



LB&I International Practice Service Process Unit – Audit

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Unit Name	Calculating Foreign Earned Income Exclusion - Employee
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Process Overview


Calculating Foreign Earned Income Exclusion - Employee


Process Description

This unit focuses on computing the foreign earned income exclusion (FEIE) for employees as provided in IRC § 911.

U.S. citizens and resident aliens are taxed on their worldwide income. However, U.S. citizens or residents who work and live abroad may qualify to exclude some or all of their foreign earned income under IRC § 911. For 2014, the maximum FEIE is \$99,200 (indexed annually for inflation) per taxpayer. The FEIE is available only for wages or self-employment income earned for personal services performed in a foreign country or countries, and is claimed on IRS Form 2555/2555-EZ. Employees of the U.S. government are not eligible for the FEIE under IRC § 911.

U.S. citizens and residents may also be able to exclude their housing expenses in a foreign country or countries which are in excess of a base amount (subject to a statutory limitation). The base amount is equal to 16% of the maximum FEIE multiplied by the number of qualifying days within the tax year. IRC § 911 limits the housing expenses eligible for the housing deduction to 30% of the maximum FEIE. The result of that limitation is then multiplied by the number of days in the qualifying period within the tax year.

 **CAUTION:** A taxpayer may not get a double benefit by taking a credit that may be available under a treaty attributable to amounts excluded from gross income under IRC § 911(a). See Treas. Reg. § 1.911-6(a) and Rev. Rul. 79-199.

 **CAUTION:** Not all overseas locations are “foreign countries.” For example, Antarctica, U.S. possessions and territories, and certain other locations are not foreign countries. See Treas. Reg. §§ 1.911-2(g) and (h).

Example Circumstances Under Which Process Applies

An examiner receives a case involving an individual taxpayer who is claiming to exclude his foreign earned income. The examiner must determine if the income is foreign earned income and thus, eligible to be excluded; and if the excluded amount was properly calculated .

Determination of Process Applicability

Calculating Foreign Earned Income Exclusion - Employee

In order to be eligible to claim the FEIE under IRC § 911, individual taxpayers must meet certain criteria.

Criteria	Resources	6103 Protected Resources
<ul style="list-style-type: none"> The individual must have a tax home in a foreign country. 	<ul style="list-style-type: none"> <i>Tax Home for Purposes of IRC Section 911,</i> DCN:JTO/CU/P_9.6_05(2013) 	
<ul style="list-style-type: none"> The individual must have foreign earned income, i.e., compensation for personal services performed in a foreign country or countries. 	<ul style="list-style-type: none"> Treas. Reg.1.911-3(a) Treas. Reg.1.911-3(b) Treas. Reg.1.911-3(c) 	
<ul style="list-style-type: none"> The individual must meet either the bona fide residence or physical presence test. 	<ul style="list-style-type: none"> <i>Bona Fide Residence Test for Purposes of Qualifying for IRC 911 Tax Benefits,</i> DCN:JTO/9431.06_14(2015) 	
<ul style="list-style-type: none"> The individual must make a valid election to exclude foreign earned income. 	<ul style="list-style-type: none"> <i>IRC 911 Election and Revocation,</i> DCN:JTO/CU/C_09.6.5_08(2014) 	

Summary of Process Steps

Calculating Foreign Earned Income Exclusion - Employee

Step 1	Determine if the individual is a qualified individual.
Step 2	Determine if the income to be excluded is foreign earned income.
Step 3	Calculate the foreign earned income exclusion amount.

Step 1

Calculating Foreign Earned Income Exclusion - Employee

Step 1: Determine if the taxpayer is a qualified individual.

In order to claim the FEIE, there are various requirements that individuals must meet.

Considerations	Resources	6103 Protected Resources
Individuals can only exclude income that is received for performing personal services in a foreign country or countries.	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.911-3(a) ▪ Treas. Reg. 1.911-3(b) ▪ Treas. Reg. 1.911-3(c) 	
<p>Individuals must have a tax home in a foreign country.</p> <p>Note: There is an IPS Unit, <i>Tax Home for Purposes of IRC Section 911</i>, DCN:JTO/CU/P_9.6_05(2013) that addresses this concept in detail.</p>	<ul style="list-style-type: none"> ▪ IRC 911(d)(1) ▪ IRC 911(d)(3) ▪ Treas. Reg. 1.911-2(b) ▪ <i>Tax Home for Purposes of IRC Section 911</i>, DCN:JTO/CU/P_9.6_05(2013) 	

Step 1 (cont'd)

Calculating Foreign Earned Income Exclusion - Employee

Step 1: Determine if the taxpayer is a qualified individual.

