Taxes for International Entrepreneurs and Expats

Proven Principles for Legally Reducing Taxes

Derren Joseph

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Editor's Note

Tax laws have always been complicated. It is more so with international tax, where there is a complex interplay of laws from several countries. To simply these complexities so that an ordinary person can understand and benefit; is no mean achievement. That's what Derren Joseph has achieved in this highly readable book.

As Derren points out in his lucid style, tax planning when done by a qualified team, is completely legitimate. Also, penalties for non-compliance are sometimes punitive and hefty.

I am sure the target audience for this book – perpetual nomads, expat employees, U.S. exposed persons, and online sellers – will all gain immensely from the study of this book. The book delineates key concepts that that can potentially save them millions.

Enjoy the book.

Vivek Sheel Sharma

Bio:

Vivek is a practising Indian Lawyer with nearly two decades of experience on various legal research and writing projects. His work includes: research on several volumes of Halsbury Laws of India; helping a high-profile Indian author on his book on Indian Constitutional law; working as a Reporter for the Supreme Court of India; and leading project teams working on statutory legal databases for Sri Lanka, Mauritius and several African countries. Vivek has also undertaken several legal writing projects on American, Australian, and Malaysian tax laws.

Email: sharmas.s.v@gmail.com

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Foreword

The extensive use worldwide of corporate structures (offshore or otherwise) suggests that the carefully planned and strategically implemented use of the corporate form, supported by appropriately experienced tax, accounting and legal professionals helps in -

- Effective asset preservation,
- Appropriate tax relief or dissipation and
- Potential recovery either during the pendency of litigation or post-judgment.

So far, so simple.

But what to do by, or on behalf of the international entrepreneur faced with effective regulatory assault? Especially if undertaken in a way and at a time that does not leave open clear exit strategies?

That I am afraid is a story all too common in an evolving regulatory world.

This short book seeks to shine a light into the world of international tax. It highlights over 10 chapters the highlight points and main concerns of major onshore jurisdictions and aims to further illuminate potential avenues for an international entrepreneur.

As will be seen, much is dependent on the fact pattern and nature of business of the international entrepreneur, it is to be noted that tax planning in and of itself does not create an impregnable fortress. However, having the right team does create viable routes of defence.

Derren Joseph has written a book that is easy to read, technically sound and a ready primer for the international entrepreneur considering retaining a professional team. It is also a useful temperature check for the experienced entrepreneur considering changing their current professional team.

Enjoy the book

Mikhael Charles

Bio:

Mikhail Charles is an experienced litigator across the Caribbean Region with Prudhoe Caribbean, a pan–Caribbean disputes and advisory firm operating out of the Turks and Caicos Islands (TCI). Mr. Charles is not admitted to practice in TCI itself but works with others within the firm on representation of companies and high–net worth individuals globally, in matters relating to trusts, cross–border insolvency, international judgment enforcement and asset recovery.

He also works closely with a licensed insolvency practitioner from within the firm. He has substantial international comparative legal experience and consultancy having worked for the Commonwealth Secretariat and the Eastern Caribbean Telecommunications Authority.

He is admitted to practice in the British Virgin Islands, Saint Kitts and Nevis, Saint Vincent and the Grenadines, Grenada and Saint Lucia. He is also Called to the Bar of England & Wales.

Email: info@mikhailcharles.com
LinkedIn: https://www.linkedin.com/in/mikhailcharles/
Website: www.mikhailcharles.com

Preface: Why I Wrote This Book

“The illiterate of the 21st century will not be those who cannot read and write, but those who cannot learn, unlearn, and relearn” - Alvin Toffler

Two things motivated me to write this book.

- Firstly, to promote a lifestyle that I myself live and that I enjoy.
- Secondly, to help others with pressing questions and are confused about where reliable answers can be found.

Back in the mid 1990s, when I was at University in Florida, I was first exposed to the writings of renowned Futurist - Alvin Toffler. Way back in 1970, he wrote about the death of “distance” in a book called ‘Future Shock’. He theorized that for “the people of the future,” commuting, traveling, and regularly relocating one’s family would become second nature. He foresaw the evolution of a new “race of nomads” in the way we have “international entrepreneurs” today who are able to leverage the internet, co-working spaces and the gig economy to enjoy location independent lifestyles.

So it was back in the mid 1990s that I determined that I would also lead a location independent lifestyle and see the world. Fast forward to 2020 and although I’m officially tax resident in Singapore, I consider south Florida and London to be my secondary homes. While at the same time, I routinely spend time in Jakarta, Bali, Kuala Lumpur, Manila and Hong Kong during each calendar year. I’m by no means special and I personally know dozens of international entrepreneurs, and we serve hundreds of clients, who choose to live similarly.

My Marketing team and myself field dozens of international tax questions daily. This led to my updating my blog more regularly to turn it into a kind of FAQ. At first this was enough. But after an exchange with a US exposed entrepreneur based in Bali, I realised that a book is needed. A book that would just serve as an introduction to the complexities of international tax planning.

I’m Derren Joseph
Email: Help@HTJ.tax
Website: www.HTJ.tax
LinkedIn: https://www.linkedin.com/in/derren-joseph-ea-0345332/

The Truth about Tax Planning

When you're a regular, salaried, domestic, employee, you probably do not think too much about taxes. When you run your own business or when you operate internationally, taxes become an important conversation piece. Those who are new to the international entrepreneur lifestyle, sometimes simplistically see tax planning as finding deductions.

No.

Tax planning is about using current laws to legally reduce taxes.

Inexperienced international entrepreneurs also get nervous when we discuss offshore bank accounts, foreign companies and considering tax treaties. The media reporting on scandals such as the Panama Papers, the Paradise Papers and 1MDB, sometimes paint all international structures as dishonest, unethical, illegal or immoral.

The point of this book is to put these fears and concerns to rest. Tax planning when done by a qualified team, acting honestly is completely legal. The bottom line is that the more informed you are about international tax planning, the better equipped your business will be to complete in this global economy.

This book is not meant to be a "tax bible" for international entrepreneurs. It is only meant to introduce you to legal tools and concepts to make your business more tax efficient. In a competitive landscape, it's important to consider every possible edge. If you don't consider it a source of competitive advantage, remember that your competitors will do it.

If you're a 6, 7 or 8 figure international entrepreneur? Be prepared to learn key concepts to potentially save you millions and allow you the freedom you were looking for.

What Your Accountant Doesn't Know Can Hurt You

Here's a secret. My team and I make more money from helping entrepreneurs and expats correct the errors made by inexperienced tax teams, than we do from proactively advising on international tax strategies.

It strikes me as bizarre that otherwise smart international entrepreneurs really expect that a one-person, domestically focused, accountant would be able to help them with all aspects of international tax planning. Accounting is like being a medical practitioner in that there are so many specialities. You would not expect a pediatrician to advise on neurosurgery. They are two separate disciplines within the practice of medicine. So why would you expect your local bookkeeper to understand the nuances of cross border taxation?

Here are 5 things to consider in choosing your international tax advisors

- Firstly, the advisor needs to be part of a team. It is highly unlikely that one person knows everything. Furthermore, everyone has heard horror stories of one person shows that disappear, get swamped with work, or fall ill with no one to cover for them. You need a team.

- Secondly, your team needs to be qualified in multiple jurisdictions. If for example, you're an American in Scotland? You need a team with members that are US and UK qualified. It's not enough that your consultant know US tax because so many provisions of UK tax law and the US/UK treaty modify how your situation may be treated.

- Thirdly, your team should be multilingual. There are too many nuances of tax law that get lost in translation. So if you're an expat in China and your international tax team includes no Mandarin speakers or you're in Bali and no one on the team speaks Bahasa Indonesia? Then it's time to find another tax team.

- Fourthly, your team should be proactive in keeping up with changes in tax law. Question your prospective tax consultants carefully. If you need someone that is US qualified, she must speak expertly about radical changes to the way foreign owned businesses are now being taxes. If you need someone Philippines qualified, they must have an opinion on Train 1 vs Train 2 etc etc. If they are not keeping up with changes with the law, you may eventually get in trouble.

- Fifthly, please ask about fees. If the tax consultant does not have a clear and easy to understand schedule of fees? You may be in for a surprise bill at the end of the process.

How to Use this Book

I assume that you already have a successful business. This book is not about growing your wealth. It is all about PROTECTING your wealth. It does this by introducing you to the tools that you as an international entrepreneur need to legally enjoy the freedom of the international lifestyle while legally minimising your international tax burden.

We put you in the driver's seat by giving you a working understanding of key concepts necessary to keeping your international entrepreneur tax bill as low as legally possible.

It cannot be overemphasised that this book is not a replacement for getting proper international entrepreneur tax advice. If our attorney had his way, we would print this in big bold letters on every page. We are international tax consultants but we are not your international tax consultants. You need to have a team and you need to be in regular contact with them.

So in this book, please use the Table of Contents and navigate to the sections you think of interest to you. Each chapter starts with “Take Aways” so you know what that chapter offers and can consider if it’s worth your time to read it.

This book will help you engage with your qualified international tax team competently and confidently.

I update my blog pretty frequently at - http://www.MooresRowland.tax/

To provide feedback to me directly or to engage us, do connect with me and contact me on LinkedIn.

I’m Derren Joseph - https://www.linkedin.com/in/derren-joseph-ea-0345332/

Chapter 1 - Legal Introduction

It is important to note that the views expressed in this book are that of the writer and do not reflect the views of the publishers or any other affiliates in any way or form.

This book is made available by the writer and publishers for educational purposes only, as well as to give general information and provide a general understanding of the legal regulations surrounding taxation.

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Enjoy the book

Deandre T Joseph

Bio:
After spending four (4) years in Singapore and South-East Asia, Deandre T Joseph is now based in Miami, Florida. He has a UK Law Degree, is an Associate with Moores Rowland Tax Consultants and is enrolled at the University of Miami School of Law. Deandre T Joseph works with US exposed entrepreneurs doing business internationally.

Email: legal@AdvancedAmericanTax.com
LinkedIn: https://www.linkedin.com/in/deandrejoseph/
Website: www.htj.tax

Chapter 2 - The End Game

In this first chapter, I want to propose four (4) pillars of your international entrepreneur lifestyle. Four ideas that will put you in the driving seat when dealing with your team of advisors.

(i) Flag Theory - Diversify Your Lifestyle

Idea 1 - You can diversify your lifestyle. Derisk yourself by ensuring that you and your assets are not under the control of any single jurisdiction.

For international entrepreneurs, this is an interesting concept to explore. In 2019, I had a Facebook Live Stream interview with Robert O'Kruk who manages a 11,000 member Facebook group called the “international entrepreneurs Forum”. It was the first time that I heard of the concept of Flag Theory.

According to Wikipedia, Flag Theory is a term used to describe the perpetual traveler. An idea which proposes that individuals live in such a way that they are not considered a legal resident of any of the countries in which they spend time or operate. By lacking a legal permanent residence status, the theory goes, they may avoid the legal obligations which accompany residency, such as income and asset taxes, social security contributions, jury duty, and military service. The idea has been described as a "late capitalist nomadism".

The Three Flags Theory is credited to investment pundit Harry D. Schultz, who proposed that everyone should have a second passport and an address in a tax haven and that their assets should be kept outside their home country. The idea was later expanded to Five Flags to include a place where money was earned and a place for recreation.

Whether to minimize governmental interference, or to maximize privacy, the theory proposes that each of the following should be in a separate country:

- Passport and citizenship – in a country that does not tax money earned outside the country or control actions.
- Legal residence – in a tax haven.
- Business base – where one earns one's money, ideally somewhere with low corporate tax rates.
- Asset haven - where one keeps one's money, ideally somewhere with low taxation of passive income and capital gains.
- Playgrounds - where one spends one's money, ideally somewhere with low consumption taxes.

In 1995, financial commentator Bob Beckman commented about his residence in Monaco:

> "A long time ago, I was told that the most efficient way for an individual to handle his affairs was to work one place, keep his money in a second place and live in a third place. I live in Monaco. I don't work here, my money is placed elsewhere, but managed from here.”

Please note that there are companies that carry the name “Flag Theory” registered in various jurisdictions. Some offer services associated with this generic term.

Associated with the concept of Flag Theory is the idea of a perpetual traveler which is discussed in upcoming Chapters. This million dollar question is whether Flag Theory or being a Perpetual Nomad would enable you to live a tax free international entrepreneur lifestyle? We will explore this in Chapter 2.

(ii) Choose Tax Systems that Work For You

Idea 2: Death may be certain but taxes are not. You can choose where and how to be taxed by choosing where to do business and where to live.

In order to help you choose, I'll talk about how international entrepreneurs see tax systems. There are many ways of classifying tax systems. Given that we are writing for International Entrepreneurs and Expats, we have chosen to put tax systems into the three (3) categories referenced above.

- In a pure worldwide tax system, resident individuals and entities are taxable on their worldwide income regardless of where the income is derived.
- By contrast, in a pure territorial tax system, the country taxes only income derived within its borders, irrespective of the residence of the taxpayer.
- A tax free jurisdictions allows resident individuals and entities to do business and pay no direct taxes on income.

That's the theory. In practice, no jurisdiction fits neatly into one of these three (3) boxes. Jurisdictions tend to be a combination of these. But I believe that it is important to think in these terms to help you decide where to plant your flags (see the section on flag theory) or where you decide to establish a presence.

Remember that your incorporated business is a separate legal entity from you as an individual. It is often subject to different tax rules from you.

So at the time of writing, in 2019, very generally speaking, tax resident individuals are subject to -

- Worldwide taxation on earned income in the USA, Canada, the UK, most of Europe, Australia and New Zealand among others;
- Territorial taxation on earned income in Hong Kong, Singapore, Malaysia, and many Caribbean islands among others;
- No tax on earned income in certain free trade zones in various jurisdictions.

When it comes to taxation, the rules are always nuanced which is why many international entrepreneurs doing their own research often get it wrong. It is possible to be -

- Tax resident in many European countries including the UK, and be taxed only on territorial income under various schemes in the UK, Portugal, Cyprus, Malta and Spain among other countries;
- Tax resident in Hong Kong and Singapore and pay taxes on income earned or dividends received from foreign sources;
- Tax resident in a free trade zone in the Philippines or Dubai but still be subject to taxes on certain types of income.

Remember your corporate structures, as legal persons, are often separate and distinct from you as a natural person. In terms of entities, the rules in a given jurisdiction can subject tax resident individuals to worldwide taxation but tax resident entities to territorial taxation. Let's have a look at corporate taxation.

- All G-7 countries including the US, "claim" to have now adopted territorial taxation (or a partial version thereof) for active business income. OECD countries claiming territorial corporate tax include - Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Estonia, Finland, France, Germany, Hungary, Iceland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, United Kingdom. I deliberately used the word "claim" because on a closer look, you would find that many of these jurisdictions have rules which do trigger worldwide corporate taxation under certain circumstances.

- Worldwide taxation is a system under which corporations deemed "resident" in a country are taxable by that country on their income from all over the world, normally with offset either by deduction or credit for taxes paid to source countries on the same income, and sometimes, with deferral of tax until repatriation of the income in the form of dividends from foreign subsidiaries to the home country resident parent. Countries with worldwide corporate taxation include jurisdictions popular with international entrepreneurs such as most Latin American nations (including Colombia), Indonesia (with 17,000 islands including Bali) and Thailand.

By now it is clear that, as an international entrepreneur, you need to be careful about where you spend your time. Even though you are a solopreneur incorporated in Estonia for example, by virtue of working from a coworking spot in Indonesia, your company may unwittingly establish a taxable presence in Indonesia and the tax authority may have the ability to levy a tax on the worldwide income of your entity.

Tread carefully. Get advice.

(iii) Choose to Live Where YOU Want

Idea 3: Most countries in the world have programs that allow foreign investors to become local residents. Others also allow investors to become citizens.

There are loads of websites that explain (and sell) residencies and citizenships. This is not necessarily illegal or unethical. Every developed country you can think of now has them as nations compete for global talent. Any team that advises international entrepreneurs needs to be familiar with economic migration options. Multiple citizenships and / or residencies now form a part of the portfolio of any international entrepreneur. It is hard to control your tax position without first taking control of your residency.

Now we will clarify these two (2) terms as they are subject to much misinterpretation. For these definitions, I will refer to the Merriam Webster dictionary.

Citizenship refers to a person's allegiance to a government in exchange for its protection at home and abroad. Full political rights, including the right to vote and to hold public office, and civil liberties are typically granted to a native-born citizen (under jus soli, a Latin legal term meaning, literally, "right of the soil") or to a naturalized citizen—i.e., a person who has successfully met official requirements that make him or her a citizen of a country other than their country of birth. (The term naturalization is of 16th-century Scottish origin.)

In a court of law, the term resident is often contrasted with citizen: it names a person who has a residence in a particular place but does not necessarily have the status of a citizen. Take, for example, an everyday occurrence in immigration law: a person who has citizenship outside of the United States and who desires to work or live in the country applies for a green card, an identification card that attests to his or her legal residence in the country as an alien—that is, a person who was born in a different country and is not a citizen of the country in which he or she now resides. He or she is not allowed to vote in, or stand for federal elections (rights which are granted to citizens); additionally, they can be subject to deportation if they commit certain crimes or security violations. After a certain period of permanent residency, an alien may apply for naturalization.

The above is simple enough but what about a variation of residency called “tax residency”?

In many countries, immigration law is separate and distinct from tax laws. So someone can, for example, enter the USA illegally and have no legal basis for being there from an immigration standpoint. But because they have spent a certain number of days there and have been working there, they may still be considered tax resident. Similarly someone can stay outside of the USA, their entire life and still be considered tax resident there!

The point I’m making is that these rules are very nuanced. It is therefore important to understand the rules around tax residency in whichever jurisdiction you may be exposed.

(iv) You can Bank Internationally

Idea 4: You have the ability to bank internationally. But you need to see things from the bank's point of view and understand why banks are now so picky.

For international entrepreneurs, banking tends to rank about the biggest concerns. To understand why banks are becoming so hard to deal with, you need to appreciate the evolving regulatory framework. Regulations are getting stricter as a result of numerous scandals. To get into these would be a book in itself, but in short -

- All of Europe's Top Ten banks have been fined for money laundering offences in the last decade.
- All major UK banks, including HSBC, Barclays, RBS and Standard Chartered, have been fined for money laundering offences. Earlier this year, Donald Toon, director of prosperity at the National Crime Agency (NCA), admitted in a Treasury Meeting that money laundering in the UK is "a very big problem" and estimated that the amount of money laundered each year had risen to a staggering £150 billion.
- In November 2019, Australia's financial crime watchdog accused Westpac bank of 23 million breaches of anti-money laundering and counter-terrorism financing laws.
- American banks have also been caught out. Citigroup, Wells Fargo and JP Morgan have had their share of problems and fines as well.

In addition to these fines, there are new rules around FATCA and CRS.

What is FATCA? In March 2010, the Hiring Incentives to Restore Employment (HIRE) Act introduced a new U.S. withholding and information tax regime under rules known as the Foreign Account Tax Compliance Act (FATCA). The stated purpose of the law is ‘‘to clamp down on tax evasion and improve taxpayer compliance by giving the IRS new administrative tools to detect, deter and discourage offshore tax abuses.’’ FATCA has extensive implications including its impact on three (3) groups.

- Firstly, it affects individuals with US tax filing requirements as they now have to comply with the requirements of Form 8938 which requires reporting of taxpayer’s specified foreign financial assets over certain thresholds.

- Secondly, most major governments have signed information sharing agreements (called intergovernmental agreements or IGAs) with the US which means that offshore financial information controlled by US persons will be shared.

