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U.S. / ISRAELI INCOME TAX UPDATE FOR YEAR 2016 (2015 Tax Year)

The 2015 U.S. and Israeli tax-filing season has commenced. In addition to all of the important tax rules and regulations which permeate the U.S. Internal Revenue Code and the Israeli Income Tax Ordinance, please be advised of the following new rules for 2016:

- a.) Exchange of Tax Information – Under the FACTA Inter-governmental Agreement (IGA) signed between Israel and the United States an exchange of tax information between the two countries is scheduled to begin during 2016. Israeli banks will be required to issue FORM 1099 to U.S. citizens and transmit them directly to the IRS. Reciprocally, in 2017, Israel should begin receiving U.S. tax information on its citizens directly from the U.S.
- b.) The new U.S. Highway Funding legislation calls for potential revocation or denial of U.S. passports for taxpayers with an outstanding balance of over \$50,000 to the IRS. Balances due to any State are not part of this legislation. The IRS must notify the taxpayer of this proceeding prior to facilitating a revocation of any U.S. passport. If payment arrangements have been made with the IRS, the taxpayer's passport would still be considered valid and will not be revoked.
- c.) Taxpayers who exclude earned income, currently up to \$100,800 (per taxpayer) on their 2015 joint tax returns will not be eligible to receive a child credit even if only one taxpayer uses the exclusion.

Israel also changed its tax regime for reporting foreign (non-Israeli) income from 2003 in addition to the regular tax on Israeli source income and has an amnesty program for taxpayers that have failed to report income earned abroad (e.g. from work or investment income earned in the U.S.). As such, it is imperative that you familiarize yourselves with certain concepts regarding **both** U.S. and Israeli income tax law and how they may affect your personal situation, details of which are presented below. Proper tax planning and minimization of your taxes requires an analysis of many important issues, including the interplay between the U.S. and Israeli foreign income tax credit rules, the foreign earned income exclusion rules, and also how the applicable provisions of the U.S. - Israel income tax treaty affects your tax situation. Delineated below are some areas of the current law, which may impact

your U.S. and Israeli tax return filings due in 2016. As always, please contact us for more details about any of the issues contained herein.

IRS Streamlined Procedures for Non-Compliant U.S. Taxpayers Living Abroad and Offshore Voluntary Disclosure Program ("OVDI"):

In recognition that some U.S. citizens living abroad have failed to file annual U.S. Federal income tax returns and foreign bank account reports (FBARs), the IRS has designed a streamlined procedure to allow taxpayers to enter the IRS tax filing system and then be considered in "good standing". Many factors and requirements apply, but primarily this procedure is available for U.S. taxpayers that have resided outside the U.S. since January 1, 2009 and have not filed U.S. income tax returns for at least 3 years. Among the strict requirements for being accepted under the IRS streamlined process are: a) filing three years of U.S. income tax returns, b) filing six years of FBARs, c) writing a detailed explanation, delineating your non-willfulness and delinquency and attaching it to your tax returns. The IRS will expedite the review process and may not assess penalties for taxpayers filing under this procedure. Taxpayers not meeting the requirements of the streamlined process can avail themselves of the IRS Offshore Voluntary Disclosure Program (please contact our office for more details about OVDI).

FATCA/ FBAR:

Under the Bank Secrecy Act, a Foreign Bank Account Report (FBAR) must be e-filed annually with the U.S. Treasury by June 30th each year, if the following criteria apply:

- i) The person has a financial interest, signature authority or other authority that is comparable to a signature authority over one or more accounts in Israel or another foreign country. Please note that shareholders who hold more than 50% of a foreign company's shares are considered having a financial interest in the company's accounts.
- ii) The aggregate value of all foreign financial accounts exceeds \$10,000 or the equivalent amount in foreign currency (e.g. 35,000 NIS or more) at any time during the calendar year.
- iii) Foreign financial accounts include, but are not limited to, both checking and savings accounts, Israeli pension accounts, brokerage accounts, mutual funds and unit trusts. FBARS must be e-filed by June 30th each year. Paper filings of FBARs (form TD F 90-22.1) are no longer accepted by the U.S. Treasury and have been replaced by online filing of form FINCEN 114.