In order to claim the FEIE, there are various requirements that individuals must meet.


Considerations	Resources	6103 Protected Resources
<p>The individual must be either:</p> <ul style="list-style-type: none"> ▪ 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 that country for an uninterrupted period that includes an entire tax year, or ▪ A U.S. citizen or 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. Days spent abroad for any reason count, including vacation time. The 330 days do not have to be consecutive. <p>Another IPS Unit, <i>Bona Fide Residence Test for Purposes of Qualifying for IRC 911 Tax Benefits</i>, DCN:JTO/9431.06_14(2015) addresses these concepts in greater detail.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.911-2(a) ▪ Treas. Reg. 1.911-2(c) ▪ Treas. Reg. 1.911-2(d) <ul style="list-style-type: none"> ▪ <i>Bona Fide Residence Test for Purposes of Qualifying for IRC 911 Tax Benefits</i>, DCN:JTO/9431.06_14(2015) 	

Step 1 (cont'd)

Calculating Foreign Earned Income Exclusion - Employee

Step 1: Determine if the taxpayer is a qualified individual.

In order to claim the FEIE, there are various requirements that individuals must meet.

Considerations	Resources	6103 Protected Resources
<p>The individual must make a valid election in order to exclude his foreign earned income under IRC § 911. There is an IPS Unit, <i>IRC 911 Election and Revocation</i>, DCN:JTO/CU/C_09.6.5_08(2014), that addresses the mechanics of how to elect and revoke the FEIE in greater detail.</p> <p> CAUTION: An individual who has elected the FEIE, may not take deductions, exclusions, or credits with respect to the excluded amounts.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.911-7(a) ▪ <i>IRC 911 Election and Revocation</i>, DCN:JTO/CU/C_09.6.5_08(2014) 	

Step 2

Calculating Foreign Earned Income Exclusion - Employee

Step 2: Determine the amount of foreign earned income.

Foreign earned income for purposes of IRC § 911 includes wages, salaries, professional fees, and other compensation (including noncash income and allowances or reimbursements) received for personal services performed in a foreign country while having a tax home in a foreign country and meeting either the bona fide residence or the physical presence test.

Considerations	Resources	6103 Protected Resources
<p>Foreign earned income does not include amounts other than a reasonable amount as compensation for personal services performed in a foreign country or countries. Additionally, foreign earned income does not include any amounts:</p> <ul style="list-style-type: none"> ▪ Excluded from gross income as meals and lodging provided by an employer under IRC § 119; ▪ Received as a pension or annuity (included social security benefits); IRC § 402(b); ▪ Paid to an employee by an employer which is the U.S. government or any U.S. government agency or instrumentality; IRC § 403(c); ▪ Included in the individual's gross income due to the taxability of a nonexempt trust or the taxability of a beneficiary under a nonqualified annuity or annuities purchased by exempt organizations; 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.911-3(b)(3) ▪ IRC 119 ▪ IRC 402(b) ▪ IRC 403(c) ▪ Treas. Reg. 1.911-6(b)(4)(ii) 	

Step 2 (cont'd)

Calculating Foreign Earned Income Exclusion - Employee

Step 2: Determine the amount of foreign earned income.

Foreign earned income for purposes of IRC § 911 includes wages, salaries, professional fees, and other compensation (including noncash income and allowances or reimbursements) received for personal services performed in a foreign country while having a tax home in a foreign country and meeting either the bona fide residence or the physical presence test.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none">▪ Included in gross income by reason of Treas. Reg. § 1.911-6(b)(4)(ii); or▪ Received after the close of the first taxable year following the taxable year in which the services giving rise to the amounts were performed.		

Step 3

Calculating Foreign Earned Income Exclusion - Employee

Step 3: Calculate the FEIE amount.

For purposes of IRC § 911, qualified individuals may exclude the lesser of (1) the limitation amount or (2) their foreign earned income minus any foreign housing exclusion or deduction. If the qualifying period is less than a year, the limitation amount must be prorated by the number of qualifying days in the year over the total number of days in the year.

NOTE: The amount of foreign earned income that is eligible for the exclusion is considered to be earned in the taxable year in which the services that gave rise to the foreign earned income are performed.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Qualified individuals may exclude the lesser of the limit on excludable foreign earned income (maximum of \$99,200 for 2014), or their foreign earned income for the tax year less the foreign housing exclusion. ▪ The limitation amount for the year is multiplied by a fraction that is determined by dividing the number of days the individual was a qualified individual by the number of days in the individual's tax year. The result is the amount of the foreign earned income that is eligible for the FEIE. 	<ul style="list-style-type: none"> ▪ IRC 911(b)(2)(D) ▪ Treas. Reg. 1.911-3(d)(2)(i) ▪ Treas. Reg. 1.911-3(d)(2)(ii) ▪ Treas. Reg. 1.911-3(d)(3) ▪ Rev. Proc. 2012-41 	

Step 3 (cont'd)

Calculating Foreign Earned Income Exclusion - Employee

Step 3: Calculate the FEIE amount.

