

LB&I International Practice Service Process Unit – Audit

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Unit Name	Bona Fide Residence Test for Purposes of Qualifying for IRC § 911 Tax Benefits
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Process Overview

Bona Fide Residence Test for Purposes of Qualifying for IRC § 911 Tax Benefits

Process Description

This unit focuses on the determination of an individual taxpayer's eligibility under IRC § 911 when that individual claims the IRC § 911 foreign earned income exclusion and/or the foreign housing exclusion or deduction ("foreign income and housing tax benefits") based on bona fide residence status in a foreign country.

U.S. citizens and resident aliens are taxed on their worldwide income. However, U.S. citizens (and in some instances, resident aliens who are citizens or nationals of a country with whom the United States has an income tax treaty in effect) who work and live abroad may be eligible to exclude some or all of their foreign earned income by claiming the IRC § 911 foreign income and housing tax benefits. The IRC § 911 foreign earned income exclusion only applies to wages or self-employment income earned for personal services performed, and is claimed on IRS Form 2555/2555-EZ.

In order to claim the IRC § 911 foreign earned income exclusion, an individual must meet either the bona fide residence test, herein also BFR, or the physical presence test, the latter of which is discussed in another IPS unit in greater detail. It should be noted that the bona fide residence status of an individual is a factual determination with a case by case analysis. 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. Further, other factors are taken into account to determine whether the individual meets the bona fide residence test, such as the requirement of an uninterrupted period of an entire taxable year.

Example Circumstances Under Which Process Applies

- Where an individual has filed a Form 1040 with a Form 2555 or 2555-EZ attached and claimed the IRC § 911 foreign earned income exclusion and/or the foreign housing exclusion or deduction based upon being a "bona fide resident" of a foreign country, the IRS examiner must determine whether the individual meets the criteria of being a bona fide resident of that foreign country to substantiate eligibility for these IRC § 911 tax benefits.

Determination of Process Applicability

Bona Fide Residence Test for Purposes of Qualifying for IRC § 911 Tax Benefits

In order to be eligible to claim the IRC § 911 foreign earned income exclusion as a bona fide resident of a foreign country, an individual must first be a qualified individual under IRC § 911 for the year in question.

Criteria	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ A qualified individual is either: <ul style="list-style-type: none"> • A U.S. citizen, or resident alien who is a citizen or national of a country with which the U.S. has an income tax treaty in effect, 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 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. • The criteria for determining whether an individual meets the bona fide residence test is the focus for the remainder of this IPS unit. 	<ul style="list-style-type: none"> ▪ IRC 911(d)(1) ▪ Treas. Reg. 1.911-2(c) ▪ Treas. Reg. 1.911-2(d) ▪ Rev. Rul. 91-58, 1991-2 CB 340 	

Determination of Process Applicability (cont'd)

Bona Fide Residence Test for Purposes of Qualifying for IRC § 911 Tax Benefits

In order to be eligible to claim the IRC § 911 foreign earned income exclusion as a bona fide resident of a foreign country, an individual must first be a qualified individual under IRC § 911 for the year in question.

Criteria	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ The individual must have a tax home in a foreign country. (There is an IPS Unit, <i>Tax Home for Purposes of IRC § 911</i>, that addresses this topic in greater detail.) <p> CAUTION: Not all overseas locations are “foreign countries.” For example, Antarctica, U.S. possessions and territories (Guam and the Northern Marianas), and certain other locations (such as international airspace or waters) are not considered as “foreign countries” for purposes of IRC § 911.</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) ▪ Treas. Reg. 1.911-2(h) 	

Determination of Process Applicability (cont'd)

Bona Fide Residence Test for Purposes of Qualifying for IRC § 911 Tax Benefits

In order to be eligible to claim the IRC § 911 foreign earned income exclusion as a bona fide resident of a foreign country, an individual must first be a qualified individual under IRC § 911 for the year in question.

Criteria	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ The individual must have foreign earned income, <i>i.e.</i> income that was earned for performing personal services in a foreign country/countries during a period in which he or she had a tax home in a foreign country or countries in order to claim the foreign income and housing tax benefits under IRC § 911. 	<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 make a valid election in order to claim the foreign income and housing tax benefits under IRC § 911. (There is an IPS Unit, <i>IRC § 911 Election and Revocation</i>, that addresses this topic in greater detail.) 	<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) 	

Summary of Process Steps

Bona Fide Residence Test for Purposes of Qualifying for IRC § 911 Tax Benefits

Step 1	Determine whether the individual issued a statement to a foreign country denying residency in that foreign country.
Step 2	Determine whether the individual met the uninterrupted period of an entire taxable year requirement.
Step 3	Examine the facts and circumstances of the individual's situation to determine whether he or she was a bona fide resident of a foreign country or countries.

