Corporation is required to be filed by each U.S. person who transfers property to a foreign corporation if, immediately after the transfer, the U.S. person holds directly or indirectly 10% of the voting power or value of the foreign corporation. Generally, this form is required for transfers of property in exchange for stock in the foreign corporation, but there is an assortment of tax code sections that may require the filing of this form. The penalty for failing to file is 10% of the fair market value of the property at the time to transfer. http://www.irs.gov/pub/irs-pdf/f926.pdf

- ✓ Form 8938 – Statement of Foreign Financial Assets is new for tax year 2011 and must be filed by anyone with significant assets outside of the United States. Who must file is complex, but, if you live in the U.S. and have an interest in assets worth more than $50,000, or you live abroad and have assets in excess of $400,000, you probably need to file. If you are a U.S. citizen or resident with assets abroad, you must consult the instructions to Form 8938 for more information. Determining who must file is a complex matter. See http://www.irs.gov/uac/Form-8938,-Statement-of-Foreign-Financial-Assets for additional information.

How Careful Structuring of Your Affairs Can Help Minimize Taxes

Before you move overseas, there are certain steps you can take to protect your assets and—in some cases—minimize your worldwide tax obligations. Best first step is to consult a tax accountant or attorney—one who specializes in helping Americans organize their affairs before moving overseas.

He or she will likely have some smart advice about the best way to structure your financial affairs so that you don't end up paying unnecessary taxes.

Multiple Bank Accounts

When relocating overseas, it is usually a good idea to maintain a checking account in the U.S. if for no other reason than convenience. Unless you are severing all ties with the U.S. you will have some need to write U.S. dollar checks or make online electronic bank transfers while overseas. The funds would also be available to you either through wire transfers to a foreign bank account or an ATM card.

In limited circumstances, foreign countries do not tax certain kinds of income unless the funds are actually transferred to that country. Maintaining one or more accounts elsewhere would in this case be a tax savings device as well as being a convenience. Here again, the need for information on local tax rules is very important.

Transfer Title of Accounts to One Spouse

There may be situations in which spouses should transfer title to certain assets before relocating overseas. This can be easily accomplished with financial assets such as savings accounts and investment accounts. Such transfers would be beneficial where one spouse will have a special exemption from foreign taxes on the earnings of the accounts.

Transferring title to jointly owned U.S. real estate, rented while you are overseas, may also provide a tax savings. Keep in mind that the transfers are reversible once you move back to the U.S.

However, such transfers may have a downside, particularly if the marital status is less than solid. The spouse with full title may not be willing to transfer half interest back to the other spouse. Don't take the decision to transfer assets lightly.

Form a Discretionary Trust

Although principally considered an estate-planning device, a trust can also serve as a tax savings device. One such trust is a discretionary trust that requires payments to beneficiaries under stated conditions in the trust instrument, such as financial need or education. The important thing to keep in mind, to avoid payment of foreign taxes on payouts, is that the conditions should prevent payments to beneficiaries while they are overseas. Under the right circumstances, trusts can save on foreign taxes.

However, you should only set one up with the help of a tax professional.

Estate Planning

If you decide to abandon your U.S. residency and domicile, there is an important catch. While you may avoid any liability for the income taxes of a U.S. state, abandoning your domicile in a U.S. state may cause some real estate and probate issues.

In other words, if you or a family member passes away while living overseas, real or personal property that you would have expected to be either distributed under a previous will (or in the absence of a will, be distributed under a U.S. state's intestacy laws) may be subject to distribution under the laws of the foreign country in which you are currently living. And these foreign rules may cause property to be distributed in a completely unintended way in a costly probate process. France, for example, has a complex set of inheritance laws that date back to Napoleonic times and guarantee children (and sometimes parents) a share of the estate. In such a situation, a spouse has no automatic right of inheritance.

While we won't explore estate-planning strategies in this guide, you should be aware that estate succession is an important consideration in your planning process.

There are many simple and convenient tools to assure the orderly and least costly succession of your property while living overseas such as use of a trust, naming a beneficiary on a financial account where permitted, or a transfer of assets. You should consult a competent tax expert who can guide you through all aspects of avoiding state, federal, and possibly even foreign income taxes and assist you with some effective estate-planning strategies. You owe it to yourself and your loved ones.

2012 IRS Offshore Compliance Program

Great News for Some ExPats and Dual-Nationals

As an ExPat American, you know that you are required to file a U.S. tax return each year and report your foreign bank accounts if you have more than $10,000 offshore. Unless you have been living under a rock in Bangladesh, you also know that the IRS has been pushing hard to force disclosure, compliance and payment.

The drive for increased revenues started in 2003 when the IRS began investigating offshore credit cards. At that time, it was about compliance. The government had not yet figured out that putting people in jail for tax crimes would generate a lot of news, and thus cause many more thousands to come forward.

In 2008 the U.S. government began its attack on UBS in Switzerland, eventually forcing the Swiss to disclose 4,450 names of U.S. citizens with unreported accounts. The U.S. followed this up by prosecuting a few people in each State or region of the country to ensure maximum news coverage and created the voluntary disclosure program to maximize the return on their campaign.

So far, there have been three programs allowing people to come forward and voluntarily report their offshore bank accounts. As of June 26, 2012, the IRS has brought in over $5 billion in new taxes, interest and penalties.

