How To Live Tax-Free Overseas

From the Editors of Live and Invest Overseas

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From The Editors at Live and Invest Overseas

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By The Editors of Live and Invest Overseas
Published by Live and Invest Overseas
Publisher: Kathleen Peddicord

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Calle Alberto Novarro, Casa # 45, El Cangrejo, Panama, Republic of Panama

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The United States of America has developed a more complicated tax-reporting, -filing, and -payment system than any other in the world, certainly when it comes to personal income taxes. The U.S. system features tax deductions, exemptions, a few loopholes still remaining, and dozens of filing forms that the poor taxpaying American may or may not be required to include with his return each year, depending on the activities he's engaged in during the 12 months prior—investment, real estate ownership, farming, self-employment...

On top of all that, the United States taxes its citizens on their worldwide income no matter where they are living. Meaning that this super-complicated, super-convoluted, and forever-changing tax-reporting and -filing system follows you no matter where in the world you wander. When a Brit or a German moves out of his home country, he doesn't have to pay taxes in that country until or unless he moves back. More important, he doesn't even have to file a tax return or any document of any kind in that country until or unless he moves back. Americans, while they do get some exclusions, credits, and deductions on their income for tax purposes, if they live outside the United States, still have to file a plethora of forms even if, after all has been reported and calculated, they don't owe any taxes.

But It's Not As Bad As You Might Think

Many Americans prepare their own tax returns when living in the United States, but the additional forms and requirements involved with a nonresident's return mean that almost every American living outside the country hires a tax accountant or tax attorney to prepare his returns for him (or her).

The truth is, though, that it isn't as complicated as it can appear, at least not in most cases. You just have to know the relevant rules and which forms to use for what purpose. If your return is straightforward, you should be able to prepare it yourself using a program like TurboTax. A simple return would be one for someone who is living and working overseas and needs to file for the Foreign Earned Income Exclusion (referred to in tax-planning circles as the FEIE or "the exclusion").

The Most Important Tool In The U.S. Expat's Tax Toolbox

If you qualify, the FEIE allows you to exclude up to US$112,000 (US$224,000 for a married couple with both spouses residing overseas) of foreign-earned income from U.S. tax.

The amount is indexed each year for inflation (U.S. government inflation… not anyone's real inflation calculation).

All U.S. citizens and residents who earn more than US$12,000 (single) or US$24,000 (married filing a joint return) in a year must file a U.S. personal income tax return no matter where you reside.

You must file, but that does not mean you must pay tax. One of the many benefits for an American living or retiring abroad is that, once you're a foreign resident, you're eligible to take advantage of the FEIE.

The exclusion applies to foreign-earned income only—that is, wages or self-employment income (independent contractor earnings, for example) you receive for services you perform while living outside the United States. Wages can come from a U.S. corporation or a foreign corporation, including an offshore corporation, and it does not matter if you are also a shareholder or owner of that foreign corporation.

Note, though, that earned income does not include interest, dividends, or other investment or passive income.

The Key Is To Qualify

Bottom line, you qualify for the exclusion in one of two ways:

1. **The 330 Day Test**. To qualify for the FEIE using the 330 Day Test, you must be in another country (just being outside the U.S. doesn't work if you're in international waters, for example) for 330 days out of any 365-day period. It does not matter if the 330 days are over two calendar years (between Nov. 1, 2021, and Oct. 31, 2022, for example), and you can avail of a special extension to file your tax return to give you time to meet this requirement.

2. **The Bona Fide Residency Test**. In this case, you achieve foreign residency by moving to another country and making it your "home." You can intend to return to the States in the future, but you must move to the foreign country for an "indefinite" or "extended" period of time that must include one full calendar year.

The 330 Day Test is fact-based, while the Residency Test hinges on your intentions and is therefore more difficult to use and to prove.

The Bona Fide Residency Test is one of the most misunderstood and misused sections of the U.S. tax code. You are a bona-fide resident of another country if you move there and make it your home. To qualify under this rule, you have to be a legal resident of another country. Sounds simple enough, but legal residency is only the start. You also have to show that you are truly a resident of the country. Proof could include owning or renting a home in the country, having a local driver's license, having kids enrolled in school there, and/or owning a car. You don't have to show all or any of these examples, but you'll need to prove somehow that you, in fact, live in the country.

An example of having legal residency and not qualifying as a Bona Fide Resident would be the Belize Qualified Retired Persons (QRP) program. Under that program, you can get legal residency in Belize. As a QRP, you are required to spend only one month per year in the country to maintain that residency status. That sounds great… until you think it through a little. Because obtaining QRP residency and continuing to live in the United States isn't going to qualify you for the U.S. tax exclusions.

