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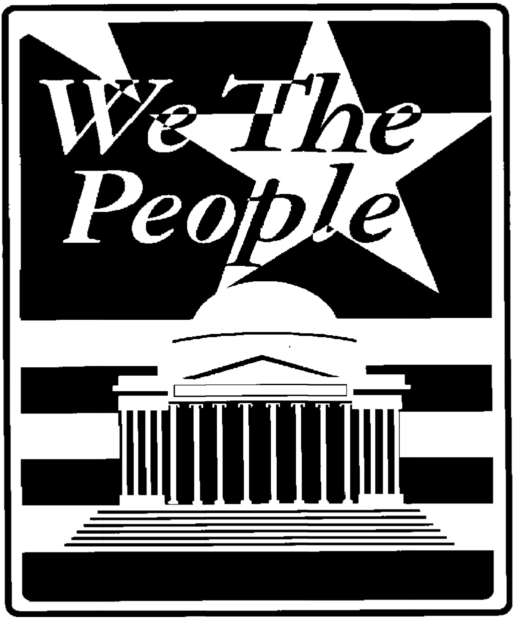
Tax Highlights for U.S. Citizens and Residents Going Abroad



Important Reminders

Form 2555–EZ. You may be able to file the simpler Form 2555–EZ, *Foreign Earned Income Exclusion,* if, among other requirements:

- You had foreign earned income of only wages and salaries of $70,000 or less,
- Your return is not for a short year, and
- You did not have business or moving expenses.

Form 2555–EZ has fewer lines than Form 2555.

Required tax return. In determining whether you must file an income tax return, include in income any excludable foreign earned income or foreign housing amount. If you must file a return and all or part of your income is excluded under these rules, you must also file Form 2555 or, if you qualify, Form 2555–EZ.

Foreign income tax withheld. If a foreign employer withheld income taxes from your pay and paid those taxes to the foreign country's tax authority (not the U.S. Treasury), you cannot claim those taxes on your U.S. income tax return as federal income tax withholding. This applies even if the withholding is reported on your Form W–2, *Wage and Tax Statement.*

You may be able to claim a foreign tax credit on Form 1116, *Foreign Tax Credit (Individual, Estate, Trust, or Nonresident Alien Individual),* based on the amount withheld and paid to the foreign tax authority. See *Foreign Income Taxes,* later.

Introduction

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

As a U.S. citizen or resident alien, your worldwide income generally is subject to U.S. income tax regardless of where you are living. Also, you are subject to the same income tax return filing requirements that apply to U.S. citizens or residents living in the United States. However, several income tax benefits might apply if you meet certain requirements while living abroad. You may be able to exclude from your income a limited amount of your foreign earned income. You also may be able either to exclude or to deduct from gross income your ***housing amount*** (defined later). To claim these benefits, you must file a tax return and attach Form 2555, *Foreign Earned Income.* If you are claiming the foreign earned income exclusion only, you may be able to use the shorter Form 2555–EZ, *Foreign Earned Income Exclusion,* rather than Form 2555.

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

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

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

Free Publications and Forms

If you need information on a subject not covered in this publication, check our other free publications. Get Publication 910, *Guide to Free Tax Services* , for a list of, and an index to, these publications. To order publications and forms, write the IRS Forms Distribution Center for your area as shown in the income tax package.

Income Earned Abroad

You may qualify for an exclusion from tax of up to $70,000 in income earned while working abroad. However, you must file a tax return to claim it. In general, foreign earned income is income received for services you perform in a foreign country. You also may be able to claim an exclusion or a deduction from gross income for your reasonable housing costs that are over a certain base amount. Generally, you will qualify for these benefits if your ***tax home*** (defined below) is in ***a foreign country,*** or countries, throughout your period of bona fide foreign residence or physical presence and you are one of the following:

1) A U.S. citizen who is a bona fide resident of a foreign country or countries for an uninterrupted period that includes a complete tax year, or

2) A U.S. resident alien who is a citizen or national of a country with which the United States has an income tax treaty in effect and who is a bona fide resident of a foreign country or countries for an uninterrupted period that includes an entire tax year, or

3) A U.S. citizen or a U.S. resident alien who is physically present in a foreign country or countries for at least 330 full days during any period of 12 consecutive months.

