



LB&I International Practice Service Concept Unit

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Unit Name	Sourcing of Fringe Benefits for FTC Limitation
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General Overview

Sourcing of Fringe Benefits for FTC Limitation

Determining the source of income, U.S. or foreign, is essential in determining whether that income is subject to U.S. taxation if earned by non-resident aliens and whether the income qualifies for the earned income exclusion if earned by U.S. individuals. In addition, sourcing of income is important for foreign tax credit purposes. In the *Sourcing of Salary and Compensation* IPS unit (under development as of 09/2014), it states that the general rule for employees is that the source of compensation received for services performed typically would be determined based on where those services were performed (“time” basis). However, in general, compensation received as an employee in the form of certain fringe benefits is sourced on a “geographical “ basis which may not necessarily be where the services are performed. This practice unit will address the proper sourcing of fringe benefits for employees. Multi-year compensation arrangements including stock options as well as tax equalization or hypothetical (“hypo”) tax will be covered in other units (currently under development as of 09/2014).

International business is evolving toward a single global marketplace that transcends national borders. With today’s proliferation of the global workforce, it is common practice for a company to engage employees to work for the company in foreign locations. Companies that transfer employees outside their home country typically provide additional compensation to supplement base salary and bonuses. This additional compensation is intended to offset the increased cost of living abroad and to reimburse for expenses associated with the relocation. Fringe benefits received in connection with the performance of services are included in income as compensation unless they are paid for by the employee at fair market value or specifically excluded by U.S. tax law. Some typical fringe benefits include a cost-of-living differential, moving expense reimbursement, automobile allowance, housing allowance, and education assistance.

General Overview (cont'd)

Sourcing of Fringe Benefits for FTC Limitation

Pursuant to the instructions for Form 1116, before the taxpayer can figure his/her taxable income from sources outside the United States, in each separate income category of the Form 1116, he/she must first determine whether their gross income in each separate category is U.S. source or foreign source. Compensation, including fringe benefit compensation, will be included in the separate category of general category income. If the taxpayer files a Form 8833 (*Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b)*) to re-source income pursuant to a treaty; the taxpayer will instead select the "Certain income re-sourced by treaty" income category instead of the general category income.

If the taxpayer is an employee and receives compensation for labor or personal services performed both inside and outside the United States, specific rules apply under the regulations in determining the source of the compensation. Compensation (other than certain fringe benefits) is sourced on a time basis. The Sourcing of Salary and Compensation practice unit (under development as of 09/2014) will cover this topic. Compensation that the taxpayer receives as an employee in the form of certain specified fringe benefits, is sourced on a geographical basis under Treas. Reg. §1.861-4(b)(2)(ii)(D)(1)-(6). Other fringe benefits are sourced consistent with the general rules for sourcing compensation income.



Caution: If the taxpayer is self-employed, he/she will determine the source of compensation for labor or personal services from self-employment on the basis that most correctly reflects the proper source of that income under the facts and circumstances of a particular case.

Facts of Concept

Sourcing of Fringe Benefits for FTC Limitation

Facts of Concept

What are the typical fact patterns that require the sourcing of certain fringe benefits?

U.S. citizens and resident aliens must report worldwide income, including income from sources outside the United States (foreign income) on the taxpayer's U.S. individual income tax return unless it is exempted by U.S. tax laws. This is true whether the taxpayer resides inside or outside the United States and whether or not the taxpayer receives a Form W-2, Wage and Tax Statement, or Form 1099 from the payer. Many individuals working overseas will not have a U.S. tax document that states the amount of gross income received by the taxpayer for the year. As part of examining a taxpayer who earns foreign source income, consideration should be given to whether the taxpayer reported all income from every source.

Employees on international assignments are typically provided additional compensation to supplement base salary and bonuses. These are intended to offset the increased cost of living abroad and to reimburse for expenses associated with the relocation. Fringe benefits received in connection with the performance of services are included in income as compensation unless they are paid for by the employee at fair market value or they are specifically excluded by U.S. tax law. Exclusion of fringe benefits under foreign tax law is not relevant for U.S. tax purposes but may reduce the amount of foreign tax on such benefits. Compensation that the taxpayer receives as an employee in the form of certain fringe benefits is sourced on a "geographical" basis. Other fringe benefits are sourced consistent with the general rules for sourcing compensation income. The amount of fringe benefits must be reasonable and the taxpayer must substantiate them with adequate records or sufficient evidence.