- Thirdly, most major financial institutions based outside of the US (called foreign financial institutions or FFIs) are sharing the financial information of US persons directly with the US or indirectly via their respective governments.

Following on from FATCA, is something called CRS. The Common Reporting Standard (CRS) adopted elements of the Foreign Account Tax Compliance Act (FATCA) to create a worldwide framework for automatically sharing financial account information. Now all the major economies are determined to introduce FATCA-like intergovernmental agreements (IGAs).

There are three primary terms surrounding the Automatic Exchange of Information that need to be understood -

- The Convention on Mutual Administrative Assistance in Tax Matters (The Convention). This is a freestanding multilateral agreement designed to promote international co-operation for better operation of national tax laws, while respecting the fundamental rights of taxpayers. It covers the exchange of information, simultaneous tax examinations, tax examinations abroad, assistance in recovery and measures of conservancy, the service of documents, and joint audit facilities.

- The Competent Authority Agreement (CAA). This is the IGA version of CRS, based on the FATCA Model 1 IGA. It is a bilateral or multilateral agreement to conduct the actual Automatic Exchange of Information (AEoI).

- The Common Reporting Standard (CRS) is also known formally as the Automatic Exchange of Information (AEoI) or informally as the global version of FATCA (GATCA). This is similar to FATCA but while FATCA is implemented through IGAs, the CRS is implemented through CAA either between two countries (bilateral CAA or BCAA) or more than two countries (multilateral CAA).

The end result is that banks are facing more rules and regulations than ever before. At the same time, they are facing governments keen to charge hefty penalties for non compliance. So banks are

- Very careful in on-boarding new account holders. Opening a bank account now feels like a job interview.
- Closing accounts with activity deemed to be suspicious.
- Avoiding business models they do not understand such as crypto and blockchain projects.
- Avoiding US exposed accounts.
- Closing accounts where the tax residency or identity of the ultimate beneficial owners is not understood.

Tax compliance and banking now go hand in hand as banks are being held responsible for actions of account holders.

Remember - It’s like a Car

Given these basic principles, we often tell clients that their international entrepreneurship structure is like a car. It needs regular maintenance by a team qualified to do so. Otherwise, when you need it most - it may break down and leave you stranded and in trouble with a huge unexpected bill.

Chapter 3 - Perpetual Nomad - Living the Tax Free Life?

Take Away: It may be possible to live a tax free life but it comes at a cost. If you are a US person, a common way to live tax free is to surrender your passport or green card. If you are originally from another country, you need to sever tax ties with your country of origin which is becoming harder. Once you take up residency in a country where you are tax resident but untaxed, it may be difficult to subsequently move your cash internationally. Why? Receiving banks increasingly require proof, ideally with tax returns and audited financials, that the funds being received have been legally earned and otherwise taxed.

U.S. Persons

Being a US person creates a very unique tax position for International Entrepreneurs. If you are a US citizen, you are subject to worldwide taxation wherever you reside. Aside from Eritrea and the US, other countries allow citizens to become tax non resident once they become bona fide residents of other countries.

You can be a US Person, if you are a US citizen, a US permanent resident (ie a Green Card holders) or someone residing in the US long enough to trigger what is called 'substantial presence'.

Once you are a US Person, you will always remain subject to both US reporting and US taxation. The only way to legally avoid this is to cease being a US person.

Now we go into more precise legal definitions of a US person. President Reagan signed H.R. 4170 into law on July 18, 1984. This law created objective definitions of the terms residents aliens ("RAs") and nonresidents aliens ("NRAs") for Federal income tax purposes. It is very important to note however, that the new definitions do not affect the determination of residence for Federal estate and gift tax purposes (discussed later).

Residence Tests

Code Section 7701(b) sets forth the following two (2) tests pursuant to which an alien individual will be considered a RA with respect to any calendar year if he:

- is a lawful permanent resident of the United States at any time during the calendar year (the "Green Card Test"); or
- is present in the U.S. for thirty-one (31) days or more during the current calendar year and has been present in the United States for a substantial period of time–one hundred eighty-three (183) days or more during a three (3) year period weighted toward the present year (the "Substantial Presence Test").

Pursuant to Section 7701(b)(1)(A), an alien individual is to be considered a RA for any calendar year, if and only if, he satisfies the requirements of the Green Card Test, the Substantial Presence Test or the First Year Election.

- The Green Card Test: A lawful permanent resident is defined as an individual who has the status of having been lawfully accorded the privilege of residing permanently in the United States in accordance with the immigration laws, and if such status has not been revoked (and has not been administratively or judicially determined to have been abandoned). Thus, a lawful permanent resident continues to be a resident for income tax purposes until he officially loses or abandons the status of lawful permanent resident.

- The Substantial Presence Test: An alien individual is classified as a RA as to a calendar year (the "current year") if he is present in the United States for thirty-one (31) or more days in the current year and has been present in the United States for one hundred eighty three (183) days or more during a three (3) year period, weighted toward the current year. This weighting takes place as follows: an alien is considered a RA during the current year if the sum of the days he is present in the United States during the current year, plus one-third (1/3) of the days present during the first preceding year, plus one-sixth (1/6) of the days present during the second preceding year, equals or exceeds one hundred eighty-three (183) days. Exceptions will be discussed later.

Part II – Income Tax Planning

A United States ("U.S.") taxpayer is subject to income, gift and estate tax on a worldwide basis with reporting obligations relating to worldwide income, gifts and assets as well. Conversely, a foreign taxpayer is subject to a more limited U.S. tax regime and to a more limited reporting regime.

U.S. Income Tax

If an individual is not a citizen of the U.S., and such individual does not satisfy the Green Card Test (the "GCT") or the Substantial Presence Test (the "SPT"), or does not qualify for and in addition make the First Year Election, such individual will be a U.S. income tax nonresident alien ("NRA"). If the individual does satisfy the GCT or the SPT, or qualifies for and makes the First Year Election, such individual will instead be a U.S. income tax resident ("RA"). It is also important to note that for U.S. income tax purposes, the definition of a U.S. Taxpayer includes an RA as well as a U.S. citizen.

Canada

We visited the Canada Revenue Authority (CRA) website in December 2019 and this is what we found –
https://www.canada.ca/en/revenue-agency/services/tax/international-non-residents/individuals-leaving-entering-canada-non-residents/non-residents-canada.html

In summary it talks about the 183 day rule (where could be considered tax nonresident if you're outside of Canada for more than 183 days in a calendar year) and "significant ties" which is reasonably similar to the UK from whose laws, this is taken. So because of "significant ties, you can be non resident (from an immigration perspective) but be a "Deemed resident" of Canada for tax purposes.

Read more about this here - https://travel.gc.ca/travelling/living-abroad/taxation

But let's cut to the chase. Some tax experts argue that the leading Canadian decision in this area is that of the Supreme Court of Canada in Thomson v. M.N.R, 2 DTC 812. In that oft-quoted decision, which is heavily influenced by UK case law, the court indicated that to be "resident" in a place meant to "dwell permanently or for a considerable time, to have one's settled or usual abode, to live, in or at a particular place".

In addition, with respect to being "ordinary resident", the decision contained the following frequently quoted passages:

> "one is 'ordinarily resident' in the place where in the settled routine of his life he regularly, normally or customarily lives.".

So what about the perpetual traveler? Can that individual still be considered a non-resident? Unfortunately, the answer is far from clear, as at 2019, no reported Canadian tax case has specifically addressed this issue.

As such, here is the CRA's position -

> "Where an individual leaves Canada and purports to become a non-resident, but does not establish significant residential ties outside Canada, the individual's remaining residential ties with Canada, if any, may take on greater significance and the individual may continue to be resident in Canada."

As such, a requirement to establish residence elsewhere, as a prerequisite to ceasing to be Canadian resident, is sometimes taken as being implied in the following passage from the aforementioned Thomson case:

> "For the purpose of income tax legislation, it must be assumed that every person has at all times a residence."

This passage, and the inherent assumption it contains, was incorporated in the recent decision of the Tax Court of Canada in Mullen v. The Queen, 2012 DTC 1154.

So in short – it is easier to make the case for being tax nonresident, if someone is tax resident elsewhere. For those taking advice to the contrary from unqualified advisors? Be careful.

Europe and Australia

Continental Europe is comprised of quite a number of jurisdictions. But very broadly speaking, the situation in most European jurisdictions is similar to Canada. In short, you are taxed on your worldwide income and can only break tax residency by becoming a bona fide resident of another jurisdiction. Which means that like Canada, perpetual travelers who cannot prove residency of another jurisdiction may be deemed tax resident with their home country in Europe.

This is becoming a trend with other OECD nations that practice taxing worldwide income (eg Germany or Italy) taking similar positions. So once you hold citizenship from a European country, Canada, Australia or New Zealand, this is something to consider.

I will take a deeper dive into Australia because of the number of queries our team receives from Australians. An individual is an Australian resident for tax purposes if they pass one of four distinctive tests:

- Reside in Australia
- Domicile in Australia unless a permanent place of abode outside Australia
- 183 days in Australia unless a usual place of abode outside Australia
- Member of a Commonwealth superannuation scheme

The residency test is the primary test for residency and is known as the common law test. Common law means case law developed over time through judges' rulings as opposed to statutory law embodied in legislation passed by legislatures or constitutional law embodied in the national constitution of Australia. So the residency test is known as the common law test because nobody can tell from s 6 (1) ITAA 1936 what reside actually means and so had to refer to case law where judges tried to put some meaning into the word. The Domicile, 183 day and Commonwealth super tests all just extend the ordinary definition of "resident" and "reside".

Test 1 – Reside

Reside – Case law is constantly changing and doesn't necessarily come to a consistent conclusion. So here is a list of the most important court cases currently referred to:

- Applegate v FCT: The judge referred to the dictionary meaning of reside as in to dwell permanently or for a considerable time, to have a usual abode, to live in a particular place – see Applegate re domicile test

- Iyengar [2011]: Mr Iyengar was an engineer and took up a 2+ years appointment overseas but kept a home and family ties in Australia to which he returned: Australian tax resident.

- Sneddon [2012]: Mr Sneddon worked in Qatar for 2.5 years but maintained a residence, car, internet, telephone, bank accounts and superannuation in Australia: Australian tax resident.

- Murray [2012]: Mr Murray even acquired a residential property overseas: Australian tax resident.

- Dempsey [2014]: Mr Dempsey worked in the building and construction industry in Saudi Arabia and intended to reside outside of Australia: Foreign resident

- The Engineering Manager v FCT [2014]: An engineer worked in Oman under an annually reviewed one year contract and returned periodically to visit his wife and children in Australia: Foreign resident

Test 2 – Domicile

Under s 6 (1) ITAA 36 a person will be a resident of Australia if they have an Australian domicile unless they can prove that they have established a permanent place of abode outside Australia.

We all have a domicile – at all times – but only one at any point in time. Domicile of origin comes with birth and follows the domicile upon whom we are dependent in infancy. But our domicile of choice is in the country where we voluntarily fix our chief residence with the intention of residing indefinitely.

What is a permanent place of abode? It doesn't have to be permanent, the intention to stay permanently is enough.

- Applegate v FCT - Mr Applegate was a solicitor who was asked by his firm to establish and manage a branch office in the New Hebrides (now part of Vanuatu). He gave up a lease on his Australian apartment and moved his family to Vila in the New Hebrides. The stay was for an unspecified period of time. Illness forced Applegate to return to Australia within two years. The Full Federal Court found that although Applegate had retained his Australian domicile, he had established a permanent place of abode elsewhere: Held not to be a resident.

- Boer [2012] and Sully [2012] - Two separate court cases but both were taken to not having established a permanent place of abode outside Australia: Australian tax resident

- IT 2650 - IT 2650 discusses when and how a person temporarily leaving Australia to live overseas acquires a permanent place of abode overseas. Factors to consider how long the individual intends and then actually stays in Australia. A period of 2 years is normally a minimum. Whether the individual established a fixed home outside of Australia. And last but not least, to what extent there is a continuing association with a place inside Australia.

Test 3 – 183-Days

A person who is in Australia for 183 days or more becomes an Australian resident for tax purposes unless they can establish that their usual place of abode is outside of Australia with no intention to take up residency in Australia. The 183 days don't have to be consecutive.

So the domicile test refers to permanent place of abode and the 183-days test refers to usual place of abode. What is the difference? No idea.

Test 4 – Commonwealth Superannuation

This the only objective test that gives a clear Yes or No – unfortunately with very limited application. Anybody who is a member of an Australian government superannuation scheme – even if no longer contributing – is an Australian tax resident.

Residency For Part of a Year

Under the reside or domicile test a person can be a resident for part of a year – from the day they arrive or until the day they depart. But there is conflicting case law re the 183- days test:

- Gregory v DCT (WA) [1937]: If resident under the 183-day test, a tax resident for the whole year.

- Case S19: If resident under the 183-day test, only a tax resident for the period actually in Australia.

Temporary Resident

Temporary residents are Australian tax residents, just a special subcategory. An individual is a temporary resident if they hold a temporary migration visa like 457, 456, ETA or any visa which does not allow the holder to remain in Australia indefinitely (s995-1 ITAA 97).

Foreign Resident

An individual is a foreign resident for tax purposes if they are not an Australian tax resident. ITAA 97 uses the term foreign resident – ITAA 36 uses the term non-resident – no difference.

Working Holiday Makers

Working holiday makers are by definition on a 417 or 462 visa. They are foreign residents, just a special subcategory, regardless of the length of their stay in Australia.

Sorry to be so long-winded but I trust that the point is well made. Unless you can demonstrate that you are properly resident somewhere else, Australia may take the view that despite your continuous physical absence, you continue to be Australia tax resident.

The UK

A trend with OECD nations that practice taxing worldwide income is that once you hold citizenship from a European country, Canada, Australia or New Zealand, you are tax resident unless and until you establish tax residency elsewhere.

UK tax depends on an individual's residence and domicile. Residence For tax years 2013-2014 onwards, UK tax residence is determined by a statutory residence test (Schedule 45 of the Finance Act 2013). Individuals are automatically non-UK resident if they:

- were UK resident in one or more of the previous three tax years and spend fewer than 16 days in the United Kingdom in the tax year;
- were not UK resident in any of the previous three tax years and spend fewer than 46 days in the United Kingdom in the tax year;
- work full time abroad with no significant breaks and spend fewer than 91 days, and fewer than 31 working days, in the United Kingdom in the tax year; or
- were not resident for either of the two previous tax years and die having spent fewer than 46 days in the United Kingdom.

Individuals are automatically UK resident if they:

- spend 183 or more days in the United Kingdom in the tax year;
- have a home in the United Kingdom in which they spend at least 30 days in the tax year and there is a 91 consecutive-day period in which they have that home and:
    - have no home abroad; or
    - have a home abroad but spend fewer than 30 days in that home;
- work full time in the United Kingdom with no significant breaks for at least 12 months and more than 75% of their working days in the year are worked in the United Kingdom; or
- die and have been automatically UK resident for the previous three tax years, provided that at the time of death they had:
    - a home in the United Kingdom; or
    - homes in the United Kingdom and abroad, but had not spent more than 30 days in the home abroad in the tax year.

If none of these tests apply, whether individuals are UK resident depends on the number of UK ties that they have and the number of days that they are in the United Kingdom.

The relevant UK ‘ties’ are:

- family – the individual’s spouse, civil partner or minor children are resident in the United Kingdom;
- accommodation – the individual has accommodation available to him or her in the United Kingdom for at least 91 days during the tax year;
- work – the individual works in the United Kingdom for more than three hours on at least 40 days in the tax year;
- UK presence in previous years – the individual spent more than 90 days in the United Kingdom in either of the two previous tax years; and
- days in the United Kingdom – the individual spends more midnights in the United Kingdom than in any other country.

Domicile - An individual’s domicile is the jurisdiction which he or she considers to be his or her permanent home and where he or she intends to live indefinitely. This may not be the country in which he or she is resident.

Individuals are born with a domicile of origin, which is usually the domicile of their father on the date of their birth (if their parents were married). Individuals can acquire a domicile of choice in another country by being resident there with the intention of remaining there permanently. If an individual ceases to be resident, and to intend to reside permanently in that country, the domicile of choice is lost. The individual will then either acquire a new domicile of choice or revert to his or her domicile of origin.

Individuals who are non-UK domiciled under general law can become deemed domiciled in the United Kingdom for tax purposes. This occurs when the individual has been UK-resident for at least 15 of the previous 20 tax years. Individuals who are UK deemed domiciled are subject to tax on their worldwide income and gains, and their worldwide estate falls within the scope of inheritance tax. A UK deemed domicile can be lost if the individual is non-UK resident for at least six complete tax years.

Individuals who have their main residence in Scotland, or who are most closely associated with Scotland, will pay Scottish income tax (at different rates) on most of their taxable income (other than dividend income and savings income). Different rates may also apply to non-UK residents with Scottish income.

Rest of the World

The US is a special case and aside from surrendering ones US citizenship or US residency, there is no other way to break tax residency. Absence from the US does not break tax residency. With other OECD nations, one can break tax residency by combining physical absence with bona fide tax residency of another nation.

Havings established the trend for OECD nations, let's talk about the rest of the world. To do this, we need to discuss something called CRS.

Let's Talk About CRS

CRS or the Common Reporting Standard is a framework for information exchange among countries. It therefore means that financial institutions in participating countries, are legally required to identify the tax residencies of its account holders. Information on financial account activity is then communicated to the tax authorities in the jurisdictions so identified. Account holders refusing to comply with the information requests from their banks, are having their accounts closed.

So this leads to two scenarios.

Firstly, if you declare that you are not tax resident anywhere, many banks would be uncomfortable with this and may ask you to close your accounts.

Secondly, when money is transferred from one jurisdiction to another, even in non-OECD nations, anti-money laundering (AML) rules demand that the receiver demonstrate the legitimacy of the funds received. If you're transferring from one account you control in country X to another account you control in country Y, then banks prefer a tax report (tax returns) from country X proving that the money was legally owned and taxed. Other documents which come from non state agents (such as unaudited company financials) may not be acceptable. We have seen cases where international entrepreneurs are unable to repatriate funds or otherwise transfer them internationally because of untaxed funds.

Chapter 4 - Expat Employees

Take Away: When dealing with your company's global mobility team, remember that their job is to represent the interest of your employer - NOT you. They therefore prefer terms that favor your employer. Get independent advice to ensure that post-relocation, your post-tax take home pay is maximized.

Tax Equalized

As an employee, when you are offered an international assignment, the global mobility team often offers you the choice of a "local contract" or to be "tax equalized". Tax equalization is often difficult to explain and we often have expat employees hire us just to spend time explaining the process and the consequent returns to them as their global mobility team is unable to do so.

Because tax rates vary from country to country, when an employee goes on assignment, their tax liability usually changes. If the assignee becomes tax resident in the host country, their income will be subject to income tax there, regardless of where they are paid. Expats often ask whether receiving their pay in a bank account of another country makes a difference? Typically, the answer is no. It does not. At the same time, there may be continuing tax and/or social security liabilities in the home country if they remain tax resident there during the assignment. Remember that fiscal law determines tax residence, not the employee's or employer's choice.

In simple terms, tax equalisation means that the employee pays no more and no less tax while on assignment than they would have paid had they remained in their home country. The company bears all the actual home and host country tax due. The employee's contribution to the tax burden is the hypothetical tax they would have paid had they not gone on assignment. This tax burden is deducted from notional home salary in the calculation of the assignment salary.

- Scenario 1 - An employee is being moved from Hong Kong to London by their employer, they are moving from a low tax to a high tax jurisdiction. If the actual tax due is higher than the hypothetical tax (or hypotax) withheld, the employer pays the difference.

