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# GLOBAL TAX WEEKLY

## a closer look

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**SUBJECTS** TRANSFER PRICING INTELLECTUAL PROPERTY VAT, GST AND SALES TAX CORPORATE TAXATION INDIVIDUAL TAXATION REAL ESTATE AND PROPERTY TAXES INTERNATIONAL FISCAL GOVERNANCE BUDGETS COMPLIANCE OFFSHORE

**SECTORS** MANUFACTURING RETAIL/WHOLESALE INSURANCE BANKS/FINANCIAL INSTITUTIONS RESTAURANTS/FOOD SERVICE CONSTRUCTION AEROSPACE ENERGY AUTOMOTIVE MINING AND MINERALS ENTERTAINMENT AND MEDIA OIL AND GAS

**COUNTRIES AND REGIONS** EUROPE AUSTRIA BELGIUM BULGARIA CYPRUS CZECH REPUBLIC DENMARK ESTONIA FINLAND FRANCE GERMANY GREECE HUNGARY IRELAND ITALY LATVIA LITHUANIA LUXEMBOURG MALTA NETHERLANDS POLAND PORTUGAL ROMANIA SLOVAKIA SLOVENIA SPAIN SWEDEN SWITZERLAND UNITED KINGDOM EMERGING MARKETS ARGENTINA BRAZIL CHILE CHINA INDIA ISRAEL MEXICO RUSSIA SOUTH AFRICA SOUTH KOREA TAIWAN VIETNAM CENTRAL AND EASTERN EUROPE ARMENIA AZERBAIJAN BOSNIA CROATIA FAROE ISLANDS GEORGIA KAZAKHSTAN MONTENEGRO NORWAY SERBIA TURKEY UKRAINE UZBEKISTAN ASIA-PAC AUSTRALIA BANGLADESH BRUNEI HONG KONG INDONESIA JAPAN MALAYSIA NEW ZEALAND PAKISTAN PHILIPPINES SINGAPORE THAILAND AMERICAS BOLIVIA CANADA COLOMBIA COSTA RICA ECUADOR EL SALVADOR GUATEMALA PANAMA PERU PUERTO RICO URUGUAY UNITED STATES VENEZUELA MIDDLE EAST ALGERIA BAHRAIN BOTSWANA DUBAI EGYPT ETHIOPIA EQUATORIAL GUINEA IRAQ KUWAIT MOROCCO NIGERIA OMAN QATAR SAUDI ARABIA TUNISIA LOW-TAX JURISDICTIONS ANDORRA ARUBA BAHAMAS BARBADOS BELIZE BERMUDA BRITISH VIRGIN ISLANDS CAYMAN ISLANDS COOK ISLANDS CURACAO GIBRALTAR GUERNSEY ISLE OF MAN JERSEY LABUAN LIECHTENSTEIN MAURITIUS MONACO TURKS AND CAICOS ISLANDS VANUATU

## Tax Court Denies Foreign Earned Income Exclusion On Late Tax Return

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This is the second of two articles examining recent judicial developments relating to the foreign earned income exclusion (FEIE). Last week, we looked at recent denials of FEIE claims because of the failure to meet the "tax home in a foreign country" requirement. This week, we look at the adverse implications of a late-filed FEIE claim.

### Introduction

One of the key messages we try to impart to US expats is that just because you can utilize the foreign earned income exclusion ("FEIE"),<sup>1</sup> does not mean that you do not have to timely file a tax

return with the IRS. The exclusion may reduce or even eliminate the requirement to pay tax, but it does not eliminate the obligation to file a US income tax return – in fact, in order to claim the FEIE, you actually need to file a tax return, and not filing on time may prevent you from being able to later make the claim on your return.

This is one of the most common mistakes that expats make,<sup>2</sup> and as a recent Tax Court decision shows,<sup>3</sup> it is a mistake that can prove very costly, even in the more sympathetic of cases.

## **The Foreign Earned Income Exclusion**

The FEIE<sup>4</sup> is one of the main tax relief measures available to expats filing US tax returns. Expats qualifying for the FEIE may be able to exclude all or part of their foreign salary or wages from their income when filing their return – so its importance cannot be overstated.

For 2017, the maximum foreign earned income exclusion is up to USD102,100 per qualifying person (a married couple filing jointly can potentially exclude as much as USD204,200). The maximum exclusion amount is generally increased each year to take into account inflation.

