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U.S. Tax Forms for American Expatriates

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Americans have another annual ritual besides celebrating the Fourth of July and Thanksgiving: gathering the necessary information to file their U.S. tax returns. Americans living abroad are not exempt from filing U.S. tax returns even if they are working in a space station, deep-water in the North Sea, or have established residency in another country. In fact, the U.S. tax rules for Americans abroad are very complex, with the potential of both significant penalties and an unlimited statute of limitations if they fail to comply with one of the specified foreign information reporting requirements. The good news is that there are some U.S. tax advantages for Americans working abroad. To take benefits of such tax rules, the tax returns must be filed on time. Due to the complexity of the rules, Americans working outside of the United States will likely need assistance from someone who understands these special international tax rules. This article provides an overview of the individual tax return filing requirements of the U.S. expatriates and a list of the most common tax forms for the U.S. expatriate's income tax return and related financial reporting filings. For starters, U.S. expatriates must be fully aware of the following:

1. They must file their U.S. (federal) income tax return to report their worldwide income – not just any income earned or effectively connected to the United States.
2. Due to the Foreign Account Tax Compliance Act (FATCA), they may also need to report specified foreign financial assets on Form 8938, along with their U.S. income tax return, if the aggregate value of those assets exceeds certain thresholds. Note that FATCA reporting does not affect the income tax liability on the return.
3. They are required to disclose all non-U.S. financial accounts if the combined total of all accounts is \$10,000 or more. This report is commonly referred to as the Report of Foreign Bank and Financial Accounts (FBAR).

(Note: while this article focuses on U.S. citizens and permanent residents living abroad, the rules above, as well as those that follow, also generally apply to those U.S. citizens and permanent residents living in the United States.)

Tax Return Filing Requirement

All U.S. citizens and resident aliens are required to file a U.S. income tax return if their gross income meets the minimum filing thresholds. The following table shows the 2016 gross income threshold based on filing status.¹

Filing Status	Amount
Single	\$10,350
(65 or older)	\$11,900
Head of household	\$13,350
(65 or older)	\$14,900
Qualifying widow(er)	\$16,650
(65 or older)	\$17,900
Married filing jointly (MFJ)	\$20,700
Not living with spouse at end of year (MFJ)	\$ 4,050

¹ Internal Revenue Service. Publication 501. *Exemptions, Standard Deduction, and Filing Information*. Table 1 - 2016 Filing Requirements. Available at <https://www.irs.gov/pub/irs-pdf/p501.pdf>

One spouse 65 or older (MFJ)	\$21,950
Both spouses 65 or older (MFJ)	\$23,200
Married filing separately	\$ 4,050

Note that expatriates with \$400 or more of self-employment income are required to file a tax return as well.

When to File

Generally, the deadline for filing Form 1040 individual tax return is April 15. An automatic two-month extension (until June 15) is available for the individuals who are resident abroad. The taxpayer needs to inform the IRS of the extension with a statement attached to the tax return, The U.S. expatriates can file an additional four-month extension (until October 15) if requested by June 15. An additional extension to December 15 is also available to the expatriates abroad. It is important to understand that the tax for the year is due and payable by April 15. Failure to pay all taxes in full by April 15 will result in late payment penalties. Taxpayers can generally avoid late payment penalties by paying their net estimated tax liability (after taking into consideration any taxes withheld or paid-in via estimated tax payments during the year) with Form 4868 by April 15.