The third, and current, program came into effect on September 1, 2012 and has several benefits for what it considers “low-risk” persons. These are U.S. citizens, including dual-citizens, who currently reside overseas, who owe little or no U.S. taxes. The objective is to convince these people to report the value and locations of their money and assets in exchange for not being hit with civil penalties.

These low-risk persons will be able to file three years of delinquent U.S. tax returns (including required information reporting forms) and six years of FBARs without the imposition of penalties. Whether a taxpayer is "low-risk" will depend on a number of factors, but will primarily require that the tax due is less than US$1,500 for each of the covered years, that the person was living and working outside of the U.S. during these years, and that the person did not take steps to conceal their income from the U.S.

It should be noted that this procedure will provide no protection from the risk of criminal prosecution. The IRS website indicates the following regarding criminal prosecution: “The Voluntary Disclosure Practice is a longstanding practice of IRS Criminal Investigation whereby CI takes timely, accurate, and complete voluntary disclosures into account in deciding whether to recommend to the Department of Justice that a taxpayer be criminally prosecuted. It enables noncompliant taxpayers to resolve their tax liabilities and minimize their chance of criminal prosecution. When a taxpayer truthfully, timely, and completely complies with all provisions of the voluntary disclosure practice, the IRS will not recommend criminal prosecution to the Department of Justice."

Because the tax due amount takes the Foreign Earned Income Exclusion and Foreign Tax Credit into consideration, many Expats and foreign residents will qualify for the program regardless of their income. For example, anyone that is an employee in a high tax country (a country with a tax rate equal to or greater than the U.S.), should qualify, as will most people earning less than $80,000 to $95,000 per year who are living in a low tax country. Those at risk are entrepreneurs living in low tax countries, high net worth individuals with significant untaxed capital gains or passive income, and just about any self-employed person who was not operating through a foreign corporation and is thus subject to self-employment tax.

There are two groups of ExPats that are excluded from this program: 1) if your account is at a bank that is currently under investigation by the U.S., you may not be eligible, and 2) if you attempt to fight the release of your banking information from your foreign bank, you will not be eligible for this program. For example, the U.S. issues a summons to Bank ABC in Lichtenstein requesting all U.S. accounts. If you attempt to block this release by exercising your rights in Lichtenstein, you are disqualified from this program.

In addition, the IRS may announce that certain groups of taxpayers that have or had accounts at specific offshore banks will be ineligible to participate in the OVDP due to pending US government actions in connection with those specific institutions. Details regarding eligibility or ineligibility of specific taxpayer groups connected to such institutions will be posted to the IRS website.

The IRS says: "US persons with undeclared bank accounts are reminded that the 2012 OVDP gives taxpayers with unreported foreign bank accounts a chance to come clean while mitigating the risk of criminal prosecution, and that they should consider remedying any past non-compliance with their US tax and information reporting obligations while there is still an opportunity to do so."

If you are a U.S. citizen who has been living and working abroad, and are willing to disclose your accounts and assets, now is the best time to evaluate your rights. I recommend the following three step plan of action: 1) discuss your situation with a qualified tax attorney and evaluate your risks of criminal prosecution, 2) have your attorney prepare U.S. tax returns to determine the amount of taxes due, and 3) if you qualify as a low-risk citizen, join the voluntary disclosure program as soon as possible, before your bank comes under attack or you are disqualified for another reason.

If you do not qualify as a low-risk taxpayer, you may still participate in the current voluntary disclosure program. However, you will be subject to substantial taxes and penalties, which are more severe than those levied by previous initiatives.

In addition to the standard tax, interest and penalties associated with your delinquent returns, the following penalties will be assessed, and must be paid or you will be disqualified from the program:

- Pay a 20% accuracy-related penalties on the full amount of your offshore-related underpayments of tax for all years;

- Pay failure to file penalties, which are up to 25% of the unpaid tax, if applicable;

- Pay failure to pay penalties, which are up to 25% of the unpaid tax, if applicable;

- Pay, in lieu of all other penalties that may apply to your undisclosed foreign assets and entities, including FBAR and offshore-related information return penalties and tax liabilities for years prior to the voluntary disclosure period, a penalty equal to 27.5% (or in limited cases 12.5% or 5%) of the highest aggregate balance in foreign bank accounts/entities **or value of foreign assets** during the period covered by the voluntary disclosure;

    - Note that this penalty includes the value of all foreign assets, including real estate.

As you can see, the penalties are very severe if you do not qualify as a low-risk taxpayer. However, getting back in to the system and removing the risk of criminal prosecution will motivate many to come forward, pay and sleep well at night knowing they are in compliance with their tax filing obligations.

If you have unreported accounts or questions about your U.S. taxes please contact a U.S. licensed tax attorney or Enrolled Agent at Premier Offshore, Inc. We offer a free and 100% confidential consultation and have decades of experience in international taxation of U.S. citizens abroad. We can be reached at (619) 564-4062 or by email info@premieroffshore.com.

Dealing with the IRS

Let's say you have filed all of your delinquent returns, and the foreign-earned income exclusion, along with the other suggestions in this book, and did not eliminate your entire U.S. tax bill. Now the IRS is at your door…what should you do?

Step One: Know your risks

First, you must understand that the IRS can levy your U.S. bank account, and possibly your foreign bank accounts, put a lien on any real estate in the United States, and possibly take your real estate outside of the U.S.

