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September 19, 2023

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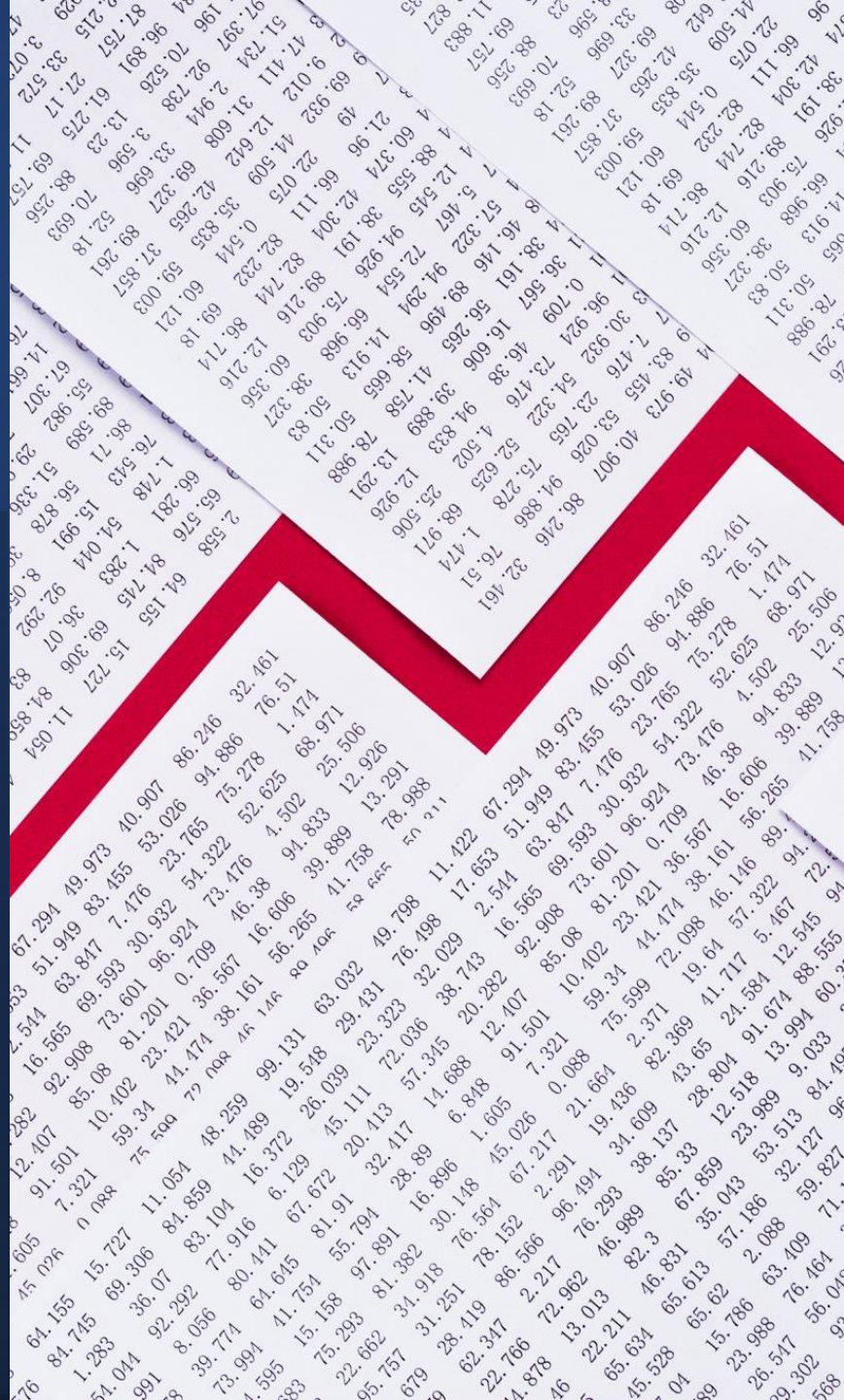
Foreign Earned Income Exclusion – IRC 911



The FEIE Was NEVER About Helping Americans Abroad NOT Employed By US Companies

The IRC 911 "Foreign Earned Income Exclusion" (which is understood to be Form 2555) have a long and difficult history.