Tax home. Generally, your tax home is the general area of your main place of business, employment, or post of duty where you are permanently or indefinitely engaged to work. You are not considered to have a tax home in a foreign country for any period during which your abode (the place where you regularly live) is in the United

States. However, being temporarily present in the United States or maintaining a dwelling there does not necessarily mean that your abode is in the United States. For details, see Publication 54.

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

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

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

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

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

Armed Forces exchanges, officers' messes, etc., operated by the U.S. Army, Navy, or Air Force.

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

Amount excludable. If your tax home is in a foreign country and you qualify under either the bona fide residence test or physical presence test for all of 1994, you can exclude your foreign income earned during the year up to $70,000. However, if you qualify under either test for only part of the year, you must reduce ratably the $70,000 maximum based on the number of days within the tax year you qualified under one of the two tests.

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

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

The ***base amount*** for 1994 is $9,060 or $24.82 per day. To figure your base amount if you are a calendar year taxpayer, multiply $24.82 by the number of days in your period of foreign residence or presence, whichever applies, that are within the tax year.

Exclusion. You can exclude your housing amount from income to the extent it is from employer-provided amounts. Employer-provided amounts are any amounts paid to or for you by your employer, including your salary, housing reimbursements, and the fair market value of pay given in the form of goods and services.

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

Deduction. If you are self-employed and your housing amount is not provided by or for an employer, you can deduct it in arriving at your adjusted gross income. ***However,*** the deduction is limited to the amount your foreign earned income for the tax year is more than the excluded foreign earned income and housing amount.

Carryover. If you cannot deduct all of your housing amount in a tax year because of the limit, you can carry over the unused part to the next year. You can deduct this carryover to the extent the limit for that year (your foreign earned income minus the foreign earned income and housing amount you exclude) is more than your housing deduction for that year. You cannot carry over any remaining amount to any future tax year.

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

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

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

1) Provided for your employer's convenience because the place where you work is in a remote area where satisfactory housing is not available to you on the open market within a reasonable commuting distance,

2) Located as close as practicable in the area where you work, and

3) Provided in a common area or enclave that is not available to the public for lodging or accommodations and that normally houses at least 10 employees.

Foreign Income Taxes

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

Tax credit. If you choose to credit foreign taxes against your tax liability, complete Form 1116, *Foreign Tax Credit, (Individual, Estate, Trust, or Nonresident Alien Individual),* and attach it to your U.S. income tax return. Do not include the foreign taxes paid or accrued as withheld income taxes on line 54 of Form 1040.

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

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

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

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

More information. The foreign tax credit and deduction, their limits, and the carryback and carryover provisions are discussed in detail in Publication 514, *Foreign Tax Credit for Individuals.*

Tax Treaty Benefits

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

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

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

Publication 90l, *U.S. Tax Treaties,* contains detailed information on tax treaties and tells you where you can get copies of them.

Filing Requirements

The U.S. filing requirements for U.S. citizens and resident aliens in foreign countries are generally the same as those for citizens and residents living in the United States. Your age, marital status, gross income, whether you are blind, and whether you can be claimed as a dependent by another taxpayer determine whether you must file a U.S. federal income tax return. To determine if you meet the gross income requirement for filing purposes, you must include all income you receive from foreign sources as well as your U.S. income. It does not matter that:

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

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

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

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

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

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

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

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

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

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

Extensions of time to file. If you are a U.S. citizen or resident and both your tax home and your abode are outside the United States and Puerto Rico on the regular due date of your return, you are automatically granted an extension to June 15 to file your return and pay any tax due. You do not have to file a special form to receive this extension. You must, however, attach a statement to your tax return when you file it showing that you are eligible for this automatic extension.