Levy: A Tax levy, under United States Federal law, is an administrative action by the IRS under statutory authority, without going to court, to seize property to satisfy a tax liability. A levy is generally used to take money out of your bank account.

Lien: A tax lien is a lien imposed by the IRS upon real estate or other property to secure the payment of taxes. It may allow the IRS to seize your property. If you sell the property, the proceeds from the sale go first to the IRS to settle your debt, and then the remainder comes to you. An IRS lien comes after any preexisting liens, such as a first or second mortgage.

Here are several questions to consider if owe money to the IRS:

- Did you know that the IRS can levy your foreign bank account if your bank has a branch in the U.S.?
- Did you know that the IRS may be able to levy your paycheck if your parent company is a U.S. entity?
- Did you know that the IRS can seize real estate in certain countries, such as France?
- Did you know that moving money out of the U.S. to avoid an IRS levy, even if you live abroad, can be a crime?
- Did you know that failure (refusal) to pay taxes can be a crime, in very specific circumstances?

Once your debt to the IRS becomes final and payable, the Service will attempt to mail four collection letters demanding payment. After sending those letters, whether or not you received them, the IRS can levy any U.S. bank account. This means they can take up to the amount of the debt out of your account(s). For example, if you owe $30,000, and you have $20,000 on the bank, they get $20,000. If you owe $30,000, and have $35,000, they get $30,000.

In addition, the IRS can levy any foreign account, so long as your bank has a branch in the U.S. For example, if you are living in Mexico, and banking with HSBC, the IRS can issue a levy to a U.S. branch of HSBC, and it must be honored by the branch in Mexico…and your money is gone.

Of course, this can be avoided by banking with institutions that do not have branch offices in the United States.

Second, the IRS can take real estate in the U.S. or real estate in certain foreign countries. The IRS can seize property in any country where such a taking is provided for in the treaty, known as a Mutual Collection Assistance Requests (MCARs) clause. There are currently five treaty countries with which the IRS has ongoing programs for MCARs that may involve seizure and sale.

Third, the IRS can levy a bank account, or garnish your wages (take money out of your paycheck) in most countries with which it has a MCARs.

This means that anyone living in a MCARs country is at risk of having their assets seized, just as if they were living in the United States. The treaty partners and types of taxes covered for collection are as follows:

- Canada — All taxes
- France — Income, Estate and Gift, Wealth and other specified taxes
- Denmark — Income and other specified taxes
- Sweden — Income and other specified taxes
- Netherlands — Income and other specified taxes

Note: It is very rare for the IRS to seize real estate, especially one's primary residence. This only happens after the IRS exhausts every other collection alternative, and the taxpayer refuses to cooperate. If you owe money, and can't afford to pay, a tax attorney can negotiate a settlement that both you and the IRS can live with. As long as clients are honest and cooperate, the process is surprisingly painless. It is those who are unwilling to cooperate, or are too scared to do so, that get hit the hardest by the IRS.

Step Two: Negotiate

There are two basic options for those who owe the IRS, and are unable to pay:

1) An installment agreement; or

2) Offer in Compromise.

In an **installment agreement**, you agree to pay what you can afford each month, and the IRS agrees to stop collection actions while you make these payments. The IRS has 10 years to collect from you, thus your installment agreement can go on for several years.

In an **Offer in Compromise**, or OIC, you and the IRS agree to settle your debt for one lump sum, or payments over a few months. Let's look at the OIC process in detail.

Offer in Compromise

Everyone is well aware of the U.S. credit crunch, plummeting home values, and the generally tough economic situation. At the same time, the U.S. government is running at a staggering deficit and looking to the Internal Revenue Service (IRS) to bring in more cash by stepping up audits and collections.

Put simply, an OIC is an offer to settle your IRS tax debt for less than the total obligation because you cannot pay the debt in full over the "collection period." Before you can request an OIC, all of your tax returns must be filed and you must pay a deposit of 20% of your offer amount.

Collection Period: In most cases, the IRS has 10 years to collect on a tax debt after it has been assessed. A debt is assessed when you file your returns, the IRS files returns for you, or an audit is finalized.

A settlement can be made in one lump sum, or over a number of months. However, it is more difficult and costly to get OICs approved that will pay over time, so a lump sum payment is the most practical option for most taxpayers.

During the OIC process, your objective is to convince the Service that you are paying them something that they would not otherwise get. To prove this claim, you are required to complete a detailed financial statement, listing all of your income, bank accounts, and assets. If your assets exceed your debt, your offer will not be accepted.

If you do not have sufficient assets to satisfy the debt, your income is compared to your allowed expenses to calculate your offer amount. For example, in 2012, a family of four living in San Diego, California is allowed to spend $3,142 per month for housing and utilities. The same family of four, living in Armstrong County, Texas, would be allowed only $1,427 per month, and $5,625 in New York County, New York.

If your income exceeds your allowed expenses, the difference, times 48 months, is added to your assets to determine your total offer amount.

For example, if you owe $100,000 to the IRS, the equity in your home, your only asset, is $20,000, and your net income after allowed expenses is $1,000 per month, your total offer amount is $68,000 ($1,000 x 48 = $48,000 + $20,000), or 68% of the debt.

