

Wednesday, Jul 10th



Português עברית Français Español [LOG IN](#)

HOME | ALIYAH PEDIA | ABOUT | APPLICATIONS | EVENTS | INSPIRATION | MEDIA ROOM | FAQ | SITE MAP | DONATE | CONTACT | עברית

YOU ARE HERE: [ALIYAH PEDIA](#) > [FINANCES](#) > [PAYING TAXES IN ISRAEL AND OVERSEAS](#) > OLEH GUIDE TO U.S. TAX COMPLIANCE

## Oleh Guide to U.S. Tax Compliance

Like Send Sign Up to see what your friends like. 2

Guest Contributor: *Jo Anne C. Adlerstein*

*Disclaimer: This article was written by a guest contributor and NBN takes no responsibility for the information listed therein. Please consult with experienced tax advisors and lawyers regarding the specifics of your situation.*

[Basic Concepts](#) | [Why you must come into Compliance](#) | [How you can come into Compliance](#) | [Conclusion](#)

### Introduction

Countries provide services to their citizens and residents. They pay for the services by collecting taxes from their citizens and residents. No one likes to pay taxes. It is absolutely legal to try to minimize your taxes by tax planning. It is absolutely illegal to hide your money in a foreign country to evade taxes.

Before we talk about current events, disclosure of offshore bank accounts to the Internal Revenue Service (IRS), and Israeli banks freezing accounts, let's get the basic concepts clear:

#### A. BASIC CONCEPTS

##### 1. U.S. CITIZENS AND LAWFUL PERMANENT RESIDENTS (PEOPLE WITH "GREEN CARDS") HAVE TO FILE U.S. INCOME TAX RETURNS WHICH REPORT THEIR WORLD-WIDE INCOME.

There is an exception for persons who do not earn the statutory minimum or threshold amount that requires filing. You can find the threshold amount on the instructions for Form 1040. The IRS website ([www.irs.gov](http://www.irs.gov)) has all forms and instructions. The threshold amount includes earned income and passive income (such as interest and dividends). If you are self-employed, a special rule applies: You must file a U.S. income tax return if your net income exceeds \$400 in the year.

**2. ISRAELI CITIZENS WHO RESIDE IN ISRAEL HAVE TO FILE RETURNS REPORTING TAXES ON THEIR WORLD-WIDE INCOME.** Since January 1, 2003, this has been the law. The fact that you report your world-wide income on U.S. tax returns does not exempt you. You need to consult with an Israeli certified public accountant (CPA) or Israeli tax lawyer to see what, if any, exceptions may apply to you. In 2012, there was an amnesty for Israeli citizens who had not reported overseas income. It is still possible to make a voluntary disclosure to the Tax Authority. Again, you need to consult an Israeli CPA or tax lawyer.

**3. SOME INCOME EARNED IN ISRAEL MAY BE EXEMPT FROM ISRAELI INCOME TAX BUT NOT U.S. INCOME TAX.** Here are two examples. First example, if you cash in a Keren Hishtalmut account that has matured, Israel does not tax it. However, it needs to be reported on your U.S. tax return because a portion of the proceeds are taxable by the U.S. Second example, let's say you own an apartment in Israel which you rent to a third party. In 2012, monthly rental income under 4,910 NIS was not taxable in Israel. However, it is taxable in the U.S. Thus the income needs to be reported on your 2012 U.S. income tax return.

**4. THERE IS A U.S.-ISRAEL TAX TREATY THAT REDUCES THE EXTENT TO WHICH YOU WILL BE TAXED BY BOTH ISRAEL AND THE U.S. ON THE SAME INCOME.** In Israel, income taxes are withheld from wages, and you may not have to file an Israeli tax return. Your earnings and the tax paid to Israel are shown on *Tofes 106* which you may need to request from your employer. The same income which has been earned in Israel and taxed by Israel has to be reported on your U.S. tax return. However, there is an earned income exclusion from U.S. taxes of \$97,600 for 2013. Form 2555 will be filed as part of your U.S. tax return to claim this exclusion. There is also a foreign tax credit. The income you earn on bank accounts and financial investments is taxed in Israel and the tax is withheld by the Israeli financial institution. *Tofes 867* (which you need to request from your bank or financial institution) will show this withholding. You get a credit against your U.S. income taxes for the taxes paid to Israel (or

### ISRAELI FOREIGN MINISTRY STRIKE

Nefesh B'Nefesh together with The Jewish Agency for Israel are working to help find a solution for the Aliyah visa Issue caused by the strike. While we understand the motivations of the strike we strongly believe that these actions should not come at the expense of new Olim. We are confident that a solution will be found imminently to ensure that Olim will be able to fulfill their Aliyah plans unimpeded.