It was designed to assist U.S. multinationals and their employees.

It was never designed to assist normal Americans abroad who are not employed by U.S. companies.

Any benefit to them is "accidental".

http://citizenshipsolutions.ca/2020/05/12/the-s-911-foreign-earned-income-exclusion-its-origins-journey-opportunities-and-limitations/

FEIE In A Nutshell – Readers Digest Version

A "qualified individual" may elect to exclude from "gross income" up to $120,000 USD of foreign "earned income" in a calendar year, provided that he has a "tax home" outside the United States and does NOT have an "abode" in the United States.

Americans abroad need to understand:

1. How the FEIE works
2. Is it a good idea to use one?
3. How to understand and complete Form 2555

The IRS has an excellent summary of the rules …

If you meet certain requirements, you may qualify for the foreign earned income exclusion, the foreign housing exclusion, and/or the foreign housing deduction. To claim these benefits, you must have foreign earned income, your tax home must be in a foreign country, and you must be one of the following:

- A U.S. citizen who is a bona fide resident of a foreign country or countries for an uninterrupted period that includes an entire tax year,
- A U.S. resident alien who is a citizen or national of a country with which the United States has an income tax treaty in effect and who is a bona fide resident of a foreign country or countries for an uninterrupted period that includes an entire tax year, or
- A U.S. citizen or a U.S. resident alien who is physically present in a foreign country or countries for at least 330 full days during any period of 12 consecutive months

https://www.irs.gov/individuals/international-taxpayers/foreign-earned-income-exclusion

Part A - Six Important Points

"Don’t move abroad without understanding them!"

Important Point 1: The FEIE Election Stays In Effect Until Revoked

(e) Election

(1) In general

An election under subsection (a) shall apply to the taxable year for which made and to all subsequent taxable years unless revoked under paragraph (2).

(2) Revocation

A taxpayer may revoke an election made under paragraph (1) for any taxable year after the taxable year for which such election was made. Except with the consent of the Secretary, any taxpayer who makes such a revocation for any taxable year may not make another election under this section for any subsequent taxable year before the 6th taxable year after the taxable year for which such revocation was made.

Important Point 2: Use the FEIE at your peril! - You may increase your tax rate

(f) Determination of tax liability

(1) In general If, for any taxable year, any amount is excluded from gross income of a taxpayer under subsection (a), then, notwithstanding sections 1 and 55—

(A) if such taxpayer has taxable income for such taxable year, the tax imposed by section 1 for such taxable year shall be equal to the excess (if any) of—

(i)

the tax which would be imposed by section 1 for such taxable year if the taxpayer's taxable income were increased by the amount excluded under subsection (a) for such taxable year, over

(ii)

the tax which would be imposed by section 1 for such taxable year if the taxpayer's taxable income were equal to the amount excluded under subsection (a) for such taxable year, and

Important Point 3: Electing The FEIE: Must Still Pay Self-Employment Tax

As per the IRS:

Self-employment income: A qualifying individual may claim the foreign earned income exclusion on foreign earned self-employment income. The excluded amount will reduce your regular income tax but will not reduce your self-employment tax. Also, as a self-employed individual, you may be eligible to claim the foreign housing deduction instead of a foreign housing exclusion.

Important Point 4: Reasons To NOT Use The FEIE

1. The FEIE is an EXCLUSION from "Gross income". This means that you will NOT be able to contribute to IRAs that require that you have "gross income". (Per IRS: "You can open and make contributions to a traditional IRA if you (or, if you file a joint return, your spouse) received taxable compensation during the year.")
2. You will NOT build up excess foreign tax credits which may be carried forward for up to 10 years in the general basket. (Note that "foreign tax credit carry forwards" were used by people to pay the transition tax.)

