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# Solving The Expatriate/Inpatriate Tax Puzzle

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by Nauman Mian

U.S. taxpayers living in a foreign country, as well as foreign nationals working in the United States, face many puzzling tax issues. In these situations, it's often difficult to understand your international tax liability. Certified public accountant Nauman Mian, expatriate tax services practice leader at Brown Smith Wallace, a St. Louis-based full service accounting firm, points out some key tax aspects to consider for an expatriate or inpatriate assignment. Determining the right answers can help you develop the solution that puts all the pieces together on your assignment.

## **Expatriate tax considerations**

U.S. citizens and aliens considered U.S. residents must file a U.S. income tax return while residing in foreign countries. That's true even when a taxpayer's foreign exclusions or deductions equal or exceed gross income and when credits, such as the foreign tax credit, eliminate U.S. tax liability.

If you have a tax home outside the United States, note that certain exclusions are applicable for qualifying U.S. taxpayers. Taxpayers can reduce their taxable income if they qualify for the foreign earned income exclusion and the housing cost exclusion. These exclusions are available only if a taxpayer maintains a foreign tax home and meets either the bona fide residence test or physical presence requirements.

How do you treat foreign taxes? If you are a U.S. citizen or resident alien, you may either deduct foreign income taxes in arriving at a taxable income or claim them as a credit

against U.S. income taxes. You cannot deduct, or take as a credit, social security taxes paid to a foreign country that has a "totalization agreement" with the United States. In fact, foreign income taxes are disallowed as credits to the extent that those taxes relate to earned income excluded under the special foreign exclusions.

When do you have to file? Tax returns for individuals are due on April 15 after the close of the calendar year. If you are a U.S. citizen or resident and your tax home and abode are outside the United States on the regular due date, however, you have an automatic extension of two months. The extension does not relieve you from paying any interest due on the unpaid portion of your ultimate tax liability. The tax liability is still due on April 15, and interest is calculated from that date until payment is received by the Internal Revenue Service.

## **Inpatriate tax considerations**

If you are a foreign national, you may be subject to one of two drastically different systems of taxation by the United States, depending on whether you are classified as a resident or a nonresident alien of the United States. Residency status is critical, but you should understand that residency status for tax purposes is different from residency status for immigration purposes. Under certain circumstances, a person may be a nonimmigrant for immigration purposes yet be considered a U.S. resident for tax purposes.

Are there advantages based on residency status? As a rule, if you are classified as a nonresident foreign national, you may have

distinct tax advantages. In individual cases, however, the advantages of resident or nonresident status may vary from year to year. That's why, if you are a foreign national in the United States, it's important to annually review the options available to minimize your tax liability in the United States as well as in your home country.

Do all types of income get taxed the same? If you are a nonresident alien, you will be taxed normally only on income derived from U.S. sources. You will be taxed at graduated rates if you have income that is considered "effectively connected" with a U.S. trade or business, such as salary and other forms of compensation. If you have U.S. investment income, it will generally be taxed at a flat rate, although certain types of investment income may be exempt from U.S. tax.

The good news for many nonresident aliens is that the burden of U.S. tax is reduced by tax treaties between the United States and their home countries. These treaties may further modify your U.S. income tax obligation, so you should review them in every tax-planning situation. As a foreign national, you may also be subject to Social Security and estate, gift and state taxes in addition to federal income tax. The timing of income recognition and the length of your assignment can significantly affect your U.S. tax liability.

Whether you are an expatriate or inpatriate, solving the international assignment tax puzzle can free up your time for your important responsibilities and for other fun and games.