

Cap Your Taxes

By Martin Kapp

Income earned on international voyages is taxable

You've heard that some merchant sailors working and/or living overseas have been claiming a Foreign Earned Income Exclusion while working aboard ships traveling between foreign ports in international waters.

Can you do the same? The simple answer is no. This often-misunderstood tax windfall could land you or some of your crewmembers in prison for tax evasion. Here's why.

In the June/July 2003 issue (PM #72) I described the phrase "your legal domicile." The simplest definition for domicile is the place you first think of as your home. If you live with your family in a rented apartment in Iowa and commute routinely to the New York area to work, then Iowa would be considered your legal domicile, even though you never earn a penny in Iowa. Under this scenario, no state taxes are owed to New York, because you do not live there, but you do owe full state taxes to Iowa.

But let me be very clear. The legal term *domicile* only refers to state tax issues — not federal tax issues. The federal government does not care in which of the 50 states you choose to live. After all, every citizen of the United States is required to file a federal tax return.

But what happens if a sailor only works on U.S. ships traveling exclusively between foreign ports, and he or she never comes into a U.S. port? The IRS allows a Foreign Earned Income Exclusion for the first \$80,000 earned in 2003 or 2004 by a U.S. taxpayer who works overseas at least 330 days out of any 365-day period. (This consecutive 365-day overseas period does not have to begin on Jan. 1.)

Many sailors who live in the States but work exclusively overseas mistakenly believe they have met the requirements.

Here comes the other falling shoe. Although this ship never reaches U.S. waters, the sailor's sea days working aboard this ship in international waters do not count as working in a foreign country. The only days that might count toward this 330-day working requirement outside the United States would either be the actual days in a foreign port or possibly the days operating within the clearly defined territorial waters of a foreign country.

IRS Regulation 1.911-2(h) defines a foreign country as follows: "foreign country" when used in a geographical sense includes any territory under the sovereignty of a government other than that of the United States. It includes the territorial waters of the foreign country (determined in accordance with the laws of the United States), the air space over the foreign country, and the seabed and subsoil of those submarine areas which are adjacent to the territorial waters of the foreign country and over which the foreign country has exclusive rights, in accordance with international law, with respect to the exploration and exploitation of natural resources."

Sorry, but this definition does not include international waters.

Now let's turn to a different scenario, where a mariner chooses to voluntarily move himself or herself and his or her family outside the United States and its territories, but routinely accepts job assignments aboard ships that normally visit U.S. ports. Does this sailor get to claim the exclusion?

The fact is that all U.S. citizens must pay income taxes on their worldwide income, no matter where they choose to live. Again, the only days that might count toward this 330-day working requirement outside the United States would either be the actual days in a foreign port or perhaps the days operating within the clearly defined territorial waters of a foreign country. Otherwise, every U.S. citizen who regularly works in an office in downtown San Diego could merely move across the border into Mexico, commute the 15 miles into work each day, and then exclude \$80,000 in wages.

Just remember, because you live outside the United States does not mean you automatically qualify for an exclusion on foreign-earned income.

Many merchant sailors faced with this revelation immediately respond to me by stating that they know some sailors who have been taking this exclusion for years "without any hassle from the IRS."

Ask yourself this question: If you are hired to transport 500 pounds of illegal drugs inside your car between Miami and Baltimore, are you committing a crime? Would your answer change if you have been doing this transporting of illegal drugs routinely for five years without being stopped by the police? In other words, just because you have not been caught does not make it legal.

Do you have a question for Martin Kapp you would like answered in a future article? You can contact him at 800-728-1040 or at mkappepa@pacbell.net. Please include your phone number.