Expats & Allowed Expenses: When negotiating with the IRS, you are allowed to spend fixed amounts on housing, utilities, automobile, health care expenses, food, clothing, and other living expenses. Collection Financial Standards are published for U.S. residents, but none have been created for those living abroad. Therefore, every aspect of an expats financial statement must be negotiated. For more information on the Collection Financial Standards, visit *www.irs.gov/individuals/article/0,,id=96543,00.html*

Installment Agreement

Let's say you owe $10,000, $30,000, $100,000 or more to the IRS and your assets exceed your debt. You are working full time abroad, but you have no savings to pay off the IRS. Can you pay off your debt over time?

Yes. In fact, almost every client onshore or offshore client I have worked with in the last 10 years, who has requested an installment, has been approved…eventually. The trick is always the same: getting to a number that both you and the IRS can live with.

If you owe taxes to the IRS, but can't afford to pay it off all at once, and you don't qualify for (or can't afford) an Offer in Compromise, then you can usually set up a payment plan, called an "Installment Agreement" in IRS lingo. The amount you will need to pay each month is based on a number of factors, including:

- Your income;
- Your assets;
- The amount you owe;
- Your actual expenses;
- Your allowed expenses;
- The remaining collection statute of limitations; and
- Whether or not you can afford to pay off the debt in full over the collection statute.

The key to setting up an Installment Agreement is the analysis of these and other factors, and thereby proving to the IRS how much you can afford to pay each month.

Here are the basics of an IRS Installment Agreement.

The IRS will enter a written agreement with you which requires installment payments based on the amount you owe and your ability to pay it within the period of time the Service has to collect from you (the "statute of limitations," as it is called). The IRS has 10 years to collect from you once you filed a return. When the 10 years are up, the debt is canceled and you get a fresh start.

Depending on the amount of tax due, there are different options within the program (see below). To apply for an Installment Agreement, you usually need to file Form 9465 and Form 433-A or Form 433-F (versions of the IRS Financial Statement, the key form when dealing with IRS collections at any level). If you are self-employed, or own a business, you may also need to file Form 433-B. A few people also need Form 433-D. If your Agreement is accepted, you will be charged a fee of $105 for a new agreement, or $45 for a reinstated agreement.

"What is a 'reinstated agreement,'" you'd ask.

An Installment Agreement is binding. You must pay the amount agreed-upon on time, every month of the year. If you skip a payment, you usually have 30 days to catch up. If you are not able to get current with your payments, the Agreement is canceled. You may apply for a new

Agreement, but your new proposal may be met with skepticism and can even be rejected. Worse, you must provide updated financial information, which may have very dire consequences if your income has increased or the person reviewing your data is less accommodating than the prior agent. If you're lucky and it's accepted again, then you'll have a "reinstated agreement."

There are two types of Installment Agreements, *mandatory* and *discretionary*. A "mandatory" agreement means that the IRS is required to accept the Agreement you propose if:

- You owe less than $10,000 (exclusive of interest and penalties);
- You've filed your tax returns and paid your due taxes on time during the past five years;
- You haven't entered another Installment Agreement during those past five years;
- You demonstrate that you can't pay the tax in full;
- You agree to pay the full amount you owe within a period of three years;
- You guarantee that you'll comply with the tax laws during the term of the Installment Agreement.

If you meet all these criteria, the IRS doesn't have the right to reject your Installment Agreement. An additional advantage of this type of agreement is that it doesn't require the same in-depth financial verification that a normal application does.

If you owe more than $10,000, you need a "discretionary" Installment Agreement, which means that the IRS can deny you a payment plan if it deems it unsatisfactory. The IRS has to consider your Installment Agreement and will request you to prepare a Financial Statement (Form 433-A or Form 433-F). If the IRS concludes that more information is needed to evaluate the proposal, then it can request you to provide supporting documents or other proof of income and expense. If not supplied, the IRS can reject your application.

During the processing of your Installment Agreement (until you receive the notice about the result of your application) your stress level will lower considerably as the IRS is not allowed to collect from you. If your IRS installment agreement request is rejected, your case will be on hold for 30 days, giving you time to appeal. If you file a timely appeal, then the IRS can't touch your property or money during the pendency of the appeal.

How much of my debt will I pay through an Installment Agreement?

The answer is that it depends on your ability to pay, the assets you have available, and the collection statute of limitations. If you have sufficient means then the IRS will require a Full-pay Agreement. This is when you pay your tax debt in full, including interest and penalties, over a period of time.

A Full-pay Installment Agreement may be for a fixed monthly amount, or it may increase at predetermined intervals. In each case, it will pay off the debt during the collection statute of limitations.

An IRS Installment Agreement where you pay a fixed amount each month until the debt is paid in full is easy to understand. An Installment Agreement where your monthly payments increase over time takes a bit of explaining.

As you know, your ability to pay the IRS is based in part on your income vs. your allowed expenses. When your actual expenses exceed your *allowed* expenses, you are generally given time to modify your lifestyle.

For example, you may be given six months to find a lower-cost apartment. If your current apartment exceeds your allowed rental expense by $400, the IRS may set up an Installment Agreement that will increase by $400 in six months' time.

Another example is where your allowed expenses go down. The most common situation is where your automobile will be paid off, thereby reducing your allowed expenses. If your auto payment is $550 and your car will be paid off in eight months, you might set up an Installment Agreement that will increase by $550 in eight months' time.

Warning: What if you have unexpected repair bills, or need to purchase another car when this one is paid? You might be forced to default on the IRS Installment Agreement and need to start the process over…something everyone dreads.