Most Common tax forms for U.S. Expatriates

The following lists the most common tax forms for U.S. expatriates and their related requirements:

- **Form 1040, U.S. Individual Income Tax Return.** It is an annual income tax return required for citizens and residents of the United States. Form 1040 is generally the primary U.S. income tax form, and most other forms and schedules are attached to it. American expatriates who are married to citizens of other countries can generally choose to file as “Married Filing Jointly,” “Married Filing Separately,” or “Head of Household” and qualify for a higher standard deduction (for Married Filing Jointly and Head of Household). If the taxpayer is claiming dependency exemptions, a Social Security Number or an Individual Taxpayer Identification Number (ITIN) are required to qualify.²
- **Form W-7, Application for IRS Individual Taxpayer Identification Number.** The Individual Taxpayer Identification Number (ITIN) is a tax processing identification number issued by the IRS, for the purpose of U.S tax return, to individuals who are not eligible for a Social Security Number. ITINs are issued to both resident and nonresident aliens who are required to file Form W-7, regardless of their immigration status. The following are examples of individuals who may need ITINs:
 - A nonresident alien required to file a U.S. tax return
 - A U.S. resident alien (based on days present in the United States) filing a U.S. tax return
 - A dependent or spouse of a U.S. citizen/resident alien
 - A dependent or spouse of a nonresident alien visa holder

² See Treas. Reg. §301.6109-1(a)(1)(ii) as well as the IRS web site “U.S Citizens and Resident Aliens Abroad – Head of Household” at <https://www.irs.gov/individuals/international-taxpayers/u-s-citizens-and-resident-aliens-abroad-head-of-household>

- **Form 2555, Foreign Earned Income.** U.S. citizens and U.S. resident aliens living in a foreign country who meet the tax home test,³ bona fide residence test,⁴ or the physical presence test⁵ can elect to exclude foreign earned income up to the IRC Section 911 limitation, and certain foreign housing costs. The exclusions are adjusted annually for inflation.⁶ Exclusion for foreign housing is based on actual expenses and the table is provided by IRS in its instructions to Form 2555. Taxpayers may not claim certain tax credits (e.g. child tax credits) and deductions (e.g. IRA and Roth IRA) if they claimed the foreign earned income exclusion. In some situations, it might be beneficial not to take foreign earned income exclusion and claim other tax credits instead.
- **Schedule SE, Self-Employment Tax.** U.S. expatriates and resident aliens are subject to the same self-employment tax rules as those who are living in the United States. These taxpayers must pay tax on self-employment income of \$400 or more. The IRC Section 911 exclusion does not apply to self-employment tax. The United States has bilateral Social Security agreements with certain countries, commonly known as Totalization Agreements. These agreements exempt citizens of one country from similar social security-type taxes in a foreign country, as long as they are contributing to their home country's social security system.
- **Form 1116, Foreign Tax Credit.** This form is used to claim foreign tax credits on a U.S. tax return for the income taxes paid in foreign jurisdictions on foreign-sourced income. Note that a U.S. expatriate cannot claim foreign tax credits or deduction on the income that is part of the foreign earned income exclusion and the foreign housing exclusion. The foreign tax credit has a current year limitation that is calculated as the following:

Maximum foreign tax credit allowed in the current year = (Foreign source taxable income/Total worldwide taxable income) multiplied by the taxpayer's U.S. tax liability (before any reduction based on a foreign tax credit).

This means that if the foreign tax paid is greater than what the U.S. tax liability would have been on the foreign source income, the foreign tax credit is limited to only the U.S. tax liability on the foreign income.

The excess amount of foreign taxes that are not creditable due the limitation can be carried back one year and carried forward ten years. These foreign tax credits can be used to offset U.S. tax on foreign source income of these carryback or carryforward years.

- **Form 8833, Treaty-Based Return Position Disclosure Under Section 6114 or Section 7701(b).** If a U.S. expatriate or U.S. resident alien is living in a country that has an income tax treaty with the United States, he or she may be entitled to certain benefits under the treaty. For example, income tax treaties provide benefits for individuals engaged in dependent personal services (i.e., employment) and independent personal services (i.e., self-employment). Generally, if certain

³ According to Treas. Reg. §1.911-2(b) the term "tax home" has the same meaning which it has for purposes of section 162(a)(2) (relating to travel expenses away from home). Thus, under section 911, an individual's tax home is considered to be located at his regular or principal (if more than one regular) place of business or, if the individual has no regular or principal place of business because of the nature of the business, then at his regular place of abode in a real and substantial sense. An individual shall not, however, be considered to have a tax home in a foreign country for any period for which the individual's abode is in the United States. Temporary presence of the individual in the United States does not necessarily mean that the individual's abode is in the United States during that time. Maintenance of a dwelling in the United States by an individual, whether or not that dwelling is used by the individual's spouse and dependents, does not necessarily mean that the individual's abode is in the United States.