Important Point 5: Reasons To Use The FEIE – Digital Nomads

In some cases you can avoid income taxes completely!!

You are living/staying in a country that has no income taxes (example UAE). A high paying job in the UAE (or similar country allows you to save a great deal of money and pay off student loans …)

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Interestingly the FEIE works very well for "Digital Nomads".

Important Point 6 – Green Card Holders ...

Green Card holders should avoid claiming the FEIE based on the "bona fide residence" test!

From an immigration perspective they are more likely to put the "Green Card" in jeopardy!

Part B - Learning About The FEIE

"From The Horse's Mouth"

Sources To Understand The FEIE

1. IRC – 911 - https://www.law.cornell.edu/uscode/text/26/911

2. Treasury Regulations - https://www.law.cornell.edu/cfr/text/26/1.911-1

3. IRS Information Page - https://www.irs.gov/individuals/international-taxpayers/foreign-earned-income-exclusion

4. Form 2555 - https://www.irs.gov/pub/irs-pdf/f2555.pdf

Statutory Components To Interpret IRC 911

1. IRC 61 – Gross Income: The FEIE is an EXCLUSION from "gross income" - https://www.law.cornell.edu/uscode/text/26/61

2. IRC 862(a)(3) - Must Be "Foreign Source Income" - "(3) compensation for labor or personal services performed without the United States https://www.law.cornell.edu/uscode/text/26/862

3. IRC 162(2)(2) - Must Have "Tax Home" Outside The United States https://www.law.cornell.edu/uscode/text/26/862

4. IRC 911

Part C – IRC 911 For Dummies

"What you really need to understand"

26 U.S. Code § 911 - Citizens or residents of the United States living abroad

The Bare Necessities - "Simplicity Is Virtue!"

911 (a)

(a) Exclusion from gross income At the election of a qualified individual (made separately with respect to paragraphs (1) and (2)), there shall be excluded from the gross income of such individual, and exempt from taxation under this subtitle, for any taxable year—

(1)

the foreign earned income of such individual, and

(2)

the housing cost amount of such individual.

_____-

(Today we will focus ONLY on "foreign earned income". We will do the "housing cost amount" another time.)

911(b)

(b) Foreign earned income

(1) Definition For purposes of this section—

(A) In general

The term “foreign earned income” with respect to any individual means the amount received by such individual from sources within a foreign country or countries which constitute earned income attributable to services performed by such individual during the period described in subparagraph (A) or (B) of subsection (d)(1), whichever is applicable.

(Note that pension income, gov benefits and 402(b) are excluded.)

The Beyer bill proposes to expand the definition of "foreign earned income" to include pensions and government benefits

911(d)(1)

(d) Definitions and special rules For purposes of this section—

(1) Qualified individual The term "qualified individual" means an individual whose tax home is in a foreign country and who is—

(A)

a citizen of the United States and establishes to the satisfaction of the Secretary that he has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year, or

(B)

a citizen or resident of the United States and who, during any period of 12 consecutive months, is present in a foreign country or countries during at least 330 full days in such period.

Tax Home outside the USA and no "abode" in the USA – Critical to read the Treasury Regs

(b) Tax home. For purposes of paragraph (a)(i) of this section, the term “tax home” has the same meaning which it has for purposes of section 162(a)(2) (relating to travel expenses away from home). Thus, under section 911, an individual's tax home is considered to be located at his regular or principal (if more than one regular) place of business or, if the individual has no regular or principal place of business because of the nature of the business, then at his regular place of abode in a real and substantial sense. An individual shall not, however, be considered to have a tax home in a foreign country for any period for which the individual's abode is in the United States. Temporary presence of the individual in the United States does not necessarily mean that the individual's abode is in the United States during that time. Maintenance of a dwelling in the United States by an individual, whether or not that dwelling is used by the individual's spouse and dependents, does not necessarily mean that the individual's abode is in the United States.

https://www.law.cornell.edu/cfr/text/26/1.911-2

Physical presence: It is critical to read the Treasury Regs!!!

