

TheNational



Expert help: Vital to maximising overseas earnings

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What to know

The many parts of a US expatriate's financial world must be brought together under one qualified tax and financial adviser. So much more hinges on the proper application of the additional tax regulations associated with earning income abroad, as opposed to the needs of US-based citizens.

However, relying only on a tax professional to manage all of the moving parts fails to take into account other critical investment, pension, legal and insurance concerns. Pulling all these parts together in a do-it-yourself fashion can lead to many costly mistakes, while working with an experienced financial advocate can help you properly implement the many advantages of living and working overseas.

Taxes

It is important to understand that US expats are always taxed on world-wide income.

However, those of us who are not residing in the US may be entitled to certain tax advantages. These advantages fall into three general categories: foreign-earned income exclusion; foreign housing exclusion/deduction; and credits for foreign income taxes paid.

Foreign Earned Income Exclusion

Most US expats qualify for the foreign earned income exclusion by meeting the "physical presence" test. You are eligible for the foreign earned income exclusion if you are physically present in a foreign country (or countries) for at least 330 full days during a period of 12 consecutive months.

Exclusion is not automatic, and you must file a US income tax return (IRS form 2555) in order to receive it. This exclusion can be used by employees and the self-employed as long as they meet the criteria. The IRS report for 2006 shows that approximately 50 per cent of all foreign-earned income fell into this category.

Foreign Housing Exclusion / Deduction

The foreign housing deduction criteria apply only to the self-employed. For the purposes of this article, we are focused on the foreign housing exclusion provided to employees. Your housing exclusion is the total of your housing expenses for the year, less the base housing amount. The calculation of your base housing amount is dependent upon your foreign earned income exclusion. The limit is generally 30 per cent of the maximum earned income exclusion; however, the limit will vary depending upon the location of your foreign tax home.

To maximize your foreign housing exclusion, you need to make sure that your foreign earned income exclusion is correctly calculated.

Foreign income tax credit

Credits for foreign income taxes paid are claimed using IRS form 1116. The amount you can claim is the amount of legal and actual tax liability you pay during the year.

The mistake most often made here is that many foreign fees and excise taxes are not considered foreign income taxes by the IRS and therefore do not qualify for credits. See IRS Publication 54 for further details.

These kinds of computations are beyond the working knowledge of most tax professionals based in the US. As you settle in to your overseas assignment, make sure you work with a professional knowledgeable in expatriate taxation rules and regulations.

Pension

While being a US expatriate may give you certain income tax advantages, there is no exclusion for US Social Security taxes. This is the famous mistake made by the US Treasury secretary, Timothy Geithner. In a nutshell, Mr Geithner earned consulting income

from the World Bank, and while he reported the income and took the foreign income exclusion, he neglected to pay the Social Security taxes on this earned income. An error like this is completely avoidable when working with a qualified tax professional.

In addition to Social Security, US expats are eligible for the same employer pension programmes and retirement options that they would have if working back home. While these options might be available, they might not have the same tax impact because of the foreign income tax exclusion. It is important to have a clear understanding of your tax position before making employee contributions while living abroad.

Beginning next year, contributions to a "Roth IRA", the individual retirement accounts named after William Roth, the late senator, who helped introduce them, will be allowed for all US taxpayers with earned income. In the past, most US expats have been excluded from this opportunity because their income levels are above the programme's limits. This is a one-year only opportunity to contribute to a Roth IRA. Everyone should be discussing with their financial adviser the best way to participate in this opportunity next year.

Offshore Finances

It is perfectly appropriate for US expats to open up bank accounts overseas. Many may wish to hold US dollars in these types of accounts, as well as foreign currencies.

Two important considerations need to be made when opening bank accounts overseas: all earnings from these accounts are reportable and taxable on your US income tax return, and a separate filing to the US Treasury must be made by June 30 of each year. (Treasury Form TD.90-22.1)

Investments

Since there is no tax advantage to earning interest and dividends overseas, most American expats keep the bulk of their investments in the US. It is not unusual, however, for expats to own rental property or have other business interests abroad.

While this is a very complex topic, generally, rents from property operations and earnings from foreign businesses with no operational ties to the US can defer taxes on profits until the money is brought back into the US. This issue is currently under scrutiny by the Obama administration, with the expectation that significant revisions will be made to the rules.

Protection

Most expat employees have life and health insurance through their employers. If you are self-employed, or a contract employee who does not have these benefits, then you will want to make sure you have proper life, health and disability coverage before you leave the US.

The most critical of the three is, of course, health insurance coverage. I strongly recommend buying an international health insurance policy that allows you the option of using local (foreign) hospitals or returning to the US for treatment.

Some policies will also cover your return flight home. The cost of these policies can be very reasonable, and sometimes substantially less than maintaining health coverage at home.

The amount of coverage needed for life and disability policies varies substantially from family to family. I recommend a thorough review of your unique situation with a qualified financial adviser who can calculate the best coverage for your family.

Estate Planning

One of the things that has been abundantly clear to me is that American expatriates should have a living trust in place to manage their estate issues. Such a trust assists in managing monetary issues as well as custodianships for minor children and any other issues and assets that need to be administrated.

It is customary for individual wills and medical powers of attorney to be executed when a living trust is established.

Returning Home

There is nothing special that expats need to do when returning home except to make sure that they have spent at least 330 days of the past consecutive 12 months overseas. Spending time abroad usually requires significant financial organisation while you are away, so when you return home make sure to continue to work with a qualified professional you can trust to handle your tax and financial issues over a lifetime, no matter where you are living and working. Remember, it is your money, and you'll need it for the rest of your life.

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