[Start My Application!](#) [Log me back in](#)

**You've got Aliyah questions, We've got answers!**  
Search the Aliyahpedia.

Aliyah Benefits, Community, Schools, Ulpan, Hebrew, Employment, Finances, Healthcare, Garin Tzabar, Army, The Jewish Agency for Israel, etc.

[Aliyah Flight Schedule 2013](#)

**Subscribe to the NBN newsletter**  
Email Address:  \* Required  
To prevent spam please answer the following:  
What is 7 + 3 ?  \*

**Click a flag for a list of local events & seminars**   
**Meet 1- on- 1 with Nefesh B'Nefesh Staff in your area. [Details >>](#)**

**All you need to know about Aliyah, Live webinars >>**

Sponsors

Community Database

School Database

Ulpan Database

2013 Summer Camp Database

JANGLO.NET is Israel's online community for English speakers! Find jobs, housing, sales, events, and much more.

another country). This is the Foreign Tax Credit. It is claimed on Form 1116 of your U.S. tax return. If the U.S. tax rate is higher than the Israeli tax rate, you may owe the U.S. some taxes.

**5. THE U.S. INTERNAL REVENUE SERVICES GATHERS INFORMATION EVEN IF IT DOESN'T REQUIRE YOU TO PAY TAXES.** There are a number of forms that need to be filed as part of your U.S. tax return even if they do not impact your tax liability. Here are some examples:

- Form 5471 if you have an ownership interest in a foreign (Israeli) company.
- Form 3520 if you receive a gift in excess of \$100,000 from a non-U.S. citizen. (Example, money for an apartment from your new Israeli in-laws.)
- Form 8865 if you have an ownership interest in a foreign partnership.
- Form 8938 if you own overseas stock or financial accounts valued over \$200,000 at year end or \$300,000 during the year (the threshold numbers vary with whether you reside outside the U.S. and are married to a U.S. citizen or green card holder).

All of these forms have complex instructions describing detailed criteria. You need to consult with a U.S. CPA if your return may require one of these forms. There are penalties for not filing these forms.

**6. THE US TAXES SOME INVESTMENTS DIFFERENTLY THAN ISRAEL.** One example is its taxation of PFICs -- passive foreign investment companies. A foreign corporation that manufactures products earns money from the sale of products. A foreign corporation that earns 75% or more of its income from the company's *investments* (rather than products) is a PFIC. Or, when 50% or more of a company's assets are investments that produce interest, dividends, or capital gains, it is a PFIC. Foreign-based mutual funds, partnerships, and pooled investments that have at least one U.S. shareholder are PFICs. PFICs are taxed differently than U.S.-based mutual funds, where capital gains tax rates apply. If you have mutual funds, stock or investments outside the U.S., you need to ask your investment advisor for a prospectus and discuss whether your investment is subject to the PFIC rules. A U.S. CPA can explain the PFIC regulations.

**7. THE U.S. REQUIRES ANNUAL FILING OF REPORTS OF FOREIGN BANK AND FINANCIAL ACCOUNTS BY JUNE 30<sup>TH</sup>.** The Report of Foreign Bank and Financial Accounts (FBAR) is filed with the U.S. Department of the Treasury. It is not a tax return and is not part of your income tax return. You are required to file an FBAR if your foreign bank and financial accounts in the aggregate exceed \$10,000 at any time in a year. Accounts you own personally, jointly with a spouse, and jointly with a child or parent are listed. So are pension accounts. So are accounts for which you have only signature authority -- like your Vaad Bayit checking account, or your employer's petty cash account. In order to prepare the FBAR, you will need to get all your year-end bank statements. The FBAR can be completed with year-end numbers *unless* you had a significantly larger amount in the account during the calendar year. For example, if you sold an apartment, you may have a high balance for a few weeks before you pay for your new apartment. The high balance must be used even if it was only in your account for one day. Remember, the FBAR provides information; it is *not* used for calculating income tax.