For purposes of IRC § 911, qualified individuals may exclude the lesser of (1) the limitation amount or (2) their foreign earned income minus any foreign housing exclusion or deduction. If the qualifying period is less than a year, the limitation amount must be prorated by the number of qualifying days in the year over the total number of days in the year.

NOTE: The amount of foreign earned income that is eligible for the exclusion is considered to be earned in the taxable year in which the services that gave rise to the foreign earned income are performed.

Considerations	Resources	6103 Protected Resources
<p><i>Number of qualifying days in the tax year</i></p> <p><i>Number of days in the tax year</i></p> <p>X</p> <p>Maximum limitation amount for the year</p> <p>=</p> <p>Amount of foreign earned income eligible for FEIE</p>	<ul style="list-style-type: none"> ▪ IRC 911(b)(2)(D) ▪ Treas. Reg. 1.911-3(d)(2)(i) ▪ Treas. Reg. 1.911-3(d)(2)(ii) ▪ Treas. Reg. 1.911-3(d)(3) ▪ Rev. Proc. 2012-41 	

Step 3 (cont'd)

Calculating Foreign Earned Income Exclusion - Employee

Step 3: Calculate the FEIE amount.

For purposes of IRC § 911, qualified individuals may exclude the lesser of (1) the limitation amount or (2) their foreign earned income minus any foreign housing exclusion or deduction. If the qualifying period is less than a year, the limitation amount must be prorated by the number of qualifying days in the year over the total number of days in the year.

NOTE: The amount of foreign earned income that is eligible for the exclusion is considered to be earned in the taxable year in which the services that gave rise to the foreign earned income are performed.

Considerations	Resources	6103 Protected Resources
NOTE: A “qualifying day” is a day that falls within a period during which the individual has a tax home in a foreign country and is either a bona fide resident of a foreign country or meets the physical presence test.		

Step 3 (cont'd)

Calculating Foreign Earned Income Exclusion - Employee

Step 3: Calculate the FEIE amount.

For purposes of IRC § 911, qualified individuals may exclude the lesser of (1) the limitation amount or (2) their foreign earned income minus any foreign housing exclusion or deduction. If the qualifying period is less than a year, the limitation amount must be prorated by the number of qualifying days in the year over the total number of days in the year.

NOTE: The amount of foreign earned income that is eligible for the exclusion is considered to be earned in the taxable year in which the services that gave rise to the foreign earned income are performed.

Considerations	Resources	6103 Protected Resources
<p>EXAMPLE: An individual was a bona fide resident of a foreign country from November 1, 2011 through March 31, 2013. The number of qualifying days in 2011 is 61 days; in 2012 is 366 days; and in 2013 is 91 days. If in 2013 the individual received \$80,000 of foreign earned income for purposes of IRC § 911, and excluded foreign housing costs of \$15,000, the amount of foreign earned income eligible for the FEIE is \$24,333. This is the lesser of foreign earned income minus the housing exclusion amount (\$80,000 - \$15,000 = \$65,000) or the limitation amount $(91/365) \times \\$97,600 = \\$24,333$. The remaining \$40,667 of foreign earned income is not excludable.</p>		

Step 3 (cont'd)

Calculating Foreign Earned Income Exclusion - Employee

Step 3: Calculate the FEIE amount.

For purposes of IRC § 911, qualified individuals may exclude the lesser of (1) the limitation amount or (2) their foreign earned income minus any foreign housing exclusion or deduction. If the qualifying period is less than a year, the limitation amount must be prorated by the number of qualifying days in the year over the total number of days in the year.

NOTE: The amount of foreign earned income that is eligible for the exclusion is considered to be earned in the taxable year in which the services that gave rise to the foreign earned income are performed.

Considerations	Resources	6103 Protected Resources
<p>NOTE: For cash basis taxpayers that perform services in Year 1, but are not paid until Year 2, such individuals can generally exclude those amounts in Year 2 under the FEIE if those amounts could have been excluded in Year 1 (the year in which the services were performed).</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.911-3(e)(1) 	

Step 3 (cont'd)

Calculating Foreign Earned Income Exclusion - Employee

Step 3: Calculate the FEIE amount.