Form 8938 (Statement of Foreign Financial Assets) must be filed with your U.S. income tax return (in addition to your FBARs), if you live in Israel (or abroad) and

- i) The value in your foreign financial accounts exceeds \$400,000 (filing joint) or \$200,000 (filing single) on the last day of the year or
- ii) Your foreign financial accounts exceed \$600,000 (filing joint) or \$300,000 (filing single) at any time during the tax year.

Passive Foreign Investment Company ("PFICs") - Most investments in mutual funds registered outside the U.S. pose a potentially complicated tax issue for U.S. taxpayers.

Whereas U.S. registered mutual funds report gains and losses annually to the IRS and to taxpayers, foreign mutual funds do not. The IRS has termed foreign mutual funds as PFICs. PFIC investments, when sold at a profit, have to report to the IRS the income subject to interest charges for each year that the investment was held. In effect the IRS wants to recoup the taxes that would have been paid had the PFIC reported its activity annually. In addition, prior year PFIC income is ordinary income and therefore not eligible for capital gain rates. Also, since PFIC losses are limited investing in a PFIC can become an expensive proposition for a taxpayer who has a U.S. filing requirement. We recommend discussing this issue with your tax and investment advisor as there are alternative investments not subject to PFIC rules.

The Affordable Care Act (aka "ObamaCare")

This law begins affecting taxpayers for 2014. Under the individual shared responsibility provision of the law, taxpayers must have minimum essential coverage (health insurance) for the entire year or will have to make a shared responsibility payment ("SRP") on their 2014 tax returns. For most U.S. citizens living abroad there is an exemption from the SRP provided that the taxpayer would qualify under the bona fide residence or physical presence tests to exclude their income. Even if their income is not excluded, taxpayers residing abroad would generally qualify for the exemption from the SRP. U.S. citizens who meet neither the physical presence nor residency requirements will need to maintain minimum essential coverage, qualify for a coverage exemption or make a shared responsibility payment for each month of the year. For this purpose, minimum essential coverage includes a group health plan provided by an overseas employer. One exemption that may be particularly relevant to U.S. citizens living abroad for a small part of a year is the exemption for a short coverage gap. This exemption provides that no shared responsibility payment will be due for a once-per-year gap in coverage that lasts less than three months.

Form W-9

Israeli banks as well as some other financial institutions are now requiring a U.S. form W-9 (or W8-BEN for non U.S. citizens) to open or continue banking with your financial institution. In many cases your Israeli bank may require a declaration that the last 3 years of U.S. income tax returns and FBARs have been duly filed.

ITIN's – Individual tax identification numbers are required on every tax return submitted to the IRS. U.S. citizens have a Social Security number that is used for all tax filings. A non-U.S. citizen with a U.S. tax filing requirement must obtain an ITIN before submitting his tax return to the Internal Revenue Service. Our office can assist you with obtaining an ITIN if required.

U.S. / Israeli Income Tax Rates:

The U.S. income tax rates for the current tax year are 10%, 15%, 25%, 28%, 33%, 35% and 39.6%. Under the "stacking rule", in order to determine your income tax bracket, income excluded on Form 2555 (Foreign Earned Income Exclusion) will be added back to adjusted gross income. As a result, investment income may potentially be taxed at a higher tax bracket.

The ordinary **Israeli** income tax rates for the current tax year are 10%, 14%, 21%, 31%, 34% and 48%. An additional 2% tax is due on high level income. You may be eligible to receive a refund of up to 35% of charitable contributions against your Israeli tax paid if you contribute to recognized Israeli charities.

Foreign Tax Credits:

A U.S. foreign tax credit may be used on non-U.S. taxes paid on income earned in a foreign country such as Israel. Conversely, Israel will also recognize taxes paid to the U.S. and apply them as a credit against your Israeli income tax liability.

Social Security Benefits Received by a U.S. Citizen Residing in Israel:

The U.S. - Israel Income Tax Treaty states that U.S. citizens that are Israeli residents are eligible to exclude U.S. Social Security benefits from their adjusted gross income. This provision may result in substantial tax savings. If you have included your social security income in the past, our office can assist you with your amended tax returns (up to three years retroactively) to potentially receive large refunds.