#### 8. U.S. SOCIAL SECURITY – THE GOOD AND THE BAD.

**The Good.** If you reside in Israel, Article 21 of the U.S.-Israeli Tax Treaty exempts Bituach Leumi and Social Security benefit payments from taxation in either country. If you do not reside in Israel, Social Security may be subject to income tax if your income exceeds a certain level. If you split your time between the U.S. and Israel, your CPA needs to help you determine whether you are a resident of Israel or the United States for income tax purposes. Keep records of the precise dates of your time out of Israel. You can obtain print-outs from the Ministry of the Interior if needed.

**The Bad.** Unlike many European countries, Israel does not have a "Totalization Treaty" with the United States. This means that self-employed dual citizens residing in Israel must pay *both* Bituach Leumi and U.S. self-employment (Social Security) tax. The Social Security Administration ([www.ssa.gov](http://www.ssa.gov)) does not have its own tax collection system. Self-employment tax is calculated on Schedule SE with Form 1040. This means that if you are self-employed and net more than the equivalent of \$400/year, you must file Form 1040.

**9. YOUR KIDS AND YOUR SPOUSE.** If your children are U.S. citizens, they are subject to U.S. income tax returns and FBAR requirements. In order to file these forms (even if you sign as their parent), they need their own Social Security numbers. Your children may be U.S. citizens from birth (depending on your citizenship and the time you lived in the U.S.), even if you have *not* reported their birth to the U.S. Consulate or Embassy and even if they do *not* have U.S. passports or Social Security numbers.

If you wish to claim your U.S. citizen children as dependents or apply for the Child Tax Credit, your children need Social Security numbers.

If your spouse is not a U.S. citizen or lawful permanent resident ("green card" holder), s/he is not required to file U.S. tax returns or FBARs. Joint accounts held with you will still be included in your

WORKING IN PARTNERSHIP TO BUILD A STRONGER ISRAEL THROUGH ALIYAH



FBAR and your non-resident spouse should sign the FBAR. Accounts solely owned by your non-resident spouse are not included on the FBAR.

In order to increase the amount of the Child Tax Credit or other benefits, some tax preparers recommend that your non-resident spouse elect to be taxed as if s/he were a U.S. citizen or lawful permanent resident. This election can only be made once and revoked once. It should not be made without a full understanding of the consequences beyond what may be a one-time refund check. Also note that IRS frequently audits returns of Israeli residents who claim the Child Tax Credit; this is the result of many returns being filed which claimed the credit for children who were not U.S. citizens in the return years.

**10. OMISSIONS AND MISTAKES.** What is an omission? There are three principal ones that relate to required forms: not filing tax returns, not filing FBARs, and not filing information returns as part of your income tax returns. Other omissions may be in the nature of mistakes: Reporting some but not all bank accounts on your FBAR, or some but not all income on your income tax returns. Whether your omissions and mistakes were unintentional or deliberate, they can be corrected. Correcting them will put you into compliance with U.S. tax laws.

#### **B. WHY YOU MUST COME INTO COMPLIANCE**

If you have had over \$10,000 in bank or financial accounts outside the U.S. in years since 2006 and haven't filed FBARs, you must come into compliance. If you have not included your Israeli income on your U.S. income tax returns, you must come into compliance. If you have income from accounts or companies in Switzerland, the Cayman Islands or any place other than the U.S., you must come into compliance. If you stopped filing U.S. income tax returns when you made aliyah, you must come into compliance. Why? Because you are going to be caught!

When you are caught, you will be lucky if you *only* pay taxes, interest and civil penalties. If IRS views your conduct as intentional, you could face a fraud penalty of 75% of the tax you didn't pay each year. You could be criminally prosecuted for tax evasion and the IRS could seek to penalize you for failing to file FBARs in an amount greater than all the funds you have on deposit! How will you be caught? Keep reading.