For purposes of IRC § 911, qualified individuals may exclude the lesser of (1) the limitation amount or (2) their foreign earned income minus any foreign housing exclusion or deduction. If the qualifying period is less than a year, the limitation amount must be prorated by the number of qualifying days in the year over the total number of days in the year.

NOTE: The amount of foreign earned income that is eligible for the exclusion is considered to be earned in the taxable year in which the services that gave rise to the foreign earned income are performed.

Considerations	Resources	6103 Protected Resources
<p>EXAMPLE: An individual was a bona fide resident of a foreign country for all of 2012 and 2013, and was a cash basis taxpayer. The individual received \$70,000 wages in 2012 for work that he performed. The individual excluded all \$70,000 under the FEIE for tax year 2012. If the individual was paid an additional \$30,000 in 2013 for work that was performed in 2012, then the individual could potentially exclude \$25,100 of this \$30,000 in 2013 (\$95,100, the maximum exclusion amount for tax year 2012, less \$70,000 (the amount previously excluded under FEIE in 2012)). The remaining \$4,900 of wages for 2012 that were received in 2013 must be included in income because these wages could not have been excluded if they were received in the prior year as they were in excess of the FEIE limit.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.911-3(e)(1) 	

Step 3 (cont'd)

Calculating Foreign Earned Income Exclusion - Employee

Step 3: Calculate the FEIE amount.

For purposes of IRC § 911, qualified individuals may exclude the lesser of (1) the limitation amount or (2) their foreign earned income minus any foreign housing exclusion or deduction. If the qualifying period is less than a year, the limitation amount must be prorated by the number of qualifying days in the year over the total number of days in the year.

NOTE: The amount of foreign earned income that is eligible for the exclusion is considered to be earned in the taxable year in which the services that gave rise to the foreign earned income are performed.

Considerations	Resources	6103 Protected Resources
<p>EXAMPLE (cont'd): For tax year 2013, such individual potentially could exclude \$122,700 (\$97,600 (the FEIE limit for 2013) plus \$25,100 (the foreign earned income excludable in 2012, but not received until 2013) under IRC § 911.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.911-3(e)(1) 	

Step 3 (cont'd)

Calculating Foreign Earned Income Exclusion - Employee

Step 3: Calculate the FEIE amount.

For purposes of IRC § 911, qualified individuals may exclude the lesser of (1) the limitation amount or (2) their foreign earned income minus any foreign housing exclusion or deduction. If the qualifying period is less than a year, the limitation amount must be prorated by the number of qualifying days in the year over the total number of days in the year.

NOTE: The amount of foreign earned income that is eligible for the exclusion is considered to be earned in the taxable year in which the services that gave rise to the foreign earned income are performed.

Considerations	Resources	6103 Protected Resources
<p>NOTE: Regardless of when foreign earned income is received, it must be applied to the year in which it was actually earned in order to figure the FEIE for each year. If a bonus is received by a qualified individual based on work performed over several years, the amount of the bonus that is considered earned in a particular year must be determined. This is found by dividing the bonus amount by the number of calendar months from the period when work was performed that resulted in the bonus. Then, the bonus amount earned per month is multiplied by the number of months work was performed during each particular year that the bonus was earned. This amount in turn is subject to the FEIE limit for that particular tax year in which the bonus was earned.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.911-3(e)(4)(i) 	

Step 3 (cont'd)

Calculating Foreign Earned Income Exclusion - Employee

Step 3: Calculate the FEIE amount.

For purposes of IRC § 911, qualified individuals may exclude the lesser of (1) the limitation amount or (2) their foreign earned income minus any foreign housing exclusion or deduction. If the qualifying period is less than a year, the limitation amount must be prorated by the number of qualifying days in the year over the total number of days in the year.

NOTE: The amount of foreign earned income that is eligible for the exclusion is considered to be earned in the taxable year in which the services that gave rise to the foreign earned income are performed.

Considerations	Resources	6103 Protected Resources
<p>NOTE: If a qualified individual is married to an individual who is also a qualified individual, then both may be able to claim the FEIE in a particular tax year.</p>	<ul style="list-style-type: none"> ▪ IRC 911(d)(9) ▪ Treas. Reg. 1.911-5(a) ▪ Treas. Reg. 1.911-7 	