Step 1

Bona Fide Residence Test for Purposes of Qualifying for IRC § 911 Tax Benefits

Step 1: Determine if the individual issued a statement to a foreign country denying residency in that foreign country.

Did the individual, who was claiming that he or she was a bona fide resident of the foreign country, issue a statement to the authorities of that foreign country stating that he or she was not a resident of that country? Based on that statement, did the foreign country's authority determine that the individual was not subject to the income tax laws of that country?

Considerations	Resources	6103 Protected Resources
<p>An individual is not considered a bona fide resident of a foreign country if</p> <p>(1) the individual submitted a statement to the authorities of that country claiming to be a nonresident of that country, <u>and</u></p> <p>(2) the individual's income is not subject to tax in that country because he or she is a nonresident of that country.</p> <p> CAUTION: If an individual has submitted a statement of non-residence to the authorities of a foreign country and 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.</p>	<ul style="list-style-type: none"> ▪ IRC 911(d)(5) ▪ Treas. Reg. 1.911-2(c) ▪ Rev. Rul. 78-254 	

Step 1 (cont'd)

Bona Fide Residence Test for Purposes of Qualifying for IRC § 911 Tax Benefits

Step 1: Determine if the individual issued a statement to a foreign country denying residency in that foreign country.

Did the individual, who was claiming that he or she was a bona fide resident of the foreign country, issue a statement to the authorities of that foreign country stating that he or she was not a resident of that country? Based on that statement, did the foreign country's authority determine that the individual was not subject to the income tax laws of that country?

Considerations	Resources	6103 Protected Resources
<p>T TREATY IMPLICATION: An income tax exemption provided in a treaty or other international agreement is not considered a statement by a U.S. citizen or resident alien that he or she is a nonresident of a foreign country for purposes of IRC § 911. The determination of whether such an agreement prevents a U.S. citizen or resident alien from being considered a bona fide resident of a foreign country will not depend on income tax exemption alone, but will be determined under all provisions of the agreement, including specific provisions with respect to residence and/or the extent of the total privileges and immunities provided under the agreement.</p>	<ul style="list-style-type: none"> ▪ Rev. Rul. 72-496 ▪ Rev. Rul. 72-497 ▪ <i>Matthews v. Commissioner</i>, 335 F.2d 231 (5th Cir., 1964) ▪ <i>Scott v. United States</i>, 432 F.2d 1388 (1970) ▪ <i>Riley v. Commissioner</i>, 74 TC 414, Dec. 36, 1975 (1980) 	

Step 1 (cont'd)

Bona Fide Residence Test for Purposes of Qualifying for IRC § 911 Tax Benefits

Step 1: Determine if the individual issued a statement to a foreign country denying residency in that foreign country.

Did the individual, who was claiming that he or she was a bona fide resident of the foreign country, issue a statement to the authorities of that foreign country stating that he or she was not a resident of that country? Based on that statement, did the foreign country's authority determine that the individual was not subject to the income tax laws of that country?

Considerations	Resources	6103 Protected Resources
NOTE: In certain cases, an individual may qualify as a bona fide resident of a foreign country for U.S. federal tax purposes, but not be considered a resident under that foreign country's law.		

Step 2

Bona Fide Residence Test for Purposes of Qualifying for IRC § 911 Tax Benefits

Step 2: Determine whether the individual met the uninterrupted period of an entire taxable year requirement.

Does the individual, who was claiming to be a bona fide resident of a foreign country, meet the uninterrupted period of an entire taxable year requirement? (“Entire taxable year” refers to the U.S. tax year; not the foreign tax year.)