It may benefit you to file for an additional extension of time to file. You may benefit if, on the due date for filing, you have not yet met either the bona fide residence test or the physical presence test, but you expect to qualify after the automatic extension discussed above and have no tax liability. To file for an additional extension, send Form 2350, *Application for Extension of Time To File U.S. Individual Income Tax Return,* to the Internal Revenue Service Center in Philadelphia or to your local IRS representative. Send the form after the close of your tax year but before June 15. If an extension is granted, it will be to a date after you expect to meet the time requirements for the bona fide residence or physical presence test. You must attach the approved Form 2350 to your income tax return when you file it.

Where to file and pay. If you claim the foreign earned income exclusion, the foreign housing exclusion, the housing deduction, or if you must file a return and you claim the exclusion of income for bona fide residents of

American Samoa, send your tax return, related forms and schedules, and any tax due to the Internal Revenue Service Center, Philadelphia, PA 19255.

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

Foreign bank and financial accounts. If you had any financial interest in, or signature or other authority over, a bank account, securities account, or other financial account in a foreign country at any time during the tax year, you may have to complete Treasury Department Form TD F 90–22.1, *Report of Foreign Bank and Financial Accounts,* and file it with the Department of the Treasury, P.O. Box 32621, Detroit, MI 48232. You need not file this form if the combined assets in the account(s) are $10,000 or less during the entire year, or if the assets are with a U.S. military banking facility operated by a U.S. financial institution.

You can get Form TD F 90–22.1 from the offices listed at the end of this publication or from the IRS Forms Distribution Center, P.O. Box 25866, Richmond, VA 23289.

Estate and gift taxes. Under certain conditions, you may have to file a federal estate or gift tax return.

Gift tax return. If you make a transfer by gift during a year, you may have to file Form 709, *United States Gift (and Generation-Skipping Transfer) Tax Return,* for that year. You generally do not have to file a return if your gifts during the year were less than $10,000 to any one person, the transfers were for educational or medical expenses, or the transfer is to your spouse and it qualifies for the unlimited marital deduction.

Estate tax return. The estate's executor or administrator must, in general, file Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return,* for any estate with a gross value (plus adjusted taxable gifts and specific gift tax exemption for gifts made by the deceased person) of more than $600,000.

More information. For details, get Publication 448, *Estate and Gift Taxes,* or write to:

Internal Revenue Service
Assistant Commissioner (International)
Estate Tax Group
CP:IN:C:E:655
950 L'Enfant Plaza South, S.W.
Washington, DC 20024

Overseas Taxpayer Assistance and Information

You may find that you will not automatically receive forms during your first year abroad because of your change of address. If your mailing address changes, be sure to notify the Internal Revenue Service using Form 8822, *Change of Address.*

The IRS has combined special forms and instructions as well as publications in Publication 776, *Overseas Filers of Form 1040 (Supplemental Package),* for U.S. citizens and residents living abroad. You may get the package and additional assistance by writing to:

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

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

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

Bonn, Germany	(49)	(228)	339-2119
Caracas, Venezuela	(58)	(2)	285-4641
London, England	(44)	(71)	408-8076
Mexico City, Mexico	(52)	(5)	211-0042 Ext. 3557
Nassau, Bahamas		(809)	766-5040
Ottawa, Canada		(613)	563-1834
Paris, France	(33)	(1)	4296-1202
Riyadh, Saudi Arabia	(966)	(1)	488-3800 Ext. 1210
Rome, Italy	(39)	(6)	4674-2560
S'ao Paulo, Brazil	(55)	(11)	881-6511 Ext. 287
Singapore	(65)		338-0251 Ext. 247
Sydney, Australia	(61)	(2)	373-9194
Tokyo, Japan	(81)	(3)	3224-5466