

United States Tax Filing and Reporting Obligations – Foreign Nationals

By: Belarmino A. Suarez, CPA
Shareholder SuarezBaldomero, P.A.

Email: bsuarez@sbpacpa.com

February 7, 2019

About the Presenter



Belarmino A. Suarez, CPA is a founding shareholder of SuarezBaldomero, P.A. Certified Public Accountants and in charge of the firm's tax practice. A tax professional with over 30 years of experience in the areas of federal, state and local tax compliance, tax audit representation, business advisory and consulting for both domestic and international clients, and high net worth individuals.

About the U.S. Tax System

- Internal Revenue Service (IRS) - the arm of the U.S. Treasury that enforces federal tax law
- States and Local tax authorities – separate reporting and compliance rules

About the U.S. Tax System

- Self-assessed tax system
- Progressive tax
- Cash method is used by individuals for reporting income and deductions
- Individuals report on a calendar year basis
- Social Security Number or Taxpayer Identification Number

About the U.S. Tax System

U.S. Tax Person - Individuals

- Citizen - A person born or naturalized in the U.S.
- Alien - Someone who is not a citizen of the U.S.
 - Resident alien
 - Nonresident alien

Classification of U.S. Tax Person

Alien – Resident or Nonresident

- Resident Alien if:
 - A Green Card holder - Permanent resident
 - 183 days Substantial Presence test
 - Married to U.S. Citizen or resident and elects to be treated as a resident alien
 - Transition year election

Classification of U.S. Tax Person

Substantial Presence Test

- 183 day test
 - All days in current calendar year,
 - 1/3 of the days in the first preceding year,
and
 - 1/6 of the days you were present in the
second preceding year

Classification of U.S. Tax Person

Elections to be Treated as Resident Alien

- 1) **First Year Choice** – treated as resident for part of the tax year immediately preceding the tax year the individual satisfies the substantial presences test.
- 2) **Joint Return Election** – nonresident alien married to a U.S. citizen or resident alien can elect to be treated as a U.S. resident for the entire taxable year.

Classification of U.S. Tax Person

Elections to be Treated as Resident Alien

3) **Joint Return Election** - nonresident alien married to a U.S. citizen or resident alien, and becomes a U.S. resident by end of the tax year, can elect to be treated as a U.S. resident for the entire taxable year.

4) Combination of First Year and Joint Return election.

Classification of U.S. Tax Person

Resident Alien – Transition Year

- Dual-Status Aliens - May apply in first year and last year of residency living in the U.S.
 - non-resident for part of the year and resident for the remainder of the year, or
 - resident for part of the year and non-resident for the remainder of the year

Classification of U.S. Tax Person

Nonresident Alien

- Not a U.S. Citizen or a U.S. Resident Alien
- Student – F, J, M or Q visa
- Teacher or trainee – J or Q visa
- Foreign Government related individuals under A or G visa
- Closer connection to a foreign country

Classification of U.S. Tax Person

Nonresident Alien

- U.S. Tax Treaty
 - Treaty trumps tax law
 - Tie-breaker rules for permanent residents
 - To qualify must be subject to tax in both countries (Article 4)

Taxation of U.S. Citizens and Residents

Taxation of U.S. Citizens and Residents

- Taxed on worldwide income, even if residing outside the U.S.
- Adjustments to income and tax credits
- Foreign Earned income exclusion
- State and local income tax return
- Returns are signed under penalties of perjury
- **Foreign Information reporting requirements**

Filing Responsibilities

Federal Tax Filing

- Form 1040 - U.S. Individual Income Tax Return (Federal – IRS)
- Due date - April 15th of the following year
- Extended due date - October 15th – to file, not pay tax, request for extension filed by April 15th

Filing Responsibilities

State and Local Income Tax Filing

- Where an individual has his or her permanent legal residence, and
- Where income is earned
- Rules vary from state to state – very complicated

Filing Responsibilities

State and Local Income Tax Filing

- April 15th of the following year - generally
- Extended due date and procedure varies from state to state – must be requested and filed by original due date
- Extension to file, not to pay tax

Taxation of U.S. Citizens and Residents

Reports and pays tax worldwide income from sources such as:

- Salaries
- Benefits in kind
- Stock options
- Pension
- Capital gains
- Investment income
- Directors' fee
- Self-employment

Taxation of U.S. Citizens and Residents

Adjustments to income and credits

- Adjustments to income:
 - Losses from trade or business
 - Loss from sale or exchange of property
 - Qualify Business Income Deduction
 - Retirement plan contributions
 - Self-employed health insurance