- Scenario 2 - An employee is being moved from Sidney to Singapore by their employer, they are moving from a high tax to a low tax jurisdiction. If the actual tax due is lower than the hypotax, the employer keeps the difference.

Typically, the employer hires an accounting firm like ours to manage the tax filings as they would be more complex than normal. As both hypothetical and actual returns are needed. Furthermore, the payment of tax on behalf of the employee is normally considered a taxable benefit itself and therefore attracts an additional tax liability.

When we explain tax equalization to Singapore based employees who moved to Singapore from a high tax jurisdiction, they are often disappointed. They would potentially have been better off financially, had they opted out of tax equalization. For this reason, there's something else called "Tax protection" which is an alternative to tax equalisation.

In this approach, the employee will pay no more tax while on assignment than they would have done in the home country - which is similar to tax equalization. But in scenario 2, where an employee moves from a high tax to a low tax country like Singapore, they would end up paying less tax since the tax burden is lower than in their home country. This is because the employer will reimburse the employee for any excess tax resulting from higher tax rates in the host country but the employer will not benefit from the situation where the tax is lower in the host.

Local Contracts

Being hired on a local contract usually refers to an arrangement where employees are responsible for their own taxation as is the case with any employee. No special arrangements are made for tax.

For many employees, especially those where an employee moves from a high tax to a low tax jurisdiction, it can be a better option. But if the employee works with a multinational with frequent relocation, then their after tax income can fluctuate widely.

US Exposed

If you're US exposed then I suggest that you need to read the section in the previous chapter on US taxation for international entrepreneurs. The following Chapter is also dedicated to US exposed persons. The point is that regardless of where you go and regardless of how long you remain outside of the US, you remain subject to US taxation.

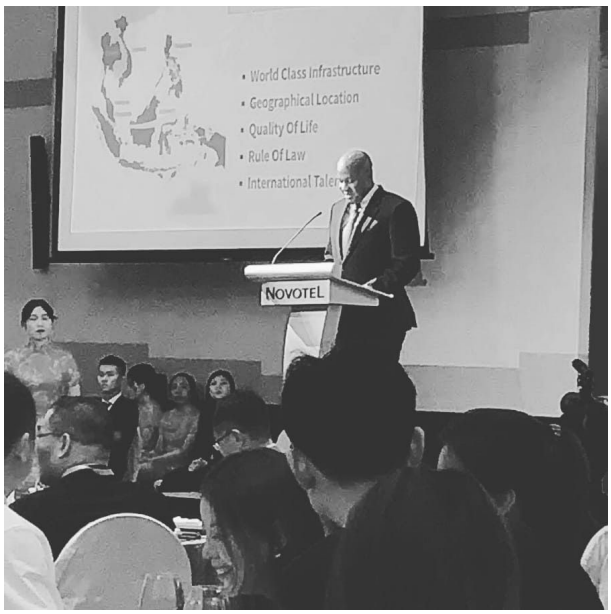
However do bear in mind that international tax returns operate on a radically different set of regulations than domestic tax. This means that a tax team focused on domestic returns cannot be expected to easily grasp the nuances of international tax rules including treaties. Do pay special attention to the sections in the next Chapter on the Foreign Earned Income Exclusion and the Foreign Tax Credits. Depending on where you are assigned, you can dramatically reduce your final tax bill just by working outside of the US.

Tax Resident in multiple jurisdictions

Increasingly, this is a situation we see in many of our clients. I myself am tax resident in Singapore, the UK and the USA. They are my 3 actual homes and my 3 tax homes. As an international entrepreneur, it is part of the cost of doing business that you would be tax exposed in multiple jurisdictions.

Most countries I'm familiar with in the West allow multiple citizenships. Many countries I'm familiar with in Asia, do not allow usually multiple citizenships but they do allow multiple residencies. But that is not important. What is important is this - how do you deal with being tax resident in multiple jurisdictions? Get advice.

If the multiple tax residencies do not offer real benefit? Then perhaps they should be eliminated. On a monthly basis we work with 3 or so international entrepreneurs severing their tax residencies with the US in particular. Of course there are more things to consider other than tax but tax should be one of the things that you consider.



Short Term Contracts

In a way, more tax planning may be needed around short term contracts rather than for longer term assignments. The reason is that it is easier for an employee to end up in limbo where they are subject to income taxation in multiple jurisdictions.

Normally, the company takes responsibility for managing the process because your working even temporarily in another country may trigger income tax payments or withholding on your wages. Depending on where you're tax resident, it may result in double taxation. So once you're deployed on a short term contract, ensure that you speak with the global mobility team in your company to get clarity on how they are handling any tax issues.

If they fail to provide proper guidance, seek counsel for an experienced tax team.

Chapter 5 - U.S. Exposed Persons - Citizens, Green Card Holders and Substantial Presence

Take aways: US tax rules are complex but not insurmountable with proper advice.

- For inbound employees, there are some visas that mean limited taxation. Otherwise you would be taxed on your worldwide income so pre immigration planning is important.
- For inbound investors, there are ways of buying and liquidating your US investments tax free. But rules are involved so get proper advice.
- For outbound employees:
    - The quick win is the Foreign Earned Income Exclusion and Housing Deduction which protect the first $100k+ of international income from US tax.
    - Do your B.E.S.T. Which means that you should be aware of international Banking, remember to pay Estimated taxes, consider State tax issues and consult before you Transfer funds.
- For international entrepreneurs and expats, note that the IRS emphasises disclosure of investments and foreign assets. The quick tax win is structuring to legally avoid self employment taxes.
- Beware of the rules that come with controlling foreign entities. Ensure that you plan before investing to prevent punitive tax regimes.
- Both inbound and outbound international entrepreneurs tend to overlook US Estate Taxes. They can be managed with proper planning

Expat Employees - inbound

To say that the tax system in the US is complex is an understatement. When you relocate to the US, your tax position depends on your visa status. Let's start off by talking about those whose visa is connected to a university or an institution of higher learning. In Chapter 2, we defined how someone is subject to tax on their worldwide income by virtue of being a US citizen, green card holder or spending enough time on US soil to trigger substantial presence.

Please review Chapter 2 because once you arrive in the US as an expat employee, you are subject to taxation on your worldwide income.

There are some exceptions to the substantial presence test. These exceptions include

- An individual who is temporarily in the United States as a foreign government-related individual. This type of person will hold an "A" or "G" visa but not an "A-3" or "G-5" class visa.
- A teacher or trainee who is temporarily in the United States under a "J" or "Q" visa. This person must substantially comply with the requirements of the visa.
- A student who is temporarily in the United States under an "F," "J," "M," or "Q" visa. This person must substantially comply with the requirements of the visa.
- A professional athlete who is temporarily in the United States to compete in a charitable sports event.

I know that this book is about international entrepreneurs and expats but because we get so many enquiries, I wanted to spend some time on the J and Q visas.

A teacher or trainee is an individual, other than a student, who is temporarily in the United States under a "J " or "Q " visa and substantially complies with the requirements of that nonimmigrant status. You are considered to have substantially complied with the requirements of that nonimmigrant status if you have not engaged in activities that are prohibited by U.S. immigration laws and could result in the loss of your nonimmigrant status. Any nonimmigrant temporarily present in the U.S. in "J" or "Q" status who is not a student is included within the definition of "Teacher or Trainee." For example, alien physicians, au pairs, short-term scholars, and summer camp workers temporarily present in the U.S. in "J" nonimmigrant status are included within the IRS definition of "Teacher or Trainee." In addition, cultural exchange visitors in "Q" nonimmigrant status are also included within the IRS definition of "Teacher or Trainee".

Members of the immediate family include the individual's spouse and unmarried children (whether by blood or adoption), but only if the spouse's or unmarried children's nonimmigrant statuses are derived from, and dependent on, the exempt individual's nonimmigrant status. Unmarried children are included only if they meet all the following:

- Are under 21 years of age.
- Reside regularly in the exempt individual's household.
- Are not members of another household.

The immediate family of an exempt individual does not include attendants, servants, or personal employees.

You will not be an exempt individual as a teacher or trainee if you were exempt as a teacher, trainee, or student for any part of 2 of the 6 calendar years preceding the current year. However, you will be an exempt individual if you were exempt as a teacher, trainee, or student for any part of 4 (or fewer) of the 6 preceding calendar years and:

- A foreign employer paid all of your compensation during the current year.
- A foreign employer paid all of your compensation during each of the preceding 6 years
- you were present in the United States as a teacher or trainee.

A foreign employer includes an office or place of business of an American entity in a foreign country or a U.S. possession. If you qualify to exclude days of presence as a teacher or trainee, you must file a fully-completed Form 8843, Statement for Exempt Individuals and Individuals with a Medical Condition with the IRS. Form 8843 may be attached to your U.S. federal income tax return for the tax year, or it may be mailed separately to the address indicated in the General Instructions attached to the Form 8843.

Expat Employees - Outbound

Foreign Earned Income Exclusion - FEIE

If you meet certain requirements, you may qualify for the foreign earned income and foreign housing exclusions and the foreign housing deduction.

You can use the IRS's Interactive Tax Assistant tool to help determine whether income earned in a foreign country is eligible to be excluded from income reported on your U.S. federal income tax return.

If you are a U.S. citizen or a resident alien of the United States and you live abroad, you are taxed on your worldwide income. However, you may qualify to exclude from income up to an amount of your foreign earnings that is adjusted annually for inflation. In addition, you can exclude or deduct certain foreign housing amounts.

You may also be entitled to exclude from income the value of meals and lodging provided to you by your employer.

In order to benefit from the Foreign Earned Income Exclusion, the taxpayer must meet one of the following two criteria:

- Work full time inside a foreign country for an entire calendar year- known as the Bona Fide Residence Test
- Work outside of the United States for at least 330 of any 365 day period - known as the Physical Presence Test

While the two criteria may appear to be similar, they are actually quite different in terms of how they apply to your US expat taxes. US Expats automatically become eligible for the exclusion if they have worked overseas throughout an entire calendar year from January 1st-December 31st. They are then considered a bona fide resident. The second clause can be more confusing when applying to Expatriate tax return.

The second clause essentially means that a person left the United States for business and has not returned for more than 35 days throughout the past twelve months. This clause is not based on a calendar year; it simply refers to any twelve month period (April to April or September to September). Also note that it makes no reference to consecutive days; so a US Expat would be considered ineligible if he made several 2-7 day trips back to the US that totaled more than 35 days during the twelve month period in question. The key to meeting the "physical presence test" is to have spent less than 35 days in the US during a 12 month period.

The Deductions

Additionally, you would qualify for the Foreign Housing Deduction as well. As the name implies, the Foreign Earned Income Exclusion relies solely on foreign income for calculation purposes and the income must be earned. Foreign income from sources such as dividends, interest and rental income are not included since this income is not "earned" in the IRS's view. Additionally, US based income from things such as pensions will not qualify for this exclusion because it was not earned inside a foreign country.

Not foreign earned income: Foreign earned income does not include the following amounts:

- Pay received as a military or civilian employee of the U.S. Government or any of its agencies
- Pay for services conducted in international waters (not a foreign country)
- Pay in specific combat zones, as designated by an Executive Order from the President, that is excludable from income
- Payments received after the end of the tax year following the year in which the services that earned the income were performed
- The value of meals and lodging that are excluded from income because it was furnished for the convenience of the employer
- Pension or annuity payments, including social security benefits

Self-employment income: A qualifying individual may claim the foreign earned income exclusion on foreign earned self-employment income. The excluded amount will reduce the individual's regular income tax, but will not reduce the individual's self-employment tax. Also, the foreign housing deduction – instead of a foreign housing exclusion – may be claimed.

Figuring the tax: Beginning with tax year 2006, a qualifying individual claiming the foreign earned income exclusion, the housing exclusion, or both, must figure the tax on the remaining non-excluded income using the tax rates that would have applied had the individual not claimed the exclusions.

- Requirements
- Can I Claim the Exclusion or Deduction?
- Tax Home In A Foreign Country
- Bona Fide Resident Test
- Physical Presence Test
- Exceptions to Tests
- Figuring The Exclusion
- Choosing The Exclusion
- Revocation
- Which Form to File
- Foreign Housing Exclusion or Deduction
- Individual Retirement Arrangements
- Extension to Claim Foreign Earned Income Exclusion
- Application of Foreign Earned Income Exclusion and the Combat Zone Exclusion to Civilian Contractors Working in Combat Zones (PDF)
- Foreign Earned Income Exclusion and the Pine Gap Facility FAQs

There are some catches to the Foreign Earned Income Exclusion, so it is almost always advisable to consult a US Expat tax expert about your specific situation. For example, business owners may be forced to pay the Self-Employment tax inside the US and this is not considered part of the Foreign Earned Income Exclusion. However you may still be able to exclude your earnings after you have paid the self employment tax. Another common scenario for the self employed is when US Expats move to countries where there is a Social Security treaty in place with the United States, like the UK. The US / UK treaty allows you to opt out of Social Security and enroll in the UK National Insurance Plan. By opting out of US social security, you could save about 15.3% annually on your US expat taxes

The last thing worth mentioning is that not all US expats are able to take advantage of the foreign earned income exclusion. If you are a US Government Employee and are paid by the US government then you will not be able to use the Foreign Earned Income Exclusion to minimize your US expat taxes. This includes individuals in the Armed Forces Exchange, Commissioned and non-commissioned Officers' messes, Armed Forces motion pictures services and employees of kindergartens on Armed Forces installations.

Detailed Explanation of Foreign Earned Income Exclusion

Following are excerpts from IRS Publication 54, Tax Guide for U.S. Citizens and Resident Aliens Abroad.

Who Qualifies for the Exclusions and the Deduction?

If you meet certain requirements, you may qualify for the foreign earned income and foreign housing exclusions and the foreign housing deduction.

If you are a U.S. citizen or a resident alien of the United States and you live abroad, you are taxed on your worldwide income. However, you may qualify to exclude from income up to $105,900 (for 2019 returns) of your foreign earnings. In addition, you can exclude or deduct certain foreign housing amounts.

Requirements

To claim the foreign earned income exclusion, the foreign housing exclusion, or the foreign housing deduction, you must meet all three of the following requirements.

- Your tax home must be in a foreign country.
- You must have foreign earned income.
- You must be either:
    - A U.S. citizen who is a bona fide resident of a foreign country of countries for an uninterrupted period that includes an entire tax year,
    - A U.S. resident alien who is a citizen or national of a country with which the United States has an income tax treaty in effect and who is a bona fide resident of a foreign country or countries for an uninterrupted period that includes an entire tax year, or
    - A U.S. citizen or a U.S. resident alien who is physically present in a foreign country or countries for at least 330 full days during any period of 12 consecutive months.

Tax Home in Foreign Country

To qualify for the foreign earned income exclusion, the foreign housing exclusion, or the foreign housing deduction, your tax home must be in a foreign country throughout your period of bona fide residence or physical presence abroad.

Tax Home

Your tax home is the general area of your main place of business, employment, or post of duty, regardless of where you maintain your family home. Your tax home is the place where you are permanently or indefinitely engaged to work as an employee of self-employed individual. Having a "tax home" in a given location does not necessarily mean that the given location in your residence or domicile for tax purposes.

Temporary or Indefinite Assignment

The location of your tax home often depends on whether your assignment is temporary or indefinite. If you are temporarily absent from your tax home in the United States on business, you may be able to deduct your away-from-home expenses (for travel, meals, and lodging), but you would not qualify for the foreign earned income exclusion. If your new work assignment is for an indefinite period, your your new place of employment becomes your tax home and you would not be able to deduct any of the related expenses that you have in the general area of this new work assignment. If your new tax home is in a foreign country and you meet the other requirements, you earnings may qualify for the foreign earned income exclusion.

Bona Fide Residence Test

You meet the bona fide residence test if you are a bona fide resident of a foreign country or countries for an uninterrupted period that includes an entire tax year. You can use the bona fide residence test to qualify for the exclusions and the deduction only if you are either:

- A U.S. citizen, or
- A U.S. resident alien who is a citizen or national of a country with which the United States has an income tax treaty in effect.

You do not automatically acquire bona fide resident status merely by living in a foreign country or countries for 1 year. If you go to a foreign country to work on a particular job for a specified period of time, you ordinarily will not be regarded as a bona fide resident of that country even though you work there for 1 tax year or longer. The length of your stay and the nature of your job are only some of the factors to be considered in determining whether you meet the bona fide residence test.

- Bona fide residence. To meet the bona fide residence test, you must have established a bona fide residence in a foreign country. Your bona fide residence is not necessarily the same as your domicile. Your domicile is your permanent home, the place to which you always return or intend to return. Example. You could have your domicile in Cleveland, Ohio and a bona fide residence in Edinburgh, Scotland, if you intend to return eventually to Cleveland. The fact that you go to Scotland does not automatically make Scotland your bona fide residence. If you go there as a tourist, or on a short business trip, and return to the United States, you have not established bona fide residence in Scotland. But if you go to Scotland to work for an indefinite or extended period and you set up permanent quarters there for yourself and your family, you probably have established a bona fide residence in a foreign country, even though you intend to return eventually to the United States. You are clearly not a resident of Scotland in the first instance. However, in the second, you are a resident because your stay in Scotland appears to be permanent. If your residency is not as clearly defined as either of these illustrations, it may be more difficult to decide whether you have established a bona fide residence.

- Determination. Questions of bona fide residence are determined according to each individual case, taking into account factors such as your intention, the purpose of your trip, and the nature and length of your stay abroad.

Statement to foreign authorities. You are not considered a bona fide resident of a foreign country if you make a statement to the authorities of that country that you are not a resident of that country, and the authorities:

- Hold that you are not subject to their income tax laws as a resident, or
- Have not made a final decision on your status.

- Special agreements and treaties. An income tax exemption provided in a treaty or other international agreement will not in itself prevent you from being a bona fide resident of a foreign country. Whether a treaty prevents you from becoming a bona fide resident of a foreign country is determined under all provisions of the treaty, including specific provisions relating to residence or privileges and immunities.

- Uninterrupted period including entire tax year. To meet the bona fide residence test, you must reside in a foreign country or countries for an uninterrupted period that includes an entire tax year. An entire tax year is from January 1 through December 31 for taxpayers who file their income tax returns on a calendar year basis. During the period of bona fide residence in a foreign country, you can leave the country for brief or temporary trips back to the United States or elsewhere for vacation or business. To keep your status as a bona fide resident of a foreign country, you must have a clear intention of returning from such trips, without unreasonable delay, to your foreign residence or to a new bona fide residence in another foreign country.
    - Example 1. You arrived with your family in Lisbon, Portugal, on November 1, 2006. Your assignment is indefinite, and you intend to live there with your family until your company sends you to a new post. You immediately established residence there. You spent April of 2007 at a business conference in the United States. Your family stayed in Lisbon. Immediately following the conference, you returned to Lisbon and continued living there. On January 1, 2008, you completed an uninterrupted period of residence for a full tax year (2007), and you meet the bona fide residence test.
    - Example 2. Assume the same facts as in Example 1, except that you transferred back to the United States on December 13, 2007. You would not meet the bona fide residence test because your bona fide residence in the foreign country, although it lasted more than a year, did not include a full tax year. You may, however, qualify for the foreign earned income exclusion or the housing exclusion or deduction under the physical presence test (discussed later).

- Bona fide resident for part of a year. Once you have established bona fide residence in a foreign country for an uninterrupted period that includes an entire tax year, you are a bona fide resident of that country for the period starting with the date you actually began the residence and ending with the date you abandon the foreign residence. Your period of bona fide residence can include an entire tax year plus parts of 2 other tax years.
    - Example. You were a bona fide resident of Singapore from March 1, 2006, through September 14, 2008. On September 15, 2008, you returned to the United States. Since you were a bona fide resident of a foreign country for all of 2007, you were also a bona fide resident of a foreign country from March 1, 2006, through the end of 2006 and from January 1, 2008 through September 14, 2008.