Foreign Earned Income Exclusion:

The foreign earned income exclusion has been adjusted for inflation and has increased to \$100,800 per taxpayer. As such, married taxpayers filing jointly, who meet certain requirements, may potentially exclude up to \$201,600 of foreign earned income per tax return. However, one spouse may not utilize the unused portion of the exclusion of the other spouse. If one taxpayer elects the exclusion on a joint return, starting for 2015 there will be no child credit available on that return. If you file separately one spouse may claim the exclusion and one spouse may claim the child credit, which may result in a smaller refund than would have been on a joint return in a previous tax year (when it was permissible). Please note that the Foreign Earned Income Exclusion applies only to work or self-employment income and does NOT apply to other passive income such as pension, investment income, rental or any other non-earned income.

Long Term Capital Gains and Qualified Dividends:

Rates on long term capital gains (whether derived in the U.S., in Israel or in another country) generally apply to assets held for more than one year. For single taxpayers with taxable income under \$36,900 and for taxpayers filing jointly with taxable income under \$73,800 a zero percent long term capital gains and qualified dividends rate will generally apply. Capital losses are still fully deductible against capital gains, and any capital losses in excess of capital gains may offset up to \$3,000 of ordinary income if married filing jointly. Net capital losses in excess of \$3,000 may be carried over indefinitely to future years.

Net Investment Taxes:

In addition to the "ObamaCare" rules discussed above, additional provisions of these rules are as follows: Beginning in 2013 the IRS has imposed an additional 3.8% tax on passive income for high income individuals (see table below). For this purpose, passive income includes interest, dividends and capital gains. Part of the passive income subject

to this tax, are dividends from your foreign-owned corporation. The tax on this income cannot be taken as a credit for Israeli tax purposes. Therefore, it may be advisable that taxpayers with Israeli corporations report earnings as additional salary rather than declaring a dividend. Earnings from salary are not subject to this tax. Please contact our Israeli department for more details.

Filing Status	Income Threshold Amount
Married filing jointly	\$250,000
Married filing separately	\$125,000
Single	\$200,000
Head of household (with qualifying person)	\$200,000
Qualifying widow(er) with dependent child	\$250,000

U.S. Child Tax Credit:

If applicable, **\$1,000 per eligible child** may be available to offset any potential U.S. income tax liability or refunded. Taxpayers must have reportable earned income from wages (via Israeli Form 106 or similar foreign wage slip) or self-employment income in excess of \$3,000. The earned income of both husband and wife can be combined even if one spouse is NOT a U.S. citizen. The non-citizen spouse requires a U.S. tax identification number (TIN), which can be acquired by filing U.S. Tax Form W-7. Children must be U.S. citizens aged 16 and below and must possess a U.S. Social Security number. Please note that maximizing the child credit can be quite complicated since there are many factors to consider. In addition, the IRS has been conducting income tax audits which may require verification of income and other information. Amended tax returns may be filed back to the tax year 2012 in order to claim the child credit (2012 amended returns must generally be filed by April 15, 2016).

Estates and Gifts:

The gifting limit per spouse of \$14,000 annually to each eligible recipient includes children and grandchildren. Gifting continues to be an excellent way to potentially reduce the value of your U.S. taxable estate as well as future U.S. estate income taxes. There is an inflation adjusted exemption of \$5,340,000 on U.S. estates. Please consult your tax advisor for more details regarding your estate planning and writing a personal will.

State and Local Tax Returns:

Refunds may be available for taxpayers who may be unnecessarily filing resident U.S. State income tax returns after they moved to Israel. You should be aware that maintaining a bank account, brokerage account or driver's license in a particular State does **not** automatically necessitate a tax filing in that particular State. However, if you own real estate, maintain a business, commute to and work in a particular State, or have any other activity considered nexus (strong connection) to a State, you would generally only file a **non-resident** income tax return in that State.

Standard Deduction:

Standard Deduction amounts are: Single or Married Filing separately - \$6,300; Married Filing Jointly - \$12,600; Head of Household - \$9,250. Taxpayers over the age of 65 may claim an additional deduction of \$1,200 each, if married, or \$1,550 if single. Taxpayers

with qualifying deductions in excess of these amounts may generally itemize their deductions. Please note that bank mortgage interest, Israeli real estate tax (armona), Israeli income taxes, and certain charitable contributions paid to Israeli sources may also qualify as itemized deductions. A phase out of itemized deductions will apply if income exceeds \$309,900 (filing joint) and \$258,250 (filing single).