Taxation of U.S. Citizens and Residents

Adjustments to income and credits

- Adjustments to Income:
 - Self-employment tax
 - Student loan interest

Taxation of U.S. Citizens and Residents

Deductions - Standard or Itemized

- Standard Deduction:

 - \$12,000 - Single or Married Filing Separate

 - \$24,000 - Married Filing Jointly

 - \$18,000 - Head of Household

 - \$ 1,300 - Additional deduction 65 and over

Taxation of U.S. Citizens and Residents

Deductions - Standard or Itemized

- Itemized deductions (Schedule A):
 - Mortgage Interest
 - State and local income taxes
 - State and local property taxes
 - Charitable contributions
 - Casualty losses

Taxation of U.S. Citizens and Residents

Credits (Schedule 3 and 5)

- Dependent child tax credit
- Other dependent tax credit
- Foreign tax credit
- Education credit
- Retirement credit

Taxation of U.S. Citizens and Residents

Foreign Earned Income and Housing Exclusion

2018

- Up to \$103,900 – maximum earned income exclusion
- Up to \$31,170 – maximum foreign housing expense (30% of Foreign Earned Income)

Taxation of U.S. Citizens and Residents

Foreign Information Reporting

Form FinCEN 114

Report of Foreign Bank and Financial Accounts

- Foreign Bank and Financial accounts
- Financial interest in or signature authority
- Aggregate value exceeds \$10,000
- At any time during the calendar year
- Form FinCEN 114 -

Form FinCEN 114

Report of Foreign Bank and Financial Accounts

- Electronically Filed via the Financial Crimes Enforcement Network – BSA E-Filing System
- April 15th of the following year
- Extended due date - October 15th – request must be filed by April 15th

Form FinCEN 114

Report of Foreign Bank and Financial Accounts

- 5 year recordkeeping requirement of accounts required to be reported on the FBAR, or
- Copy of filed FBAR

Form FinCEN 114

Report of Foreign Bank and Financial Accounts

Foreign Bank Accounts

- Checking
- Savings
- Time Deposits

Form FinCEN 114

Report of Foreign Bank and Financial Accounts

Financial Accounts

- Brokerage accounts - with a bank or broker dealer
- Life insurance with cash value
- Annuity account

Form FinCEN 114

Report of Foreign Bank and Financial Accounts

- Mutual fund available to the general public
- Financial account of a foreign entity owned more than 50%, of voting power, assets, or equity value, by a U.S. person

Form FinCEN 114

Report of Foreign Bank and Financial Accounts

Civil and Criminal Penalties

- Non-Willful Violation

Civil penalty - Up to \$12,459 for negligent violation

Criminal penalty – none

Form FinCEN 114

Report of Foreign Bank and Financial Accounts

- **Willful – Failure to file or retain records of account**

Civil penalty – Up to the greater of \$124,588, or 50 percent of the amount in the account at the time of violation, **and**

Criminal penalty – Up to \$250,000 or 5 years or both

Form FinCEN 114

Report of Foreign Bank and Financial Accounts

- **Willful – Failure to file or retain records of account while violating certain other laws**

Civil penalty – Up to the greater of \$100,000, or 50 percent of the amount in the account at the time of violation, **and**

Criminal penalty – Up to \$500,000 or 10 years or both

Form FinCEN 114

Report of Foreign Bank and Financial Accounts

- **Knowingly and Willfully Filing False FBAR**

Civil penalty – Up to the greater of \$100,000, or 50 percent of the amount in the account at the time of violation, **and**

Criminal penalty – \$10,000 or 5 years or both

Form 8938

Statement of Specific Foreign Financial Assets

Report financial accounts held at foreign financial institutions:

- Savings, checking and time deposit accounts
- Brokerage accounts held with a bank or broker dealer

Form 8938

Statement of Specific Foreign Financial Assets

Direct and indirect investments in non-financial institution issued by non-U.S. person

- Stock or securities issued by a foreign corporation
- Note, bond or debenture issued by a foreign person

Form 8938

Statement of Specific Foreign Financial Assets

- A partnership interest in a foreign partnership
- Interest in a foreign retirement plan or deferred compensation plan
- Interest in a foreign estate
- Interest in a foreign-issued insurance or annuity with a cash-surrender value

Form 8938

Statement of Specific Foreign Financial Assets

Reporting Threshold - living in U.S.

- Last day of tax year - Aggregate Fair Market Value exceeds \$50,000, or
- More than \$75,000 at anytime during the tax year (married filing a jointly, residing in U.S. thresholds are \$100,000 and \$150,000)

Form 8938

Statement of Specific Foreign Financial Assets

Reporting Threshold - living outside U.S.