Other Considerations / Impact to Audit

Calculating Foreign Earned Income Exclusion - Employee

Considerations	Resources	6103 Protected Resources
Individuals claiming the FEIE, the foreign housing exclusion and/or the foreign housing deduction are not eligible to claim the earned income credit.	<ul style="list-style-type: none"> ▪ IRC 32(c)(1)(C) ▪ Treas. Reg. 1.911-6(a) 	
Once a qualified individual elects to exclude foreign earned income, that individual cannot take a foreign tax credit or deduction for foreign taxes paid on the excluded amounts. If an individual does take a credit or deduction on any such foreign taxes in lieu of the FEIE for the current year, his or her prior election to exclude his foreign earned income is considered revoked.	<ul style="list-style-type: none"> ▪ IRC 911(d)(6) ▪ Treas. Reg. 1.911-6(c) ▪ Rev. Rul. 79-199 	
If an individual excludes foreign earned income under IRC § 911, the excluded amount must be added back to adjusted gross income when computing modified adjusted gross income for purposes of the child tax credit and/or additional child tax credit.	<ul style="list-style-type: none"> ▪ IRC 24(b)(1) 	

Other Considerations / Impact to Audit (cont'd)

Calculating Foreign Earned Income Exclusion - Employee

Considerations	Resources	6103 Protected Resources
<p>For individuals who have foreign earned income from both employee compensation and self-employment, the amount excluded under IRC § 911 is deemed to include a pro rata amount of the income from employment and self-employment income. Similarly, a pro rata portion of deductible expenses attributable to self-employment income must be disallowed.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.911-6(a) 	
<p>Special rules govern the determination of the tax liability of individuals who exclude any amount from gross income under IRC § 911 . These rules impose a “stacking” principle under which individuals claiming the FEIE and/or housing cost exclusion are subject to the same marginal rates of tax as individuals with the same level of income who are not eligible for (or do not elect to claim) the exclusions. Thus, the exclusions are no longer treated as coming “off the top” of an individual's income, as under pre-2006 law.</p>	<ul style="list-style-type: none"> ▪ IRC 911(f) 	

Training and Additional Resources

Chapter 9.6.5 Foreign Earned Income Exclusion (IRC § 911)

Type of Resource	Description(s) and/or Instructions for Accessing	References
White Papers/Guidance	<p>Memorandum s issued by Associate Chief Counsel (International)</p> <p>Internal Revenue Manual</p> <p>Pub. 54, <i>Tax Guide for U.S. Citizens and Resident Aliens Abroad</i></p>	<ul style="list-style-type: none"> ▪ IRS AM 2009-003 ▪ TAM 200202072 ▪ TAM 200226010 ▪ IRM 3.38.147.5 ▪ IRM 21.8.1.2
Podcasts/Videos	2011 IIC CPE Session: 911 and FTC	<ul style="list-style-type: none"> ▪ CPE PowerPoint Lesson
Databases/Research Tools	BNA Tax Management Portfolios: Foreign Income Series Taxation of US Person's Foreign Income 918-2nd Sec. 911	<ul style="list-style-type: none"> ▪ BNA 918-2nd – TMFEDPORT No 918 s I

Glossary of Terms and Acronyms

Acronym	Definition
AM	Advice Memorandum
CPE	Continuing Professional Education
DCN	Document Control Number
FEIE	Foreign Earned Income Exclusion
FTC	Foreign Tax Credit
IIC	International Individual Compliance
IRC	Internal Revenue Code
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
TAM	Technical Advice Memorandum
UIL	Uniform Issue List
USD	United States Dollars

Index of Related Issues

Issue	Associated UIL(s)	References
Calculating the Foreign Earned Income Exclusion – Self-Employed Individual	<ul style="list-style-type: none"> ▪ 9431.06 	<ul style="list-style-type: none"> ▪ <i>Calculating Foreign Earned Income Exclusion – Self-Employed Individual</i>, DCN:JTO/9431.06_13(2015),
Bona Fide Residence Test for Purposes of IRC § 911 Tax Benefits	<ul style="list-style-type: none"> ▪ 9431.06-05 ▪ 9431.06-06 	<ul style="list-style-type: none"> ▪ <i>Bona Fide Residence Test for Purposes of Qualifying for IRC 911 Tax Benefits</i>, DCN:JTO/9431.06_15(2015)
Tax Home for Purposes of IRC § 911	<ul style="list-style-type: none"> ▪ 9431.06-05 ▪ 9431.06-06 	<ul style="list-style-type: none"> ▪ <i>Tax Home for Purposes of IRC Section 911</i>, DCN: JTO/CU/C_09.6_05(2013)
IRC § 911 Election and Revocation	<ul style="list-style-type: none"> ▪ 9431.06-05 ▪ 9431.06-06 	<ul style="list-style-type: none"> ▪ <i>IRC 911 Election and Revocation</i>, DCN: JTO/CU/C_09.6_08(2014)