



2024



IRS Nationwide
TaxForum

International Tax Essentials: Reporting Global Income in the United States

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Objectives:

- Understanding Worldwide Income Reporting.
- Navigating Exclusion Options and Credits (Form 2555 & Form 1116).
- Tax Treaty Considerations.
- Sourcing and Taxability Determination.

Worldwide Income

U.S. citizen or resident alien, the rules for filing income, estate, and gift tax returns and paying estimated tax are generally the same whether you are in the United States or abroad.

You are subject to tax on worldwide income from all sources and must report all taxable income and pay taxes.



US Tax Residency

- **US Citizens**
- **Green card test:** An alien is a resident alien with respect to a calendar year if the individual is a lawful permanent resident at any time during the calendar year.
- **Substantial presence test:** An alien individual is a resident alien if the individual meets the substantial presence test. An individual satisfies this test if he or she has been present in the United States on at least 183 days during a three-year period that includes the current year.



How do we count days?

- Current Year = Full Day.
- First preceding year = $1/3$ Day.
- Second preceding year = $1/6$ Day.





Additional Information about Substantial Presence Test

- **Determination of presence:** an individual shall be treated as present in the United States on any day that he or she is physically present in the United States at any time during the day.
- **Thirty-one day minimum:** If an individual is not physically present for more than 30 days during the current year, the substantial presence test will not be applied for that year even if the three-year total is 183 or more days.

EXAMPLE - Substantial Presence Test

Bob, alien individual, is present in the United States for the following days:

- 122 days in the current year.
- 122 days in the first preceding calendar year.
- 122 days in the second preceding calendar year.



EXAMPLE - Substantial Presence Test

- Current Year - 122 days $\times$ 1 = 122 Days.
- First preceding year - 122 days $\times$ $\frac{1}{3}$ = 40 $\frac{2}{3}$ Days.
- Second preceding year - 122 days $\times$ $\frac{1}{6}$ = 20 $\frac{1}{3}$ Days.

The total of $122 + 40 \frac{2}{3} + 20 \frac{1}{3}$ equals 183 days.

Bob meets the substantial presence test and is a resident alien for the current year.



Foreign Earned Income Exclusion (Form 2555)

You qualify to exclude your foreign earned income from gross income if both of the following apply:

- You meet the tax home test.
- Tax home must be in a foreign country, or countries throughout your period of bona fide residence or physical presence, whichever applies.

You meet either the bona fide residence test or the physical presence test.



Bona Fide Residence Test (1 of 2)

To meet this test, you must be one of the following:

- A U.S. citizen who is a bona fide resident of a foreign country, or countries, for an uninterrupted period that includes an entire tax year (January 1–December 31, if you file a calendar year return).



Bona Fide Residence Test (2 of 2)

- A U.S. resident alien who is a citizen or national of a country with which the United States has an income tax treaty in effect and who is a bona fide resident of a foreign country, or countries, for an uninterrupted period that includes an entire tax year (January 1–December 31, if you file a calendar year return).



Physical Presence Test

- To meet this test, you must be a U.S. citizen or resident alien who is physically present in a foreign country, or countries, for at least 330 full days during any period of 12 months in a row. A full day means the 24-hour period that starts at midnight.



Foreign Tax Credit

- Taxpayer can take a credit for income or a deduction, on war profits, excess profits taxes paid or accrued during your tax year to any foreign country or U.S. possession, or any political subdivision (for example, city, state, or province) of the country or possession.



Foreign Tax Credit

Requirements - A foreign levy is a foreign income tax only if:

A. It is a foreign tax; and

B. Either:

- 1) The foreign tax is a net income tax, as defined in paragraph (a)(3) of this section; or
- 2) The foreign tax is a tax in lieu of an income tax, as defined in § 1.903-1(b).



Foreign Tax Credit

- A penalty, fine, interest, or similar obligation is not a tax, nor is a customs duty a tax!
- Taxpayer method of accounting is important, Cash basis taxpayers may elect Accrual method on form 1116.



Foreign Tax Credit (1 of 2)

- You may be able to claim the foreign tax credit without filing Form 1116.
- This election is available only if you meet all of the following conditions.
 - All of your foreign source gross income was “passive category income” (which includes most interest and dividends).



Foreign Tax Credit (2 of 2)

- All the income and any foreign taxes paid on it were reported to you on a qualified payee statement. Qualified payee statements include Form 1099-DIV, Form 1099-INT, Schedule K-1 (Form 1041), Schedule K-3 (Form 1065), Schedule K-3 (Form 1120-S), or similar substitute statements.
- Your total creditable foreign taxes aren't more than \$300 (\$600 if married filing a joint return).