- Reassignment. If you are assigned from one foreign post to another, you may or may not have a break in foreign residence between your assignments, depending on the circumstances.
    - Example 1. You were a resident of Pakistan from October 1, 2007, through November 30, 2008. On December 1, 2008, you and your family returned to the United States to wait for an assignment to another foreign country. Your household goods also were returned to the United States. Your foreign residence ended on November 30, 2008, and did not begin again until after you were assigned to another foreign country and physically entered that country. Since you were not a bona fide resident of a foreign country for the entire tax year of 2007 or 2008, you do not meet the bona fide residence test in either year. You may, however, qualify for the foreign earned income exclusion or the housing exclusion or deduction under the physical presence test, discussed later.
    - Example 2. Assume the same facts as in Example 1, except that upon completion of your assignment in Pakistan you were given a new assignment to Turkey. On December 1, 2008, you and your family returned to the United States for a month's vacation. On January 2, 2009, you arrived in Turkey for your new assignment. Because you did not interrupt your bona fide residence abroad, you meet the bona fide residence test.

Physical Presence Test

You meet the physical presence test if you are physically present in a foreign country or countries 330 full days during a period of 12 consecutive months. The 330 days do not have to be consecutive. Any U.S. citizen or resident alien can use the physical presence to qualify for the exclusions and the deduction.

- The physical presence test is based only on how long you stay in a foreign country or countries. This test does not depend on the kind of residence you establish, your intentions about returning, or the nature and purpose of your stay abroad.

- 330 full days. Generally, to meet the physical presence test, you must be physically present in a foreign country or countries for at least 330 full days during a 12-month period. You can count days you spent abroad for any reason. You do not have to be in a foreign country only for employment purposes. You can be on vacation.

- You do not meet the physical presence test if illness, family problems, a vacation, or your employer's orders cause you to be present for less than the required amount of time.

- Exception. You can be physically present in a foreign country or countries for less than 330 full days and still meet the physical presence test if you are required to leave a country because of war or civil unrest.

- Full day. A full day is a period of 24 consecutive hours, beginning at midnight.

- Travel. When you leave the United States to go directly to a foreign country or when you return directly to the United States from a foreign country, the time you spend on or over international waters does not count toward the 330-day total.

- Passing over a foreign country. If, in traveling from the United States to a foreign country, you pass over a foreign country before midnight of the day you leave, the first day you can count toward the 330-day total is the day following the day you leave the United States.

- Example. You leave the United States by air at 9:30 a.m. on June 10 to travel to Kenya. You pass over western Africa at 11:00p.m. on June 10 and arrive in Kenya at 12:30 a.m. on June 11. Your first full day in a foreign country is June 11.

- Change of location. You can move about from one place to another in a foreign country or to another foreign country without losing full days. If any part of your travel is not within any foreign country and takes less than 24 hours, you are considered to be in a foreign country during that part of travel.
    - Example 1. You leave Ireland by air at 11:00 p.m. on July 6 and arrive in Sweden at 5:00 a.m. on July 7. Your trip takes less than 24 hours and you lose no full days.
    - Example 2. You leave Norway by ship at 10:00 p.m. on July 6 and arrive in Portugal at 6:00 a.m. on July 8. Since your travel is not within a foreign country or countries and the trip takes more than 24 hours, you lose as full days July 6, 7, and 8. If you remain in Portugal, your next full day in a foreign country is July 9.

- In United States while in transit. If you are in transit between two points outside the United States and are physically present in the United States for less than 24 hours, you are not treated as present in the United States during the transit. You are treated as traveling over areas not within any foreign country.

- How to figure the 12-month period. There are four rules you should know when figuring the 12-month period.
    - Your 12-month period can begin with any day of the month. It ends the day before the same calendar day, 12 months later.
    - Your 12-month period must be made up of consecutive months. Any 12-month period can be used if the 330 days in a foreign country fall within that period.
    - You do not have to begin your 12-month period with your first full day in a foreign country or end it with the day you leave. You can choose the 12-month period that gives you the greatest exclusion.
    - In determining whether the 12-month period falls within a longer stay in the foreign country, 12-month periods can overlap one another.
        - Example 1. You are a construction worker who works on and off in a foreign country over a 20-month period. You might pick up the 330 full days in a 12-month period only during the middle months of the time you work in the foreign country because the first few and last few months of the 20-month period are broken up by long visits to the United States.
        - Example 2. You work in New Zealand for a 20-month period from January 1, 2007, though August 31, 2008, except that you spend 28 days in February 2007 and 28 days in February 2008 on vacation in the United States. You are present in New Zealand 330 full days during each of the following two 12-month periods: January 1, 2007 - December 31, 2007 and September 1, 2007 -

August 31, 2008. By overlapping the 12-month periods in this way, you meet the physical presence test for the whole 20-month period.

Housing Deduction

If your tax home is in a foreign country and you meet the bona fide residence test or the physical presence test, you can choose to exclude from your income a limited amount of your foreign earned income.

You can also choose to exclude from your income a foreign housing amount.

If you choose to exclude foreign earned income, you cannot deduct, exclude, or claim a credit for any item that can be allocated to or charged against the excluded amounts. This includes any expenses, losses, or other normally deductible items allocable to the excluded income.

Limit on the Excludable Amount

Part-year exclusion. If the period for which you qualify for the foreign earned income exclusion includes only part of the year, you must adjust the maximum limit based on the number of qualifying days in the year. The number of qualifying days is the number of days in the year within the period on which you both:

- Have your tax home in a foreign country, and
- Meet either the bona fide residence test or the physical presence test.

For this purpose, you can count as qualifying days all days within a period of 12 consecutive months once you are physically present and have your tax home in a foreign country for 330 full days. To figure your maximum exclusion, multiply the maximum excludable amount for the year by the number of your qualifying days in the year, and then divide the result by the number of days in the year.

Foreign Housing Exclusion and Deduction

In addition to the foreign earned income exclusion, you can also claim an exclusion or a deduction from gross income for your housing amount if your tax home is in a foreign country and you qualify for the exclusions and deduction under either the bona fide residence test or the physical presence test.

The housing exclusion applies only to amounts considered paid for with employer-provided amounts. The housing deduction applies only to amounts paid for with self-employment earnings.

Foreign Tax Credits - FTCs

As an international entrepreneur or expat, you may be required to pay taxes in the jurisdictions in which you work or are based. Fortunately, international entrepreneurs and expats often have the opportunity to claim the Foreign Tax Credit on their US tax returns.

Applying this credit is more easily said than done. For instance, you cannot take this credit against income which has already been excluded by the Foreign Earned Income Exclusion, nor can the credit exceed the US tax liability relating to foreign earned income (that is, you cannot receive a refund of foreign taxes paid through your US tax return).

Taxes that are due to be refunded to you are not included in the amount of foreign taxes paid. All of the foreign taxes paid will need to be converted to US dollars. The IRS prefers that each transaction be converted at the foreign exchange rate at the date of each transaction. Alternatively, will accept the annual average foreign exchange rate.

Certain foreign taxes are not eligible to be claimed as foreign tax credits. These include taxes paid to certain countries that the Secretary of State has designated as supporting international terrorism, such as Cuba, Iraq, and North Korea. Other taxes that cannot be claimed include those associated with financial services income, dividends from each 10 to 50 percent-owned foreign corporation, shipping and aircraft income, “domestic international sales corporation” dividends, dividends from foreign sales corporations, foreign trade income of foreign sales corporations, and foreign oil and gas extraction income. They can however, be claimed as an itemized deduction on Schedule A.

For US citizens who have lived abroad for extended periods, *carrybacks and carryforwards* of credits can be very important. If you are eligible for a foreign tax credit larger than your US expat income tax liability, the credit can be carried back to the tax year immediately preceding the current, or carried forward for the next ten years. This means that you can use the excess credit to try to obtain a refund from the prior year where you did not have enough credits to offset your US tax liability or choose to offset your future years’ tax liability. Most taxpayers will retain a schedule attached to their annual US tax return that includes all of the foreign tax carryovers for which they are eligible.

Reporting

It may seem counterintuitive but when it comes to international taxation, greater emphasis is placed on reporting your international business activity than on actually paying taxes. I say this because the penalties for failure to report certain assets are quite punitive. This is quite a detailed area of international tax but I would summarize it by saying that any international asset held, or investment made may be subject to US reporting by US persons.

By way of example, I will use the reporting of financial assets. Each U.S. citizen and permanent resident must report worldwide income to the IRS even when paying taxes elsewhere. Moreover, you must file an annual FBAR (now called FinCEN Form 114) disclosing your foreign bank accounts if their aggregate value exceeds $10,000 at any point during the year. The penalties for either failure are big, potentially even criminal. FBAR penalties are even worse than tax evasion.

According to the FBAR instructions, U.S. persons include U.S. citizens and U.S. residents. Similarly, the FBAR regulations state that a U.S. person is a citizen of the United States or a resident of the United States, meaning "an individual who is a resident alien under 26 USC 7701(b) and the regulations thereunder."

In the minds of so many people, FBARs are tied to FATCA. Nothing could be further from the truth. Way back before I was born, (we're talking about 1970 now), Congress enacted the Bank Secrecy Act, which is codified in Title 31 (Money and Finance) of the U.S. Code. The purpose of the Bank Secrecy Act was to require the filing of reports and the retention of records where doing so would be helpful to the U.S. government in carrying out criminal, tax and regulatory investigations.

One of the most important provisions of the Bank Secrecy Act was Section 5314(a), which provides that:

> The Secretary of the Treasury shall require a resident or citizen of the United States or a person in, and doing business in, the United States, to keep records, file reports, or keep records and file reports, when the resident, citizen, or person makes a transaction or maintains a relation for any person with a foreign financial agency.

A careful reading of the statute, along with a review of the applicable regulations, reveals that Section 5314 actually has two distinct requirements: filing FBARs and retaining certain records related to foreign accounts. With regard to the former, the relevant regulation (i.e., 31 C.F.R. §103.24) mandates the following:

> Each person subject to the jurisdiction of the United States (except a foreign subsidiary of a U.S. person) having a financial interest in, or signature or other authority over a bank, securities or other financial account in a foreign country shall report such relationship to the [IRS] for each year in which such relationship exists, and shall provide such information as shall be specified in a reporting form prescribed by the Secretary to be filed by such persons.

With regard to the latter, the regulations contain considerable detail concerning exactly who must retain records, what these records must contain, when these records may be discarded, and where the records must be kept. In particular, the pertinent regulation states that:

> Records of accounts required by § 103.24 to be reported to the [IRS] shall be retained by each person having a financial interest in or signature or other authority over any such account. Such records shall contain the name in which each such account is maintained, the number or other designation of such account, the name and address of the foreign bank or other person with whom such account is maintained, the type of such account, and the maximum value of each such account during the reporting period. Such records shall be retained for a period of 5 years and shall be kept at all times available for inspection as authorized by law.

Now let's talk about the penalties a bit. An FBAR violation that is non-willful is $10,000 per account per year. Willful—but still civil—violations can be up to 50% of the value in a foreign account, again, per year. In a recent Florida case, one man had to pay penalties of 150% of his offshore account. An FBAR violation that is criminal is even worse, carrying up to 10 years in prison. You have to file FBARs even if you are only a signatory but not a beneficial owner.

Persons required to file the FBAR:

- US persons (including a Green Card holder, or individual who is treated as a US "resident" due to prolonged physical presence in the US pursuant to the US tax laws) who have ownership or control (for example, signature authority) of foreign accounts with an aggregate value of over $10,000 in the calendar year.
- Please note that a non-US individual, who merely makes a so-called 6013(g) election in order to file a joint tax return with their US spouse, is not treated as a US person for purposes of filing the FBAR.

Foreign (non-US) “Accounts” required to be disclosed:

- Bank, securities, financial instruments accounts
- Commodity futures or options accounts
- Accounts held in commingled funds (mutual funds) and the account holder holds an equity interest in the fund
- Foreign life insurance or annuities with cash surrender value
- Individually owned bonds, notes, stock certificates, and unsecured loans are not “accounts”

Many mistakes are made with FBAR filings, the most common being:

- Many people are under the mistaken belief that if one has several overseas accounts and a particular account is not over $10,000 then that account does not have to be reported. This is incorrect. Remember if the highest aggregate value of all of the foreign accounts on any day in the tax year is over $10,000, then all accounts must be reported on the FBAR.
- Another common mistake arises when an account beneficially belongs to another person. In this case it is often erroneously believed that the nominee does not need to report that account on an FBAR. This is incorrect; the nominee must still file the FBAR if the dollar threshold is met by the nominee.
- Other mistakes involve an improper understanding about what must be disclosed on the FBAR – for example foreign mutual funds or foreign life insurance / foreign annuity with a cash surrender value.

Don’t Forget Schedule B

Even if you do not have enough dividend or interest income to require filing of Schedule B with your tax return, US taxpayers filing Form 1040 are required to check a box on Schedule B, Part III, indicating whether they have an interest in or signature authority over a financial account in a foreign country. Make sure this question and its follow-up are answered both accurately and completely.

The FBAR form is not to be attached to any tax return. It must be filed (assuming the requisite conditions are met) even if the individual is not under an obligation to file an income tax return.

FATCA and Form 8938

The Foreign Account Tax Compliance Act (FATCA) of 2009/2010 did introduce an additional reporting requirement. Under FATCA, certain U.S. taxpayers holding financial assets outside the United States must report those assets to the IRS on Form 8938, Statement of Specified Foreign Financial Assets. There are serious penalties for not reporting these financial assets (as described below). This FATCA requirement is in addition to the long-standing FBAR requirement.

FATCA will also require certain foreign financial institutions to report directly to the IRS information about financial accounts held by U.S. taxpayers or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. The reporting institutions will include not only banks, but also other financial institutions, such as investment entities, brokers, and certain insurance companies. Some non-financial foreign entities will also have to report certain of their U.S. owners.

Therefore, if you set up a new account with a foreign financial institution, it may ask you for information about your citizenship and tax residency.

Reporting by U.S. Taxpayers Holding Foreign Financial Assets

FATCA requires certain U.S. taxpayers who hold foreign financial assets with an aggregate value of more than the reporting threshold (at least $50,000) to report information about those assets on Form 8938, which must be attached to the taxpayer's annual income tax return. The reporting threshold is higher for certain individuals, including married taxpayers filing a joint annual income tax return and certain taxpayers living in a foreign country.

There are some exceptions to the requirement that you file Form 8938. For example, if you do not have to file a U.S. income tax return for the year, then you do not have to file Form 8938, regardless of the value of your specified foreign financial assets. Also, if you report interests in foreign entities and certain foreign gifts on other forms, you may just list the submitted forms on Form 8938, without repeating the details.

Reporting Thresholds

Reporting thresholds vary based on whether you file a joint income tax return or live abroad. If you are single or file separately from your spouse, you must submit a Form 8938 if you have more than $200,000 of specified foreign financial assets at the end of the year and you live abroad; or more than $50,000, if you live in the United States. If you file jointly with your spouse, these thresholds double.

You are considered to live abroad if you are a U.S. citizen whose tax home is in a foreign country and you have been present in a foreign country or countries for at least 330 days out of a consecutive 12-month period. Taxpayers living abroad. You must file a Form 8938 if you must file an income tax return and:

- You are married filing a joint income tax return and the total value of your specified foreign financial assets is more than $400,000 on the last day of the tax year or more than $600,000 at any time during the year. These thresholds apply even if only one spouse resides abroad. Married individuals who file a joint income tax return for the tax year will file a single Form 8938 that reports all of the specified foreign financial assets in which either spouse has an interest.

- You are not a married person filing a joint income tax return and the total value of your specified foreign financial assets is more than $200,000 on the last day of the tax year or more than $300,000 at any time during the year.

Taxpayers living in the United States. You must file Form 8938 if you must file an income tax return and:

- You are unmarried and the total value of your specified foreign financial assets is more than $50,000 on the last day of the tax year or more than $75,000 at any time during the tax year
- You are married filing a joint income tax return and the total value of your specified foreign financial assets is more than $100,000 on the last day of the tax year or more than $150,000 at any time during the tax year.
- You are married filing separate income tax returns and the total value of your specified foreign financial assets is more than $50,000 on the last day of the tax year or more than $75,000 at any time during the tax year.

For purposes of calculating the value of your specified foreign financial assets in applying this threshold, include one-half the value of any specified foreign financial asset jointly owned with your spouse. However, report the entire value on Form 8938 if you are required to file Form 8938.

Specified Foreign Financial Assets

Specified foreign financial assets include foreign financial accounts and foreign non-account assets held for investment (as opposed to held for use in a trade or business), such as foreign stock and securities, foreign financial instruments, contracts with non-U.S. persons, and interests in foreign entities.

There are exceptions to the reporting requirement. For example, you do not have to report the following assets because they are not considered specified foreign financial assets:

- A financial account maintained by a U.S. payor. A U.S. payor includes a U.S. branch of a foreign financial institution, a foreign branch of a U.S. financial institution, and certain foreign subsidiaries of U.S. corporations. Therefore, financial accounts with such entities do not have to be reported.
- A beneficial interest in a foreign trust or a foreign estate, if you do not know or have reason to know of the interest. If you receive a distribution from a foreign trust or foreign estate, however, you are considered to have knowledge of your interest in the trust or estate.
- An interest in a social security, social insurance, or other similar program of a foreign government.
- Other Exceptions from Reporting
    - If you reported specified foreign financial assets on other forms, you do not have to report them a second time on Form 8938. These include interests in
        - trusts and foreign gifts reported on Form 3520 or Form 3520-A (filed by the trust);
        - foreign corporations reported on Form 5471;
        - passive foreign investment companies reported on Form 8621;
        - foreign partnerships reported on Form 8865; and
        - registered Canadian retirement savings plans reported on Form 8891.

The value of the foreign financial assets reported on these forms is included in determining the total value of assets for the reporting threshold, but you do not have to list the assets on Form 8938. In this situation, identify on Form 8938 which and how many of these form(s) report the specified foreign financial assets.

Additional exceptions from reporting are made for certain trusts, certain assets held by bona fide residents of U.S. territories, and assets or accounts for which mark-to-market elections have been made under Internal Revenue Code Section 475. For example, a U.S. beneficiary of a domestic bankruptcy trust or a domestic widely held fixed investment trust is not required to report any specified foreign financial asset held by the trust on Form 8938.

The Instructions for Form 8938 provide more information on specified foreign financial assets.

Asset Valuation

You will need to determine the value of your specified foreign financial assets to know if the total value exceeds the threshold applicable to you. Generally, a reasonable estimate of the highest fair market value of the asset during the tax year is reported, but special rules apply to ease valuation burdens.

For reporting purposes, you may rely on periodic financial account statements (provided at least annually) to determine the maximum value of a financial account. For a specified foreign financial asset that is not held in a financial account, you may rely on the year-end value of the asset if it reasonably approximates the maximum value of the asset during the tax year. Special rules also apply for reporting the maximum value of an interest in a foreign trust, a foreign retirement plan, or a foreign estate.

You may determine the fair market value of a specified foreign financial asset based on information publicly available from reliable financial information sources or from other verifiable sources. Even if there is no information from reliable financial information sources regarding the fair market value of a reported asset, a reasonable estimate of the fair market value will be sufficient for reporting purposes.

