International Outbound

As a US resident or US citizen, you need to report worldwide income to the US government, even if they don't have to pay any US income tax. Not reporting worldwide income and their foreign activities to the US government carries severe penalties, which are designed to discourage hiding of assets overseas.

On the other hand, US government encourages its citizens and permanent residents to carry business beyond US border. This is done by exempting its citizens and permanent residents from US income taxation up to $99,200 in 2014. This benefit is specified in Internal Revenue Code ("IRC") section 911, referred to as foreign earned income exclusion.

There are over six million US citizens living abroad (and more US permanent residents or greencardholders), also referred to as "expats". They need to report income to both US and local country's tax authorities. You may only need to report income generated within local country. To US government, you need to report your worldwide income.

When you report your income to the local tax authorities, you will pay local country income taxes, if your are considered to be a tax resident under local country income tax law. Foreign (local country) income taxes, that paid or accrued, can be claimed as a credit against US income taxes, when reporting Korean income on the US income tax return. A foreign tax credit is a dollar for dollar reduction of US income taxes. This foreign tax credit mechanism provides relief from double taxation of same income, when reporting worldwide income.

With the combination of foreign earned income exclusion and foreign tax credit, many US expats pay little, if any US income taxes, when they are working overseas. In addition, they usually don't have to pay any state income taxes, since they are not resident of any state, within the US.

To take the benefit of IRC Sec. 911, an US citizen or permanent resident have to be present in foreign country for more than 330 days or be a bona fide resident of foreign country. As these residency rules are complicated, you should consult your tax advisors to maximize your benefit under IRC section 911.

Generally, there are three forms of business in foreign country:

1. Individual's name,
2. Foreign corporation, or
3. Foreign partnership.

Foreign corporation is the most commonly used form of business by expats, to operate foreign businesses. Like US "C" corporation, profit from a business is paid by the corporation and the dividend paid to shareholders are taxed again in the local country. This works much like US double taxation mechanism of C corporation.

Although the profit made by foreign corporation is taxed in the local country, the second level of taxation on dividend is actually within the control of the shareholders. As such, the after tax profit of foreign corporation can avoid local country and US income taxation, if it kept within foreign corporation. As long as reasonable amount of profit is kept in the foreign corporation, US government will not try to tax that profit, until it is returned to the US. Since the timing of this return of profit (also referred to as repatriation) is within the control of the shareholders, this second level of taxation can be avoided, if desired.

For the US expats living in foreign country, a care must be taken when investing in foreign investment products. Many of the foreign investment products, including life insurance products, are considered to be passive foreign investment company income ("PFIC"). Without having to go into details of this very complex area, there are punitive volume of reporting, which must be done on PFIC by the expats. In addition, PFIC income is taxed at higher tax rate by the US government. This result is intended by the US government to encourage US citizens and permanent residents to invest with US investment firms, who have higher reporting requirements, compared to foreign investment companies.

Although more cumbersome, the expasts invest in US investment products to avoid complex PFIC rules and resulting taxes. Most US investment firms have offices around the world. You should contact them to obtain advice on your investments.

The area of international tax is full of minefields for the unwary. Care should be taken by discussing with professionals to make sure that you don't become subject to penalty mechanism, designed to catch the tax evaders (different from tax avoidance, which is legal).