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An Eye for Moving Abroad? Bye-Bye USA, Hello Tax Complications!

By Virginia La Torre Jeker

It has certainly been a year to remember. So many changes have been wrought as a result of Covid-19, one of the biggest being remote working. As a direct result of the pandemic we see people are moving or considering moving. Some are moving back home to mom and dad, many are moving from high-tax states like New York, to low- or no-tax states like sunny Florida.

Have internet? A trusty laptop? Maybe you can work from anywhere! Why not look at a location with lower taxes, a nicer quality of life, better weather, and where you can gain a wider perspective?

Those looking at a residency change are not limiting their options to the various states. Indeed, more adventurous souls are looking at a move overseas. Some will move to a country where their current employer has an office. Others will rely on telecommunication technology to earn their living and some will live as so-called "digital nomads," working remotely from foreign lands—be it from a rented apartment abroad, coffee shops, shared work spaces, or airport lounges. The trend is indeed gaining momentum. The United Arab Emirates just announced its new visa program encouraging remote working professionals to reside there.

U.S. Tax Follows You . . .

Any international move comes with an entire smorgasbord of interesting U.S. tax issues. I invite you to enter my world, a world in which I have been feasting for decades on an extremely broad array of fascinating and nuanced tax matters affecting the American who has left the homeland. I'm a member of the New York Bar and have specialized in U.S. international tax issues since leaving the U.S. in 1986: 15 years in Hong Kong, 20 years in Dubai. Let's dive into some of the tax issues that come with a move overseas.

Remember, U.S. tax follows you wherever you go. Don't leave home without understanding it. Here's the good, the bad and the ugly.

Foreign Earned Income & Housing—A Special Break

As a U.S. person, even if you live abroad, you are taxed on your worldwide income. You must still file U.S. tax returns, even if you pay foreign taxes. A foreign tax credit may help offset the U.S. tax owed.

You may qualify to exclude a certain amount of earnings paid for your services. For 2021 this "foreign earned income exclusion" (FEIE) amount is $108,700. In addition, you can exclude (or deduct, if self-employed) certain foreign housing amounts. Collectively, let's call these, "exclusion benefits." They can significantly reduce your tax bite, but if you don't file a return, you may lose them entirely. Let's look at the basic requirements.

First, you must have a "tax home" in a foreign country. You cannot have a "tax home" in a foreign country, however, if you have an "abode" within the U.S. For the U.S. person who simply wants to dip his toes in foreign waters and maintain his U.S. base, the "abode" concept may trip up his tax plan!

'Tax Home,' 'Abode,' and Qualification Tests

The "tax home" is generally your main place of business or employment, regardless of where you maintain your family home. Lacking a regular or main place of business because of the nature of your work, your tax home may be the place where you regularly live. If you do not have either a regular or main place of business or a place where you regularly live, you are an "itinerant.'' Your tax home is wherever you work. The typical ''digital nomad'' would be an ''itinerant.''

''Abode'' means your home, residence, or domicile and depends on where you maintain economic, family, and personal ties. ''Home is where the heart is,'' might be a good way to understand this tax concept. If you keep too many strong ties in the U.S., you risk having an ''abode'' there and will not be considered to have your ''tax home'' in a foreign country, thus precluding the exclusion benefits.

Second, you must meet either the bona fide foreign resident (BFR) or physical presence test (PPT). The BFR test is based on facts and circumstances and requires that you be a bona fide resident of a foreign country for an uninterrupted period, which includes a full calendar year. Your actions and affiliations must demonstrate that you have in effect settled in the foreign country.

Often it is not possible in the first year to meet the BFR criteria, because you have not lived in the foreign country for the full calendar year. You can apply for an extension of time to file until you have met the time requirement, or try to satisfy the PPT. PPT requires that you be physically present in a foreign country or countries for 330 days in any 12 consecutive months. The 330 days do not have to be consecutive, but they must be whole days present in a foreign country. There are many nuanced rules and record-keeping is obviously critical.

Self-Employment

Many Americans moving overseas will be ''self-employed,'' but this does not preclude claiming the exclusion benefits. It often comes as a rude awakening, however, that the FEIE amount will not reduce self-employment income. While regular income tax will be reduced, the permissible exclusion for income earned abroad will not reduce self-employment tax.

Don't Forget Estimated Taxes

Americans stateside are familiar with employers withholding taxes from salary. If you work overseas for a non-U.S. employer, no withholding of U.S. tax is undertaken. Likewise if you are self-employed, no withholding tax is drawn. In these cases, make sure to timely pay the correct amount of estimated tax.

Don't Overlook Tax Information Filings

Tax information reporting can multiply exponentially when living overseas, especially if you create a foreign entity to run your business. While there are numerous information reporting forms, it does not mean you will owe tax. Failure to file, however, can result in harsh penalties. Examples that trigger special information reporting include ownership in a non-U.S. entity (foreign corporation, partnership, fund etc.); receiving gifts or inheritances from foreigners; running a business in a country named on the U.S. Treasury Department boycott list (e.g., Lebanon, Kuwait); having foreign bank or financial accounts (including mere signature authority); and participating in a foreign pension or deferred compensation plan.

Last But Not Least

You may be presented with unique investment opportunities while abroad. Don't be confused by the sales pitches of expat investment advisors who are often not familiar with U.S. tax laws. Look out for foreign mutual funds, ETFs, life policies, portfolio bonds, and similar fund arrangements. Don't let the label fool you, as all of these investments usually mean exposure to the so-called PFIC tax regime which can eat up your investment. Get professional tax advice before you buy in.

State taxes should not be forgotten. In these times of Covid, states will not easily let taxpayers off the ''resident'' hook. If you are working overseas for an indefinite time and may not return to the state, look into terminating your state residency. This is generally signified by filing a ''part-year'' state tax return the year you move. A tax advisor familiar with the laws of the particular state should definitely be consulted.

Above All. . . . Remember

For most who take on the challenge, including myself, moving to a foreign country is one of the most rewarding—and intimidating—of experiences. Stepping out of your bubble means a move into unfamiliar territory. You will be confronted with new ideas, and novel ways of thinking, all of which will push you to grow. While the tax issues cannot be forgotten, don't let them scare you off a life-changing experience. A good tax advisor can take away your worries.

This column doesn't necessarily reflect the opinion of The Bureau of National Affairs Inc. or its owners.

Author Information

With over 35 years of U.S. tax and international experience, Virginia has been a member of the NYS Bar since 1984. Virginia has been practicing U.S. tax overseas since 1986; after spending 15 years in Hong Kong, she has been in Dubai since 2001. She provides expert insight into the latest changes in American tax laws and outlines the U.S. tax obligations of American expats and foreign persons with U.S. connections.