For assets denominated in a currency other than U.S. dollars, use the U.S. Treasury Department's Financial Management Service foreign currency exchange rate to convert the denomination into U.S. dollars. If no U.S. Treasury Financial Management Service foreign currency exchange rate is available for a particular currency, use another publicly available foreign currency exchange rate to convert the value of a specified foreign financial asset into U.S. dollars. The exchange rate is determined by reference to the exchange rate on the last day of your tax year.

Non-Compliance with Form 8938 Reporting Requirements

If you must file Form 8938 and do not do so, you may be subject to penalties: a $10,000 failure to file penalty, an additional penalty of up to $50,000 for continued failure to file after IRS notification, and a 40 percent penalty on any understatement of tax attributable to non-disclosed assets.

The statute of limitations is extended to six years after you file your return if you omit from gross income more than $5,000 that is attributable to a specified foreign financial asset, without regard to the reporting threshold or any reporting exceptions. If you fail to file or properly report an asset on Form 8938, the statute of limitations for the tax year is extended to three years following the time you provide the required information. If the failure is due to reasonable cause, the statute of limitations is extended only with regard to the item or items related to such failure and not for the entire tax return.

If you make a showing that any failure to disclose is due to reasonable cause and not due to willful neglect, no penalty will be imposed for failure to file Form 8938, however. Reasonable cause is determined on a case-by-case basis, considering all relevant facts and circumstances.

State Issues

Most states in the United States define “residency” based on a person’s “domicile.” Domicile, in general, is the place where an individual intends to be his or her permanent home and to which such individual intends to return whenever absent.

An individual can only have one domicile at a time. Once a person acquires a domicile, he/she retains that domicile until another is acquired.

A change of domicile requires:

- abandonment of a prior domicile,
- physically moving to and residing in the new locality, and
- intent to remain in the new locality permanently or indefinitely.

If a person moves to a new location but intends to stay there only a limited time (no matter how long), their domicile does not change.

Domicile is not dependent on citizenship. However,

- A United States citizen shall not ordinarily be deemed to have changed domicile by going to a foreign country unless it is clearly shown that such individual intends to remain there permanently.

- Special rules apply to United States permanent residents especially when working abroad.

Unlike moving from state to state within the US, tougher rules apply for someone moving from a US State to a foreign country and simply changing residence is not always sufficient to break State domicile. We often encounter situations where US citizens move to a foreign country on a work visa. Many US States will argue that as a visa is conditional (for example on employment), that the individual does not have the right to permanently remain in the foreign country and as such cannot have established a new domicile whilst their immigration status is conditional.

How to Choose a Domicile State

For full-time travelers, the difference between residency and domicile matters a lot. Residency is legally defined as “your place of abode.” It’s where you live right now. Your domicile is your legal, permanent residence; it’s the place where you intend to return after your absence. Your domicile is what ties you to a specific state. You can have many residences but only one domicile.

Another way to look at the difference between residency and domicile is through a profession. For example, a professional in Louisiana might travel to Missouri to work for six or nine months, or even longer. They might be considered “residents” of Missouri because of their length of stay. But they keep their old address, old driver’s license, and vehicle tags in Louisiana. Louisiana is where their home is, and more importantly, where they intend to return when their work is finished. In other words, Louisiana is their domicile.

Every U.S. citizen has to have a domicile to pay taxes, vote, open a bank account, and handle all the other logistical details that come with being a legal citizen. Even when you don’t have a “home” in the traditional sense of the word, you still have to choose and set up a domicile.

Factors to Determine Intent

As indicated above, the location of a person’s domicile is dependent on a person’s intentions. Intent is a state of mind. A state of mind is difficult to prove. As a result, taxing authorities (and courts) look to a person's actions to determine their intent. Some of the factors that courts and taxing authorities look to include:

- Amount of time you spend in one location versus another
- Location of your spouse and children;
- Location of your principal residence;
- Where your driver’s license was issued;
- Where you maintain your professional licenses;
- Where you are registered to vote;
- Location of the banks where you maintain accounts;
- Location of your doctors, dentists, accountants, and attorneys;
- Location of the church, temple or mosque, professional associations, or social and country clubs of which you are a member;
- Location of your real property and investments;
- Permanence of your work assignments in a location; and
- Location of your social ties.

Overseas Assignments

A classic situation where an individual has moved outside of the US, but has not changed their domicile. Even if the move is for an extended period of time, there has been no change in domicile unless the individual intends to remain in the new locality permanently or indefinitely.

How the States Catch You

States do not typically track in detail the activities of each taxpayer. If a taxpayer leaves a state, has no further income sourced in that state, and ceases to file tax returns in that state, then the tax authorities of that state do not typically inquire where the taxpayer moved to or whether they changed their domicile. The domicile/residency issue usually arises in two different circumstances.

In the first circumstance, the taxpayer continues to have income sourced from that state, but the taxpayer begins filing as a nonresident.

The second circumstance is when a person, who has been filing as a resident of the state, ceases all filings in that state, and then at some point in the future again files as a resident of the state.

This second circumstance often applies to individuals that move overseas for a period of time and then return to the same state. When the state tax authorities receive a tax return, they check to see if that individual filed a tax return in prior years. If prior year resident tax returns have been filed, but there is a gap in filings (of perhaps several years), the state tax authorities begin to wonder why no tax returns were filed during the intervening years.

If the state tax authorities identify a person with a gap in tax filings, and they believe that that person retained their domicile in that state, then they will require the filing of state income tax returns for the intervening years. Statutes of limitations for tax returns generally begin to run on the date a tax return is filed. If no tax return has been filed for the intervening years, then the statute of limitations for those years remains open indefinitely.

Substantial Taxes May be Due

States do not typically allow foreign taxes paid as credits against state income taxes. Further, states may or may not conform to the federal rules which allow certain foreign earned income to be excluded from taxable income. As a result, persons temporarily residing overseas will often owe significant state income taxes, even though they may not be present in the state at all during the year.

Residency Exceptions

Some states provide exceptions to individuals being treated as residents, even if the individuals retain their domicile in that state. For instance, California allows (with certain exceptions) individuals that are domiciled in California to be treated as nonresidents of California if they are located outside California under an employment-related contract that lasts for at least 546 days.

Connecticut, on the other hand, has two alternative tests that allow Connecticut domiciled individuals to be treated as nonresidents. To meet the requirements of the first test, an individual must:

- not maintain a permanent place of abode in Connecticut for the entire year,
- maintain a permanent place of abode outside of Connecticut for the entire year, and
- not spend more than 30 days in Connecticut during the year.

To meet the requirements of the second test, an individual must: be in a foreign country for at least 450 days during any period of 548 consecutive days, and during this period, not spend more than 90 days in Connecticut (or have a spouse or minor children that spend more than 90 days in Connecticut).

As can be seen from the California and Connecticut rules, the state exceptions to residency for domiciled individuals are not consistent. Thus, it is important to review the rules for the state in which the person is domiciled.

Important Considerations

Choosing your domicile state is one of the most important decisions as an international entrepreneur. The state you choose will affect how much (if any) income tax you pay. It will affect how your will is processed if you pass away, how much your spouse is entitled to if you get divorced, and even how easy it is to get health insurance.

You can choose any state to be your domicile state, but there are three states that are “domicile friendly,” making them popular choices for location independent workers: Texas, Florida, and South Dakota. These states make it easy to establish and maintain domicile. There are many mail-forwarding services set up in these states to process and forward your mail. They also have no state income tax.

Other states are more complicated. Many states require you to spend at least 183 days within the state in fixed quarters, such as a house or apartment, to qualify for domicile. When you transition to your domicile state, it’s important that you do your best to cut all ties with the state you currently live in. When states try to claim you as a resident (for tax and census purposes), they look for property to establish domicile. If that’s nonexistent, they look for other “contacts,” like a driver’s license, vehicle registration, voter registration, or employment records.

If you establish domicile in one state but still have “contacts” in another state, you might find yourself caught between two states that both want you to pay income taxes or other fees.

Choose one state, and cut ties with the other completely if you can.

What do you need to consider when choosing your domicile state? Let's take a closer look at some of the big issues.

Voting

Most states allow you to register to vote when you go in for your driver's license. But how easy is it to vote absentee in your domicile state of choice? Absentee ballots can always be used in national elections; however, every state is different when it comes to voting absentee for state and local elections. This is an important consideration when you start looking at the benefits and drawbacks of domicile for each state.

Banking

Banking can be challenging as a full-time traveler. Thanks to the Patriot Act, financial institutions are required to have a residential address on file for every consumer. Additionally, the law specifically excludes mail-forwarding addresses. Even if you have existing accounts at your bank, you can still get in trouble if you don't change your address, and even temporarily lose access to your accounts if you get caught banking under an old address.

You also need to look at how easy it will be to use your current financial institutions on the road. Do they have an easy to use online banking system? If it's going to be a hassle to access your money easily on the road, you might need to find a new bank.

Do your B.E.S.T.

What does this mean? It's an acronym I came up with when doing tax seminars with the US exposed faculty of the Yale-NUS University in Singapore.

- B stands for Bank accounts. To understand this, please see the section above on FBARs and Form 8938.

- E stands for estimated taxes. The IRS prefers to receive their money as you earn it. They dislike having to wait to the end of the year to receive payment. If you don't pay enough tax through withholding and estimated tax payments, you may be charged a penalty. You also may be charged a penalty if your estimated tax payments are late, even if you are due a refund when you file your tax return.

- S stands for State returns. To understand this, please see the section above on State Issues

- T stands for talking. It's important that US exposed International Entrepreneurs and Expats should have a team of Tax Advisors that they could speak to. Especially before investing internationally.

Outbound Investors

As an international entrepreneur who is US exposed, you should always remember that anything and everything you do, may have US tax consequences. Investments in international real estate and other such international assets would be treated in line with the equivalent asset within the US. I'm assuming that before you started being an international entrepreneur you were doing business domestically within the US.

There're two (2) exceptions I want to draw to your attention. Owning or controlling companies overseas and investing in international mutual funds (known as PFICs). We will discuss PFICs later but I want to discuss the US international tax implications of owning a company outside of the US.

Tax Reform under the December 2017 Tax Cuts and Jobs Act (TCJA) was meant to make tax compliance easier for International Entrepreneurs by shifting corporate taxation from worldwide basis to territorial basis. For very large multinationals, one can make the argument that things are now more tax efficient and a quasi territorial system for US corporations now exists.

For US exposed international entrepreneurs however, the TCJA may have unintentionally made things more complicated. I'll now explain why but do bear in mind that we're now entering into an area of international tax which has quite a number of moving pieces. This is just an overview and it is definitely necessary to retain a qualified tax team is definitely needed.

In short, the ability of international entrepreneurs to retain profits in a US controlled foreign corporation (called a CFC or controlled foreign corporation) is virtually eliminated. Previously it was easier to have a CFC on which we only pay US taxes when we enjoyed a distribution (in the form of salary, bonus or dividends). As a result of the TCJA, we must now pay US tax on our profits, even though the profit is not distributed. So we pay US tax on what is essentially phantom income.

Also strengthened attribution rules mean that using nominees is a weaker strategy than it was previously. It basically does not work.

Controlled foreign corporation (CFC) rules are features of an income tax system designed to limit artificial deferral of tax by using offshore low taxed entities. The rules are needed only with respect to income of an entity that is not currently taxed to the owners of the entity. Generally, certain classes of taxpayers must include in their income currently certain amounts earned by foreign entities they or related persons control.

These CFC rules generally define the types of owners and entities affected, the types of income or investments subject to current inclusion, exceptions to inclusion, and means of preventing double inclusion of the same income. Countries with CFC rules include not only the United States (since 1962), but also the United Kingdom, Germany, Japan, Australia, New Zealand, Brazil, Russia (since 2015), Sweden, and many others. Rules in different countries may vary significantly.

In the US -

- A Controlled Foreign Corporation is any corporation organized outside the U.S. (a foreign corporation) that is more than 50% owned by U.S. Shareholders.

- A U.S. Shareholder is any U.S. person (individual or entity) that owns 10% or more of the foreign corporation. Complex rules apply to attribute ownership of one person to another person.

Under prior and current law, a C.F.C. is any foreign corporation in which U.S. Shareholders (defined below) own more than 50% of the foreign corporation's stock by value or vote.

Under prior law, a foreign corporation was required to be controlled for 30 days before the Subpart F rules applied. Under the new law, the 30-day requirement is no longer in effect. Let's take a look at what Subpart F means.

Subpart F

Enacted in 1962, these rules incorporate most of the features of CFC rules used in other countries. Subpart F was designed to prevent U.S. citizens and resident individuals and corporations from artificially deferring otherwise taxable income through the use of foreign entities.

The rules require that a U.S. Shareholder, of a Controlled Foreign Corporation ("CFC") must include in his/its income currently

- His / its share of Subpart F Income of the CFC and
- His/its share of earnings and profits ("E&P") of the CFC that are invested in United States Property,

and further exclude from his/its income any dividends distributed from such previously taxed income.

Subpart F income includes the following:

- Foreign personal holding company income (FPHCI), including dividends, interest, rents, royalties, and gains from alienation (ie when you get rid of it) of property that produces or could produce such income. Exceptions apply for dividends and interest from related persons organized in the same country as the CFC, active rents and royalties, rents and royalties from related persons in the same country as the CFC, and certain other items.

- Foreign base company sales income from buying goods from a related party and selling them to anyone or buying goods from anyone and selling them to a related party, where such goods are both made and for use outside the CFC's country of incorporation. A branch rule may cause transfers between a manufacturing branch of a CFC in one country and a sales branch in another country to trigger Subpart F income.

- Foreign base company services income from performing services for or on behalf of a related person. A substantial assistance rule can cause services performed for unrelated parties to be treated as performed for or on behalf of a related party.

- Foreign base company oil-related income from oil activities outside the CFC's country of incorporation.

- Insurance income from insurance or annuity contracts related to risks outside the CFC's country of incorporation.

but it does not include:

- Items of income which (after considering deductions, etc., under U.S. concepts) were subject to foreign income tax in excess of 90% of the highest marginal U.S. tax rate for the type of shareholder;

- De minimis amounts of Subpart F income in the absence of other Subpart F income in the period;

- Such income if the CFC has a deficit in E&P, in which case it is deferred from recognition until the CFC has positive E&P.

- Any dividend received which is considered paid from amounts previously taxed under Subpart F.

Corporate U.S. shareholders are entitled to a foreign tax credit for their share of the foreign income taxes paid by a CFC with respect to E&P underlying a Subpart F inclusion. To prevent avoidance of Subpart F, U.S. shareholders of a CFC must recharacterize gain on disposition of the CFC shares as a dividend. In addition, various special rules apply.

We will leave Subpart F there for now.

For US Shareholders (of CFCs) that are domestic corporations, the Act puts into place a "participation exemption" in the form of a 100% dividends-received deduction for dividends from 10%-or-greater owned foreign corporations (including but not limited to CFCs).

But the TCJA introduced a new "GILTI" tax. In an effort to ensure that some minimal amount of tax is paid by U.S. taxpayers on their low-taxed foreign income, the Act features a new tax on "global intangible low-taxed income" ("GILTI"). Every US Shareholder of a CFC will be required to include in gross income its GILTI for the taxable year. But whereas US Shareholders that are domestic corporations will pay the GILTI tax at half the rate of the regular tax, US Shareholders who are individuals will pay the tax at their top marginal rate (37% under the TCJA).

And whereas domestic corporations will be eligible to claim foreign tax credits for 80% of foreign taxes paid on GILTI income, individuals will not be entitled to any foreign tax credits.

In addition to the benefits described above, domestic corporations may also benefit from a new tax incentive contained in the Act, for income referred to as "foreign-derived intangible income" ("FDII"). The Act allows a U.S. corporation to claim a 37.5% deduction with respect to its FDII, effectively reducing the tax rate thereon to 13.125%. Generally, FDII is intended to capture income, over a base return on tangible property, derived from property sold or services provided in foreign markets. While sometimes referred to as a "patent box," it applies more broadly to foreign-derived income.

Again, please note that this is just an introduction. Just bear in mind that when US persons control foreign companies (especially those in low tax jurisdictions), it could be subject to US tax on income that has not yet been distributed to the US shareholders.

Inbound Investors

We have spoken so far about US exposed international entrepreneurs investing internationally. Now we speak about non US exposed international entrepreneurs investing into the USA.

Taxable corporate acquisitions -

- Asset acquisitions are often tax inefficient for US sellers who want to enjoy the lower capital gains tax rates plus it may result in double taxation when sale proceeds are distributed to the target's shareholders. Under certain circumstances where there are non-US shareholders, this second layer of taxation can be avoided in respect of such non-US shareholders via distribution of sale proceeds through a liquidation (as opposed to payment of a dividend). At the same time, acquirers prefer asset acquisitions owing to the ability to receive a step-up in basis in the target's assets, resulting in higher post-acquisition depreciation deductions.

- It is possible, through a section 338(h)(10) election to structure a transaction as a stock acquisition but giving the acquirer a basis step-up in the target's assets so that it can receive higher post-acquisition depreciation deductions.

- Corporate acquisitions in the US can be accomplished via tax-free reorganisation, provided that the strict conditions to qualify for the applicable reorganisation under the Internal Revenue Code (the Code) are met.

- Interest and dividend payments - In general, US federal tax law imposes a 30 per cent withholding tax on US-source interest and dividends paid to non-US payees, subject to reduction via an applicable income tax treaty. Important exceptions to withholding on interest include debt obligations that qualify under the portfolio interest rules, bank deposit interest and obligations that mature within 183 days or less.

Usually, the sale by a non-US parent of its shares of a US corporate subsidiary will not be subject to US federal income tax. However, if that US subsidiary owns US real-property interests (real estate), then the gains on the sale of stock could be subject to US federal income tax.

The 2017 TCJA significantly reduced the US federal corporate income tax rate which has resulted in a new focus on the use of corporations for inbound investment. Where a US corporate subsidiary can be paired with a non-US corporate parent, benefits may include:

- limited US income tax filing exposure; and
- for non-US natural persons owning interests in the non-US corporate parent, US estate tax protection.

Moreover, depending on the type of assets held by the US corporate subsidiary, the non-US corporate parent, company or individual may not be subject to US federal income tax on disposal of the shares in such a subsidiary.

By far the most common investment target we deal with as a practice is US real estate. Naturally foreign (also called Non Resident Alien or NRA) investors, want to know how investment into American business should best be structured. An NRA can acquire U.S. assets using several alternative ownership structures. The NRA's goals and priorities dictate the type of structure that is used. Each alternative has its own advantages and disadvantages – there is no perfect structure.

Direct investment (assets owned by the NRA) is simple. Assets are held in the NRA's own name and is subject to only one level of tax on the disposition. The disadvantages of the direct investment are: no privacy, no liability protection, the obligation to file U.S. income tax returns, and if owned at death, the U.S. asset is subject to U.S. estate taxes.

Under an LLC/LP structure, the NRA acquires the U.S. asset through an LLC or a limited partnership. The LLC may be a disregarded entity or a tax partnership for U.S. income tax purposes. This is an improvement over the direct ownership alternative, because this structure provides the NRA with some privacy and liability protection and allows for lifetime transfers that escape the gift tax. The obligation to file U.S. income tax returns and the possibility for a U.S. estate tax on death remain.

Ownership of U.S. assets through a domestic corporation (the corporation will always be a “C” corporation; a foreign shareholder precludes an “S” corporation) (Code Section 1361(b)(1)(C)) will afford privacy and liability protection, allow lifetime gift tax-free transfers, and avoid the foreigner’s need to file U.S. income tax returns. Engaging in a U.S. trade or business requires a U.S. tax return; ownership of stock will not trigger a return filing obligation.