Considerations	Resources	6103 Protected Resources
<p>To meet the bona fide residence test, an individual must reside in a foreign country or countries for an uninterrupted period that includes an entire tax year. For calendar year taxpayers, an entire tax year is from January 1st through December 31st.</p> <ul style="list-style-type: none"> • NOTE: During the period of bona fide residence in a foreign country, an individual may leave that foreign country for brief or temporary trips back to the United States or elsewhere as long as the individual has the clear intention of returning to his or her foreign residence or to a new foreign bona fide residence without unreasonable delay. 	<ul style="list-style-type: none"> ▪ IRC 911(d)(1)(A) ▪ Treas. Reg. 1.911-2(c) 	

Step 2 (cont'd)

Bona Fide Residence Test for Purposes of Qualifying for IRC § 911 Tax Benefits

Step 2: Determine whether the individual met the uninterrupted period of an entire taxable year requirement.

Does the individual, who was claiming to be a bona fide resident of a foreign country, meet the uninterrupted period of an entire taxable year requirement? ("Entire taxable year" refers to the U.S. tax year; not the foreign tax year.)

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> EXAMPLE 1: A U.S. citizen arrived in a foreign country with her family on October 15, 2012 for an indefinite assignment and immediately established residency in the foreign country. On March 1, 2013, the individual left that foreign country on a business trip and returned on April 1, 2013. (Her family remained in the foreign country during this time.) The individual and her family remained in the foreign country for the remainder of the year, thus completing an uninterrupted period of residence for the entire tax year beginning on January 1, 2013, and ending on December 31, 2013. 		

Step 2 (cont'd)

Bona Fide Residence Test for Purposes of Qualifying for IRC § 911 Tax Benefits

Step 2: Determine whether the individual met the uninterrupted period of an entire taxable year requirement.

Does the individual, who was claiming to be a bona fide resident of a foreign country, meet the uninterrupted period of an entire taxable year requirement? ("Entire taxable year" refers to the U.S. tax year; not the foreign tax year.)

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> • EXAMPLE 2: Same facts as in Example 1, except that the individual was transferred back to the United States on November 25, 2013. Even though the individual's residency in the foreign country lasted more than a year (from the period beginning on October 15, 2012 and ending on November 25, 2013), it did not include a full taxable year. Therefore, the individual is not considered a bona fide resident for purposes of IRC § 911. • NOTE: The individual may still be eligible for the IRC § 911 foreign earned income exclusion based on the physical presence test. 	<ul style="list-style-type: none"> ▪ <i>Dawson v. Commissioner</i>, 59 T.C. 264 (1972) 	

Step 2 (cont'd)

Bona Fide Residence Test for Purposes of Qualifying for IRC § 911 Tax Benefits

Step 2: Determine whether the individual met the uninterrupted period of an entire taxable year requirement.

Does the individual, who was claiming to be a bona fide resident of a foreign country, meet the uninterrupted period of an entire taxable year requirement? ("Entire taxable year" refers to the U.S. tax year; not the foreign tax year.)

Considerations	Resources	6103 Protected Resources
<p>NOTE: If an individual has established bona fide residency in a foreign country for an uninterrupted period that includes an entire taxable year, that individual will qualify as a bona fide resident starting with the date he or she actually began the residency and ending with the date he or she abandons the foreign residence. The individual could thus qualify as a bona fide resident for parts of one or two other tax years in addition to the full tax year(s) of bona fide residency.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.911-3(d)(3) ▪ IRS Publication 54, <i>Tax Guide for U.S. Citizens and Residents Living Abroad</i> 	

Step 2 (cont'd)

Bona Fide Residence Test for Purposes of Qualifying for IRC § 911 Tax Benefits

Step 2: Determine whether the individual met the uninterrupted period of an entire taxable year requirement.

Does the individual, who was claiming to be a bona fide resident of a foreign country, meet the uninterrupted period of an entire taxable year requirement? ("Entire taxable year" refers to the U.S. tax year; not the foreign tax year.)

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> EXAMPLE 3: A U.S. citizen and calendar year taxpayer moved to and became a resident of a foreign country on February 14, 2010, and remained there through October 31, 2014. The individual established bona fide residency for an uninterrupted period (January 1, 2011 through December 31, 2011) and remained a bona fide resident until departing on October 31, 2014. Therefore, he or she qualified as a bona fide resident for part of 2010 (from February 14, 2010 through December 31, 2010) and continued as a bona fide resident of the foreign country through October 31, 2014. Note that the qualifying days for year of arrival and year of departure may be greater under the Physical Presence Test than under the BFR. 		