Personal Exemptions:

A personal exemption of \$4,000 per person is available for each individual listed on the tax return. A U.S. citizen may only be claimed as an exemption once during each tax year. In some cases, grandparents may sometimes claim their grandchildren as exemptions on their income tax returns if they provided at least half the support of the grandchild **and** the grandchild lived with the grandparent.

Self-employment Income:

In order to qualify for future U.S. Social Security retirement benefits one must pay in to the U.S. Social Security system a minimum of 40 quarters (credits). These credits can be earned even while residing in Israel. One can accrue a maximum of 4 quarters per year by earning in excess of \$5,500 annually. This is primarily accomplished by:

- i) Being self-employed in Israel and reporting Israeli self-employment income on your U.S. income tax return,
- ii) Working in Israel for a U.S. entity and receiving a Form W-2 (employee) or Form 1099 (independent contractor),
- iii) Traveling to the U.S. to work as an employee (W-2) or as a self-employed individual (1099).

Automatic Extension, Estimate Tax Payments and Automatic Withdrawals:

Automatic income tax return extensions are available until June 15, 2016 for U.S. taxpayers, who reside outside of the U.S. If there is a balance due with your tax return, interest will be accrued from April 15, 2016 while penalties will begin to accrue after June 15, 2016. Filing an extension will extend the time to file until October 15, 2016. An additional extension may be granted until December 15, 2016 but certain restrictions may apply. It is strongly recommended that taxpayers who owe income tax but do not file by June 15th should make a payment with their extension. For the upcoming year, it is imperative that taxpayers pay estimated taxes on a timely basis in order to avoid underpayment of estimated tax penalties. Our office can assist you in setting up electronic payments with the IRS using the Electronic Federal Tax Payment System (EFTPS) via withdrawal from your U.S. bank or other financial account.

Tax Retirement Plans/Required Minimum Distributions ("RMD"):

Within 60 days of a distribution from an Individual Retirement Plan ("IRA") a taxpayer can roll over the distribution to another retirement plan tax free. If no rollover is made within 60 days the taxpayer is required to pay tax on the distribution at ordinary income tax rates. Once you reach age 70 1/2 you generally must begin to withdraw funds from traditional IRAs on an annual basis and pay the required income tax. The amount of your RMD is calculated by using the IRS life expectancy tables. In addition, conversion to a

Roth IRA can be a valuable tax planning tool for both U.S. and Israeli tax purposes. Your tax and pension advisor should be contacted in this regard.

Avoiding Early Withdrawal Penalties from Retirement Funds:

An early IRA distribution may be made without being subject to the 10% early withdrawal penalty provided the funds are used to purchase a first home even in Israel. The distribution amount is limited to \$10,000 per taxpayer and/or spouse from each individual's account. The early withdrawal penalty will also not apply in certain circumstances such as medical premium payments or higher educational expenses.

Higher Education Credit:

The American Opportunity credit can be claimed for qualified tuition and related expenses for any of the first four years of a college or university degree. The credit is up to \$2,500 for those paying \$4,000 or more in qualifying expenses for an eligible student. Forty percent of the credit is refundable which allows a taxpayer to receive up to \$1,000 cash back for each eligible student claimed on the tax return, even if no income tax is due. You cannot claim the credit and the tuition and fees deduction for the same student. The credit is generally available for U.S. universities and for certain foreign universities (please contact our office for the list of eligible Israeli universities). The credit begins to phase out at \$80,000 for taxpayers filing single or \$160,000 for taxpayers filing jointly.

Corporations, LLC's and Trusts:

Corporations may be excellent tax planning vehicles, especially for taxpayers working outside Israel and in light of Israeli tax reform. "C" Corporation tax rates are 15% on taxable income up to \$50,000, 25% from \$50,001 - \$75,000 and 34% from \$75,001 - \$100,000, with higher rates for higher taxable incomes. "S" Corporations, Limited Liability Companies ("LLC's") and certain Trusts are called pass-through entities. The pro-rata share of the pass-through entity's income must be reported on the taxpayer's personal income tax return and is taxed at the individual's personal income tax bracket. If you have a foreign corporation, you will be required to file form 5471 (Information Return of U.S. Persons with Respect to Certain Foreign Corporations) with your tax return (please contact our office for more details).

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