There are three disadvantages to the ownership of U.S. assets through a domestic corporation:

- federal and state corporate income tax at the corporate level will add a second layer of tax,
- dividends from the domestic corporation to its foreign shareholder will be subject to 30% withholding, and

- the shares of the domestic corporation will be included in the U.S. estate of the foreign shareholder.

If the corporation owns primarily real estate in the U.S., on the disposition of the stock in the corporation the foreign shareholder will be subject to FIRPTA. This is a tax rule that will require the filing of a U.S. income tax return and 15% tax withholding by the purchaser of the shares.

Ownership of the U.S. assets may be by the U.S. corporation directly, or through a U.S. partnership or disregarded entity owned by the corporation. The corporation may even be an LLC that checks-the-box to be taxed as a corporation. In turn, the ownership of the U.S. corporation by the NRA may be direct, or through a foreign partnership or disregarded entity.

Foreign corporation ownership offers the following advantages:

- liability protection,
- no U.S. income tax or filing requirement for the foreign shareholder,
- shares in the foreign corporation are non-U.S. assets not included in the U.S. estate,
- dividends are not subject to U.S. withholding,
- no tax or filing requirement on the disposition of the stock, and
- no gift tax on the transfer of shares of stock.

The disadvantages of using the foreign corporation are:

- corporate level taxes (just like with the domestic corporation), because the foreign corporation may be deemed engaged in a U.S. trade or business; and
- the foreign corporation will be subject to the branch profits tax, the largest disadvantage of ownership of U.S. real estate through a foreign corporation.

Because the branch profits tax is often not reduced or eliminated by a treaty, the most advantageous structure for ownership of U.S. assets by NRAs is through the foreign corporation-U.S. corporation structure. Here, the NRA owns a foreign corporation, which in turn owns a U.S. LLC taxed as a corporation.

This structure affords privacy and liability protection, escapes U.S. income tax filing requirements, avoids U.S. estate taxes, allows for gift tax-free lifetime transfers and avoids the branch profits tax. Distributions from the U.S. subsidiary to the foreign parent are subject to the 30% FDAP withholding, but the timing and the amount of such dividend is within the NRA's control.

Other Concerns for Location Independent Entrepreneurs

There are three (3) other issues I wanted to touch on under the heading of taxation for US exposed international entrepreneurs and expats.

i. Self Employment (S.E.) Taxes

When an international entrepreneur runs a business as either a sole proprietor or a pass-through such as an LLC, it often tax inefficient. What I mean is that such a business is exposed to a completely avoidable US tax called self employment (SE) taxes.

If you are a self-employed U.S. citizen or resident, the rules for paying self-employment tax are generally the same whether you are living in the United States or abroad. The self-employment tax is a social security and Medicare tax on net earnings from self-employment. You must pay self-employment tax if your net earnings from self-employment are at least $400.

There are 2 ways of mitigating this tax.

Firstly by working for or through an incorporated entity as opposed to a pass through.

Secondly, the United States has entered into social security agreements with foreign countries to coordinate social security coverage and taxation of workers employed for part or all of their working careers in one of the countries. These agreements are commonly referred to as Totalization Agreements. Under these agreements, dual coverage and dual contributions (taxes) for the same work are eliminated. The agreements generally make sure that social security taxes (including self-employment tax) are paid only to one country. So if you are paying SE taxes in another country with a Totalization Agreement you may not have to pay SE taxes to the US.

ii. PFICs

We previously discussed CFC rules which were designed to prevent US persons from deferring paying US tax on international earnings using structures. Another anti deferral tool would be the PFIC regime.

The PFIC tax regime was created via the Tax Reform Act of 1986 with the intent to level the playing field for US based investment funds (ie mutual funds). Prior to the legislation of 1986, U.S.-based mutual funds were forced to pass-through all investment income earned by the fund to its investors (resulting in taxable income). In contrast, foreign mutual funds were able to shelter the aforementioned taxable income as long as it was not distributed to its U.S. investors.

After the passage of the Tax Reform Act of 1986, the main advantage of foreign mutual funds was effectively nullified by a tax regime that made the practice of delaying the distribution of income prohibitively expensive for most investors. To employ this punitive regime, the IRS requires shareholders of PFICs to effectively report undistributed earnings via choosing to be taxed through one of three possible methods- Section 1291 fund, Qualified Election Fund, and Mark to Market election.

Defined in the Internal Revenue Code (section 1297), a Passive Foreign Investment Company is any foreign corporation that has either:

- 75% or more of its gross income classified as passive income (i.e. interest, dividends, capital gains, etc…), or
- 50% or more of its assets are held for the production of passive income.

While there are a few exceptions to the above rules, most foreign mutual funds, pension funds, some insurance policies and money market accounts would be good examples of PFICs. Furthermore, many foreign REITS also get trapped in the PFIC web. Finally, a foreign holding company that possesses passive investments (like rental real estate or government bonds) would be subject to PFIC regulations if the company was set up as a corporation.

Be careful with PFICs as the tax consequence is often draconian.

iii. Related Party Transactions - Transfer Pricing

Transfer pricing potentially applies not US exposed international entrepreneurs but it potentially applies to any entrepreneur who operates a structure with related party transactions.

Transfer pricing can be defined as the mechanism by which related entities switch price intercompany flows of tangible goods, intellectual property, services and loans. Note that -

- This applies to both international and domestic transactions
- Transfer prices allocates profits across the enterprise.

Transfer pricing is a hot topic globally. In the USA, section 482 of the Internal Revenue Code 1986 provides the statutory basis for regulating transfer pricing. Treasury Regulation Section 1.482-1(b) states that "in determining the true taxable income of a controlled taxpayer, the standard to be applied in every case is that of a taxpayer dealing at arm's length with an uncontrolled taxpayer."

So it is as simple as this. When you structure inter party transactions, tax authorities want to know that the pricing was determined at arm's length as if dealing with a third party.

This is a priority for the IRS and recent transfer pricing cases decided by the US Tax Court include:

- Eaton Corporation and Subsidiaries v Commissioner (TC Memo, 2017-147) – in which the Internal Revenue Service (IRS) abused its discretion in cancelling two unilateral advanced pricing agreements covering the transfer of certain products, the license of intangible property and cost sharing between Eaton's US subsidiaries and foreign subsidiaries;
- Medtronic Inc v Comm'r (TC Memo 2016-112) – in which the IRS abused its discretion in adjusting royalties paid by a licensed Class III medical device manufacturer to produce and sell implantable cardiac medical devices;
- Amazon.com, Inc v Comm'r (148 TC No 8, 2017) – in which the IRS's determination of a cost-sharing 'buy-in' payment using a discounted cash flow method was arbitrary, capricious and unreasonable. Amazon's use of the comparable uncontrolled transaction method, "with appropriate upward adjustments" was the best method to determine the buy-in payment; and
- Altera Corp v Commissioner (145 TC No 3, 2015) – in which a final treasury regulation requiring participants in qualified cost-sharing agreements to share stock-based compensation costs in order to achieve an arm's-length result was invalid.

Appeals are pending in Medtronic, Amazon and Altera. In addition, high-profile cases involving Coca Cola and Microsoft are pending in the courts.

Virtually all transactions are subject to the US transfer pricing rules, including:

- transfers of tangible property (Treasury Regulation Section 1.482-3);
- transfers or use of intangible property (Section 1.482-4);
- providing (or receiving) services (Section 1.482-9);
- borrowing transactions (Section 1.482-2(a));
- global trading in financial instruments (Proposed Treasury Regulation Section 1.482-8);
- leasing transactions (Treasury Regulation Section 1.482-2(c); and
- intangible property cost sharing arrangements (Section 1.482-7).

The knee jerk reaction among many international entrepreneurs is to use nominees. In the US context, as well as with many other jurisdictions - this just does not avoid the legal obligation. The statute and regulations refer to commonly owned or 'controlled' entities and commonly 'controlled' transactions. Treasury Regulation Section 1.482-1(i)(4) includes the following definition for 'controlled':

> "Controlled includes any kind of control, direct or indirect, whether legally enforceable or not, and however exercisable or exercised, including control resulting from the actions of two or more taxpayers acting in concert or with a common goal or purpose. It is the reality of the control that is decisive, not its form or the mode of its exercise. A presumption of control arises if income or deductions have been arbitrarily shifted."

U.S. Estate Taxes

The annual federal gift tax exclusion allows you to give away up to $15,000 in 2019 to as many people as you wish without those gifts counting against your $11,400 million lifetime exemption. (After 2019, the $15,000 exclusion may be increased for inflation.)

Worldwide Assets

The U.S Estate Tax is imposed on the “Gross Estate” of U.S Citizens and U.S residents. This phrase, “wherever situated”, imposes the Estate and Gift Tax on “worldwide assets “. The Estate Tax and Gift Tax attach to all assets regardless of the location of U.S citizens or residents (or his property) at the time of gift or death. Citizens and non-citizens residents are afforded a unified credit against the Estate and Gift Tax, which currently “shields” assets. No Gift Tax or Estate Tax is actually payable by U.S citizens and residents until the value of lifetime gifts and bequests exceed the unified credit.

Transfers Between U.S. Citizens Spouses

U.S citizens may delay the imposition of either the Gift Tax or the Estate Tax transfer between citizens spouses.

Such transfers may be accomplished during life or at death and either by outright gift or through gifts in trust (for the benefit of the other spouse).

The first spouse to die may leave his or her entire estate to the surviving U.S citizen spouse without triggering the Estate Tax (payable on the death of the second spouse). Thus, any Estate Tax owed by the first spouse to die may be delayed (by devising the deceased’s estate to the surviving spouse). This concept is known as the “unlimited” marital deduction.

A U.S citizen or resident may also “port” his or her individual exclusion amount to the surviving spouse. Any exclusion amount not used by the first spouse to die (by lifetime and testamentary non-spousal gifts) may therefore be transferred (or “ported”) to the qualifying surviving spouse. The total amount of property excluded from the Estate tax may therefore be “pooled” by the U.S spouses (and applied against the taxable estate of the second spouse to die).

Certain limitations are, however, imposed on the marital deduction for property transferred to a non-U.S citizen spouse (even if the recipient spouse is a U.S resident).

Testamentary Transfers to Non-Citizen Spouses

Marital Deduction For Bequests - The marital deduction on testamentary transfers to non-citizen spouses is restricted. If the surviving spouse is not a U.S is not a U.S citizen, the survivor may not generally receive a bequest (of the deceased spouse’s estate) tax-free. The restriction is intended to limit the risk that the surviving (even if a U.S. resident) leaves the U.S. with a taxable estate. A shift in domicile would allow for avoidance of Estate tax, as the survivor (with the assets) could permanently leave the U.S. and elude Estate Tax on “worldwide” assets.

Qualified Domestic Trusts

Any U.S. citizen or U.S resident with a U.S. estate may defer Estate tax on testamentary transfers to a non-citizen spouse through a special trust. The grantor spouse must leave his or her estate to a “Qualified Domestic Trust” (“QDOT”), as a condition to receiving the marital deduction. Only through the QDOT may Estate Tax be deferred until the death of the non-citizen surviving spouse.

Rules of administration exempt the QDOT from “foreign trust" (and the associated onerous reporting requirements).

Lifetime Gifts to Citizen and Non-Citizen Spouse

Only citizens enjoy an unlimited deduction (i.e., no tax imposed) for lifetime spousal gifts. Similar to the restriction on tax-free testamentary gifts to non-citizen spouses, tax-free lifetime gifts are also limited.

If the spouse receiving a lifetime gift is not a U.S. citizen, the gifting spouse may only deduct $147,000 in tax-free spousal gifts during any calendar year.

The limitation on lifetime gift applies even if both spouses are domiciled in the U.S. at the time of the gift. The domicile of both the donor and done is irrelevant. Annual lifetime gifts to non-citizen spouses are taxed on value exceeding $147,000. Interestingly, the limitation on gifts to non-citizen spouses does not limit tax-free gifts by non-citizen spouses to a U.S. citizen spouse.

A non resident non citizen (NRNC) considering U.S. residency should make any intended large spousal gifts of foreign property and U.S. intangible property before moving to the U.S. Once domiciled in the U.S. (with a non-citizen spouse), the (now U.S.) grantor is subject to the Gift Tax on all assets held worldwide. The U.S. grantor spouse then faces the $147,000 limitation on tax-free spousal gifts.

This leaves the U.S. spouse the options of

- applying his or her remaining Estate Tax and Gift Tax exclusion (against gifts exceeding the limitation) or
- deferring the gift until death.

Deferral until death of the U.S. spouse will potentially avoid Gift and Estate Tax entirely through either

- a testamentary QDOT trust or
- applying the grantor's Estate Tax Credit (to the extent sufficient to cover the value of the gift).

Estate Tax Imposed on Non-Resident Non Citizens (NRNC)

- Property "Situated in the United States" - The Estate Tax imposed on NRNCs is limited to property owned "which at the time of the NRNC's death is situated in the United States". The U.S. taxable estate of a NRNC also includes U.S. assets held in a foreign or U.S. trust generally controlled by or accessible to the NRNC.

- To avoid the Estate Tax, the NRNC should avoid having assets "situated" in the United States.

- To determine where an asset is "situated", one must first look to the U.S Treasury Regulation which deem certain assets U.S "situs" property. Such assets (deemed located in the U.S.) include U.S. real estate, stock in U.S, corporations and certain tangible personal property. Determining the "situs" of other assets is a more factual inquiry. Factors include the owner's rights to the assets and the connections between the asset and a given country.

Gift Tax on Non-Resident Non Citizens

- NRNCs are subject to U.S. Gift Tax on U.S. assets. Intangible assets are, however, excluded.

- A non-resident non-citizen may therefore make unlimited gifts to U.S. stocks and bonds free of Gift Tax.

- Although neither Congress nor the IRS has defined “intangible property”, case law allows for certain generalizations. Assets whose value is derived from contract law or a cause of action similar to contract law are considered intangible property. Such assets include annuities, shares of stock, membership interests and other entity ownership rights. Life insurance policies and bank deposits also qualify as intangible property.

- Interestingly, if U.S. securities (or other intangible U.S. assets) are not given away (before death), they become subject to Estate Tax upon the NRNC owner’s death. To minimize Estate Tax (ultimately payable on death), NRNCs should make lifetime transfer of U.S. intangible property.

- NRNC gifts of tangible U.S. property are taxed to the extent of value exceeding $14,000 (per donee per year). Smaller gifts fall within the annual Gift Tax exclusion. Unlike gifts made by U.S. residents or citizens, Gift Tax incurred by NRNCs may not be avoided by offset against the Estate Tax credit.

- There are also significant restrictions on tax-free lifetime gifts to non-citizen spouses. The most significant is the absence of the “unlimited” lifetime marital deduction.

Shifting Assets from U.S. Situs

Although lifetime gifts of U.S intangibles by NRNCs are exempt from Gift Tax, all U.S. situs assets (both tangible and intangible) are taxable upon the death of a NRNC owner.

Those same assets held in a foreign corporation are, however, excluded from Estate Tax. Shares of corporate stock in a foreign entity held by a NRNC are subject to neither Gift Tax nor Estate Tax.

Treasury Regulation indicate that the “situs” of an entity is determined by looking at the place where the entity is created or organized. The regulations further state that this test applies “irrespective of the location of the (ownership) certificates”. Consequently, shares of stock owned by the decedent in a U.S. entity are subject to Estate Tax. Conversely, ownership by a NRNC in foreign corporate entity (if properly organized) is not subject to Estate Tax.

Real Property

Real property has situs in the jurisdiction in which it is located. Consequently, U.S. real estate (a tangible asset) is included in the taxable estate of a NRNC.

If real estate is instead owned by a foreign corporation (itself owned by the NRNC), the property is excluded from the Gift Tax and Estate Tax.

The NRNC acquiring U.S. real estate should initially do so through a foreign corporation. If U.S. real estate is initially purchased directly by the NRNC, later transfer of the property to an offshore corporation could have tax consequences. Appreciated U.S. real estate held by a NRNC will trigger taxable gain upon transfer to a foreign corporation.

Chapter 6 - Online Sellers - Indirect Taxes

Take Away: If you're an online seller, be prepared for indirect taxes. It may impact your bottom line and your back office processes since you are responsible for collecting and paying it to the authorities.

- Indirect tax varies by jurisdiction. In the US alone, there are over 10,000 sales and use tax jurisdictions.
- Some jurisdictions allow online processing of returns and payments. Some still require paper filing.
- Some jurisdictions identify a "responsible person" and hold that person liable for non payment. Selling through a company cannot protect you.
- If you have not been compliant in the past, some jurisdictions allow for tax amnesty options.
- If you're in the UK, get your team prepared for EU indirect tax (VAT) changes post Brexit.

Unsurprisingly, most of our location independent international entrepreneurs, run their businesses online. As a result, it is a space that our team has had to spend time mastering. In fact we have had to take on associates who specialize in taxation around online selling.

The rules are somewhat fluid so this section of the book needs to be read with caution. It is written in 2019 and it is quite likely that by the time it is read, many of the rules may be outdated. But it gives an indication as to the rules that you and your team need to consider.

In this chapter, I use the US, the UK and Singapore as case studies. Please check with your tax team to determine what rules apply in your jurisdictions.

USA

Originally, sales and use tax collection was based on having a physical presence (such as a fulfillment center) in the state. On June 21, 2018, the U.S. Supreme Court overturned decades of established law that required vendors to have a physical presence in a state before that state could require them to collect and remit sales and use taxes on purchases by customers within the jurisdiction. The Court overturned its 1992 decision, Quill Corp. v. North Dakota, with its recent decision in South Dakota v. Wayfair, Inc., noting that "the physical presence rule, both as first formulated and as applied today, is an incorrect interpretation of the Commerce Clause." It is safe to say that this is the most important development in the sales tax world in at least 25 years.

But what does it mean for online sellers? If your tax team was paying attention, they would have seen this coming. The shift from physical nexus to a broader economic nexus has been years in the making.

Click-through nexus

In 2008, New York enacted click-through nexus legislation that requires out-of-state internet retailers to collect and remit state sales tax on tangible personal property or taxable services sold through links on websites owned by in-state residents, referred to as "affiliates." The law applied a threshold requirement of at least $10,000 in gross receipts from referred sales. Since 2008, approximately 22 additional states have enacted similar legislation or issued guidance interpreting current state laws to allow comparable treatment.

Affiliate nexus

In 2010, Colorado took a different approach to taxing out-of-state sellers and enacted controlled group nexus. Under this law, out-of-state sellers must collect Colorado tax if they are part of a "controlled group," defined by reference to the Internal Revenue Code, that has a "component member" that is a retailer with a physical presence in the state. The statute permits the nexus presumption to be rebutted under certain conditions. Since Colorado enacted its law, over 20 states have enacted some form of controlled-group nexus.

Cookie nexus

Massachusetts took a different position than other states on how to require sales tax collection from internet sellers. The commonwealth, through issuance of Directive 17-1, stated that it was adopting an administrative bright-line rule for internet vendors based on a dollar and transaction threshold, as long as they had physical presence in the state. While at first, the interpretation seems similar to other economic nexus standards, Directive 17-1 went on to explain that physical presence is invariably satisfied for internet vendors by the presence of in-state internet "cookies" (which identify the user) or content delivery networks such as in-state computer servers. The directive was immediately challenged on procedural grounds and withdrawn, but new regulations were issued on Sept. 22, 2017, that provide substantially the same requirements.

Marketplace provider nexus

Yet another strategy to increase sales tax collection has been to enact "marketplace provider" provisions. The provisions generally require marketplace providers to either -

- collect or remit on behalf of their sellers, or
- comply with certain notice and reporting requirements.