⁴ A person is considered a "bona fide resident" of the foreign country if that person resides in that country for an uninterrupted period that includes an entire tax year.

⁵ Under *Physical Presence Test*, a person is considered physically present in a foreign country if the person resides in that country for at least 330 full days in any consecutive 12-month period.

⁶ The maximum foreign earned income exclusion is \$102,100 for 2017 and \$101,300 for 2016.

conditions are met, such treaties provide an exemption for tax withholding requirement on payments to non-residents. If a treaty-based position is taken in a return, it should be disclosed on Form 8833, Treaty-Based Return Position Disclosure Under Section 6114 or Section 7701(b). The benefit may include credits, deductions, exemptions, and reductions in the rate of taxes.

- **Form 8621, Information Return by a Shareholder of a Passive Foreign Investment Company (PFIC) or Qualified Electing Fund.** If a U.S. citizen or U.S. resident alien invests savings through a non-U.S. financial institution, it may be considered a PFIC that requires significant costs and efforts in tax reporting. PFICs are “pooled investments” registered outside the U.S. that include mutual funds, money-market account, hedge funds, certain insurance products and foreign retirement plans. Foreign pension plans could be exempt if recognized as “qualified” under tax treaty. PFICs are any corporation organized under the laws of a non-U.S. jurisdiction, which satisfies either an income test (75% or more of foreign entity’s income is passive) or an asset test (at least 50% of assets of foreign entity produce or held to produce passive income). The tax treatment of PFICs is more punitive related to similar investment held through a U.S. institution. For example, capital gain classified as PFICs could be subject to the highest individual tax rate of 39.6% instead of the long-term capital gain rate of 15%. Additionally, the disclosure requirement on Form 8621 is complex. Under the rules, there are three alternative methods to determine the taxable income of the investment in each fund. Each method is designed to eliminate the benefit of deferral that is one of the main benefits of a foreign mutual fund. The specifics depend on whether the taxpayer made any PFIC election such as an election to treat the PFIC as a qualified electing fund (QEF), or an “election to mark-to-market PFIC stock”. If no election is made, the “default” PFIC tax regime of IRC Section 1291 applies. Due to the complexity of these rules, the IRS estimates that for the year 2016, individual taxpayers would require 47 hours for recordkeeping, learning about the rules of the form and preparing the form.⁷
- **FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR).** A U.S. citizen or U.S. resident alien is required to file this form if he or she had a financial interest, signature or other authority over a bank, securities, or other financial account in a foreign country if the combined balance in all such accounts exceeds \$10,000. Form 114 is not filed with IRS. It is filed electronically with the Financial Crimes Enforcement Network (Fin-CEN), an agency within the U.S. Department of Treasury.⁸ Failure to file or maintain the required records carries severe penalties, especially if the government determines that the violation was willful. The due date for FBAR filing was recently changed from June 15 to April 15 for tax years beginning after December 31, 2015. In addition, the law provides an automatic six-month extension (without the need to file for an extension) until October 15.⁹
- **Form 8938, Statement of Specified Foreign Financial Assets¹⁰.** Also known as the FATCA form, is used to report a U.S. person’s specified foreign financial assets if the total value of all the specified foreign financial assets, in which he or she has an interest, is more than the appropriate reporting threshold. Specified foreign financial assets include any financial account in a foreign financial institution and any investment in securities, interest, or instrument in a foreign entity where

