

Tax Considerations When Living or Working in Israel or Abroad

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Part I – Before Moving Abroad

Foreign Accounts, FBARs, and Tax Reporting

- ▶ Schedule B, Part III (“did you have a financial interest in or signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in a foreign country?”).
- ▶ FBAR Requirement - \$10k or more in foreign accounts (in aggregate across all such accounts) at any time during the calendar year.
- ▶ Form 8938 (living in U.S.)
 - Single/MFS Filers – More than \$50k in foreign accounts, as of December 31, or \$75k at any point during the year.
 - Joint Filers – More than \$100k in foreign accounts, as of December 31, or \$150k at any point during the year.
- ▶ Form 8938 (living outside U.S.)
 - Single/MFS Filers – More than \$200k in foreign accounts, as of December 31, or \$300k at any point during the year.
 - Joint Filers – More than \$400k in foreign accounts, as of December 31, or \$600k at any point during the year.

	Form 8938, Statement of Specified Foreign Financial Assets	FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR)
Financial (deposit and custodial) accounts held at foreign financial institutions	Yes	Yes
Financial account held at a foreign branch of a U.S. financial institution	No	Yes
Financial account held at a U.S. branch of a foreign financial institution	No	No
Foreign financial account for which you have signature authority	No, unless you otherwise have an interest in the account as described above	Yes, subject to exceptions
Foreign stock or securities held in a financial account at a foreign financial institution	The account itself is subject to reporting, but the contents of the account do not have to be separately reported	The account itself is subject to reporting, but the contents of the account do not have to be separately reported
Foreign stock or securities not held in a financial account	Yes	No
Foreign partnership interests	Yes	No
Indirect interests in foreign financial assets through an entity	No	Yes, if sufficient ownership or beneficial interest (i.e., a greater than 50 percent interest) in the entity. See instructions for further detail.
Foreign mutual funds	Yes	Yes
Domestic mutual fund investing in foreign stocks and securities	No	No
Foreign accounts and foreign non-account investment assets held by foreign or domestic grantor trust for which you are the grantor	Yes, as to both foreign accounts and foreign non-account investment assets	Yes, as to foreign accounts
Foreign-issued life insurance or annuity contract with a cash-value	Yes	Yes
Foreign hedge funds and foreign private equity funds	Yes	No
Foreign real estate held directly	No	No
Foreign real estate held through a foreign entity	No, but the foreign entity itself is a specified foreign financial asset and its maximum value includes the value of the real estate	No
Foreign currency held directly	No	No
Precious Metals held directly	No	No
Personal property, held directly, such as art, antiques, jewelry, cars and other collectibles	No	No
'Social Security'- type program benefits provided by a foreign government	No	No

Other International Tax Forms

- ▶ Form 3520 – Foreign Trusts and Gifts
 - ▶ Form 5471– Foreign Corporations Acquired and Owned by U.S. Persons
 - ▶ Form 5472– Domestic Corporations Owned by Foreign Persons—25% Threshold
 - ▶ Form 8858 – Foreign Disregarded Entities
 - ▶ Form 8865 – Foreign Partnerships
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Interests in Foreign Trusts/Receipt of Foreign Gifts – Form 3520

- Must be filed by any U.S. Person who:
 - Is considered the owner of a foreign trust (under the grantor trust rules);
 - Received a distribution from a foreign trust;
 - Received a gift/bequest of over \$100,000 from a foreign individual or a foreign estate; or
 - Received a gift of over \$15,358 from a foreign corporation or partnership.
- Filed with U.S. Person's income tax return.
- Failure to File Penalty is greater of \$10,000 or 35% of the distribution or gift received or 5% of the gross value of the portion of the trust's assets deemed owned by the U.S. Person.
- Failing to report an interest in or distribution from a foreign trust will keep the SOL on the entire return open (failing to report a foreign gift does not keep the SOL open).

Interests in Certain Foreign Corporations – Form 5471

- ▶ Filed with U.S. Person's income tax return.
- ▶ Must annually include in income - pro rata share of the Corporation's "Subpart F income" and earnings invested in U.S. property to the extent of the Corporation's E&P, regardless of whether it is distributed (not entitled to Qualified Dividend Rates).
- ▶ Failure to File Penalty:
 - \$10,000 and escalates to \$50,000 at 7 months late; and
 - 10% reduction of foreign tax credits otherwise available and additional 5% reduction for each 3-month period failure to file continues.

Interests in Certain Foreign Corporations – Form 5471

- ▶ Significant changes in 2018
 - Substantially revised schedule J
 - The CFC's accumulated E&P Schedule
 - Reported in functional currency
 - Addition of Schedule P
 - Used to report previously taxed income (PTI) of the U.S. shareholder
 - Requires a separate schedule for each U.S. Shareholder