- Last day of tax year - Aggregate Fair Market Value exceeds \$200,000, or
- More than \$300,000 at anytime during the tax year (married filing a jointly, residing in U.S. thresholds are \$400,000 and \$600,000)

Form 8938

Statement of Specific Foreign Financial Assets

- Filed with Form 1040
- Form 8938 and FinCEN 114 Information reporting may be duplicated

Form 8938

Statement of Specific Foreign Financial Assets

Penalty

- \$10,000 for failure to disclose or timely file a complete Form 8938

Form 8621

Information Return by Shareholder of Passive Foreign Investment Company or Qualified Electing Fund (PFIC)

What is it:

- A foreign corporation - If during the tax year:
 - 75% of its gross income is passive, or
 - 50% or more of its average assets are assets that produce passive income

Form 8621

PFIC Examples

- Foreign Mutual Funds
- Interest in foreign corporation that has passive investment. Ex. rents, interest, dividends,

Form 8621

PFIC

Taxation

- Excess Distribution Regime
- Qualified Electing Regime
- Market to Market Regime

Form 8621

PFIC

Excess Distribution Regime (default)

- Gain and excess distributions realized on sale of PFIC shares are allocated to their entire holding period,
- Interest is charged on taxes deemed owed allocated to tax years prior to tax year in which excess distribution was received

Form 8621

PFIC

Qualified-Electing-Fund Regime (must elect)

- Annually includes in gross income a pro-rate share of the PFIC income,
- Previously taxed are treated a return of capital

Form 8621

PFIC

Market to Market Regime (must elect)

- Excess of FMV at end of tax year over its adjusted basis is included in income, or
- a loss where excess of adjusted basis over FMV exceeds amount include in previous year's income

Form 8621

PFIC

- Attached to Form 1040
- Separate Form 8621 must be attached for each PFIC
- Form 8938 and FinCEN 114 reporting depends on the fund and how it is owned

Form 5471

Information Return of U.S. Person With Respect to Certain Foreign Corporations

- Provides information about U.S. persons interest in a foreign corporation, and
- Foreign corporations' income and activities
- A separate form is required for each applicable foreign corporation

Form 5471

Information Return of U.S. Person With Respect to Certain Foreign Corporations

- 5 Different Categories of Filers
- Filed with Form 1040

Form 5471

Information Return of U.S. Person With Respect to Certain Foreign Corporations

- \$10,000 penalty, per for 5471, for late filing, or incomplete and inaccurate
- Penalty also applies for failure to maintain records as required by IRS

Form 926

Transfer of Property to Foreign Corporation

- Report transfers certain transfers of tangible and intangible property to a foreign corporation
- Filed with Form 1040

Form 926

Transfer of Property to Foreign Corporation

- 10% penalty of the fair market value of the property at the time of transfer or exchange,
- not to exceed \$100,000, unless failure was due to intentional disregard

Form 8865

Information Return of U.S. Persons With Respect To Certain Foreign Partnerships

- Every controlling 50% partner of a foreign partnership, and
- Every U.S. person that holds, at any point during a foreign partnership's tax year, a 10% or greater interest in a the partnership while the partnership was controlled by U.S. persons holding at least 10% interests

Form 8865

Information Return of U.S. Persons With Respect To Certain Foreign Partnerships

- report outbound transfers to a foreign partnership
- File with form 1040
- Variety of penalties with a minimum of \$10,000

Form 3520

Annual Return to Report Transactions With Foreign Trust and Receipts of Certain Foreign Gifts

- Transactions with foreign trusts,
- Large gifts or bequests from foreign persons of more than \$100,000, or
- More than \$16,076 from foreign corporation or partnerships

Form 3520

Annual Return to Report Transactions With Foreign Trust and Receipts of Certain Foreign Gifts

- Form 3520 must be filed for each foreign trust, and
- Independently filed by the due date of the individual tax return or U.S. estate tax return

Form 3520

Annual Return to Report Transactions With Foreign Trust and Receipts of Certain Foreign Gifts

Penalty

- Minimum \$10,000, or
- percentage of the gross value of any property transferred to a foreign trust for failure by a U.S. transferor to report the creation of or transfer to a foreign trust

Form 3520A

Annual Information Return of Foreign Trust With a U.S. Owner

- Information return of a foreign trust with at least one U.S. owner,
- information about the foreign trust, its U.S. beneficiaries, and any U.S. person who is treated as an owner

Form 3520A

Annual Information Return of Foreign Trust With a U.S. Owner

- Must file, and furnish annual statements to its U.S. owners and U.S. beneficiaries
- Due the 15th day of the 3rd month after the end of the trust's tax year
- Independently filed