⁷ See IRS “Instructions for Form 8621” at <https://www.irs.gov/pub/irs-pdf/i8621.pdf>

⁸ See Treasury’s Financial Crimes Enforcement Network BSA E-Filing System: <http://bsaefiling.fincen.treas.gov/main.html>

⁹ See the December 16, 2016 FinCEN Release at: <https://www.fincen.gov/news/news-releases/new-due-date-fbars-0>

¹⁰ See IRS “Instructions for Form 8938” at <https://www.irs.gov/uac/form-8938-statement-of-foreign-financial-assets>

counterparty that is not a U.S. person. This form has some overlap with the FinCEN 114 Form, but the filing thresholds are higher and depends on the taxpayer's residency and marital status. These thresholds range from a low of \$50,000 to a high of \$600,000 for the highest value during the year and on the last day of the year. Please note that Form 8938 is not a replacement of FinCEN 114 Form. There could be a \$10,000 civil penalty for failure to file Form 8938, with additional \$10,000 penalties up to a maximum of \$50,000 after a notice from the IRS. The statute of limitations for the entire 1040 return is also extended if Form 8938 is not filed when required.

- **Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts¹¹.** U.S. citizens or U.S. resident aliens (and executors of estates of U.S. decedents) are required to file this form to report certain transactions with foreign trusts, ownership of foreign trusts, and receipt of certain large gifts or bequests from certain foreign persons. A separate Form 3520 must be filed for transactions with each foreign trust. Reportable event for filing Form 3520 include the following:
 - Formation of a foreign trust
 - Conversion of domestic trust to foreign trust
 - Transfer of assets to foreign trust
 - Sale of a foreign trust if it is not at "arms-length" transaction
 - Death of a US grantor of a foreign trust

Generally, a penalty is imposed if Form 3520 is not timely filed, or if the information is incomplete or incorrect.

- **Form 3520-A, Annual Information Return of Foreign Trust with a U.S. Owner (Under Section 6048(b)).** The trustee of a foreign grantor trust is required to file Form 3520-A annually. If a foreign trustee does not file the form with IRS, then in addition to Form 3520, a grantor in a foreign trust is also required to file Form 3520-A to provide information about the trust, its U.S. beneficiaries, and any U.S. person who is treated as an owner of any portion of the foreign trust. This form is similar to Form 1041, U.S. Income Tax Return for Estates and Trusts.
- **Form 8832, Entity Classification Election.** The entity classification regulations under IRC section 7701, known as check-the-box regulations, allows certain business entities to choose their classification for the U.S. federal tax purpose. The classification of a foreign entity as a corporation, a partnership, or a disregarded entity, affects many aspects of the U.S. taxation. If a U.S. expatriate owns his or her own business and sets up a legal entity in the country of residence, the entity is classified as either a partnership, corporation or a disregarded entity based on the following criteria:
 - 1) A partnership if it has two or more members and at least one member does not have limited liability.
 - 2) An association taxable as a corporation if all members have limited liability.
 - 3) A disregarded as an entity separate from its owner if it has a single owner that does not have limited liability.¹²

¹¹ See IRS "Instructions for Form 3520" at <https://www.irs.gov/uac/about-form-3520>

¹² See the foreign default rule in the Form 8832 instructions.

However, Form 8832 can be used to change the classification of the foreign entity as a disregarded entity (with a single member) or a partnership (at least two members) if certain requirements are met. For example, a single member limited liability company that is owned by an individual can be elected to be treated as a corporation.