## **Form 2555**

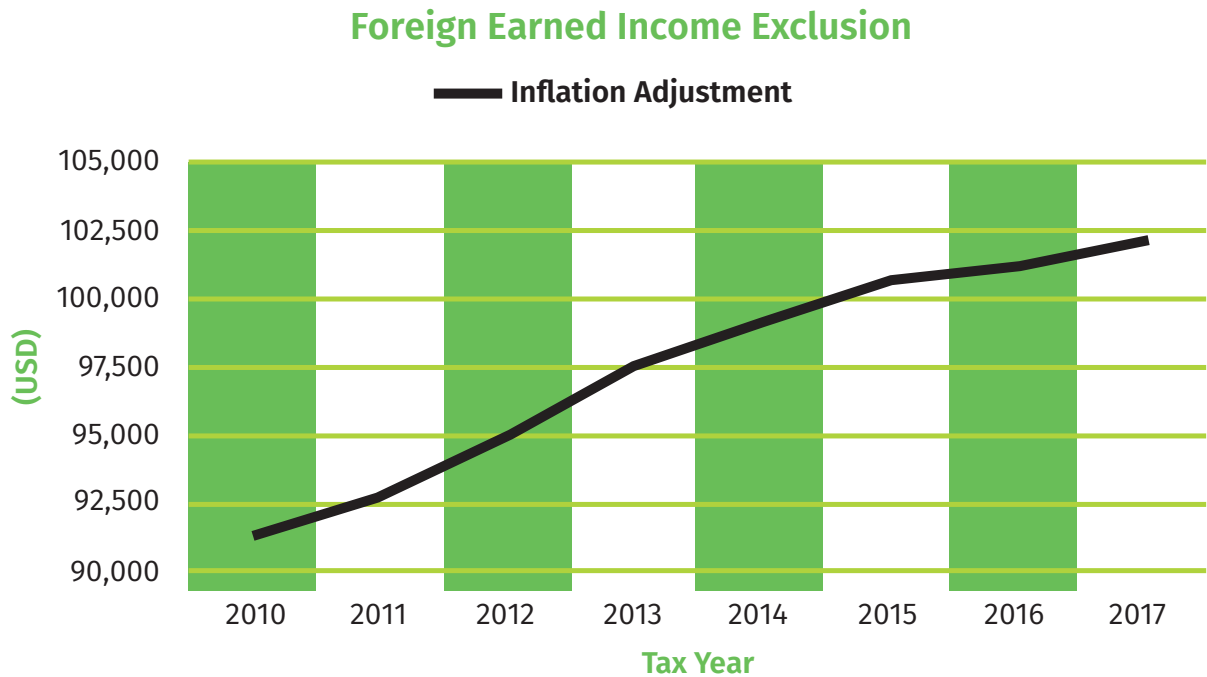
### *Timely filing the Form 2555*

The FEIE is claimed by filing the Form 2555 with the IRS.<sup>5</sup> Once you choose to claim an exclusion, the choice remains in effect for that year and all future years unless it is revoked. However, you need to include the form each year with your tax return in order to claim the benefit of that year. To revoke your choice, you must attach a statement to your return for the first year you do not wish to claim the exclusion. If you revoke your choice, you cannot claim the exclusion for the next five tax years without the approval of the IRS.

In order for a Form 2555 to be considered timely filed, it must be attached to your timely-filed income tax return. US expats are generally required to file their returns by April 15 of the following year, just like US residents. However, if you live outside the US on April 15, you are entitled to an automatic extension (without the filing of an extension form) until June 15.

An automatic extension can also be filed resulting in additional time to file until October 15. Due dates that fall on a weekend or holiday are pushed to the next business day.

Figure 1:



#### *Late filing the Form 2555*

If you have not filed the Form 2555 on a timely-filed return, the form generally must be filed with:

- A return amending a timely-filed return; or
- A late-filed return filed within one year from the original due date of the return (determined without regard to any extensions).

You can choose the exclusion on a return filed after the above periods, provided you owe no federal income tax after taking the exclusion into account. If you do owe federal income tax after taking the exclusion into account, you can choose the exclusion on a return filed after the periods described above, provided you file before the IRS discovers that you failed to choose the exclusion.

#### **The *Redfield* Decision (T.C. Memo 2017-71)**

The Tax Court's *Redfield* case,<sup>6</sup> which was decided in April of this year, involved a taxpayer who served 12 years in the US Marines, including several stints in Afghanistan.

Sometime before 2010, Mr. Redfield left the Marines as a disabled veteran suffering from memory loss and post-traumatic stress disorder. He was then offered a civilian position at the Kandahar Air Field in Kandahar Province, Afghanistan. Believing that he had made sufficient progress in his

recovery, he began his job in Kandahar in January 2010. Unfortunately, his physical and mental condition worsened, and he was unable to work for very long in his new position.

On the tax side of things, Mr. Redfield did not file his 2010 tax return for several years. In May of 2014, the IRS sent him a notice of deficiency for the 2010 tax year. Mr. Redfield did not respond, but instead late filed his 2010 return, attaching a Form 2555 and excluding USD49,136 of earnings from his work in Afghanistan. Even with the exclusion, he ended up owing residual tax to the IRS, some of which he did not pay until his filing in 2014. The IRS rejected Mr. Redfield's exclusion claim, and he brought a suit against the IRS in the Tax Court.

Under these facts, the Court could not find any path that would allow Mr. Redfield to utilize the exclusion. The exclusion was not filed within one year of its due date, Mr. Redfield did in fact owe some tax, and he was in fact caught by the IRS before he filed his tax return claiming the exclusion. This perfect storm of bad facts prompted the Tax Court to grant the IRS's motion to summarily dismiss this portion of the taxpayer's suit, leaving him without the ability to utilize the exclusion.

Interestingly, the Tax Court judges noted:

"We acknowledge petitioner's military service to this country and recognize that he emerged far from unscathed from his tours of duty in Afghanistan. We understand that the procedural requirements for making a timely FEIE election are not exactly intuitive and that the scars petitioner incurred during his military service may have contributed to the tax delinquency at issue."

However, the Court still concluded: "While these facts may be relevant to the penalty and additions to tax that the IRS determined, they do not alter the requirement of a timely election."

The *Redfield* case highlights the importance of timely filing your US tax return. As the decision shows, late filing your tax return can have serious unintended consequences, especially if you are claiming an exclusion such as the FEIE.

## ENDNOTES

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<sup>1</sup> See <https://www.expattaxprofessionals.com/Form-2555-Foreign-Earned-Income-Exclusion>

<sup>2</sup> See <http://finance.alot.com/personal-finance/5-most-common-mistakes-made-by-us-expat-taxpayers--11279>

<sup>3</sup> See <http://www.ustaxcourt.gov/ustcinop/opinionviewer.aspx?ID=11189>

<sup>4</sup> See <https://www.expattaxprofessionals.com/tips-foreign-earned-income-exclusion/>

<sup>5</sup> *Supra*, note 1.

<sup>6</sup> *Supra*, note 3.