Economic nexus

While several states saw the expanded nexus provisions described above as the path forward, South Dakota enacted a law in 2016 that required out-of-state sellers to collect and remit sales tax based on economic nexus, not on physical presence. The law requires a remote seller with no physical location in South Dakota to collect and remit sales tax on transactions with South Dakota customers if the remote seller, in the previous calendar year or the current calendar year, has either sales of over $100,000 a year or 200 separate transactions with South Dakota customers. Several states followed South Dakota's lead.

Notice and reporting

In addition to states' expanding the definition of physical presence, in 2010 Colorado enacted the nation's first use tax notice and reporting requirement for out-of-state sellers. Enacted in 2017, the law requires out-of-state sellers that do not collect sales tax on sales made to customers within Colorado and that have gross receipts in excess of $100,000 during the previous calendar year to report information about Colorado customers to the Colorado Department of Revenue. Several states have followed Colorado's lead, enacting similar notice and reporting requirements in an effort to increase use tax compliance by individuals.

Implications of the Wayfair decision

So here we are in 2020. What happens now? Well, the State of California is now retroactively seeking sales tax from out-of-state online merchants, going back as far as 2012. How is this possible? Prior to Wayfair, as mentioned above, there were many other kinds of nexus statutes on the books of states that businesses had to comply with, e.g., “click-thru nexus”, “cookie nexus”, “affiliate nexus”, “marketplace nexus”, etc. These nexus rules were variations on the physical presence test under Quill. However, post-Wayfair, those laws are still on the books and so far, remain effective for current as well as past years. And there are two risks here.

- The first risk is that these rules might have applied to the business in the past (whether it knew it, should have known it or not) and so in its zeal to register in states under Wayfair, a business may find itself liable for unexpected and unbudgeted past tax liability under these other nexus rules.

- The second risk is that once a business registers, it may no longer be entitled to use a Voluntary Disclosure Agreement (VDA or amnesty) to limit past liability exposure.

Voluntary Disclosure Agreements to Manage Past Liability

There are two basic types of VDAs:

- individual state-sponsored VDAs and
- the multistate VDA.

Businesses that use either type of VDA are looking to avoid criminal responsibilities, avoid penalties and interest, and limit the so-called lookback period—how far back the revenue authorities can go for past assessments. Most importantly, businesses want confidentiality—until a VDA is reached, businesses only want to be known to that state by its voluntary disclosure case number. In the case of the multistate VDA, neither the VDA nor any of its terms is disclosed to any other state. And the business does not have to disclose any information that would reveal its identity prior to execution of the VDA.

However, prior contact between a state and the taxpayer concerning sales tax, for example, disqualifies the business from participation in a VDA with respect to sales tax. Contact includes filing a tax return, paying tax, or even receiving an inquiry form the state regarding sales tax. What to do? Get legal advice.

It is important to note that sales and use taxes are "trust fund taxes," or taxes that the collector holds "in trust" for the state until remittance. These taxes are imposed not on the seller but on the purchaser or user. As such, the laws passed in the wake of Wayfair do not increase tax liability for sellers but allow states to shift the collection and remittance obligation from the customer to you - the seller.

Sales-and-use-tax obligations, however, do not necessarily stop at the entity level, so even conducting business as a corporation does not necessarily protect owners from liability. This realization can come as a shock to those who find themselves saddled with the liability, particularly business owners who formed corporations or limited liability companies (LLCs) specifically to shield themselves from personal liability for business debts. It is a rude awakening when they become ensnared by responsible person rules.

All states with sales and use taxes have rules that impose responsibility for tax liabilities on certain parties when their associated businesses cannot satisfy their obligations. Many of the rules expressly allow the respective state to file a demand for payment against any responsible person even if the business files for bankruptcy — although bankruptcy is not a prerequisite for personal liability.

UK

First I'll start with the UK then touch on Europe. In the UK and Europe, online selling is largely covered by the Distance Selling rules. Distance selling occurs when a business supplies and delivers goods from one EU country supplies and delivers goods to a customer in another EU country who is not registered for VAT.

You're distance selling into the UK if:

- you're outside the UK
- you sell goods that are located in another EU member state to customers in the UK or Isle of Man who are not VAT registered
- you deliver the goods or arrange for their delivery

Distance selling only involves goods, not services. It only takes place when a business sells and delivers goods located in one EU member state to someone in another EU member state who is not, and does not have to be registered for VAT.

If you distance sell into the UK and Isle of Man you have to register for UK VAT if the value of your distance sales exceeds £70,000 in a year. If you distance sell excise goods like alcohol and tobacco you'll have to register for UK VAT and Excise Duty no matter how much your sales are worth. Sales you make to customers who are VAT registered do not count as distance sales.

If you're outside the EU any sales of goods you make from a non-EU member state to the UK are not distance sales.

Online marketplaces

Separate rules apply to overseas businesses using an online marketplace to sell goods in the UK, where those goods are in the UK at the point of sale or sold to a UK customer and then imported in the UK by the seller. If you use an online marketplace to sell such goods in the UK you must register for VAT by submitting a VAT1 'Application for Registration'.

Threshold for distance selling

The distance selling threshold is £70,000.

- If the annual value of your distance sales into the UK and the Isle of Man is less than the distance selling threshold, you charge VAT at the rate that applies in your own country. You account for the VAT there too.
- If the value of your distance sales goes over the limit then you have to register for UK VAT. You then charge VAT on your VAT taxable sales at the UK rate instead of using your own country's rate and account for it here.
- You can apply to register for UK VAT as a distance seller voluntarily, even if you do not exceed the threshold.

Sales to the UK from outside the EU

If you are outside the EU and you sell goods to customers in the UK then this is not classed as distance selling for VAT purposes. The Channel Islands are not part of the EU. Your customers should be aware that they may have to pay UK import VAT on the goods when they arrive in the UK. They may also have to pay duty.

When to register for VAT in the UK

You must register for UK VAT if the value of your distance sales into the UK during a calendar year (1 January to 31 December) goes over the distance selling threshold. So you must keep proper records of your distance sales to the UK. If you distance sell any excise goods like alcohol and tobacco into the UK, you always have to register for UK VAT. It makes no difference how much your distance sales are worth. You also have to register for UK Excise Duty. You'll have to account for the VAT and Excise Duty in the UK.

Choosing to register for UK VAT voluntarily

Even if you do not have to register for UK VAT, you may choose to do so if you think it would help your business.

Brexit Implications

The current VAT rules for B2B and B2C supplies of goods to EU customers will change when the UK leaves the EU. The precise details will depend on what, if any, deal is reached between the UK and the EU.

If the UK leaves without a deal, all such supplies will become exports from the UK, which will be subject to zero rate VAT, provided certain conditions are satisfied. Import VAT and possibly Customs duties will be due in the destination country. If the UK supplier acts as the importer of record, it will need to register for VAT in the country of importation, reclaim the import VAT and account for local VAT on the supply of the goods to the end customer.

Businesses should prepare now for the possibility of a no deal Brexit. For example, this may include speaking to your shipping providers to discuss export and import procedures, to ensure business continuity.

Europe

Ordinarily, when goods are sold to VAT registered business customers in other EU countries, these goods are zero rated for VAT in the supplier's country, as long as -

- the goods are dispatched from the country of supply and
- the customer accounts for the VAT due on the goods as acquisition tax, calculated at the relevant rate in the country of receipt.

Distance Selling Thresholds

Each EU member state sets an annual distance selling threshold, which can be either €35,000 or €100,000 per calendar year. For countries that don't use the Euro, the equivalent value in the local currency applies e.g. the UK distance selling threshold is £70,000, which broadly equated to €100,000 when the threshold was set.

VAT registered businesses are required to keep a record of all sales made over a calendar year to non-taxable persons in each EU member state, to ensure that they remain aware of when they might breach the distance selling threshold. Once the threshold is breached in an EU state, the supplier is required to register and account for VAT to the local tax authorities on all future sales of goods in that country. In addition, businesses can also voluntarily register and account for VAT in another EU member state if they wish to, prior to exceeding the distance selling threshold.

An exception to the threshold rule, however, is where a supplier sells goods which are subject to Excise duty, such as beer and wine; these goods are not subject to the threshold and suppliers of such goods are required to register for VAT as soon as they make any supplies to other EU states.

Applying the Distance Selling Rules

The distance selling rules described apply where goods sold to customers in other member states are dispatched from the supplier's country. However, in some instances suppliers may also wish to hold stocks of their goods in other member states, for speed and ease of shipment. As soon as a stock of goods is held by a supplier in a member state other than its own, this triggers a liability for the supplier to register for VAT in the member state where goods are held.

Applying to ECommerce

Many businesses that sell goods via Amazon have supplies of their stock held in fulfilment warehouses in other member states at Amazon's request, to make it easier to ship goods to the end customers when orders are placed. Amazon are obliged to inform sellers that the placement of their stock in other EU warehouses triggers a requirement to register for VAT, but many small businesses find the process of obtaining EU VAT registrations daunting and difficult.

How EU VAT works for distance selling physical products

It all depends on annual sales thresholds. If your sales are below a threshold so far that year, you do VAT in your own country. If your year sales surpass a threshold, you do VAT in the other country.

Here's a bit more detail. EU VAT distance selling thresholds for physical products vary. Most €35,000, some are €100k — and, of course, some member states use their own currency. If your total sales remain under the threshold of the customer's country, then your sales are liable to VAT in your own membership state. You charge your local VAT rate, you owe that VAT to your home tax authority each quarter. But as soon as your total sales in a certain country have hit the distance selling threshold, then your VAT liability switches over to that country for those sales and you must register for VAT in that country.

The distance selling thresholds do NOT apply to:

- B2B sales. Any goods sold to buyers who have a valid VAT number!
- Excisable goods (tobacco, alcohol, petrol) are always subject to VAT in the destination country. No threshold. You must register in those states.
- Digital products.

How EU VAT works for digital products

Digital products are governed by different tax laws, even though the transactions are technically distance sales.

- For B2C sales - If your business stays below €10,000 in cross-border sales of digital goods per year, throughout the EU, then you can charge the VAT rate of your home country on all those cross-border sales. This makes it much easier to comply with VAT, because you're only using one tax rate on your digital goods. Once you pass that threshold, you charge the VAT rate of your customer's country.
- For B2B sales - You charge the VAT rate of the customer's country. If you're selling to a customer abroad, then you don't even think about your home country's VAT. It's always about the destination rate. There are no registration thresholds. Even one sale in a foreign country requires you to be registered and compliant with their local VAT system. For this reason, it's hugely helpful for digital businesses to register for a VAT MOSS, even more so than for businesses that sell physical goods. With a MOSS, you can avoid registering individually in each country where you make a sale.
- VAT MOSS (which stands for Value Added Tax: Mini One Stop Shop) was introduced so that UK sellers could just pay VAT to HMRC, instead of having to register for VAT in every EU country.

Singapore

GST is a form of value added tax charged on goods and services supplied in Singapore by GST-registered persons and on the import of goods into Singapore. The current rate of GST imposed on standard rated supplies is 7 per cent.

Input GST incurred by a GST-registered person for the purpose of making GST-taxable supplies is generally recoverable from the IRAS (subject to certain exceptions) by way of a refund or credit against the output GST payable on supplies made by such GST-registered persons.

GST on Imported Goods. The amount of GST payable is computed based on the CIF value (cost, insurance and freight) of the goods plus all duties payable. The postage paid for the goods can be taken as freight and insurance charges. However, GST only applies to goods (except for dutiable products) with CIF value greater than $400.

Persons in Singapore whose total value of GST-taxable supplies exceeds or is expected to exceed S$1 million over four quarters (i.e., 12 months) will have to register for GST. However, entities may also register voluntarily to claim any input GST incurred on GST-taxable supplies made to such entities (which are used by such entities to make their own GST-taxable supplies).

GST on imported services will be introduced on or after 1 January 2020 to ensure a level playing field by according the same GST treatment to imported and local services. For imported services provided by a business outside Singapore to a business in Singapore, GST will be charged through a reverse charge mechanism (i.e., the Singapore entity is to account to IRAS for GST chargeable on services it imports and is entitled to make input tax claims on such GST, provided the relevant input tax requirements have been complied with).

In addition, for imported digital services between a business outside Singapore and a customer in Singapore, foreign businesses with a global turnover exceeding S$1 million per annum and making supplies of digital services to customers in Singapore exceeding S$100,000 per annum, including electronic marketplace operators, will be required to register for GST, and such services will be subject to tax through an overseas vendor registration mode.

Change in GST rate

The Minister announced in the 2018 Budget that the government plans to raise the GST rate to 9 per cent at some point in the period from 2021 to 2025.

Chapter 7 - Online Sellers - Direct Taxes

Take Away: As an international entrepreneur running your companies across borders, special care must be taken to limit tax exposure. Failure to do so may lead to tax assessments based on territorial sales or even global sales if you trigger permanent establishment or nexus in your sales markets.

- Be careful in deploying staff or in retaining representatives in your sales markets.
- Incorporating a subsidiary is not as simple as finding an online service provider. Inattention to details such as operating agreements and sales contracts may have tax consequences.
- Whether or not there is a treaty between your company's home country and the sales market makes a difference
- Be careful in the duties performed by staff in subsidiaries.
- Please review the previous discussion on Transfer Pricing for related party transactions.

If you're running a business you need to be aware of tax obligations. We already discussed indirect taxes that may be triggered by ecommerce business. Now we can direct taxes which tend to be more straightforward that indirect taxes.

For international entrepreneurs, whether or not your entity would be subject to corporate income taxes depends on the extent of corporate activity and whether there is a double tax treaty in place between the country where your company is domiciled and where your company is selling.

Let's start with the scenario in which there is a treaty between the country where your company is based and where your company is selling. To illustrate how it works, we will assume that your foreign company is selling product into the USA.

Minimising Tax where there is a Double Tax Treaty

A permanent establishment (PE) is a fixed place of business which generally gives rise to income or value-added tax liability in a particular jurisdiction. The term is defined in many income tax treaties and in most European Union Value Added Tax systems. The tax systems in some civil-law countries impose income taxes and value-added taxes only where an enterprise maintains a PE in the country concerned. Definitions of PEs under tax law or tax treaties may contain specific inclusions or exclusions.

Some examples of places of business, which create a permanent establishment, listed on the OECD Model Treaties include the following:

- Place of management
- Branch or office
- Factory
- Workshop
- Mine, oil or gas well, or any other place of extraction of natural resources

Examples of activities that do not create a permanent establishment include the following:

- Use of a facility to store, display or deliver goods or merchandise (E.g. Showroom)

- Maintaining a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise

- Maintaining a fixed place of business solely for the purpose of advertising, supplying information, scientific research, or for the preparations relating to the placement of loans, or for similar activities which have a preparatory or auxiliary character, for the enterprise.

Companies based in a Treaty Countries like the U.K.

The profits of a resident of a Treaty Country are usually only subject to federal income taxes if the taxpayer has what is termed “Permanent Establishment” in the U.S.

As such, a virtual presence in the U.S. via a website hosted on a foreign server should not, all things being equal, be considered a permanent establishment. However, servers and other computer equipment located in the U.S. and owned or leased by a foreign enterprise may be treated as a permanent establishment unless the use of such equipment is limited to activities that are of a preparatory or auxiliary nature. Activities such as advertising, gathering market data and/or supplying information are generally considered activities of a preparatory or auxiliary nature. On the other hand, the use of any such equipment to accept orders for the sale of goods may be considered to exceed activities that are simply of a preparatory or auxiliary nature.

U.S. income tax treaties generally provide that the permanent establishment of an independent agent will not be attributed to its principal so long as the agent is acting in its ordinary course of business. Foreign enterprises will often consider entering into contracts with third-party hosting services if U.S.-based servers are needed or desired. The bottom line is that the determination as to whether certain contacts, activities or property, constitute a permanent establishment is extremely fact intensive.

Furthermore, it should be noted that tax treaties do not generally prevent state and local governments from imposing taxes on a foreign enterprise’s activities. Therefore, if a foreign enterprise has any contacts with or nexus to a particular state, the income tax implications of such contacts should be considered. Finally, the availability of treaty protection does not relieve a foreign taxpayer from U.S. tax return filing obligations.

Having a subsidiary in the US, however, does not automatically create a permanent establishment for its parent as it is considered to be an independent legal entity, but there are ways that it could create a permanent establishment, for example, if both the parent and the subsidiary have the same officers, a permanent establishment could be created by the parent, if the activities of such officers in the US are considered to be on behalf of the parent rather than the subsidiary.

Note that under Reg. Section 1.882-4(a)(3)(vi), foreign corporations with limited activities in the US that determine that these activities do not give rise to effectively connected income may file a return for the tax year to protect their rights to receive the benefit of deductions and credits in the event that it is later determined, after the return is filed, that the determination was incorrect. The protective return does not need to report any income as effectively connected income or report deductions or credits but should include a statement that the return is being filed to preserve the foreign corporation’s right to deductions and credits

If a foreign company has agents in the United States, they could also create a permanent establishment for the foreign company. For this to happen, two requirements would have to be met:

- The person is not a broker, commission agent, or other agent of independent status, and is conducting acts in the ordinary course of its business on behalf of the foreign company in the United States.
- That person has and habitually exercises in the United States an authority to conclude contracts that are binding on the corporation.

To understand PE issues requires more than reviewing the IRC code sections but we need to grasp the principles derived from case law too.

Minimising Tax where there is no Double Tax Treaty

In the absence of an applicable income tax treaty, a foreign taxpayer's exposure to federal income taxes is based entirely upon the Internal Revenue Code. As noted above, only the U.S.-source income of a foreign taxpayer is subject to U.S. income tax.

The sourcing rules for a foreign taxpayer's income from the sale of goods into the U.S. does not depend on permanent establishment but rather whether the foreign person has an office or fixed place of business in the U.S. What's the difference? In many ways, an office or fixed place of business is similar to a permanent establishment – but it is not the same. Because the phrase "office or fixed place of business" is somewhat subjective, it is important that taxpayers consult with their tax professional to determine whether their U.S. contacts would be considered an office or fixed place of business.

If the taxpayer has an office or fixed place of business in the U.S., then any sales attributable to such office or fixed place of business would be subject to U.S. income tax. On the other hand, if the taxpayer does not have an office or fixed place of business in the U.S., then the sales of inventory will be sourced to the place where title to the inventory passes. Subject to a tax-avoidance rule, the parties can generally elect where title passes in the sales contract. Therefore, a properly structured sales contract is essential to avoiding U.S. income taxes.

Chapter 8 - Interesting Options for Tax Residency

Take away: When looking for at tax residence options, there are many attractive options. From my perspective -

- Most people don't know that most countries are open for business. That is, they have residency options for people with businesses, talent or wealth.

- If you're US exposed and are looking for a base in the Americas, Puerto Rico is interesting. Interesting because it is probably the most tax efficient option for US exposed individuals looking to easily reduce their effective tax rates. Otherwise, Costa Rica is an attractive jurisdiction.

- If you are looking for a base to do business in Europe, the Middle East and Africa, I like the resident - non - domicile (called "res-non-dom) options for Malta and the non habitual residence option for Portugal. I expect that post Brexit, tax rates should become even more competitive in the UK so it is something to watch.

- In Asia, there is really no alternative to Singapore with Malaysia serving as your back up jurisdiction.

At this point, I consider 3 places my home. North Miami, London and Singapore. Recently someone told me that Europe is about culture, America is about efficiency and Asia is about growth. An interesting perspective but I do enjoy spending time in, and doing business in these 3 worlds. Singapore is a low tax jurisdiction so it is my permanent base but I count my days in the UK and the US to limit my tax exposure there as these are high tax jurisdictions.