Detailed Explanation of the Concept

Sourcing of Fringe Benefits for FTC Limitation

Analysis	Resources
<p>Geographical basis. Compensation received by an employee in the form of the following fringe benefits is sourced on a geographical basis.</p> <ul style="list-style-type: none"> •Housing •Education •Local transportation •Tax reimbursement •Hazardous or hardship duty pay •Moving expense reimbursement <p>Pursuant to Treas. Reg. § 1.861-4(b)(2)(ii)(E) and (G), certain other fringe benefits, can be sourced on a time basis or other alternative basis. These benefits may include but not limited to: Excess life insurance; Stock Option Compensation; Cost of Living Adjustment (COLA/G&S); Home Leave; Mobility Premiums; Tax Equalization; Hypothetical Tax, and Tax Preparation fees.</p> <p>The amount of fringe benefits must be reasonable and must be substantiated by adequate records or by sufficient evidence. Multi-year compensation arrangements including stock options will be discussed in a separate IPS unit. An alternative basis for determining sourcing of fringe benefits will be discussed later in this unit.</p>	<ul style="list-style-type: none"> ▪ IRC 61, Gross Income ▪ Treas. Reg. 1.61-21, Taxation of Fringe Benefits ▪ Treas. Reg. 1.861-4(b)(2)(ii)(D)(1)-(6), Fringe Benefits Sourced on a Geographical Basis ▪ Treas. Reg. 1.861-4(b)(2)(ii)(E) and (G), Fringe Benefits Sourced on a Time Basis or other alternative basis. ▪ Pub. 17, Your Federal Income Tax (For Individuals) ▪ Pub 54, Tax Guide for U.S. Citizens and Resident Aliens Abroad ▪ Pub 514, Foreign Tax Credits for Individuals

Detailed Explanation of the Concept (cont'd)

Sourcing of Fringe Benefits for FTC Limitation

Analysis	Resources
<p>Housing. The source of a housing fringe benefit is determined based on the location of taxpayer's principal place of work. A housing fringe benefit includes payments to or on taxpayer's behalf (and for a family residence, if taxpayer's family resides with the taxpayer) only for the following: rent, utilities (except telephone charges), real and personal property insurance, occupancy taxes not deductible under IRC § 164, (<i>Taxes</i>) or § 216(a), (<i>Allowance of Deduction</i>), nonrefundable fees for securing a leasehold, rental of furniture and accessories, household repairs, residential parking, and fair rental value of housing provided in kind by taxpayer's employer.</p> <p>A housing fringe benefit does not include: deductible interest and taxes (including deductible interest and taxes of a tenant stockholder in a cooperative housing corporation), the cost of buying property, including principal payments on a mortgage, the cost of domestic labor (maids, gardeners, etc.), pay television subscriptions, improvements and other expenses that increase the value or appreciably prolong the life of property, purchased furniture or accessories, depreciation or amortization of property or improvements, the value that the taxpayer excludes from gross income, or the value that the taxpayer deducts as moving expenses.</p>	<ul style="list-style-type: none"> ▪ IRC 61, Gross Income ▪ IRC 164 and 216 (a) ▪ Treas. Reg. 1.61-21, Taxation of Fringe Benefits ▪ Treas. Reg. 1.861-4(b)(2)(ii) (D) (1)-(6), Fringe Benefits Sourced on a Geographical Basis ▪ Pub. 17, Your Federal Income Tax (For Individuals) ▪ Pub 54, Tax Guide for U.S. Citizens and Resident Aliens Abroad ▪ Pub 514, Foreign Tax Credits for Individuals

Detailed Explanation of the Concept (cont'd)

Sourcing of Fringe Benefits for FTC Limitation

Analysis	Resources
<p>Education. The source of an education fringe benefit for the education expenses of taxpayer's dependents is determined based on the location of taxpayer's principal place of work. An education fringe benefit includes payments only for the following expenses for education at an elementary or secondary school:</p> <ul style="list-style-type: none"> • Tuition, fees, academic tutoring, special needs services for a special needs student, books, supplies, and other equipment. • Room and board and uniforms that are required or provided by the school in connection with enrollment or attendance. <p>Local transportation. The source of a local transportation fringe benefit is determined based on the location of taxpayer's principal place of work. Taxpayer's local transportation fringe benefit is the amount that the taxpayer receives as compensation for his/her local transportation or that of taxpayer's spouse or dependents at the location of taxpayer's principal place of work. The amount treated as a local transportation fringe benefit is limited to actual expenses incurred for local transportation and the fair rental value of any employer provided vehicle used predominantly by the taxpayer or spouse or dependents for local transportation. Actual expenses do not include the cost (including interest) of any vehicle purchased by the taxpayer or on taxpayer's behalf.</p>	<ul style="list-style-type: none"> ▪ IRC 61, Gross Income ▪ IRC 216 (a) ▪ Treas. Reg. 1.61-21, Taxation of Fringe Benefits ▪ Treas. Reg. 1.861-4(b)(2)(ii) (D) (1)-(6), Fringe Benefits Sourced on a Geographical Basis ▪ Pub. 17, Your Federal Income Tax (For Individuals) ▪ Pub 54, Tax Guide for U.S. Citizens and Resident Aliens Abroad ▪ Pub 514, Foreign Tax Credits for Individuals

