

US Individual Income Tax Newsletter

March 2011



As we head into the 2011 US personal income tax filing year, there are a number of changes and developments that may be relevant to your tax filing position. I hope you find the following information helpful, and naturally if you have any questions your local PwC contact would be happy to assist.

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What's new in 2011 for US Individual Taxation?

1 Reduction in tax rates and other changes

In late December 2010 Congress extended a number of tax cuts that had been set to expire. For 2010, 2011 and 2012 the top rate will remain at 35%, increasing in 2013 to 39.6%. The maximum 15% long-term capital gains rate and qualified dividend tax rate will also continue until the end of 2012. Additionally, the child tax credit remains at \$1,000 per child, and the American Opportunity Credit for certain higher education expenses has been extended through 2012.

The personal exemption and standard deduction amounts increased slightly in 2011, the personal exemption is now \$3,700. The standard deduction for a single person is \$5,800 and for a married couple \$11,800. The reduction in personal exemptions and itemised deductions has been eliminated again for 2011, regardless of income level.

Beginning in 2010, a qualified IRA rollover contribution to a Roth IRA is allowed, regardless of modified AGI.

Social Security withholding has been reduced by 2% for 2011. The employees' portion of Social Security taxes will be reduced to 4.2% from 6.2% (potential savings of \$2,136). The employer portion remains unchanged at 6.2%.

Gain on the sale of a main home or primary residence is no longer excludable if allocable to periods of non-qualified use, specifically when neither you nor your spouse/former spouse used it as a main home.

2 Roth IRA Conversion

A Roth IRA is a special type IRA where qualified distributions are not subject to federal tax as long as certain conditions are met. Roth IRAs are a good retirement vehicle choice for high-income and high-net-worth taxpayers. However, IRS eligibility criteria generally made it available to lower-income taxpayers until recently. Now anyone (regardless of income) can convert an existing traditional IRA to a Roth IRA. The regular income limitations on annual contributions continue to apply. There are many things to consider if you decide that a Roth IRA may be correct for you. Prior to converting your Roth IRA, professional advice should be sought as there are tax implications at the time the traditional IRA is converted to a Roth IRA. PwC can assist you in this matter.

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Overview of US tax implications whilst working overseas

Living and working overseas is both exciting and challenging. However, one of the challenges should not be the filing of a tax return. US citizens and permanent residents (Green Card Holders) are taxed on their worldwide income. The US is one of the only countries that require their citizens to file annual tax returns while working abroad.

The Internal Revenue Service (IRS) considers not just base salary to be income, but also foreign allowances that are commonly paid in the Middle East such as housing, dependent education, home leave airfare, overseas premium or cost of living, etc. Failure to report these items as income may mean penalties if your return is audited and it is determined that your income is under-reported.

The Foreign Earned Income Exclusion (FEIE) and housing exclusion

The IRS does allow some exclusion for foreign earned income and foreign housing expenses incurred which may decrease your tax liability; knowing exactly how all the rules affect a taxpayer is crucial.

In order to claim the foreign exclusions, taxpayers must satisfy certain requirements. First, they must have established a tax home in a foreign country. While this may sound as simple as working overseas for any period of time, there are many pitfalls. Second, the taxpayer must meet either the Bona Fide Residence Test (BFR) or the Physical Presence Test (PPT). There are benefits for qualifying under PPT in the first year and last year working overseas. If married, both spouses maybe eligible to claim the foreign exclusions.

The IRS may disallow these exclusions if a proper election is not made on a timely filed return. An individual has an obligation to file an annual US tax return even if they earn less than the FEIE exclusion for the year.

State tax considerations

State tax filing obligations vary from state to state. Individuals may still be required to file a state tax return even while residing overseas. Whether an individual is required to continue to file a state return is determined upon the state they left and their specific facts and circumstances. Many factors should be considered, however, if the wrong decision is made you may find yourself subject to taxes and penalties for state taxes that should have been previously paid. We have also found that many people continue to pay state taxes when their facts and circumstances indicate that they have broken state residency.

Additionally, not all states allow the federal FEIE which means 100% of the income earned outside the US may be liable to state taxation. Penalties could apply if estimated tax payments have not been made on time.

Foreign bank account reporting

In addition to federal and state filing requirements, foreign bank and securities accounts may have to be reported to the US Treasury Department. There are no extensions to filing this report and the penalties for non filing range from \$10,000 to criminal penalties.

This requirement also applies if you have signatory authority over an account such as an individual who signs cheques on a company account.

When is my return required to be filed?

The deadline for 2010 federal tax returns is 18 April 2011 due to a public holiday.

If a taxpayer is residing overseas on 18 April they will receive an automatic extension to file their federal return until 15 June. The extension, however, only extends the time to file the return not the payment of tax. Interest (and possibly penalties) will continue to apply on any balance due from 18 April until the balance is received. If an individual is unable to file their return by 15 June an additional extension may be requested to 15 October. Individuals who

must qualify, in their first year working overseas, under BFR, may request an extension of time to file their return until 30 January of the next year in order to obtain sufficient time to qualify for the foreign exclusions.

Deadline for submission of tax information to PwC

31 March (Federal)

31 March (State)

31 March (Local)

15 May (Foreign bank account reporting form)

Note: These dates will guarantee delivery of returns by the due date.

How long should I retain tax documents?

Generally the IRS has three years from the date that the tax return is filed to request additional information.

However, in some cases this can be extended to five years. We suggest that you retain your tax documents for at least six years.

By using our secure website, MyTaxes (which is described below), you can upload your tax documents and print a copy of your return whenever you want and wherever you are. This may alleviate the requirement to maintain paper copies of your documents and move them when you change locations.

Why PwC?

The US tax code is already complicated for individuals living and working in the US but even more so for those individuals living and working overseas. We have found that many tax professionals in the US are not familiar with the added complexities of preparing federal and state returns for individuals residing overseas and their clients often pay more tax than they are legally obligated to pay.

MyTaxes

We at PwC have invested highly in new technology and have released a secure website, MyTaxes.pwc.com.

MyTaxes is intended to provide you with an intuitive, user friendly experience in supplying us with the information we require to prepare a complete and accurate tax return for you. MyTaxes is a 100% web-based application which can be used on multiple platforms such as PC, Mac and iPad and is compatible with all web browsers. Advantages of this website means you can view your tax returns, complete questionnaires and securely exchange information with PwC from any computer no matter where in the world you may be.

This document was not intended or written to be used, and it cannot be used, for the purpose of avoiding tax penalties that may be imposed on the taxpayer.

Local Knowledge

PwC has a team of knowledgeable experts based in Qatar, Saudi Arabia, the United Arab Emirates and Lebanon that specialise in US individual income tax consulting and compliance. We have the capability to handle the most complex of returns efficiently and competently. Please feel free to contact us for additional information or assistance.

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