I'm surprised that more people do not know about economic migration options. If you run a successful business or have accumulated some wealth, very few countries do not have options for welcoming you. We deal most commonly with the US, the UK and countries in South East Asia such as the Philippines, Malaysia, Singapore and Indonesia but we work with established Migration consultants that offer the entire world. Please note that this is an area of professional practice infested with unscrupulous snake oil salesmen that act unethically and illegally. So ensure that your chosen team is indeed an established team, officially recognized and experienced. Be warned!

Costa Rica and Puerto Rico in Latin America

Latin America has its share of international entrepreneurs. Unfortunately, Latin America is not the most tax efficient of regions. The average corporate statutory tax rates tend to be higher than the OECD average Europe.

It is not enough to just look at absolute corporate tax rates though. As an international entrepreneur, of greater importance is whether a jurisdiction taxes worldwide income or not. A domestic company is liable to be taxed on its worldwide income in Argentina, Brazil, Chile, Colombia, Mexico and it is granted tax credits for taxes paid abroad.

Fortunately, there are 5 countries in Latin America that have territorial tax regimes as opposed to worldwide tax regimes.

The following countries either have a traditional territorial tax system or elements of one at the time of this writing:
Andorra- Territorial taxation, only of nonresidents.
Angola – Territorial taxation.
Anguilla – Territorial taxation.
Bhutan – Territorial taxation.
Botswana – Territorial taxation.
Costa Rica – Territorial taxation.
Cuba – Residential taxation of citizens, territorial taxation of foreigners. Does not tax nonresidents.
Democratic Republic of the Congo – Territorial taxation.
Djibouti – Territorial taxation.
French Polynesia – Territorial taxation.
Georgia – Territorial taxation.
Gibraltar – Territorial taxation.
Guatemala – Territorial taxation.
Hong Kong – Territorial taxation.
Lebanon – Territorial taxation.
Macau – Territorial taxation.
Malawi – Territorial taxation.
Malaysia – Territorial taxation.
Marshall Islands – Territorial taxation.
Micronesia – Territorial taxation.
Namibia – Territorial taxation.
Nicaragua – Territorial taxation.

North Korea – Residential taxation of foreigners, territorial taxation of nonresidents. Does not tax income of resident citizens.
Palau – Territorial taxation.
Palestine – Territorial taxation.
Panama – Territorial taxation.
Paraguay – Territorial taxation.
Philippines – Residential taxation of citizens, territorial taxation of foreigners.
Saint Helena – Territorial taxation.
San Mari – Territorial taxation.
Saudi Arabia – Residential taxation of citizens, territorial taxation of foreigners.
Seychelles – Territorial taxation.
Singapore – Territorial taxation.
Somaliland – Territorial taxation.
Syria – Territorial taxation.
Taiwan – Territorial taxation in general, but residential taxation under the alternative minimum tax.
Tokelau – Territorial taxation.
Tuvalu – Territorial taxation.
Zambia – Territorial taxation.

Despite having a 33% corporate tax rate, and a 7.5% withholding tax on dividends to foreigners, Colombia is popular with international entrepreneurs. This is important because by law, any branch or permanent establishment is taxed on worldwide income. Bearing in mind that they have a notoriously aggressive tax authority, I would avoid Colombia.

By comparison, of the 5 territorial tax jurisdictions, Panama and Costa Rica are the more interesting. Honestly speaking, Panama does not have a good reputation which makes for -

- Reputational issues when using a Panama structure in business activities and
- Difficulties in banking

I know many would disagree but it is just my perspective. Costa Rica is a more attractive jurisdiction than Panama.

Under the Costa Rica tax system, residents and corporations are taxed only on income earned in Costa Rica. Branches and permanent establishments are taxed in the same way as subsidiaries.

- Taxation of dividends– Dividends received from domestic entities are exempt from corporate tax. A 15% withholding tax is levied on dividends paid to individual shareholders and 5% for dividends paid by stock corporations whose shares are registered on an officially recognized stock exchange.

- Capital gains – Capital gains are exempt unless derived from the habitual activity of the seller (i.e. the normal trade of business) or the assets sold are tangible and can be depreciated. Such gains are taxed at 30%.

- Losses - Industrial losses may be carried forward for 3 years (5 years for agricultural losses). Capital losses are deductible only if a gain on the disposal is taxable in the current year.

- Tax Rate – The rate is 10% for corporations earning less than USD 69,080; 20% for corporations earning more than USD 64,809 and less than USD 139,000; and 30% for companies earning more than USD 139,000. The tax rate is 30% for trading and non-trading companies.

- Holding company regime – No

- Tax Incentives – Industrial, processing and service companies located in free zones are entitled to a full exemption from income tax in the first 8 years of operation and a 50% exemption in the next 4 years. Forest sustainability incentives and tourism incentives also are available.

- Costa Rica has a special program called the free trade zone regime, which grants a 100% exemption status to companies that meet minimum fixed-asset investment requirements and that are foreign-market oriented.

- The rate of General Sales Tax (GST) in Costa Rica is 13%.

If someone is not US exposed, I would suggest that they consider Costa Rica but if someone is US exposed, I suggest Puerto Rico.

Hopefully, Puerto Rico needs no introduction. It is a commonwealth of the US. That means that most things follow US federal law, including immigration, customs and border enforcement. Fortunately, Puerto Rico's tax system is independent from the US and it has its own tax agency. This is what makes Puerto Rico unique - it is a part of the US, but taxwise, it's not a part of the US.

In short, it is the most tax efficient place for US exposed persons. There, a US passport or green card holder can arrange one's affairs to enjoy:

- Zero US federal income tax,
- 4% corporate tax and
- Zero capital gains and dividends tax.

To enjoy these benefits, one needs to be resident in Puerto Rico. The three tests to be considered a bona fide Puerto Rican tax resident -

- Physical presence test - You need to spend six months per year in Puerto Rico.

- Tax home test - To pass the tax home test, your tax and business activities need to be located in Puerto Rico. If your primary business activities are located anywhere else in the world, you won't pass this test.

- Closer connection test - The final test is more qualitative, and it's similar to the 'significant connection' criterion mentioned with the physical presence test. Here you are proving to the IRS that you're not liable for US federal taxes on your qualified income.

It is ideal for the international entrepreneur that wants to live more tax efficiently but is unwilling to surrender their US passport or green card. More tax efficient than Panama or Costa Rica, Puerto Rico is a great base for doing business in the Americas or even globally.

Portugal and Malta in Europe

Europe is not usually synonymous with tax efficiency. Tax rates tend to be high to support the welfare states and taxes are levied on worldwide income.

However, there are countries that offer special schemes for foreigners that allow for greater tax efficiency.

- Portugal - offers the 10 year non habitual residence (NHR) program offers tax exemption on income earned abroad assuming that such income was subject to effective taxation at the state of source of that income, under the rules of the Double taxation agreement (DTA) between Portugal and the respective state of source. In relation to the passive income when earned abroad, it will be exempt from tax if
    - It is not considered to be earned in Portugal,
    - the source state is not included in the black-list and
    - it was subject to tax in the source state.

- Italy is also very keen on well off non-doms. Move there, and, while you have to pay ordinary income tax on income actually generated in Italy, the rest can be dealt with by one single lump sum payment of €100,000 a year regardless of how much you as a non-dom might actually have made.
    - No income taxes, wealth taxes or local taxes due.
    - This program lasts for 15 years and (unlike in the UK regime) remit both assets and income to Italy anytime without incurring any new tax liabilities.

- France allows anyone who relocates there to work and, in doing so, makes France their primary residence can end up partially exempt from French income tax for eight years. They are also exempt from the French wealth tax on all assets held outside France for the first five years for their residence.

- Denmark offers a six-year flat rate of income tax at 32.84%.

Other countries such as Switzerland (annual lump sum payment) offer similar incentives and are popular with older and more established international entrepreneurs. Bulgaria and Estonia are popular with younger international entrepreneurs but they tax the worldwide income of tax residents so I don't see them as attractive options.

I'll return to Portugal as it is extremely popular now.

- A charge to Portuguese tax is dependent on whether the income arises in Portugal and the extent of the charge will be determined by an individual's tax residency status.
- A resident of Portugal is taxed on his worldwide income for the period of residency. A non-resident of Portugal is taxed on Portuguese source income only.

Exposure to Portuguese tax will be determined by the expatriate's residence and domicile status. Tax residence in Portugal is determined by the expatriate's actual presence within a tax year. The expatriate will be treated as Portuguese resident where:

- they spend 183 days or more in Portugal in any tax year
- they have stayed less than that period but on 31 December, live in Portugal and intend to continue doing so (eg own a dwelling in Portugal).

In both cases, it is important to note that once an individual becomes a Portuguese tax resident, their family (i.e. the spouse and dependent children) will also become Portuguese tax residents. If the spouse does not meet the conditions referred above, then the spouse must show proof that there is no connection between their major economic activity and the Portuguese territory. If this is the case, then they can be treated as a nonresident subject to taxation only for the income obtained in Portugal.

In this case the expatriate will file a tax return only with his/her Portuguese income and his/her part of the family income. Otherwise, they have to present joint tax returns.

But Portugal is attracting major interest because of the NHR or the non-habitual resident program. The Portuguese Investment Tax Code ("Código Fiscal do Investimento") was approved by Decree-Law no. 249/2009. This diploma amended the Portuguese Individual Income Tax ("PIT") Code establishing a favourable PIT regime for non-habitual resident individuals that qualify as resident for tax purposes in Portugal, and seeks to attract qualified expatriates to perform high added value activities, as well as other high net worth individual investors.

The 10 year program gives a 20% rate on income from employment or self-employment (if it comes from the exercise of scientific or technical professions of high value) earned in Portugal. Income earned abroad would be tax exempt provided that such income was already taxed. Passive income earned abroad will be exempt from tax if -

- it is not considered to be earned in Portugal,
- the source state is not included in the black-list and
- it was subject to tax in the source state.

Foreign income is tax exempt in Portugal if -
(i) the same is taxed in the State of origin according to the Double Tax Treaty entered into between Portugal and that State; or
(ii) Portugal has not entered into a Double Tax Treaty with that State of origin, the income will be taxed in that State as long as the income cannot be considered as obtained in Portugal according to domestic law.

That brings us to the UK. The UK likes to fly under the radar but once you add in all their island dependencies (including Malta), it is clear that the UK is the Queen of all offshore banking. It is widely believed that post Brexit, the UK's already attractive non dom program will become even more attractive.

The Maltese tax liability of an individual is determined on the basis of source, residence, domicile and remittance. An individual may be:

- resident and domiciled in Malta;
- resident but not domiciled in Malta;
- domiciled but not resident in Malta; or
- neither resident nor domiciled in Malta.

Individuals who are ordinarily resident but not domiciled in Malta, or who are domiciled in Malta but not ordinarily resident, are taxed only on:

- income arising in Malta;
- capital gains arising in Malta; and
- income arising outside of Malta that is remitted to Malta.

Income arising outside of Malta that is not remitted to Malta and capital gains arising outside of Malta are not subject to tax (regardless of whether the capital gains are remitted to Malta).

Beneficiaries of the Residence Programme (open to EEA and Swiss nationals) and the Global Residence Programme (open to third-country nationals) benefit from a tax rate of 15% on income received in Malta from foreign sources, with the possibility of claiming double taxation relief. A number of criteria must be satisfied in order for an individual to benefit from this special tax status, including:

- ownership or rental of a qualifying property; and
- proof that the beneficiary has sufficient means of economic subsistence and that the beneficiary and all applicants are covered by a comprehensive insurance policy.

Beneficiaries are subject to a minimum amount of tax set at €15,000 per annum. The Malta Retirement Programme and the United Nations Pensions Programme are similar programmes specifically designed for retirees.

Portugal and Malta offer great bases for international entrepreneurs doing business in Europe, the Middle East and Africa.

Singapore and Malaysia in Asia

Now we get to my favorite city. Singapore. World class infrastructure with only territorial taxes, Singapore is hard to beat.

- Low tax rates on personal and corporate income.
- No taxes on dividends
- No taxes on capital gains
- Foreign-sourced income in the form of dividends, branch profits and service income received or deemed to be received in Singapore by a Singapore-resident company would be exempt from tax if certain conditions are met.

As mentioned above, Singapore does not tax foreign-sourced income, unless such income is received (or deemed to be received in Singapore). Under the ITA, the following are deemed as income received in Singapore from outside Singapore:

- any amount from any income derived from outside Singapore that is remitted to, transmitted to or brought into Singapore;
- any amount from any income derived from outside Singapore that is applied in or towards satisfaction of any debt incurred in respect of a trade or business carried on in Singapore; and
- any amount from any income derived from outside Singapore that is applied to purchase any movable property then brought into Singapore.

However, foreign-sourced income in the form of dividends, branch profits and service income received or deemed to be received in Singapore by a Singapore-resident company would be exempt from tax if:

- such income is subject to tax of a similar character to income tax under the law of the territory from which it is received; and
- at the time such income is received in Singapore, the highest rate of tax of a similar character to income tax levied under the law of the territory from which income is received on any gains or profits from any trade or business carried on by any company in that territory at that time is not less than 15 per cent.

Previously, there was a healthy rivalry between Singapore and Hong Kong. Today, there is no better base for doing business in Asia.

Malaysia is my choice as a great runner up jurisdiction to Singapore, in Asia.

We have always advocated Malaysia as a great alternative to Singapore so it's time to give it special attention. The most common forms of business entities are companies (private or public), partnerships, limited liability partnerships and sole proprietorships. For foreign enterprises, business activities can also be carried out through a local branch as opposed to an incorporated local subsidiary.

Under the Malaysian Income Tax Act 1967 (ITA), most of the business entities above are taxable given the non-exhaustive definition of a taxable person under the ITA. However, Malaysia offers a multitude of tax exemptions under the ITA and the Promotion of Investments Act 1986 (PIA), which exempt either the entirety of the income of an entity from tax or income in respect of specific business activities. Tax incentives are also offered in the form of allowances or increased tax deductions.

Other points of interest include -

- Local branches of non-resident entities are generally treated as non-residents for income tax purposes unless it can be established that the management and control of its affairs or businesses is exercised in Malaysia. From a tax perspective, it is generally more tax-efficient for foreign enterprises to carry on their business activities in Malaysia by incorporating a local subsidiary rather than by registering a branch.

- Labuan company - In a bid to attract investors and promote the Federal Territory of Labuan as an international offshore financial centre, preferential tax rates are provided under the Labuan Business Activity Tax Act 1990 (LBATA) for companies incorporated under the Labuan Companies Act 1990 undertaking Labuan trading activities such as banking, insurance, trading, management, licensing and shipping operations.

- Limited liability partnerships - Unlike conventional partnerships, limited liability partnerships (LLPs) are recognised as taxable persons for income tax purposes and are taxed at a rate of 24 per cent. Where an LLP has a capital contribution of 2.5 million ringgit or less, the LLP will enjoy a reduced tax rate of 17 per cent for the first 500,000 ringgit of its income and 24 per cent for the remainder. Significantly, profits paid or distributed to partners in an LLP are exempt from tax and no withholding tax is applicable.

Like Singapore, Malaysia's income tax system is territorial in nature. Income tax is levied on any person's income accruing in or derived from Malaysia, including business gains or profits, employment income, interest, rents and royalties. However, income of a resident company carrying on the business of air or sea transport, banking, or insurance is taxable on a worldwide basis. In respect of dividends, Malaysia operates on a single-tier system where income tax imposed on a company is a final tax and dividends are tax exempt in the hands of shareholders.

Non-resident businesses are taxed on income accruing in or derived from Malaysia if they have permanent establishments in Malaysia.

Like most developed economies, Malaysia has implemented transfer pricing legislation. Cross-border related party transactions are subject to the transfer pricing provisions in the ITA as well as the Income Tax (Transfer Pricing) Rules 2012 (the TP Rules). Businesses must ensure that their intercompany transactions are priced at arm's length.

Unlike countries such as the United Kingdom, Malaysia also has no capital gains tax, with the exception of RPGT, which is only applicable to gains from the sale or disposal of real property or shares in a real property company (RPC). An RPC is a controlled company in which real property or shares in another RPC make up at least 75 per cent of its total tangible assets. For companies, RPGT is imposed at a rate of 30 per cent for disposals within three years after the date of acquisition of the real property or RPC shares, 20 per cent for disposals in the fourth year, 15 per cent for disposals in the fifth year, and 10 per cent for disposals in the sixth year and thereafter.

Chapter 9 - Your Personal and Corporate Structures

So now that we have introduced these basic concepts, how do we pull this all together? It is done in your international entrepreneur plan that you develop with your preferred tax team.

Here are some of the factors that you discuss with your advisors which may impact on your international entrepreneur plan -

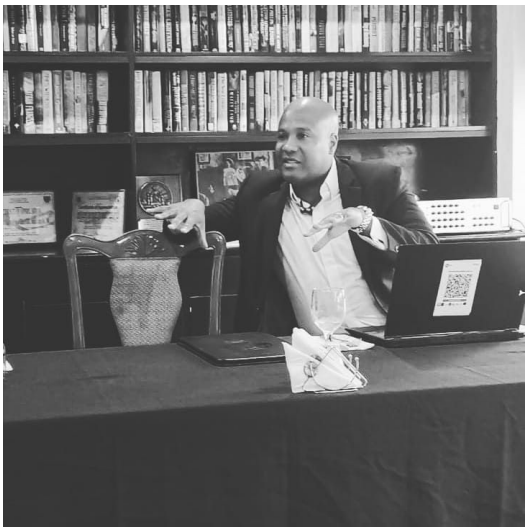
- Which citizenships do you now hold?
- Which residencies do you now hold?
- Which citizenships and residencies does your partner hold?
- Which citizenships and residencies do the kids partner hold?
- Give me 10 countries where you enjoy spending time during the year?
- What is the nature of your business?
- Where is your business incorporated?
- If you have multiple businesses, may we please see a diagram showing your corporate structure, share holdings and intercompany payments?
- Which citizenships and residencies does your business partner hold?
- Where are your clients based?
- Where is your staff based?
- Where do you bank?
- What are the plans for your business? Eg consistently reinvesting profits to drive growth, vs preparing for an exit vs extracting as much profit as possible?

Once you and your advisors come up with a plan -

- It may first be necessary to do some clean up work. This may involve filing prior year returns or even taking you through a tax amnesty.
- It should be possible to compare your old effective tax rates in the various jurisdictions with the new effective tax rates and see some improvement with the new structure.
- It may be necessary to come up with proper documentation to support the new structure - especially Transfer Pricing Documentation where there are intercompany transactions.

Chapter 10 - Take Action

“Analysis paralysis or paralysis by analysis is an anti-pattern, the state of over-analyzing (or overthinking) a situation so that a decision or action is never taken, in effect paralyzing the outcome. “



So here we are at the end of this journey. I hope that I have delivered what I promised. You now have the tools necessary to meaningfully engage with your team of advisors. You should also have a stronger sense of how you want to develop your own international entrepreneur plan for your already successful business.

Unfortunately, experience tells me that most of you will read. But many will delay taking action trapped in a cycle of analysis paralysis and unable to make that first step. You will spend hours on Google and maybe in online chat groups gathering more and more information but at some point, you would need to make that first step.

Our team gets dozens of enquiries each week from successful entrepreneurs like yourself who want to move to the next level. I would say just 2 in 10 of them graduate from enquiries to international entrepreneurs who actively engage a team (not necessarily ours) to develop and implement an action plan.

Don’t be another “International Wantrepreneur”. Take action and engage a qualified team to become an “International Entrepreneur” today.