Careful analysis of your current and future finances, along with a solid understanding of IRS practice and procedure, prior to applying for an Installment Agreement can prevent these and other problems.

For example, as a result of planning ahead, you might decide to purchase a new car, with a longer payoff period, before submitting your request.

What if I can't afford to pay off the IRS in full?

In the case you (1) do not have sufficient income to support a Full-pay Agreement, and (2) have no significant equity in assets or cannot sell or borrow against assets due to the fact that selling them will cause an undue hardship, then the IRS will grant a Partial-pay Agreement and you'll pay off only a portion of your debt within the statute of limitations, with the remaining debt being canceled.

However, if you are granted a Partial-pay Agreement, you must provide updated financial information every two years to prove your continuing financial hardship.· If your income has increased, or your allowed expenses have decreased, you will be required to increase your monthly payment.

Still, there's a third situation. You pay zero dollars. Is that possible? Sure. Basically, when you cannot afford an Offer in Compromise, you have no assets to use to pay the IRS, and your income equals your allowed expenses, you can't afford to pay IRS anything.

A taxpayer in an Installment Agreement at zero dollars is referred to as being "temporarily uncollectable," with temporarily being the operative word here.· As with a Partial-pay Installment Agreement, the IRS will review your financial situation periodically to see if it can start collecting from you. If your financial situation doesn't improve and the statute of limitations runs out, then your debt is eliminated. In other words, if you prove to the IRS that you are uncollectable over the entirety of the collection statute of limitations, you have paid nothing and your debt expires.

IMPORTANT NOTE: While you are making installment payments to the IRS, penalties and interest accrue on the unpaid balance. Essentially, you are locked into a late-payment penalty of one quarter of a percent a month plus interest on the unpaid amount. Taken together, the cost comes at around 10% a year. It's still less than the interest you pay on your credit card, but you need to think before you commit.

What if my Installment Agreement is rejected?

This may happen in one of the following cases:

(1) The information included in Forms 433-A or 433-B is incomplete or untruthful. If the IRS discovers that you have property or income not recorded on the forms then it will reject your application. Be careful here..**your financial statement is signed under penalty of perjury, so it is very important to be truthful and very detailed in the information you provide to the government.**

(2) The IRS deems some of your living expenses unnecessary. If you owe money to the government but nevertheless send your kids to private schools or drive expensive cars, then be prepared to get no deal at all. The IRS expects you to have quite a frugal life while paying off your debt.

(3) You defaulted on a prior Installment Agreement. It's a matter of trust…if you've once defaulted on your payments then the IRS will think twice whether to grant you a second chance. If your Installment Agreement is rejected, then you can appeal the decision. If the IRS sees your efforts to pay off your debt then your application may be reconsidered.

What if I need professional help with filing an Installment Agreement?

Don't get scammed!

So, why do you see so many claims on the Internet and television promising to settle your tax debt for pennies on the dollar? Because there are settlements like that, which are then used by a few unscrupulous promoters to mislead people into spending thousands of dollars to only have their OICs rejected.

Take the example above, but assume the tax debt is $1 million. It will still settle for $68,000, or about 15%.

If that same family owes $1 million, has lost their home, and their income does not exceed their allowed expenses, or the breadwinner is permanently disabled and unable to work, then total offer amount might be $1,000. This is a dream scenario for any national OIC marketing firm…the perfect client who can be used in their multi-million dollar advertising campaign!

I have had a few such clients over the years. For example, a 72-year-old retired person, who was living with family and on Social Security only, settled his debt of $150,000 for about $2,000.

Before hiring anyone, especially a national firm, you should check them out on the Internet. Here are a few suggestions:

- Click here to go to a review of American Tax Relief by the Better Business Bureau.
- Click here for a review of JK Harris by the Better Business Bureau. Click here to read what consumers have to say about JK Harris.
- Click here for a review on Roni Lynn Deutch by the Better Business Bureau. Click here to see what consumers have to say about Roni Deutch.
- Click here to read a review of TaxMasters, Inc. by the Better Business Bureau. Click here to read what consumers have to say about TaxMasters. For more opinions on TaxMasters, click here and here.
- Click here to see what consumers have to say about Power Tax Relief. Click here to read a review of Power Tax Relief by the Better Business Bureau.

NOTE: Government figures show that 75% of Offers in Compromise are returned due to forms being filled out incorrectly; and of the 25% that are processed, approximately 50% of them are rejected. Add to this the complexities of expat negotiations, and it is clear quality representation is required…just be careful!

When do I need help?

Many clients ask, “Do I need an attorney to help me deal with the IRS?” That’s a hard question and depends on your ability to negotiate, organize, and handle IRS paperwork. Some people are much more capable than others when it comes to handling their tax matters.

My standard answer is this:

1. If you owe the IRS $24,000 or less, and can afford to pay $500 per month, just call them up and make that offer. If it is accepted, as it usually is, you do not need professional help.

2. If you owe $24,000 to $99,000, you have an average sized case that will usually be handled by a centralized collection unit. While this size accounts for about half of my collection cases, they are easier to handle than larger cases…thus, we charge a lower fee.

3. If you owe $100,000 or more, you have a large case and can expect the IRS to be very aggressive in collecting from you. I suggest that anyone with a debt in excess of $100,000 seek legal counsel immediately.