**1. FATCA.** The Foreign Account Tax Compliance Act (FATCA) will soon require foreign banks and financial institutions to report U.S. account holder's names, addresses, and Social Security Numbers to the IRS. That is why Israeli banks are asking for Forms W-9, sworn statements, and copies of your FBARs and U.S. tax returns. They want to make sure that they and their employees are not prosecuted, fined, or penalized for assisting tax evasion. Did you show your U.S. passport when you opened your account? Does your Teudat Zehut show you were born in the U.S.? Do you get wire transfers from the U.S.? Your bank knows you are a U.S. citizen. Let's make it simple: your bank cares more about its reputation than it does about you. If you want to read more about FATCA, start with the IRS webpage: <http://www.irs.gov/Businesses/Corporations/Foreign-Account-Tax-Compliance-Act-%28FATCA%29>. Some Israeli banks have started to "freeze" accounts of customers they think are U.S. citizens if the customer refuses to sign Form W-9 or to present the bank with proof of IRS return filing.

**2. CRIMINAL INVESTIGATIONS.** The IRS and Department of Justice are not waiting for FATCA. They are actively investigating banks and investment advisors world-wide. Several Israeli banks are under investigation for activities that allegedly helped U.S. clients hide money in Israel and Switzerland. Their customers are entering into plea agreements. If you want to read more about this, start with the Federal Criminal Tax Blog's spreadsheet showing charges and indictments: <http://federaltaxcrimes.blogspot.co.il/p/offshore-charges-convictions.html>. It is highly unlikely you will be the first "target" of a federal criminal investigation. How will you get caught in the net? Over 30,000 taxpayers entered the IRS 2009 Offshore Voluntary Disclosure Program and 2011 Offshore Voluntary Disclosure Initiative. Each of them revealed the names of their bank, their bankers, and their investment advisors. Generally, the investment advisor who guided the customer into a hidden or secret offshore account will be the first "target." To save themselves, the investment advisors identify the cooperative/complicit in-house employees of the bank. In turn, the bank employees identify their U.S. clients. Most of the indictments give details on the tax evasion by "Client 1" and "Client 2" etc. You don't want to wait until you make such a list.

**3. PASSPORT RENEWAL.** If you renew your U.S. Passport in Israel, it is highly likely that you reside in Israel. If you reside in Israel, it is likely that you have income in Israel. To make it easier for IRS to identify U.S. citizens living abroad who are not filing income tax returns, applicants for passports are now asked to provide their Social Security Number on the application form. Failure to provide it may result in IRS asserting a \$500 penalty.

**4. INTERGOVERNMENTAL AGREEMENTS.** As presently drafted, FATCA requires individual overseas banks and financial institutions to enter into compliance agreements directly with the IRS by January 2014. In July 2012, the U.S. Treasury Department announced that it is drafting and entering into

agreements with various countries which will create a framework for foreign bank and financial institutions to report account information to the tax authority in their own country which will then provide it to the United States. This is much simpler than having each bank and financial institution enter into an agreement with IRS and report directly to IRS. Agreements have been finalized with the United Kingdom, Mexico, Denmark and Switzerland. Over 50 countries are in negotiations with the U.S., including Israel. Many tax professionals expect Israel to sign an agreement in 2013. That would mean Israeli banks and financial institutions may begin reporting their U.S. customers' accounts to the Israeli Ministry of Finance for transmission to the U.S. in 2013.

### **C. HOW YOU CAN COME INTO COMPLIANCE**

Some people think they can just start doing what is required in 2013.

However, coming into compliance requires filing FBARs for the past six years (if you had enough money in foreign accounts to require such filing). It may require filing amended returns back eight years, or new returns back three years. It means gathering records, getting help and spending money.

The starting point is to do an "al chet" analysis...what "sins" could IRS allege you have committed? You then can make a decision on which compliance option will best meet your needs. It is likely that you will need the advice of a U.S. CPA and/or U.S. tax attorney who regularly works in the area of remediation and compliance to avoid the possibility of choosing a strategy that is more expensive than necessary.

There are a number of ways to come into compliance. One size does not fit all. Once you have identified what you have failed to do or what you have done wrong, you can consider which compliance strategy will fit your circumstances.

