

LB&I Process Unit Knowledge Base – International

Library Level	Number	Title
Shelf		Individual Outbound
Book	9	Jurisdiction to Tax (Individual Outbound)
Chapter	9.6	Credits / Exclusions / Special Treatments
Section	9.6.5	Foreign Earned Income Exclusion
Subsection		

Unit Name	Physical Presence Test for Purposes of Qualifying for IRC 911 Tax Benefits	
Primary UIL Code	9431.02-10	Taxation of U.S. Citizens and Resident Aliens: FEIE – Physical Presence Test

Document Control Number (DCN)	JTO/P/09_06_05-06
Date of Last Update	03/06/17

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Introduction

Physical Presence Test for Purposes of Qualifying for IRC 911 Tax Benefits

- The purpose of this Practice Unit is to determine whether an individual meets the physical presence test for purposes of claiming the foreign earned income exclusion under IRC 911 and, if the individual does meet the test, to determine the number of qualifying days and the maximum amount of foreign earned income that may be excluded based on the number of qualifying days.

Process Overview

Physical Presence Test for Purposes of Qualifying for IRC 911 Tax Benefits

- U.S. citizens and resident aliens of the United States are taxed on their worldwide income. However, U.S. citizens and residents who work and live abroad may qualify to exclude some or all of their foreign earned income by claiming the foreign earned income exclusion and/or the foreign housing exclusion or deduction. The foreign earned income exclusion applies only to wages or self-employment income earned for services performed in a foreign country, and is claimed on IRS Form 2555 or Form 2555-EZ.

Detailed Explanation of the Process

Physical Presence Test for Purposes of Qualifying for IRC 911 Tax Benefits


Analysis

- In order to claim the foreign earned income exclusion, an individual must either meet the physical presence test or be a bona fide resident of a foreign country, which is discussed in detail in another Practice Unit. To meet the physical presence test a U.S. citizen or resident must have been present in a foreign country or countries for at least 330 days during a consecutive 12-month period. The individual must also maintain a tax home in the foreign country. For purposes of this Practice Unit, assume that the U.S. citizen or resident maintains a “tax home” in a foreign country.
- For example, an examiner receives a case involving an individual that has filed a Form 1040 with a Form 2555 (Part III) or Form 2555-EZ (Part I, question 2) attached claiming the foreign earned income exclusion based upon meeting the physical presence test. The examiner must determine whether the individual qualified for the exclusion and met the physical presence test.

Process Applicability

Physical Presence Test for Purposes of Qualifying for IRC 911 Tax Benefits

In order to claim the foreign earned income exclusion under the physical presence test, an individual must first be considered a qualified individual under IRC 911 for the year in question.

Criteria	Resources
<ul style="list-style-type: none"> ▪ The individual must be 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. Practice Unit “Bona Fide Residence Test for Purposes of Qualifying for IRC 911 Tax Benefits” addresses the concept of bona fide residence in detail. 	<ul style="list-style-type: none"> ▪ IRC 911(d)(1)(B) ▪ Treas. Reg. 1.911-2(d) ▪ Practice Unit, “Bona Fide Residence Test for Purposes of Qualifying for IRC 911 Tax Benefits,” DCN:JTO/9431.06_14(2015)
<ul style="list-style-type: none"> ▪ NOTE: The criteria for determining whether an individual has met the physical presence test as mentioned above is the focus of the remainder of this unit. The individual must have a tax home in a foreign country. Practice Unit “Tax Home for Purposes of IRC Section 911” addresses this concept in detail. 	<ul style="list-style-type: none"> ▪ IRC 911(d)(1) and (3) ▪ Treas. Reg. 1.911-2(b) ▪ Practice Unit, “Tax Home for Purposes of IRC Section 911,” DCN:JTO/CU/P_9.6_05(2013)
 <p>CAUTION: Not all overseas locations are “foreign countries.” For example, Antarctica, U.S. possessions and territories, and certain other locations (such as international airspace or waters) are not foreign countries.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.911-2(h)