Detailed Explanation of the Concept (cont'd)

Sourcing of Fringe Benefits for FTC Limitation

Analysis	Resources
<p>Tax reimbursement. The source of a foreign tax reimbursement fringe benefit is determined based on the location of the jurisdiction that imposed the tax for which taxpayer is reimbursed.</p> <p>Hazardous or hardship duty pay. The source of hazardous or hardship duty pay fringe benefit is determined based on the location of the hazardous or hardship duty zone for which the hazardous or hardship duty pay fringe benefit is paid. A hazardous or hardship duty zone is any place in a foreign country which meets either of the following conditions:</p> <ul style="list-style-type: none"> • The zone is designated by the Secretary of State as a place where living conditions are extraordinarily difficult, notably unhealthy, or where excessive physical hardships exist, and for which a post differential of 15 percent or more would be provided under § 5925(b) of Title 5 of the U.S. Code to any officer or employee of the U.S. government at that place. • The zone is where civil insurrection, civil war, terrorism, or wartime conditions threaten physical harm or imminent danger to taxpayer's health and well-being. 	<ul style="list-style-type: none"> ▪ IRC 61, Gross Income ▪ IRC 216 (a) ▪ Treas. Reg. 1.61-21, Taxation of Fringe Benefits ▪ Treas. Reg. 1.861-4(b)(2)(ii) (D) (1)-(6), Fringe Benefits Sourced on a Geographical Basis ▪ Pub. 17, Your Federal Income Tax (For Individuals) ▪ Pub 54, Tax Guide for U.S. Citizens and Resident Aliens Abroad ▪ Pub 514, Foreign Tax Credits for Individuals

Detailed Explanation of the Concept (cont'd)

Sourcing of Fringe Benefits for FTC Limitation

Analysis	Resources
<p><i>Hazardous or hardship duty pay (cont'd)</i></p> <p>Compensation is treated as a hazardous or hardship duty pay fringe benefit only if taxpayer's employer provides the hazardous or hardship duty pay fringe benefit only to employees performing labor or personal services in a hazardous or hardship duty zone.</p> <p>The amount of compensation treated as a hazardous or hardship duty pay fringe benefit cannot exceed the maximum amount that the U.S. government would allow its officers or employees present at that location.</p>	<ul style="list-style-type: none"> ▪ IRC 61, Gross Income ▪ IRC 216 (a) ▪ Treas. Reg. 1.61-21, Taxation of Fringe Benefits ▪ Treas. Reg.1.861-4(b)(2)(ii) (D) (1)-(6), Fringe Benefits Sourced on a Geographical Basis ▪ Pub. 17, Your Federal Income Tax (For Individuals) ▪ Pub 54, Tax Guide for U.S. Citizens and Resident Aliens Abroad ▪ Pub 514, Foreign Tax Credits for Individuals

Detailed Explanation of the Concept (cont'd)

Sourcing of Fringe Benefits for FTC Limitation

Analysis	Resources
<p><i>Moving expense reimbursement.</i> In most cases, the source of a moving expense reimbursement is based on the location of taxpayer's new principal place of work. However, the source is determined based on the location of taxpayer's former principal place of work if the taxpayer has sufficient evidence that such determination of source is more appropriate under the facts and circumstances of taxpayer's particular case. Sufficient evidence generally requires an agreement between taxpayer and taxpayer's employer in most cases, or a written statement of company policy, which is reduced to writing before the move and which is entered into or established to induce the taxpayer or other employees to move to another country. The written statement or agreement must state that taxpayer's employer will reimburse the taxpayer for moving expenses that taxpayer incurs to return to taxpayer's former principal place of work regardless of whether the taxpayer continues to work for taxpayer's employer after returning to that location. It may contain certain conditions upon which the right to reimbursement is determined as long as those conditions set forth standards that are definitely ascertainable and can only be fulfilled prior to, or through completion of, taxpayer's return move to taxpayer's former principal place of work.</p>	<ul style="list-style-type: none"> ▪ IRC 61, Gross Income ▪ IRC 216 (a) ▪ Treas. Reg. 1.61-21, Taxation of Fringe Benefits ▪ Treas. Reg. 1.861-4(b)(2)(ii) (D) (1)-(6), Fringe Benefits Sourced on a Geographical Basis ▪ Pub. 17, Your Federal Income Tax (For Individuals) ▪ Pub 54, Tax Guide for U.S. Citizens and Resident Aliens Abroad ▪ Pub 514, Foreign Tax Credits for Individuals

Detailed Explanation of the Concept (cont'd)