- **Form 8858, Information Return of U.S. Persons with Respect to Foreign Disregarded Entities.** A U.S. person is required to file this form if he or she owns, directly, indirectly, or constructively, a foreign business entity that is classified as a disregarded entity.
- **Form 5471, Information Return of U.S. Persons with Respect to Certain Foreign Corporations.** This form is “used by certain U.S. persons who are officers, directors, or shareholders in certain foreign corporations. The form and schedules are used to satisfy the reporting requirements” of transactions between foreign corporations and U.S. persons¹³. A separate Form 5471 and all applicable schedules is required for each foreign entity that is classified as a corporation for U.S. federal tax purposes. IRC Section 6038(b)(1) imposed \$10,000 disclosure penalty for each Form 5471 that is not filed or incomplete. There is additional \$10,000 penalty “if the failure continues for more than 90 days after the IRS mails notice of failure.”¹⁴
- **Form 8865. Return of U.S. Persons with Respect to Certain Foreign Partnerships.** This form is required to be filed if a U.S. person owns an interest in a foreign eligible entity that elects to be classified as a foreign partnership for the U.S. federal tax purposes. This form is used to report “transfers, acquisitions, dispositions, and changes in foreign partnership interests” along with other financial information. This form is required to be filed with the partner's tax return. There is a penalty of \$10,000 per year for each partnership return that is not filed when required. A 10% partner, who makes a contribution of property to a foreign partnership and does not disclose the transfer, is subject to a penalty of 10% of the amount transferred up to \$100,000.
- **Form 926, Return by a U.S. Transferor of Property to a Foreign Corporation.** This form is required to be filed by a U.S. person upon certain transfers or deemed transfers of tangible or intangible property to a foreign corporation. If a taxpayer fails to file the form, there would be penalty equals 10% of the fair market value of the property at the time of the transfer. The penalty will not apply if the failure to comply is due to reasonable cause and not to willful neglect. The penalty is limited to \$100,000 unless the failure to comply was due to intentional disregard¹⁵. This form is filed with the tax return of transferor for the year the transfer is made.
- **Form 8275 Disclosure Statement and Form 8275-R Regulation Disclosure Statement.** According to IRS instructions, “Form 8275 is used by taxpayers and tax return preparers to disclose items or positions, except those taken contrary to a regulation, that are not otherwise adequately disclosed on a tax return to avoid certain penalties. The form is filed to avoid the portions of the accuracy-related penalty due to disregard of rules or to a substantial understatement of income tax for non-tax shelter items if the return position has a reasonable basis. It can also be used for disclosures relating to the economic substance penalty and the preparer penalties for tax

¹³ The form and schedules are used to satisfy the reporting requirements of sections 6038 and 6046, and the related regulations

¹⁴ See IRS “Instructions to form 5471” at <https://www.irs.gov/instructions/i5471/ch01.html#d0e22>

¹⁵ See IRS “Instructions to form 8865” at <https://www.irs.gov/instructions/i8865/index.html>

understatements due to unreasonable positions or disregard of rules.”¹⁶ This form is filed by “individuals, corporations, pass-through entities, and tax return preparers.” When “disclosing a position taken contrary to a regulation, use Form 8275-R, Regulation Disclosure Statement, instead of Form 8275.”¹⁷

Disclosures are necessary when dealing with certain expatriate tax issues, for example the timing or sourcing of foreign income and taxes, sometimes it is not possible to get a 100 percent assurance that the position taken on the expatriate tax return is the correct. Another example could be the valuation method used to quantify foreign assets when calculating gain or loss. The rules are complex, and the application is not very clear. In these situations, Form 8275 or Form 8275-R should be used to disclose the position. It will provide a valuable protection for both the tax preparer and the taxpayer as long as the position is not frivolous, made in good faith, substantiated. If the tax preparer feels that this form is necessary, it should be discussed with the taxpayer.

This is not a comprehensive list of all the forms U.S. expatriates may need to file. The list does not include tax forms that are generally filed with domestic taxpayers without foreign activities or assets.