Step 3

Bona Fide Residence Test for Purposes of Qualifying for IRC § 911 Tax Benefits

Step 3: Examine the facts and circumstances of the individual’s situation to determine whether he or she was a bona fide resident of a foreign country or countries.

An individual does not automatically acquire bona fide resident status by living in a foreign country or countries for a full tax year. Rather, bona fide resident status is determined on a case by case basis. Various factors are taken into account when determining whether an individual has qualified as a bona fide resident of a foreign country.

Considerations	Resources	6103 Protected Resources
<p>Since bona fide resident status is based on the individual’s facts and circumstances, consider the following factors in determining whether an individual who has met the uninterrupted period of an entire taxable year requirement is, in fact a bona fide resident of a foreign country:</p> <ul style="list-style-type: none"> ▪ The individual’s intent; ▪ Establishment of his or her home temporarily in the foreign country for an indefinite period; ▪ Extent of the individual’s assimilation into the life and society of the foreign country; ▪ Physical presence in the foreign country consistent with his or her employment; ▪ Nature, extent and reasons for temporary absences from his or her temporary foreign home; ▪ Whether the individual paid taxes to the foreign country, 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.911-2(c) ▪ Treas. Reg. 1.871-2 ▪ Treas. Reg. 1.871-5 ▪ Rev. Rul. 73-492 ▪ Rev. Rul. 2004-28 ▪ <i>Sochurek v. Commissioner</i>, 300 F. 2d 34; (7th Cir., 1962) 	

Step 3 (cont'd)

Bona Fide Residence Test for Purposes of Qualifying for IRC § 911 Tax Benefits

Step 3: Examine the facts and circumstances of the individual's situation to determine whether he or she was a bona fide resident of a foreign country or countries.

An individual does not automatically acquire bona fide resident status by living in a foreign country or countries for a full tax year. Rather, bona fide resident status is determined on a case by case basis. Various factors are taken into account when determining whether an individual has qualified as a bona fide resident of a foreign country.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Status of resident contrasted to that of transient or sojourner; ▪ How the employer treated the individual's income for income tax purposes; ▪ Whether the individual's spouse and children also resided in the foreign country; ▪ Nature and duration of employment – whether the assignment could be promptly accomplished within a definite or specified time; and ▪ Good faith in making the trip abroad – whether it is for purpose of tax evasion. <div style="margin-top: 10px;">  <p>CAUTION: The above list is not all-inclusive. Additional factors may be considered to determine whether an individual is a bona fide resident of a foreign country.</p> </div>		

Other Considerations / Impact to Audit

Bona Fide Residence Test for Purposes of Qualifying for IRC § 911 Tax Benefits

Considerations	Resources
Individuals who claim the foreign income and housing tax benefits 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)
 CAUTION: Once a qualified individual elects to exclude foreign earned income, that individual cannot take a foreign tax credit or deduction for taxes on the excluded income. If an individual does take a credit or deduction for foreign taxes on the excluded income, the individual's prior IRC § 911 foreign earned income exclusion is considered revoked.	<ul style="list-style-type: none"> ▪ IRC 911(d)(6) ▪ Treas. Reg. 1.911-6(a) ▪ Rev. Rul. 90-77
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)
Special rules govern the determination of the tax liability of individuals who exclude any amount from gross income under IRC § 911(a). These rules impose a “stacking” principle under which individuals excluding foreign income and housing cost amounts or deducting foreign housing cost amounts are subject to the same marginal tax rates as individuals with the same level of income who are not eligible to (or did not) do so. Thus, the exclusions are no longer treated as coming “off the top” of individuals’ income, as under pre-2006 law.	<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>Memorandums 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
Bloomberg BNA	BNA Tax Management Portfolios –:Foreign Income Series-Taxation of U.S. Persons' Foreign Income 918-2 nd 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
BFR	Bona Fide Residence Test
CPE	Continuing Professional Education
CB	Cumulative Bulletin
DCN	Document Control Number
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

Index of Related Issues

Issue	Associated UIL(s)	References
Calculating the Foreign Earned Income Exclusion – Employee	<ul style="list-style-type: none"> ▪ 9431.06 	<ul style="list-style-type: none"> ▪ <i>Calculating the Foreign Earned Income Exclusion – Employee</i>, DCN:JTO/9431.06_12(2015),
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 the Foreign Earned Income Exclusion – Self-Employed Individual</i>, DCN:JTO/9431.06_13(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)