Sourcing of Fringe Benefits for FTC Limitation

Analysis	Resources
<p>Alternative basis (Treas. Reg. § 1.861-4(b) (2) (ii) (C) (1)) , Employee Compensation, Exception and Special Rules, Alternative Basis:</p> <p>If taxpayer is an employee, the taxpayer can determine the source of compensation under an alternative basis if the taxpayer can establish to the satisfaction of the IRS that, under the facts and circumstances of that particular case, the alternative basis more properly determines the source of taxpayer's compensation than either the time or geographical basis. If the taxpayer uses an alternative basis, the taxpayer must keep (and have available for inspection) records to document why the alternative basis more properly determines the source of taxpayer's compensation. Also, if taxpayer's total compensation from all sources was \$250,000 or more, the taxpayer must check the box on Form 1116, line 1b, and attach a written statement to taxpayer's tax return with various taxpayer personal information and the relevant method of allocation identified and the computations, along with a comparison to either the time or geographical method of allocation.</p> <p>The Commissioner also may determine, under the facts and circumstances of the particular case, the source of compensation that is received by a taxpayer as an employee for services performed partly within and partly without the U.S. The Commissioner can make a determination other than on a geographical or time basis as defined in the regulations, only if such alternative basis is a more reasonable method than the method used by the taxpayer.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.861-4(b) (2) (ii) (C) (1)) , Employee Compensation, Exception and Special Rules, Alternative Basis: ▪ Treas. Reg. 1.861-4(b)(2)(ii) (D) (1)-(6), Fringe Benefits Sourced on a Geographical Basis ▪ Pub. 17, Your Federal Income Tax (For Individuals) ▪ Pub 54, Tax Guide for U.S. Citizens and Resident Aliens Abroad ▪ Pub 514, Foreign Tax Credits for Individuals

Examples of the Concept

Sourcing of Fringe Benefits for FTC Limitation	
Examples	
Housing, education, and local transportation	Location of principal place of work
Tax reimbursement	Location of the jurisdiction that imposed the tax for which taxpayer was reimbursed
Hazardous or hardship duty pay	Location of the hazardous or hardship duty zone for which taxpayer received the fringe benefit.
Moving expense reimbursement	Location of taxpayer's new principal place of work*
*You can determine the source based on the location of your former principal place of work if you have sufficient evidence that such determination of source is more appropriate under the facts and circumstances of your case.	

Training and Additional Resources

Sourcing of Fringe Benefits for FTC Limitation		
Type of Resource	Description(s) and/or Instructions for Accessing	References
CENTRA sessions	IIC FTC CENTRA Event (KRP260984) This course provides a brief overview of income and deduction sourcing for FTC purposes followed by detailed discussions of issues raised by the field. Specific issues include fringe benefits and flow thru entities. 12/17/2013-FTC Workbook Training (WLN967076) 02/14/2014-FTC Workbook Training II recorded session (LHS193548) 02/18/2014-FTC Workbook Training III (HVR308928) 06/12/2014-FTC Workbook Training IV-Adjustments (LQP387992) 07/22/2014-FTC Workbook Training V-Per Exam (HPM417809) FY14 CPE – IIC Matrix Application Training (Weeks 1-3)	
Issue Toolkits	FTC Workbook – Used to assist agents in computing FTC limitation for Form 1116. The FTC Workbook is available on the IIC FTC IPN SharePoint site under “Best Practices”.	
Podcasts / Videos	FY11 CPE – IIC Jurisdiction to Tax & International Basics	
Databases / Research Tools	Westlaw - BNA Tax Management Portfolios - Outbound U.S. Taxation, The Foreign Tax Credit in Overview LexisNexis – The Foreign Tax Credit in Overview CCH – The Foreign Tax Credit in Overview	

Glossary of Terms and Acronyms

Acronym	Definition
FTC	Foreign Tax Credit
IIC	International Individual Compliance
IPS	International Practice Service
IPN	International Practice Network
USBA	U.S. Business Activities (IIC) IPN

Index of Related Issues

Issue	Associated UIL(s)	References
Foreign Tax Credit	<ul style="list-style-type: none"> ▪ 9432.01-01 	<ul style="list-style-type: none"> ▪ Sourcing of Multi-Year Compensation Arrangements Including Stock Options DCN FTC/CU/P_10.2_02(2014) Under Development as of 09/2014
Jurisdiction to Tax	<ul style="list-style-type: none"> ▪ 9431.04-00 ▪ 9431.06-05 ▪ 9431.06-06 	<ul style="list-style-type: none"> ▪ Cross Border Pension Issues (Under Development as of 09/2014) ▪ Foreign earned income exclusion (IRC 911) (Under Development as of 09/2014) ▪ Housing deduction/exclusion (Under Development as of 09/2014)
Treaties	<ul style="list-style-type: none"> ▪ 9450.00-00 	<ul style="list-style-type: none"> ▪ Treaty Implications (Under Development as of 09/2014)