Form 3520A

Annual Information Return of Foreign Trust With a U.S. Owner

Penalty

- Minimum \$10,000, or
- Percentage of the gross value of the portion of the trust's assets treated as owned by the U.S. person at the close of that tax year,

Taxation of U.S. Citizens and Residents

Foreign Information Reporting

- 1040-C – U.S. Departing Alien Income Tax Return
- 8854 – Initial and Annual Expatriate Statement (Exit Tax)
- 8858 – Information Return of U.S. Persons With Respect to Foreign Disregarded Entities

Taxation of Nonresident Alien

Nonresident Aliens

Taxation of Nonresident Alien

Nonresident Alien

- Not a Citizen or resident Alien of the U.S.
- Present in the U.S. under temporary U.S. Visa
 - Permitted to work
 - Exempt individuals

Taxation of Nonresident Alien

Nonresident Alien

- Exempt Individuals
 - exempt for purposed of days counted in meeting the substantial presence test
 - Does not mean that all income is exempt from U.S., state and local income tax

Filing Responsibilities

Federal Tax Filing

- Form 1040NR - U.S. Nonresident Income Tax Return
- Due date

Employees, self-employed persons, or with a place of business in U.S.

Due date - April 15th of the following year

Filing Responsibilities

Federal Tax Filing

Not an employee, or self-employed persons,
or do not have a place of business in U.S.

Due date - June 15th of the following year

Filing Responsibilities

Federal Tax Filing

- Extended due date - October 15th, or 6 months after original due date
- Extension to file, not pay tax
- Must pay tax by April 15th, or original due date of return

Filing Responsibilities

State and Local Income Tax Filing

- Where an individual has his or her permanent legal residence, and
- Where income is earned
- Rules vary from state to state – very complicated

Filing Responsibilities

State and Local Income Tax Filing

- April 15th of the following year - generally
- Extended due date and procedure varies from state to state – must be requested and filed by original due date
- Extension to file, not to pay tax

Taxation of Nonresident Alien

Income subject to tax

- Fixed or determinable, annual or periodical gains, profits, or income (FDAP)
 - Dividends
 - Interest
 - Alimony
 - Royalties
 - Rents
 - Pensions
 - Compensation for personal services

Taxation of Nonresident Alien

Income subject to tax

- Taxed on U.S. source gross income
 - Effectively Connected Income (ECI) connect to U.S. trade or business
 - Personal Services performed in the U.S. is considered Effectively Connected Income

Taxation of Nonresident Alien

Income subject to tax

- FDAP Income is tax at a 30% rate (or lower treaty),
- Applies gross FDAP income or gains from U.S. sources, only if they are not effectively connected with your U.S. trade or business
- No deductions against FDAP income.

Taxation of Nonresident Alien

Income subject to tax

- Certain kind of FDAP income are treated as Effectively Connected Income by:
- IRS Code requirement that the income be treated as ECI,
- IRS allows for elections treat as ECI,
- If the investment income passes, either the asset used test, or business activity test

Taxation of Nonresident Alien

Income subject to tax

- Nonresident aliens employed by a foreign person
 - Wages paid by a foreign person to a nonresident alien with respect to services performed in the United States are effectively connected with the conduct of a trade or business in the United States.

Taxation of Nonresident Alien

Income subject to tax

- These wages are subject to the U.S. graduated tax rates and federal income tax withholding and reporting by the foreign employer.
- Treaty exceptions

Taxation of Nonresident Alien

Income subject to tax

- Totalization Agreements
 - Purpose of avoiding double taxation of income with respect to social security taxes.

Taxation of Nonresident Alien

Income subject to tax

- Totalization Agreements
 - Secure a Certificate of Coverage from the social security agency of his home country and present such Certificate of Coverage to his employer in the U.S.

Taxation of Nonresident Alien

Income subject to tax

Self-Employment Tax

- On the self-employment income of any U.S. citizen or resident alien who has such self-employment income

Taxation of Nonresident Alien

Income subject to tax

- Nonresident aliens are not subject to self-employment tax
- Once a nonresident alien individual becomes a U.S. resident alien under the residency rules of the IRC

Form 8843

Statement for Exempt Individuals and Individuals With a Medical Condition

- File for yourself and any dependent family members in the U.S. claiming to exclude days presence in the U.S. for purpose of substantial presence test or unable to leave the country because of a medical condition

Form 8843

Statement for Exempt Individuals and Individuals With a Medical Condition

- Filed with Form 1040NR
- Filed independently if the individual did not have any income
- May not exclude days present in the U.S. and may be treated resident under the substantial presence test for late filed or failure to file

Form 8840

Closer Connection Exception Statement for Aliens

Alien who meets the substantial presence test can be treated as an NRA if the individual is present in the U.S.