The perfect example of a U.S. foreign resident is a person who moves to a foreign country, does not intend to return to the States, files and pays taxes in the new country, obtains a long-term visa that allows him to work in that country, sells his U.S. home and buys one in the foreign country, and who relocates with his family.

Of course, though, few cases are perfect.

For example, a husband might move to France to work there indefinitely, leaving his family in California. Maybe he returns to the States for 40 days per year to visit and intends to return again full time as soon as financially possible.

In this case, the American in question has a good chance of being allowed the exclusion, assuming he is physically outside the States for at least one year, but it's not guaranteed, and the determination by the IRS would depend on many facts and factors.

Note that simply being out of the States for a full calendar year does not make you a resident of a foreign country. For example, if you go to a foreign country to work on a construction job for a specified period of time, say 14 months, you ordinarily would not be regarded as a bona fide resident of that country, even though you're living and working there for one tax year or longer. The length of your stay and the nature of your job are only some of the factors taken into consideration.

Why Bother With The Residency Test?

If the residency test is so complex… you may be wondering… why should you use it? The biggest reason would be if you want to be able to spend more than 35 days a year in the United States.

Furthermore, once you qualify as a resident of a foreign country, you remain a resident of that country until you give up that residency. With the 330-day test, you must be out of the country for 330 days of each 365-day period. In other words, the determination is made year by year.

The Bona Fide Resident rule allows you more flexibility regarding your travels and allows you to spend time in the United States. Unlike the 330-day test, the bona fide resident test is tied to calendar years. This distinction becomes important for someone who is on a one-year temporary assignment from July 1 to June 30, as he won't be able to qualify under this test even if he is, in fact, a bona fide legal resident of the country, with the local driver's license, mortgage payments, and school tuitions to prove it. This poor taxpayer would have to qualify under the 330-day test.

With the residency test, you can qualify for all or only part of a year. Here is an example from the IRS website:

"You were a bona fide resident of Singapore from March 1, 2010, through Sept. 14, 2012. On September 15, 2019, you returned to the United States. Since you were a bona fide resident of a foreign country for all of 2018, you were also a bona fide resident of a foreign country from March 1, 2017, through the end of 2017 and from January 1, 2019, through September 14, 2019."

Use It Or Lose It

Finally, understand that the foreign-earned income exclusion is "use it or lose it." If you don't file your returns year by year, you can't later go back and try to claim the exclusion. You'll be required to pay U.S. tax on all your worldwide income for any year in which you failed to file.

The foreign-earned income exclusion applies to U.S. tax only. You can have a local tax obligation, as well, in the country where you're a foreign resident. However, choose a zero-tax jurisdiction such as Panama, Belize, or Uruguay as your place of foreign residence… earn no more than US$112,000 in foreign income each year… and you could reduce your overall tax bill to nothing.

Further Live and Invest Overseas Resources

"Diversify or Die Broke" is the philosophy of Lief Simon, Live and Invest Overseas' resident Offshore Investment Guru. Lief Simon has been living and doing business around the world for the last 20 years. He shares his insights with subscribers to his *Simon Letter*, as well as with members of his VIP subscription service *Global Property Advisor*. The Wealth Building and Diversification Kit includes invaluable advice on banking, tax, residency, citizenship, asset-protection, international business, and offshore investing. More details below…

Simon Letter

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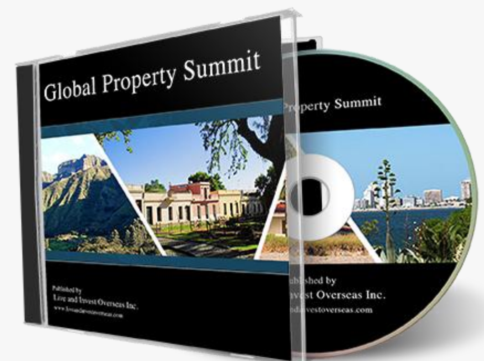
Learn more here.

Lief Simon's Global Asset Protection And Wealth Summit



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Global Property Advisor

A portfolio of international real estate holdings should be an important part of your diversification strategy. First, if you're an American, it is one of two assets you can hold offshore without triggering a reporting requirement. Secondly, depending on where you invest, you're diversifying your assets into other currencies… protecting yourself from any potential dollar crisis in the United States.

And perhaps most important, international real estate can become the most lucrative and stable investment of your portfolio holdings. Lief Simon's *Global Property Advisor* service informs you where and how to buy, when to exit, and how to take your profits, following a proven strategy for building real wealth that lasts. Lief has led his readers to a number of remarkably profitable investments in markets from Croatia to Mexico... from Argentina to the coast of Spain... from Romania to Honduras... Now he shares his most promising finds and his unique and extensive experience with members of his *Global Property Advisor*. **Find more here.**

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