**1. NO FBARS.** Did you file U.S. tax returns and report all your worldwide income? Is your only problem that you didn't file FBARs? FAQ 17 of the IRS Offshore Voluntary Compliance Program (OVDP) makes compliance easy. Essentially, you prepare FBARs for years 2006-2011 and file them with the Treasury Department in Detroit along with a letter explaining your "reasonable cause" for failing to file FBARs. FAQ 17 is found at:

<http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers>. The best explanation of "reasonable cause" is a December 2011 IRS memorandum:

<http://www.irs.gov/uac/Information-for-U.S.-Citizens-or-Dual-Citizens-Residing-Outside-the-U.S.>

**2. MISSING INFORMATION RETURN.** Did you file U.S. tax returns, report all your worldwide income, and file FBARs? Is your only problem that you didn't file an information return as part of your income tax return? (An example is Form 5471 for a company you own in Israel.) FAQ 18 of the IRS Offshore Voluntary Compliance Program (OVDP) makes compliance palatable. Essentially, your accountant prepares the missing forms and amended income tax returns for each year. The returns will show no additional tax due. The amended tax returns, with the necessary information returns, will be filed with IRS along with a letter explaining your "reasonable cause" for failing to timely file the information returns. FAQ 18 is found at: <http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers>.

**3. NO FBARS AND NO INFORMATION RETURN.** If you have failed to file FBARs *and* filed tax returns without a required information return, you may come into compliance by use of both FAQ 17 and FAQ 18. This would be a choice *only* if you have filed all your income tax returns and reported all your worldwide income. To be sure that you have not missed anything else, you should consult with a U.S. CPA.

**4. NO FBARS AND NO TAX RETURNS.** The IRS Streamlined Program is a good deal for "low risk" taxpayers. If you have lived outside of the U.S. since January 1, 2009 and have filed neither U.S. tax returns nor FBARs, and owe less than \$1,500 in tax for years 2009, 2010, and 2011, you may qualify. The detailed "rules" are found in instructions and a questionnaire on the IRS website:

<http://www.irs.gov/uac/Instructions-for-New-Streamlined-Filing-Compliance-Procedures-for-Non-Resident-Non-Filer-US-Taxpayers>

and: [http://www.irs.gov/pub/irs-utl/non-resident\\_questionnaire.pdf](http://www.irs.gov/pub/irs-utl/non-resident_questionnaire.pdf)

This program is also open to taxpayers who did not file information returns. If you apply but the IRS determines you are "high risk" because you have accounts in several countries, sophisticated planning, and big account balances, you may not be accepted. The result is that your returns will be closely examined (the new term for "audited"). You will also be unable to enter the 2012 OVDP described below. There is some flexibility with the \$1,500 cap. You should submit a "reasonable cause" letter even

though it is not required. You should have a U.S. CPA or tax attorney review the appropriateness of this option for your particular circumstances.

**5. RETURNS THAT DIDN'T REPORT OFFSHORE INCOME, INCOMPLETE FBARS, SWISS ACCOUNTS, BIG BUCKS, OR RISK OF PROSECUTION.** The 2012 Offshore Voluntary Disclosure Program (2012 OVDP) is no fun. You will need to pay all income taxes, some civil penalties, and interest due for the past eight years. You will need the help of a U.S. CPA and U.S. tax lawyer. And, you will be agreeing to pay a penalty of 5%, 12.5% or 27.5% of the greatest aggregate balance of your offshore accounts for the eight year period. If your bank or financial institution is already under investigation, you need to act quickly. If IRS already has your name and account information, you can be declined entry into the 2012 OVDP. If you can qualify for the 5% penalty, you will do well by entering the program. If there is a risk of criminal prosecution, the 27.5% is a painful but life-saving operation. To start digesting the details, see: <http://www.irs.gov/uac/2012-Offshore-Voluntary-Disclosure-Program>.

**6. "OPTING OUT" OF THE 2012 OVDP.** In FAQ 51.1 of the 2012 OVDP Frequently Asked Questions, IRS recognizes that some taxpayers should not go into the 2012 OVDP because the penalties they risk for non-compliance by "opting out" (not going into the program) are less than what they would pay going into the 2012 OVDP. See: <http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers>. In these situations, the advice of a U.S. CPA and/or tax attorney is essential to your decision. There are two ways to "opt out" if no compliance option seems to fit your circumstances: quiet and noisy.