Statute of limitations rules for non-compliance with certain foreign information reporting requirement

Generally, there is three years of statute of limitation after tax return is filed. The statute is extended to six years if 25% of income is omitted from the tax return.¹⁸ In the case of foreign information reporting, we need to pay special attention to IRC section 6501(c)(8). It states, “in the case of any information which is required to be reported to the Secretary pursuant to an election under section 1295(b) or under section 1298(f), 6038, 6038A, 6038B, 6038D, 6046, 6046A, or 6048, the time for assessment of any tax imposed by this title with respect to any tax return, event, or period to which such information relates shall not expire before the date which is 3 years after the date on which the Secretary is furnished the information required to be reported under such section...If the failure to furnish the information ... is due to reasonable cause and not willful neglect, (this) apply only to the item or items related to such failure.”

The IRC sections listed in section 6501(c)(8) related to foreign information reporting on forms 5471, 8865, 8858, 5472, 926, 8865, 8621 and 8938.

It means that the taxpayers and their tax accountants need to fully understand which foreign informational forms they are required to file and make sure that the forms are complete, accurate and filed on time. If any of these required forms is missing or containing errors, it should be amended so that the statute of limitation does not stay open forever.

Take-away

If a U.S. person is on a short-term assignment to a foreign country or a commuter assignment, generally he will not be eligible for foreign earned income exclusion under IRC section 911. The U.S. person must reside outside the United States and must meet either the Bona Fide Resident or the Physical Presence test to qualify for the exclusion. If the U.S. person had paid or accrued income taxes in the country of assignment, he can claim foreign tax credits in the U.S. with certain limitations via Form 1116. He does not have to file

¹⁶ See IRS “Instructions to form 8275” at <https://www.irs.gov/instructions/i8275/ch01.html>

¹⁷ See IRS “Instructions to form 8275” at <https://www.irs.gov/instructions/i8275/ch01.html>

¹⁸ See IRC Section 6501

FinCen Form 114 or Form 8938 if he does have any beneficial interest or signature authority in a non-U.S. account at a foreign financial institution.

On the other hand, the situation would be different if a U.S. person is residing in a foreign country on long-term basis. Let's say that a U.S. person moved to France and started his own business as a sole proprietorship. In this case, once he meets either the Bona Fide Resident or Physical Presence tests, he will qualify for the IRC section 911 exclusion (Form 2555). Even if he can exclude all of his foreign earned income from his business for income tax purposes, he will still be subject to the self-employment tax (Schedule SE). If all the foreign earned income is excluded, he will not be able to use foreign tax credits for French taxes paid. He will be subject to FBAR (FinCen Form 114) and FATCA reporting (Form 8938) requirements if he has foreign financial assets above the threshold amount. If he has an ownership interest in a passive foreign investment company (PFIC) – typically foreign-based companies that either have 75% or more of their income is the form of passive income or 50% or more of their assets as passive assets), he will be subject to potential PFIC reporting and subject to the U.S. tax on that income (Form 8621). If he is benefiting from US-France income tax treaty, he will have to disclose the treaty-based return position on Form 8833.

You can see that even if a U.S. expatriate does not have any activities with a foreign trust or ownership in a controlled foreign corporation or foreign partnership, his tax return could still be complex. The risk may not just be the miscalculation of the U.S. tax liability. The real risk is associated with the misreporting that carries severe penalties even if there is no tax liability is due.

Tax accountants who provide services to U.S. citizens or U.S. resident aliens abroad should understand the extensive and complex filing requirements related to U.S. persons abroad and their foreign assets. They have to make sure that the clients understand these requirements and the risk associated with noncompliance. To reduce the chance of miscommunication, they need to ask appropriate questions to understand the expatriates' situation. For example, a U.S. expatriate is likely to answer "no" when asked if they have any Passive Foreign Investment Company (PFIC) account. It is because they probably do not understand what a PFIC means. The tax penalties for failure to file these forms are severe. As a result of the FATCA initiative, the IRS is receiving more information about U.S. persons' foreign financial assets from the foreign financial institutions. It is just matter of time for the IRS to go through all the FATCA data and initiate audits for the unreported foreign assets of the U.S. persons.