- Less than 183 days during the tax year
- Establish that you had a tax home in a foreign country during the tax year; and

Form 8840

Closer Connection Exception Statement for Aliens

- Closer connection during the tax year to one foreign country, in which the individual has a tax home, other than to the U.S.
- Exception: Individual has a closer connection to two (but not more than two) foreign countries

Form 8840

Closer Connection Exception Statement for Aliens

- File Form 8840 with Form 1040NR
- File independently when Form 1040NR not required to file
- Not be eligible to claim the closer connection exception and may be treated as a U.S. resident if late file or not filed

Form 8833

Treaty Based Return Position Disclosure

- File Form 8833 with Form 1040NR
- File independently if individual does not have to file Form 1040NR
- If you are required to report the treaty benefits but do not, you are subject to a penalty of \$1,000 for each failure.

Form 8833

Treaty Based Return Position Disclosure

Some typical treaty benefits available:

- Personal Services
- Teachers, Professors, and Researchers
- Employees of Foreign Government
- Students, Apprentices, and Trainees
- Capital Gains

Form 5472

Information Return of a 25% Foreign Owned U.S. Corporation

- Form 5472 – Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business (New filing requirements for Foreign Owned U.S. Disregarded Entities)

Form 5472

Information Return of a 25% Foreign Owned U.S. Corporation

- Must file a pro-forma Form 1120
- Attach a completed Form 5472 with all required disclosures
- Must be paper file

Form 5472

Information Return of a 25% Foreign Owned U.S. Corporation

- \$25,000 penalty for each Form 5472 that is filed late or not include the complete and accurate information
- Penalty also applies for failure to maintain records as required by IRS

Taxation of Nonresident Alien

Tax treaties between the U.S. and other countries can operate to:

- Reduce (or even eliminate) the rate of U.S. tax on certain types of U.S. income;
- Override various statutory source of income rules;
- Exempt certain types of income or activities from taxation;

Taxation of Nonresident Alien

Tax treaties between the U.S. and other countries can operate to:

- Eliminate double taxation
- Provide certainty to taxpayers where overlapping tax jurisdictions may cause confusion
- Provide clear rules for which taxing authority has the authority to tax income that has some connection to both countries that have negotiated the income tax treaty

Sailing or Departure Permits

U.S. Departing Alien Income Tax Return

- Must obtain Sailing or Departure permits
- Must file Form 1040-C or Form 2063
- Report income received or expected to be received for the entire tax year, and
- Pay the expected tax liability on that income they are required to do so.

Sailing or Departure Permits

U.S. Departing Alien Income Tax Return

- Form 1040-C – U.S. Departing Alien Income Tax Return
 - Must be filed before an alien leaves the United States or any of its possessions.
 - You must file a final tax return

Sailing or Departure Permits

U.S. Departing Alien Income Tax Return

- Form 2063 – U.S. Departing Alien Income Tax Statement and Annual Certificate of Compliance
 - If you have filed all U.S. income tax returns you were required to file,
 - You paid any tax due, and either

Taxation of Nonresident Alien

Taxation of U.S. Source Income

- Foreign Investment in Real Property Tax Act – (FIRPTA)

Real Estate ownership

- First Year election -Treat property as effectively connected with U.S. trade or business.

Taxation of Nonresident Alien

Taxation of U.S. Source Income

- Withholding on rental income
 - 30% or lower treaty rate if no election is made in the first year
- Withholding at time of sale
 - Sale of real estate - Gain is taxable
 - 10% or 15% withholding depending on net selling price, or

Taxation of Nonresident Alien

Taxation of U.S. Source Income

- File Withholding Certificate
Form 8288-B
Form 8288

Real estate operating losses are deductible if they have been reported on prior tax returns which have been timely filed. (No deduction rule)

New Developments

International Data Exchange Services - IDES System

- A system that allows the IRS to exchange taxpayer information with foreign authorities
- Foreign Account Tax Compliance Act (FATCA) data exchange system

Passport Revocation

Revocation or Denial of Passport in Case of Certain Unpaid Taxes

- State Department to revoke or deny the passports of “long-term tax delinquents who owe more than \$51,000 in tax debts”
- \$51,000 threshold can include penalties and interest

Taxation of Nonresident Alien

- Very technical and very complicated
- Reference IRS Publication 519
- Determine your U.S. residency status
- Consult with a tax professional

THE END