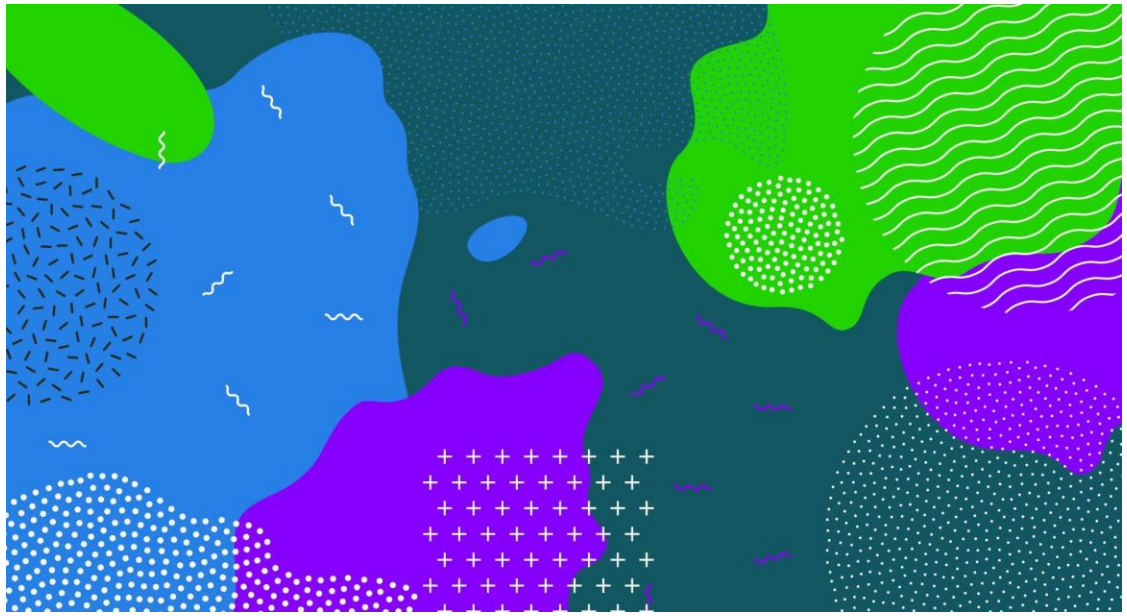
For example:

(3) Illustrations of the physical presence requirement. The physical presence requirement of paragraph (a)(2)(ii) of this section is illustrated by the following examples:

Example 1.

B, a U.S. citizen, arrives in Venezuela from New York at 12 noon on April 24, 1982. B remains in Venezuela until 2 p.m. on March 21, 1983, at which time B departs for the United States. Among other possible twelve month periods, B is present in a foreign country an aggregate of 330 full days during each of the following twelve month periods: March 21, 1982 through March 20, 1983; and April 25, 1982 through April 24, 1983.

https://www.law.cornell.edu/cfr/text/26/1.911-2



Bonafide Residence: It is critical to read the Treasury Regulations

(c) Determination of bona fide residence. For purposes of paragraph (a)(2)(i) of this section, whether an individual is a bona fide resident of a foreign country shall be determined by applying, to the extent practical, the principles of section 871 and the regulations thereunder, relating to the determination of the residence of aliens. Bona fide residence in a foreign country or countries for an uninterrupted period may be established, even if temporary visits are made during the period to the United States or elsewhere on vacation or business. An individual with earned income from sources within a foreign country is not a bona fide resident of that country if:

(1) The individual claims to be a nonresident of that foreign country in a statement submitted to the authorities of that country, and

(2) The earned income of the individual is not subject, by reason of nonresidency in the foreign country, to the income tax of that country.

If an individual has submitted a statement of nonresidence to the authorities of a foreign country the accuracy of which has not been resolved as of any date when a determination of the individual's bona fide residence is being made, then the individual will not be considered a bona fide resident of the foreign country as of that date.

https://www.law.cornell.edu/cfr/text/26/1.911-2

911(d)(2)

(2) Earned income

(A) In general

The term "earned income" means wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered, but does not include that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered.