"Quiet Disclosure" is mentioned in FAQ 15 of the 2012 OVDP FAQs. It is a two-step procedure: (1) filing some or all delinquent and/or amended FBARs (with the Treasury Department in Detroit) and tax returns (on which interest and civil penalties will be due) with IRS, and (2) hoping IRS does not select your FBARs and returns for audit. If IRS questions your FBARs or tax returns you can contest proposed penalties, but you will not be able to go into the 2012 OVDP. "Quiet Disclosure" is a gamble.

"Noisy Disclosure" is a term coined by tax professionals, not IRS. To me it means (1) filing 2006-2011 FBARs ASAP with a letter explaining your reasonable cause for late filing; (2) filing your 2012 FBAR by the June 30th due date (no extensions are available); (3) filing your 2012 income tax return by the June 15th due date (or filing for an automatic extension before that due date); and (4) filing delinquent and/or amended tax returns for no less than the 2009-2011 years, and sometimes one or more earlier returns. The late-filed and amended returns should be accompanied by a letter of explanation.

## CONCLUSION AND DISCLAIMER

In my experience, most non-compliant taxpayers fall into one of two groups. Most olim are *unjustifiably* petrified that they will be prosecuted and lose their life savings to IRS. These are extraordinarily unlikely events. A minority of dual citizens are outraged that IRS can demand filing and payment and adamant that they haven't intended to cheat IRS or Israel by putting money in Switzerland. The anger is misdirected. Peace of mind comes with getting into compliance.

You may notice that I make reference to consulting with U.S. certified public accountants (CPAs). Anyone can prepare a U.S. income tax return.

Paid preparers have been issued preparer tax identification numbers (PTINs) by IRS. Having a PTIN does not mean that one is an expert in U.S. taxation and the special issues of dual citizen taxpayers. Enrolled Agents (EAs) have passed three IRS examinations covering individual and corporate taxation and practice and procedures. Accountants can be people who studied accounting in school or have college degrees in related fields. That doesn't mean they are CPAs. U.S. CPAs have passed rigorous licensing examinations and are required to take hours of continuing education courses each year. The lists of "Accountants" on the U.S. Consular websites and various olim websites include CPAs, preparers, enrolled agents, and self-described accountants. It is up to the client to verify credentials. In Israel, the fees for CPAs are not always higher than those for other preparers.

This article does not, and is not intended to constitute legal advice. Neither transmission nor receipt of this article creates an attorney-client relationship with the author. Readers are advised not to take, or refrain from taking, any action based upon this article without consulting legal counsel currently licensed to practice law in a U.S. state.

*Jo Anne C. Adlerstein is a former Assistant U.S. Attorney who supervised income tax prosecutions in the District of New Jersey for 6 1/2 years. She has defended clients accused of tax evasion since 1985 and is a Certified Anti-Money Laundering Specialist. She made aliya in 2008. She is a member of the New York and New Jersey Bars. Her website is [www.FBARadvice.com](http://www.FBARadvice.com).*

**Israel:** Beit Ofer - 5 Nahum Hefzadi • Jerusalem, 95484 Israel • Tel: 02-659-5800 | [Link to Google Map](#)

**North America:** 50 Eisenhower Drive • Paramus, NJ 07652 • Tel: 1-866-4-ALIYAH | [Link to Google Map](#)

**United Kingdom:** JNF House: Spring Villa Park • Edgware, Middx HA8 7ED, UK • Tel: 0800-075-7200 | [Link to Google Map](#)

**Questions? Email [webmaster@nbn.org.il](mailto:webmaster@nbn.org.il)**

The content of this website is for informational purposes only. Nefesh B'Nefesh does not endorse specific service providers. [Click here](#) for details.

המדינה אינה ממליצה על כל גוף שנותן חסות או שמפרסם באתר זה ואינה אחראית לטיב השירותים, לאמינות הגוף המפרסם או לפרטים אודות ניהולו התקין

The State of Israel does not endorse any entity that provides a sponsorship or advertises on this website and is not responsible for the quality of the services, the credibility of the advertiser or the details regarding its proper management.