Process Applicability (cont'd)

Physical Presence Test for Purposes of Qualifying for IRC 911 Tax Benefits	
Criteria	Resources
<ul style="list-style-type: none">▪ The individual must have income that was received for performing services in a foreign country during a period in which he or she had a tax home in a foreign country and met either the bona fide residence test or the physical presence test.	<ul style="list-style-type: none">▪ Treas. Reg. 1.911-3(a), (b) and (c)
<ul style="list-style-type: none">▪ The individual must have a valid election in place in order to exclude the foreign earned income. Practice Unit "IRC 911 Election and Revocation" addresses the election process in greater detail.	<ul style="list-style-type: none">▪ Treas. Reg. 1.911-7(a)▪ Practice Unit, "IRC 911 Election and Revocation," DCN:JTO/CU/C_09.6.5_08(2014)

Summary of Process Steps

Physical Presence Test for Purposes of Qualifying for IRC 911 Tax Benefits

Process Steps

Determine days of presence in a foreign country or countries, count the number of qualifying days, and determine the maximum amount of excludable foreign earned income.

Step 1	Determine whether the individual was present in a foreign country or countries for 330 full days in any consecutive 12-month period that includes all or part of the tax year in question.
Step 2	Count the number of qualifying days during the tax year in question.
Step 3	Determine the maximum amount of excludable foreign earned income based on the total number of qualifying days during the tax year in question.

Step 1: Determine Presence in Foreign Country

Physical Presence Test for Purposes of Qualifying for IRC 911 Tax Benefits

Step 1

Determine whether the individual was present in a foreign country or countries for 330 full days in any consecutive 12-month period that includes all or part of the tax year in question.

Considerations	Resources
<ul style="list-style-type: none"> ▪ In order to meet the physical presence test, the individual must have been physically present in a foreign country (or countries) for 330 full days during a period of 12 consecutive months. ▪ The 12-month period may begin with any day, but must end on the day before the corresponding day in the twelfth succeeding month – for example, April 10, 2013 through April 9, 2014. ▪ The 12-month period may begin before or after the individual’s arrival in a foreign country, may end before or after the individual’s departure from a foreign country, and may include days when the individual does not have a tax home in a foreign country. ▪ Example 1: An individual arrived in a foreign country on June 1 of year 1 and remained there through October 31 of year 2, departing on November 1 of that year. The first full day of presence was June 2 of year 1. For year 1, the individual may choose, as the qualifying period, the 12-month period from April 28 of year 1 through April 27 of year 2. During this period, the individual was present in the foreign country a total of 330 full days and therefore satisfied the physical presence test for year 1. For year 2, the individual may choose, as the qualifying period, the 12-month period from December 6 of year 1 through December 5 of year 2. During this period, the individual was present in the foreign country a total of 330 full days and therefore satisfied the physical presence test for year 2. 	<ul style="list-style-type: none"> ▪ IRC 911(d)(1)(B) ▪ Treas. Reg. 1.911-2(d)(1) ▪ Treas. Reg. 1.911-2(d)(3)

Step 1: Determine Presence in Foreign Country (cont'd)

