



Tax issues in a foreign environment

Tax implications of marriage to foreign nationals

By Cordelia A. Johnson

So you're getting ready to file your taxes? Got your W-2s and all the 1099INTs-DIVs-Bs and any letter from anybody with statements such as ..."this information is being reported to the IRS." You and your new non-US citizen bride "tied the knot" in Denmark on 24 December 2011 and have been happy ever since. You were going to file a joint return, claiming her and the two children she brought into the marriage.

Marrying a non-resident alien (NRA) late in the year can turn tax filing into a trying experience. You may think that having been married for only eight days in 2011 is just like not having been married at all, but beware, as far as the IRS is concerned, filing "single" is not an option. For income tax purposes, if you were married on the last day of the year, you are deemed married for the entire year. Your spouse's name and tax identifying number must appear on the income tax return, whether you file choose to file "married separately" or "married jointly."

American citizens and resident aliens (those admitted to the United States as permanent residents - commonly referred to as "green card holders") use their social security number – non-resident aliens generally don't qualify for a social security number and must apply for an "Individual Taxpayer Identification Number" (ITIN). Internal Revenue Service (IRS) Form W-7 is used to apply for the ITIN.

Non-resident aliens with U.S. income tax filing requirements need to apply for an ITIN. You should contact your local tax center for help in completing and submitting Form W-7 and to find out what supporting documents you will need.

What about your new spouse's two children? Any claimed dependents that do not have a social security number will be disallowed, as well as any of the credits which involve those dependents, such as the child tax credit, the earned income credit or the child and dependent care credit. So even though you have accepted parental responsibility for the minor children, are supporting them and the Army considers them your "dependents," they will not qualify for dependent exemptions and the associated credits until they have become citizens or permanent residents in the United States. Generally, this will occur upon your next permanent change of station (PCS) move. If you are in doubt as to whether your stepchildren can be claimed, discuss your specific case with your tax preparer or legal assistance attorney.

Taxpayers married to non-resident aliens have unique choices to make that may have long-lasting implications on future tax years. Filing "single" and ignoring that you are married is not one of them. So what are the real options?

If the taxpayer chooses to file a "married separate" return, only the taxpayer's income will be reported and he/she may claim a "personal exemption" for the non-resident alien spouse, provided they have no income from US sources. In this case only the taxpayer is liable for any taxes owed and the NRA spouse need not report any of her income and does not subject her/himself to U.S. taxation.

If the taxpayer has a qualifying child (U.S. citizen or resident alien) that can be claimed as a dependent, he/she may be able to claim "Head of Household" and claim a personal exemption for the non-resident alien spouse. This is usually a possibility for someone, who has custody of his U.S. citizen child from a previous marriage and subsequently marries a non-resident alien.

Alternatively, the taxpayers may make the election to file a joint return in order to avail themselves of the more favorable joint rates. In this case the non-resident alien spouse subjects him/herself to U.S. taxation and must report his or her worldwide income. This is a one-time election, which once revoked can not be claimed again. The NRA taxpayer should be aware that certain items of income that are not taxable in the home country are subject to taxation in the U.S., for instance unemployment compensation, sick pay, and child benefits (Kindergeld), will be fully taxable in the U.S.

In an effort to avoid "double taxation" by the German and American governments, there are generally two options. First, any taxes paid to the foreign government can be claimed to offset your tax liability to the U.S. government. You would use Form 1116 to compute the foreign tax credit. Form 1116 can be used any time foreign income taxes are paid.

A second option is using Form 2555, which excludes foreign earned income. There are certain limitations to the use of the Foreign Earned Income exclusion. Most significantly, the income to be excluded must be *earned* income. Foreign interest income, capital gains, rental income, or your German lottery winnings cannot be excluded. Also, the income may not derive from U.S. Government employment, which means that anyone paid by the United States government or one of its instrumentalities as an employee cannot exclude this income. This includes obvious sources of U.S. pay, such as military pay or DOD civilian pay, as well as the pay of local national civilians working for the DOD. Once you have determined your income qualifies for the exclusion, there is another hurdle – the physical presence requirement. The individual seeking the exclusion must have spent at least 330 days outside the U.S. during the *qualifying year*. (The qualifying year does not necessarily coincide with the tax year; rather it is any consecutive 365 days.) Finally, there is a limit to the amount of foreign earned income that can be excluded. The excludable amount can be further enhanced by the Foreign Housing Exclusion. Sounds complicated? See your local tax center or legal assistance attorney for more details.

Foreign income earned and foreign taxes paid in a foreign currency must be converted to U.S. dollars. This can be accomplished using the average exchange rate (\$ 1.00 = EU 0.719 in 2009) for the year, or by using the actual rate on the day of the taxable transaction.

There may also be state income tax obligations, depending on the taxpayer's state of legal residence. Some states exempt all income earned outside the state, while others tax all income regardless of where it is earned. Some states apply a physical presence test, meaning you only pay income tax if you spent a certain number of days in the state, while some states have no income tax at all. Since each state is different, no single answer can be given in an article such as this.

Wiesbaden runs a Tax Assistance Program from January through June each year, in which eligible clients are entitled to assistance in preparation and electronic filing of their federal and state income taxes, all free of charge. The Wiesbaden Tax Assistance Center is located Building 1043 on Wiesbaden Army Airfield. The office is open for appointments Monday, Tues, Thurs, and Fri 0900-1600 and on Wednesday 1100 - 1800.