

The only certainties in life are death and taxes. For US citizens, that is true twice over...
Photo by GAS



Two Holes in Your Pocket

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You're an Icelander, studying at an American university, and you're pregnant. You had planned to go home to Iceland to have the child. But then you find out that anyone born in the U.S. is automatically entitled to U.S. citizenship. American citizenship might make it easier for your child to study or work in America later on. Why not stay in the States for the birth?

It sounds like a good idea. But there's a catch: American citizens must report their income and pay taxes to the United States for their entire life. No matter where they live. The United States is just about the only country that taxes its citizens in this way. Normally, people are taxed only in the country where they actually live. The American approach is controversial. Many people think it is unreasonable. There has been a lot of commotion about it in the U.S. Congress. The law was recently changed again - not in overseas taxpayers' favour, though. Further changes are likely.

Meanwhile, welcome to February. Tax season is coming up. American citizens in Iceland have a double-strength filing headache to look forward to. And Icelanders who are tempted to give birth in the United States should think carefully about the tax consequences for their children when making their plans. There is some good news. Americans in Iceland can usually avoid most U.S. income taxes, because U.S. tax law allows you to take a deduction or credit for foreign-earned income. But there's more bad news than good. You still have to file. And these deductions and credits only cover a limited set of circumstances. American citizens in Iceland can find themselves owing money to the U.S. government if they have substantial income from interest, capital gains, self-employment, or owning a business, or if their regular salary is relatively high.

Double Social Security Contributions too

The biggest problem for many Americans in Iceland is not income tax but social security contributions (tryggingargjöld). This means the money that you pay into the old-age pension system, both in both America and Iceland. If you work for someone else, your employer sends this money to the government on your behalf. If you are self-employed, you pay it all yourself.

Under United States law, all U.S. citizens, anywhere in the world, who have self-employment income of more than \$433 per year must contribute a part of that income to the United States social security system, at a rate that normally amounts to 14.1%. That means that American citizens in Iceland who run their own unincorporated businesses - anything from translating to piano lessons to jewellery making - have to pay twice: 5.79% in Icelandic social security contributions, and 14.1% to America too (using IRS Form 1040-SE).

Realising that this kind of situation is not

very workable, the U.S. Social Security Administration has made agreements with many countries under which Americans abroad only have to contribute to one system (local or American), but not both. These agreements are called social security totalisation agreements. Every other Nordic and Western European country, and every other legacy OECD country, now has a totalisation agreement with the United States. Iceland still doesn't. The U.S. Embassy in Iceland has recently turned its attention to this issue, and has had Iceland placed on the Social Security Administration's list of countries with which a totalisation agreement would be desirable. This is a very welcome step forward. However, the negotiation process is slow, and relief for Americans in Iceland is still at least several years away.

In the meantime, one way to get around the Social Security problem is by starting an Icelandic company and becoming its employee, thus having no self-employment income. The down side is that besides the regular cost of starting and running a company, any American who owns a corporation abroad has to file the dreaded IRS Form 5471. This form is so complex and time-consuming that it absolutely requires a tax accountant skilled in international matters.

The lack of a totalisation agreement has wider effects. Americans who have moved to Iceland, and Icelanders who have moved to America, do not always get the full benefit of the two countries' social security systems after they retire. A written understanding between the two governments, dating from 1981 and meant to be provisional, ensures that they do receive a very basic level of support. But a totalisation agreement would ensure fully fair treatment, not just for mobile workers, but also for their survivors and dependents.

Frequently Asked Questions

Here are some answers to the tax questions I commonly hear from Americans in Iceland (I am not a tax attorney, though, so please consult one before making any important decisions):

Q. I grew up in America but have lived here for quite some time, and quit filing years ago because I never owed anything. Isn't that OK, practically speaking? I can't imagine that the IRS cares.

If anything, enforcement is getting tougher. If you think you might ever use your American citizenship - by moving back or even just travelling back to the United States - it is especially important to file. Even if you owe nothing. Jane Bruno, a tax accountant who specialises in Americans overseas, notes that the IRS and the U.S. immigration authorities are working more closely together. She says, "I advise my clients who are travelling or relocating back to the U.S. to have at least 3 years of prior tax returns available to show if they are

asked. Just make it a part of your travel packet." U.S. passports now include the following warning: "All U.S. citizens working and residing overseas are required to file and report on their worldwide income."

Q. Come on. Do I really have to pay American self-employment tax? I mean, the work is barely worth doing if I lose an extra 14% in tax. And I am already contributing to the Icelandic system. Unfortunately, according to the law, the answer is yes. But there are some things you can do to minimise your U.S. self-employment tax: (1) Think broadly and deduct as many business expenses as you possibly can. (2) Form an Icelandic corporation and become its employee, if you have enough turnover to make this worthwhile. (3) Let the Social Security Administration know of your interest in getting a totalisation agreement signed as soon as possible, by writing or having your congressman write to them using the instructions at www.ssa.gov/international/agreements_overview.html. In practice, overlooking a few hundred dollars in self-employment income on your American tax returns is perhaps unlikely to get you punished, and is probably a lesser sin than not filing at all. But it leaves you wide open to penalties from the IRS, and creates a slippery slope if your self-employment income grows over the years.

Q. Can't I get out of this all by renouncing my United States citizenship?

It's not that simple. After renouncing your citizenship - a consequential decision that shouldn't be taken lightly - you can file Form 8854 with the IRS in order to signal the end of your tax liability to the U.S. But if you have not fulfilled your tax obligations to the United States during the five years before renunciation, or if you have assets over a certain level, the U.S. will consider you subject to U.S. tax at an even higher, penalty rate for ten years after your renunciation.

Q. Where can I go if I need help from a tax accountant who understands both the U.S. and Icelandic systems?

I don't know of a tax accountant in Iceland with expertise in the American system, but there are accountants in America who specialise in expatriate issues. You can contact Jane Bruno through her website, www.oceanwavestax.com, where she also sells The Expat's Guide to U.S. Taxes, an electronic book designed to help Americans abroad. The website of American Citizens Abroad, www.aca.ch, offers news updates, basic tax advice, and a chance to join in lobbying for simplified income tax filing for Americans abroad.

Text by Ian Watson