Interaction between exclusion and foreign tax credit (1 of 2)

- No double dipping! If the taxpayer elects the foreign earned income exclusion and pays foreign taxes on that income, taxpayer cannot take a foreign tax credit for taxes allocable to the excluded income.
- FEIE is an Election, once elected remains in effect until revoked, taxpayer cannot re-elect until 5 years.



Interaction between exclusion and foreign tax credit (2 of 2)

- **Foreign Tax Credit unused credit:** Any unused credit taxpayer can carry back one year and, if not used, then forward for up to 10 years.
- **No Additional Child Tax Credit or Earned Income Credit if FEIE is used:** The taxpayer cannot qualify for these credits for any tax year subject to a FEIE election. Taxpayer may benefit from FTC instead.



United States income tax treaties

- The United States has tax treaties with a number of foreign countries. Under these treaties, residents (not necessarily citizens) of foreign countries are taxed at a reduced rate, or are exempt from U.S. taxes on certain items of income they receive from sources within the United States.
- Treaty provisions are generally reciprocal (apply to both treaty countries), a U.S. citizen or resident who receives income from a treaty country may also be taxed at a reduced tax rate by that foreign country.



Saving Clause (1 of 2)

- Most tax treaties have a saving clause that preserves the right of each country to tax its own citizens and treaty residents as if no tax treaty were in effect.
- The saving clause generally excepts specified income types from its application, which may allow you to claim certain treaty benefits even if you are a U.S. citizen or resident.



Saving Clause (2 of 2)

- Generally, If the treaty does not cover a particular kind of income, or if there is no treaty between your country and the United States, you must pay tax on the income in the same way and at the same rates shown in the instructions for the applicable U.S. tax return.



Disclosing Treaty Benefits Claimed

- If you claim treaty benefits that override or modify any provision of the Internal Revenue Code, and by claiming these benefits your tax is or might be reduced, you must attach a fully completed Form 8833, Treaty-Based Return Position Disclosure, to your tax return.



Treaty Assistance (1 of 2)

- Assistance may be requested from the U.S. competent authority, if actions of the U.S., the applicable treaty country or both caused or will cause double taxation or taxation otherwise inconsistent with the treaty.



Treaty Assistance (2 of 2)

1. **Competent Authority Arrangements:** bilateral agreement between the United States and the treaty partner to clarify or interpret treaty provisions.
2. **Competent Authority Assistance:** Two primary offices within the U.S. competent authority conduct the MAP process. Those offices are the Advance Pricing and Mutual Agreement Program (“APMA”) and the Treaty Assistance and Interpretation Team (“TAIT”).



Rules for compensation

- Compensation for services provided is United States-source if the taxpayer performs the services in the U.S, if the taxpayer performs services outside the U.S., then the income is foreign-source.



Sourcing and Taxability Determination (1 of 5)

1. Wages Paid by a U.S. Corporation to a U.S. Citizen in Mexico:
 - **Scenario:** A U.S. citizen is employed full-time by a U.S. corporation but works and resides in Mexico.
 - **Source:** The wages earned by the U.S. citizen for work performed in Mexico are considered foreign-source income.



Sourcing and Taxability Determination (2 of 5)

2. Interest from a Non-U.S. Bank Account:

- **Scenario:** An individual holds a savings account with German Bank, which is located in Germany.
- **Source:** The interest earned on the savings account is considered foreign-source income since it is paid by a non-U.S. bank and the account is located outside the United States.



Sourcing and Taxability Determination (3 of 5)

3. Dividends on U.S. Corporation Stock Held Abroad:

- **Scenario:** An investor holds stock in a US corporation. stock held in a brokerage account with a Spaniard bank located in Spain.
- **Source:** Despite the brokerage account being in Spain, the dividends paid on the US Stocks are considered U.S.-source income because the paying corporation, is a U.S. entity.



Sourcing and Taxability Determination (4 of 5)

4. Rental Income from Foreign Real Estate

- **Scenario:** An individual owns a residential property in Colombia and earns rental income from it.
- **Source:** The rental income derived from the property located in Colombia is considered foreign-source income.



Sourcing and Taxability Determination (5 of 5)

5. Gain from the Sale of Foreign Real Estate:

- **Scenario:** A U.S. citizen residing in the United States sells a residential rental property located in Brazil.
- **Source:** The gain realized from the sale of the property in Brazil is considered foreign-source income.





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Thank You!

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