4. Finally, you should decide if you need representation before contacting the IRS. It is very difficult to overcome mistakes and I generally do not take on cases after the documents have been filed. It's like coming in to the game down by 21 points and being asked to bring the team back with five minutes to go.

Taxpayer's Bill of Rights

In tough economic times, many business owners and self-employed people find it difficult or impossible to pay their federal taxes. When the debt is too large to pay, you then get the joy of negotiating with the Internal Revenue service.

Note: Of course, everyone has a hard time paying their taxes. Business owners and the self-employed are more likely to have large debts because many do not have taxes withheld from their paychecks, do not make quarterly estimates, and hope that there is enough cash in the business at the end of the year to keep the IRS at bay.

The following is a list of protections that taxpayers have when facing the IRS, known in the industry as the "Taxpayer's Bill of Rights." The first step in dealing with the IRS is to know these basic rights.

1. Innocent Spouse Relief (Publication 971):

   a. Is available for all understatements of tax (previously, only substantial understatements) attributable to erroneous items (previously, only grossly erroneous items) of the other spouse.
   b. You must file this claim within two years of the IRS beginning collection action.
   c. You must show that the innocent spouse did not know and had no reason to know about the underpayment of taxes.
   d. Innocent Spouse can be claimed for any tax liability arising after July 22, 1998 and any tax liability unpaid as of that date.
   e. If Innocent Spouse is claimed and rejected, you can file a petition and go to tax court.
   f. The IRS can grant equitable relief to taxpayers who do not satisfy the above tests.

g. If you filed a joint return, you can use innocent spouse as long as: 1) you are divorced or legally separated, or b) have been living apart for more than one year.

2. The IRS must abide by the Fair Debt and Collections Practices Act, which includes not communicating with you at an inconvenient time or place. This right basically protects against harassment.

3. The 10-year statute of limitations period on collection may generally not be extended if there has been no lien on any of the taxpayer's property.

4. The IRS must give you an installment agreement if:

a. You owe less than $10,000,

b. In the previous five tax years you have **not** 1) failed to file a tax return, 2) failed to pay any tax required to be shown on a return, and/or 3) entered into an installment agreement, and you

c. Agree to full payment within three years.

5. A supervisor must approve the issuance of a Notice of Lien or Levy or seizing of property.

6. The IRS must notify you within five business days after the filing of a Notice of Lien and must include certain information in the notice, such as the amount of the tax and your appeal rights.

7. Anyone who will be affected by the filing of a lien is entitled to a fair hearing with an Appeals officer who had no prior involvement with the unpaid tax that gave rise to the filing of the lien.

8. You can get a certificate of discharge of a lien by depositing the amount in question with the IRS or you furnish a bond. You then have the right to sue to dispute the tax due.

9. The IRS must release a wage levy once it is determined that your outstanding tax liability is uncollectible. This basically means that the IRS determines that you do not have the financial resources (cash flow after allowed business and personal expenses and assets) to pay the debt.

10. You and third parties can sue for money damages for reckless or intentional disregard of the statutory collection provisions. This has been made easier because it includes negligence on the part of an IRS employee. You must first follow administrative remedies and you are limited to $100,000 for negligence and $1 million for intentional or reckless disregard.

11. The IRS must notify you, 30 days before filing a levy, that you have a right to a hearing.

   a. You can then request an Appeals officer hear the case before the levy.

   b. You cannot challenge the underlying tax unless you had no previous opportunity to do so.

   c. If not resolved, you have 30 days to appeal to the U.S. Tax Court or Federal Court.

12. Standards are provided exempting some personal property and tools of the trade from levy.

13. Property can't be sold below the property's minimum bid price.

   a. Where no one is willing to pay the minimum bid price, the IRS can return the property or it is deemed to have paid that price.

   b. Generally, this is 80% or more of the forced sale value.

14. If the amount of the debt is less than $5,000, the IRS cannot take your primary residence.

15. The IRS cannot seize your principle residence without prior court approval.

16. The IRS cannot reject an Offer in Compromise from a low income taxpayer solely on the basis of the amount of the offer.

   a. This does not apply to the self-employed.

17. While you have an Offer in Compromise pending, and 30 days thereafter, the IRS cannot take your property or levy your bank account.

For additional information, please refer to these IRS publications:

- Form 565 http://www.irs.gov/pub/irs-pdf/f656.pdf
- Form 433-A http://www.irs.gov/pub/irs-pdf/f433a.pdf
- Form 433-B http://www.irs.gov/pub/irs-pdf/f433b.pdf

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Consultation

Phone us at (619) 564-4062 or email info@premieroffshore.com for a free and private consultation on any offshore planning or international taxation issue.

Please note that our open office hours are Monday through Friday, from 8:30 a.m. to 5:30 p.m. PST.

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By email at: support@premieroffshore.com

Comments and Article Submissions

Do you have a question or would you like to become part of our global network of contributors? Contact our Editorial Department at chris@premieroffshore.com

OFFSHORE COMPANY QUESTIONNAIRE

Please complete and return to us by email, info@premieroffshore.com or by fax to (619) 374-2154.

PROPOSED NAME

- Please list at least three alternatives in order of preference.
- A limited liability company must end in LLC and a corporation must end with the word Corporation, Incorporated, Aktiengesellschaft or Sociedad Anónima or the abbreviation Corp, Inc, A.G. or S.A.