Foreign Business Income – Subpart F and GILTI

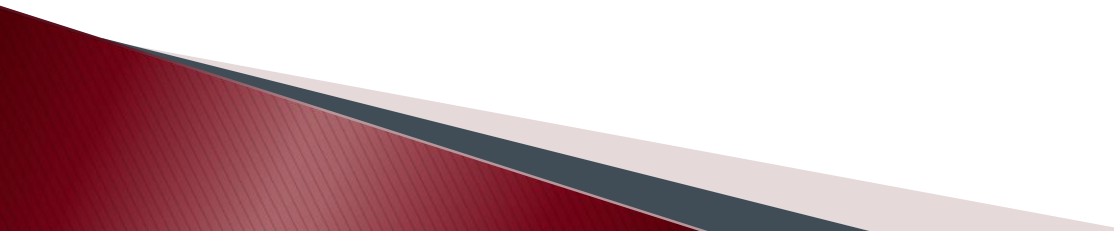
- ▶ Passive income from CFCs (controlled foreign corporations) are taxed presently in the United States, even if not distributed to U.S. persons.
 - A foreign company is considered a CFC if more than 50% of either voting power or value is owned by a U.S. person.
 - Includes foreign dividends, interest, rents, and royalties, even if such income is not actually distributed to U.S. persons.
- ▶ GILTI expands Subpart F to include even active business income earned abroad.
 - **HOWEVER:** recent regulations clarified that GILTI will not apply to certain “high-tax” income, currently identified as income taxed at 18.9% or higher.
 - Thus, as a practical matter, most active business income earned abroad will not be subject to GILTI.
 - **HOWEVER:** income that does not fall under the “high-tax” or some other exception is subject to highly complex and onerous tax and reporting obligations.

Part II – Working Abroad

Foreign Employee v. Foreign IC

- ▶ U.S. person living abroad and working as an employee has wage income reportable on Line 1.
 - Essentially no different than wage earner in U.S.
 - **Watch Out:** Foreign retirement plans could be PFICs.
 - **Watch Out:** U.S. company that has an employee in foreign country will cause nexus in that country, causing a cascade of tax and reporting requirements in the foreign jurisdiction.
- ▶ Independent contractors will generally report income on Schedule C, flow through to Line 3 of Schedule 1.
 - Must check whether country where Taxpayer works has a Totalization Treaty with the United States (treaty which governs Social Security type payments).
 - **Israel does not have a Totalization Agreement with the United States.**
 - This will almost always result in double taxation.
 - **Planning Tip:** Formation of foreign entity.

Income Apportionment

- Personal services are generally sourced to the location of where the service provider is physically located.
 - Always be on the lookout for U.S sourced income if you are traveling back and forth to the United States.
 - Generally speaking, income earned while present in the United States will not be shelterable using the Foreign Tax Credit, even if that individual is in the foreign jurisdiction most of the time.
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Retirement Plans - PFICs and Form 8621

- ▶ What is a PFIC (passive foreign investment company)?
 - At least 75% of the corporation's gross income is "passive"—that is, derived investments or other sources not related to regular business operations; OR
 - At least 50% of the company's assets are investments, which produce income in the form of earned interest, dividends, or capital gains.
- ▶ Must be on the lookout for:
 - Foreign retirement accounts;
 - Foreign index funds;
 - Certain foreign financial instruments;
 - Certain foreign bank products.
- ▶ Required to file Form 8621
 - Labor intensive
 - Requires substantial amounts of information not easily obtained/obtainable

Part III – Retiring Abroad

Retirement Income

- ▶ Social Security Payments
 - Treated differently depending on the foreign country
 - In Israel, Social Security payments are not taxed by either Israel or the United States

- ▶ Pensions/Retirement Plans/IRAs/Etc.
 - Treated differently based on the foreign jurisdiction
 - In Israel, if you make Aliyah (immigrate and become a citizen of Israel) for 10 years all foreign-sourced income is tax free
 - Afterward, fall into the Israeli tax regime (but won't be taxed in the US)

Real Property

- ▶ I.R.C. 121 personal residence exclusion available even for foreign held property.
- ▶ I.R.C. 1031 exchange cannot be used to exchange domestic property with foreign property.
- ▶ However I.R.C. 1031 can be used to exchange foreign property with other foreign property.
- ▶ **Planning Tip:** Use I.R.C. 121 to exclude U.S. personal residence gain to purchase foreign personal residence. Once in foreign jurisdiction, foreign property can be exchanged for other foreign property under 1031.

Part IV – Miscellaneous Considerations

Foreign National Spouses

- ▶ *Inter vivos* transfers to non-resident alien spouse limited to \$155,000 in 2019 (annually adjusted for inflation).
 - **Watch Out:** real estate purchases.
 - **Watch Out:** transfers into joint bank account.
- ▶ Transfers at death to non-resident alien spouses of U.S. property limited to \$60,000 (unlimited for U.S. residents).
 - **Watch Out:** U.S. real property.
 - **Watch Out:** retirement accounts established while in U.S.
 - **Planning Tip:** some countries have Estate and Gift Treaties with U.S. that can mitigate some of the harshest results.
- ▶ Non-residents can elect to be treated as a U.S. residents.
 - **Watch Out:** such election will require non-resident spouse to report on a worldwide basis.
 - **Watch Out:** FBAR, PFIC, etc. rules will also apply.

Estate and Gift Tax Considerations

- ▶ Estate tax exemption for non-resident aliens is very low, \$60,000 with respect to U.S. situs property.
- ▶ Gift Tax lifetime limitation is very low, \$60,000 with respect to US situs property.
- ▶ Watch for situations where foreign nationals own US real property directly or through a disregarded entity. Will be subject to estate/gift tax during life.
- ▶ Planning tip: Own real property through US entity that is regarded (C corporation or partnership). If gifted during life, should avoid US gift tax as not considered US situs purposes. NOTE: The situs will switch upon death and the entity interest will be subject to US estate tax.

Other Considerations

- ▶ State Tax Consequences
 - Many states do not provide foreign tax credit
 - Several states have adopted special procedures to address offshore assets
- ▶ Don't forget about the Net Investment Income Tax
 - Foreign tax credit will not offset NIIT
- ▶ Streamlined Disclosures (Domestic or Foreign)
 - OVDP (Offshore Voluntary Disclosure Program) no longer available
 - Streamlined procedures now only mechanism to correct past non-compliance
 - Six years of FBARs
 - Three years of tax returns
 - Special form
 - Accompanying narrative

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