(B) Taxpayer engaged in trade or business

In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income-producing factors, under regulations prescribed by the Secretary, a reasonable allowance as compensation for the personal services rendered by the taxpayer, not in excess of 30 percent of his share of the net profits of such trade or business, shall be considered as earned income.

911(d)(3)

(3) Tax home

The term "tax home" means, with respect to any individual, such individual's home for purposes of section 162(a)(2) (relating to traveling expenses while away from home). An individual shall not be treated as having a tax home in a foreign country for any period for which his abode is within the United States, unless such individual is serving in an area designated by the President of the United States by Executive order as a combat zone for purposes of section 112 in support of the Armed Forces of the United States.

911(d)(5)

(5) Test of bona fide residence If—

(A)

an individual who has earned income from sources within a foreign country submits a statement to the authorities of that country that he is not a resident of that country, and

(B)

such individual is held not subject as a resident of that country to the income tax of that country by its authorities with respect to such earnings,

then such individual shall not be considered a bona fide resident of that country for purposes of paragraph (1)(A).

911(d)(6)

(6) Denial of double benefits

No deduction or exclusion from gross income under this subtitle or credit against the tax imposed by this chapter (including any credit or deduction for the amount of taxes paid or accrued to a foreign country or possession of the United States) shall be allowed to the extent such deduction, exclusion, or credit is properly allocable to or chargeable against amounts excluded from gross income under subsection (a).

911(f) - Repeated!!

(f) Determination of tax liability

(1) In general If, for any taxable year, any amount is excluded from gross income of a taxpayer under subsection (a), then, notwithstanding sections 1 and 55—

(A) if such taxpayer has taxable income for such taxable year, the tax imposed by section 1 for such taxable year shall be equal to the excess (if any) of—

(i)

the tax which would be imposed by section 1 for such taxable year if the taxpayer's taxable income were increased by the amount excluded under subsection (a) for such taxable year, over

(ii)

the tax which would be imposed by section 1 for such taxable year if the taxpayer's taxable income were equal to the amount excluded under subsection (a) for such taxable year, and

Never Forget The Regs!!

https://www.law.cornell.edu/cfr/text/26/1.911-1

https://www.law.cornell.edu/cfr/text/26/1.911-2

https://www.law.cornell.edu/cfr/text/26/1.911-3

https://www.law.cornell.edu/cfr/text/26/1.911-4

https://www.law.cornell.edu/cfr/text/26/1.911-5

https://www.law.cornell.edu/cfr/text/26/1.911-6

https://www.law.cornell.edu/cfr/text/26/1.911-7

https://www.law.cornell.edu/cfr/text/26/1.911-8

The Regs Tell You HOW To Make The Election

(2) Requirement of a return—(i) In general. In order to make a valid election under this paragraph (a), the election must be made:

(A) With an income tax return that is timely filed (including any extensions of time to file),

(B) With a later return filed within the period prescribed in section 6511(a) amending the foregoing timely filed income tax return,

(C) With an original income tax return that is filed within one year after the due date of the return (determined without regard to any extension of time to file); this one year period does not constitute an extension of time for any purpose—it is merely a period during which a valid election may be made on a late return, or

(D) With an income tax return filed after the period described in paragraphs (a)(2)(i)(A), (B), or (C) of this section provided—

(1) The taxpayer owes no federal income tax after taking into account the exclusion and files Form 1040 with Form 2555 or a comparable form attached either before or after the Internal Revenue Service discovers that the taxpayer …

https://www.law.cornell.edu/cfr/text/26/1.911-7

Part D – It's All About The Form

"Understanding how Form 2555 relates to IRC 911 and the regulations"

How Form 2555 Incorporates IRC 911 And The Regs …

https://www.irs.gov/pub/irs-pdf/f2555.pdf

Part E – Goodbye For Now, But ...

Another session will deal with the

"(2)

the housing cost amount of such individual."

Ending the FEIE Module …

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