1. ____
2. ____
3. ____

OBJECTS OF THE COMPANY

For our information only, please describe the proposed activities of the company:

____

____

____

Please confirm that the company will not:

– Carry on banking business.	☐ Confirmed
– Carry on business as an insurance or reinsurance company.	☐ Confirmed
– Carry on business as a trust company.	☐ Confirmed

First Owner / Manager

Name of Manager: ______________________

Home Address: ______________________

Office Address: ______________________

Phone: ______________________

Email: ______________________

Passport # & Country: ______________________
(send copy of photo page by email or fax)

Driver's License: ______________________
(send copy of by email or fax)

Profession: ______________________

U.S. Social Security No. ______________________

Date of Birth: ______________________

Second Owner / Manager

Name of Manager: ____

Home Address: ____

Office Address: ____

Phone: ____

Email: ____

Passport # & Country: ____
(send copy of photo page by email or fax)

Driver's License: ____
(send copy of by email or fax)

Profession: ____

U.S. Social Security No. ____

Date of Birth: ____

SHAREHOLDERS

A company must have a minimum of one shareholder. Shareholders may be individual or corporate. Please attach a separate page if there is not enough space below to indicate your requirements.

Please select and complete one of the following options:

☐ **Registered Shares** (shares issued in the name of the owner/s). If you want Premiere Offshore to prepare the share certificates, please indicate below the number of shares to be issued and the name of the shareholder:

Cert. #1: Shares ________________ Shareholder ________________

Address ________________________________

Cert. #2: Shares ________________ Shareholder ________________

Address ________________________________

Cert. #3: Shares ________________ Shareholder ________________

Address ________________________________

☐ **Bearer Shares**. If you require Premiere Offshore to prepare the share certificates, please indicate below how many shares are to be issued with each certificate:

Cert.#1: Shares __________ Cert. #2: Shares __________ Cert. #3: Shares __________

DIRECTORS – CORPORATIONS ONLY

A minimum of three directors are required for a corporation (not LLC). Directors may be individual or corporate. The name and address of each director is filed with the Public Registry.

Please select one of the following options:

☐ Client will provide directors. Please provide below the name and residential address of each director.

Name ____________________

Address ____________________

Name ____________________

Address ____________________

Name ____________________

Address ____________________

☐ Premiere Offshore to arrange for: ☐ Individual Directors ☐ Corporate Directors

If you select this option, the principal beneficial owner/s will be required to execute a standard indemnity agreement.

OFFICERS

A company is required to have a President, Secretary and Treasurer. The officers may be individuals or corporations. Any person may hold two or more positions.

Please select one of the following options:

☐ Client will provide officers. Please provide below the name and residential address of each officer.

President ____________________

Secretary ____________________

Treasurer ____________________

☐ Premiere Offshore to arrange for corporate officers. *Officers are only provided if Director services are also requested*

LOCAL REGISTERED AGENT

All companies must have a local Registered Agent. Unless otherwise instructed, Premiere Offshore will arrange for this service to be provided.

Completed by:

Name ____________________ Phone ____________________

Address ____________________ Fax ____________________

____________________ Email ____________________

GUIDANCE NOTES

When to Submit Supporting Documents

Please submit a scanned or faxed copy of the Owner/Member(s) passport with your formation request. We will request notarized documents and letters of reference when we prepare bank account opening forms on your behalf. Note that most banks will require notarized documents and reference letters from the beneficial owners and account signatories(s).

Certified Copy of Passport

- Notarized or certified copies of passports may be required (photo and signature page). A U.S. licensed notary is recommended. Certified documents may be provided by a suitable person such as a lawyer, accountant, a director or manager of a regulated financial institution.
- Please note that all documents provided should be clearly legible, particularly documents containing photographs and signatures.

Proof of Address

- This requirement is usually fulfilled by providing:
  - a recent utility bill
  - a current year local tax authority bill
  - a current photocard driving license (provided it contains the individual's relevant address) or
  - a bank statement.

- The document provided must reflect the name current address of the individual. Documents may be original or notarized copies.

Reference

- References are often required from two independent professionals who know the beneficial owner in a professional capacity (not simply an acquaintance). For example, a lawyer, accountant or a director or manager of a regulated financial institution.
- The reference should state the full name of the Settlor/Protector, residential address, and the length of time (not less than one year) that the referee has known the Settlor/Protector.
- References provided should be current, i.e. not older than three months.
- The reference should be addressed to the Premier Offshore – Corporate Services Division or "To Whom it may Concern." Some banks will accept letters addressed to in this manner and some will not. *Please discuss this requirement with us before obtaining reference letters.*

How to Submit

Please send formation requests via email to info@premieroffshore.com or by fax to (619) 374-2154.

Premier Offshore Investor
Research, News, and Legal Services for the Offshore Entrepreneur

OFFSHORE TRUST

Trust

The following information is required to establish an International Trust.

PURPOSE OF THE TRUST

Proposed name of the Trust (Please note that the name must include the word Trust)

____

____

For our information only, please provide details of the purpose for which the Trust is to be established

____

PROFESSIONAL REFERENCE (If tax guidance is not provided by Premier Offshore)

Company/Firm/Individual ____________________________

Address ____________________________________

____

Phone __________________ Fax __________________

Email _____________________________________

Name of Contact Person ____________________________

Type of Organization ☐ Law Firm ☒ Accounting Firm ☐ Bank ☐ Other (please provide details)

SETTLOR INFORMATION

Note: This refers to the person who establishes the Trust.

Name ______________________________________

Nationality __________________ Occupation __________________

Date of Birth __________________ Place of Birth __________________

Residential Address *(Including post code)* ________________________

Phone __________________ Fax __________________

Email _____________________________________

How should we contact you? (Please select box as appropriate)

- ☐ Through intermediary
- ☐ Mail to home address
- ☐ Telephone
- ☐ Fax
- ☐ Email
- ☐ Other (please provide details)

Please describe below how you were referred to Premier Offshore Investor

____

Please provide the following documentation for the Settlor (see Notes below):

- Notarized copy passport
- Proof of address
- References from two professionals

OFFSHORE LLC MANAGEMENT COMPANY

Jurisdiction

☐ Nevis ☐ Cook Islands ☐ Other: ______________________________

PROPOSED NAME

- Please list at least three alternatives in order of preference. Must end in LLC

1. ____
2. ____
3. ____

LLC Manager (May be the Settlor)

Name of Manager: ____

Home Address: ____

Office Address: ____

Phone: ____

Email: ____

Passport # & Country: ____
(send copy of photo page by email or fax)

Driver's License: ____
(send copy of by email or fax)

Profession: ____

U.S. Social Security No. ____

Date of Birth: ____

PROTECTOR INFORMATION (If Not Provided by Premier Offshore)

Name ______________________________

Address ______________________________

Phone ______________ Fax ______________

Email ______________________________

Please state the responsibilities and powers of the Protector

____

In respect of the Protector, please provide the following documentation:

- Notarized copy passport
- Reference from a professional

BENEFICIARY INFORMATION

Beneficiary 1

Name ______________ In Trust Document or Letter of Wishes ______________

Date of Birth ______________ Place of Birth ______________

Address ______________________________

Phone ______________ Fax ______________

Email ______________________________

Beneficiary 2

Name ______________ In Trust Document or Letter of Wishes ______________

Date of Birth ______________ Place of Birth ______________

Address ______________________________

Phone ______________ Fax ______________

Email ______________________________

Beneficiary 3

Name ______________ In Trust Document or Letter of Wishes ______________

Date of Birth ______________ Place of Birth ______________

Address ______________________________

Phone ______________ Fax ______________

Email ______________________________

Beneficiary 4

Name ______ In Trust Document or Letter of Wishes ______

Date of Birth ______ Place of Birth ______

Address ______

Phone ______ Fax ______

Email ______

In respect of each Beneficiary listed in the Trust document, please provide the following documentation:

- Notarized copy passport

TRUST PERIOD

Please specify the period for which the Trust is to be established. If not stated, it will be considered "indefinite".

______

TRUST ASSETS

Please identify the value of the initial assets that will be transferred to the Trust and/or LLC. (Please note that the minimum amount is US $10,000.)

______

OTHER INFORMATION

Please provide on a separate any specific instructions or additional information you consider appropriate for the establishment of the Trust.

DECLARATION

I declare and affirm that the information provided herein is true and correct and that the assets to be transferred to the Trust are from lawful sources and not deemed to be illegal in the Settlor(s) country of origin or country of ordinary residence. If requested to do so, I will provide Premier Offshore with any further documentation.

Completed by:

Name ______ Phone ______

Address ______ Fax ______

Signature ______ Email ______

GUIDANCE NOTES

When to Submit Supporting Documents

Please submit a scanned or faxed copy of the Settlor(s) passport with your formation request. You may submit notarized documents and letters of reference after we complete the formation and before we prepare bank account opening forms on your behalf. Note that most banks will require notarized documents and reference letters from the Settlor(s).

Certified Copy of Passport

- Notarized or certified copies of passports are required (photo and signature page) of the Settlor, Protector (if any), and Beneficiaries (see below). A U.S. licensed notary is recommended. Certified documents may be provided by a suitable person such as a lawyer, accountant, a director or manager of a regulated financial institution.
- Please note that all documents provided should be clearly legible, particularly documents containing photographs and signatures.

Beneficiaries

Supporting documentation is required from beneficiaries listed in the Trust document. Documentation is not required from beneficiaries listed only in the Letter of Wishes. The Trust may define beneficiaries in general, such as “children of the settlor,” and provide specifics in the Letter of Wishes. Please contact us with any questions.

Proof of Address

- This requirement may be fulfilled by providing:
  - a recent utility bill
  - a current year local tax authority bill
  - a current photocard driving license (provided it contains the individual’s relevant address) or
  - a bank statement.

- The document provided must reflect the name current address of the individual. Documents may be original or notarized copies.

Reference

- References are required from two independent professionals who know the Settlor (one reference in respect of the Protector) in a professional capacity (not simply an acquaintance). For example, a lawyer, accountant or a director or manager of a regulated financial institution.
- The reference should state the full name of the Settlor/Protector, residential address, and the length of time (not less than one year) that the referee has known the Settlor/Protector.
- References provided should be current, i.e. not older than three months.
- The reference should be addressed to the Premier Offshore – Corporate Services Division or “To Whom it may Concern.” Some banks will accept letters addressed to in this manner and some will not. Please discuss this requirement with us before obtaining reference letters.

How to Submit

Please send formation requests via email to info@premieroffshore.com or by fax to (619) 374-2154.