Physical Presence Test for Purposes of Qualifying for IRC 911 Tax Benefits

Step 1

Considerations	Resources
<ul style="list-style-type: none"> ▪ Although they need to fall within a 12-month consecutive period, the 330 days of physical presence need not be consecutive. ▪ The individual's presence in a foreign country or countries need not be for business. Days spent on vacation in a foreign country, or time spent in a foreign country for any other purpose, are also counted so long as the individual's tax home is in a foreign country. ▪ A full day means 24 continuous hours, starting at midnight and ending the following midnight. ▪ Example 2: An individual leaves the United States for a foreign country on June 10 and arrives in the foreign country at 9:00 a.m. on June 11. The first full day of presence in a foreign country is June 12. ▪ The term "foreign country" includes the air space above a foreign country. ▪ Example 3: An individual leaves the United States for a foreign country at 9:30 a.m. June 10, flies over the coast of a foreign country at 11:00 p.m. June 11, and lands in the foreign country at 12:30 a.m. June 12. The first full day of presence in a foreign country is June 12. ▪ Example 4: An individual leaves the United States for a foreign country at 10:30 p.m. on January 10. The individual passes over a different foreign country at 11:30 p.m. that same day and then passes over a U.S. territory at 12:45 a.m. on January 11, before arriving at the foreign destination at 6:00 a.m. January 11. The first full day of presence is January 12 because the individual passed over a U.S. possession on the 11, and that is considered part of the United States for purposes of the physical presence test. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.911-2(d)(3) ▪ Treas. Reg. 1.911-2(d)(2) ▪ Treas. Reg. 1.911-2(h)

Step 1: Determine Presence in Foreign Country (cont'd)

Physical Presence Test for Purposes of Qualifying for IRC 911 Tax Benefits


Step 1

Considerations	Resources
<ul style="list-style-type: none"> ▪ Time spent on or over international waters does not count as time spent in a foreign country unless it is time spent in transit from one foreign country to another during a trip that takes less than 24 hours. ▪ Example 5: An individual who is present in a foreign country leaves that country at 11:00 p.m. on July 6, flies overseas, and arrives in another foreign country at 5:00 a.m. July 7. Since the trip took less than 24 hours, the individual did not lose any days of presence. ▪ Example 6: An individual who is present in a foreign country leaves that country at 10:00 p.m. on July 6, travels overseas, and arrives in another foreign country at 8:00 a.m. July 8. Since the trip took more than 24 hours, the individual lost three days of presence – July 6, 7 and 8. If the individual remains in the foreign country, the next full day of presence is July 9. ▪ AUDIT TIP: Review the schedule in Form 2555, Part III, and note in which 12-month period(s) the taxpayer is claiming to meet the 330 day test. The burden is on the taxpayer to prove that he or she was physically present in a foreign country or countries by means of passport entries/stamps and/or other reliable third-party documentation. ▪ NOTE: The minimum time requirement may be waived or shortened if an individual must leave a foreign country because of war, civil unrest, or similar adverse conditions in that country. The individual must be able to show that: <ul style="list-style-type: none"> (1) He or she reasonably could have expected to meet the minimum time requirements if not for the adverse conditions. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.911-2(d)(2) ▪ Form 2555 - <i>Foreign Earned Income</i> ▪ IRC 911(d)(4) ▪ Treas. Reg. 1.911-2(f) ▪ Rev. Proc. 2014-25 ▪ Rev. Proc. 2015-25

Step 1: Determine Presence in Foreign Country (cont'd)

Physical Presence Test for Purposes of Qualifying for IRC 911 Tax Benefits

[Step 1](#)

Considerations	Resources
<p>(2) He or she had a tax home in the foreign country and was physically present in the foreign country on or before the beginning date of the waiver.</p> <p> DECISION POINT: Was the individual present in a foreign country or countries for 330 full days in any consecutive 12-month period that includes all or part of the tax year in question? If not – stop here, as the individual does not meet the physical presence test and thus is not eligible to exclude his or her foreign earned income.</p>	

Step 2: Count Qualifying Days

Physical Presence Test for Purposes of Qualifying for IRC 911 Tax Benefits

Step 2

Count the number of qualifying days during the tax year in question.

Considerations	Resources
<ul style="list-style-type: none">▪ To arrive at the number of qualifying days during the tax year in question, count the total number of days during the tax year that fall within any 12-month qualifying period.▪ Example 1: If an individual's period of physical presence is the 12-month period beginning June 1, 2012 (the 153rd day of 2012, which is a leap year), and ending May 31, 2013 (the 151st day of 2013), the number of qualifying days in 2012 is 214 (366 minus 152) and the number of qualifying days in 2013 is 151.▪ NOTE: The number of days for which an individual can claim the foreign earned income exclusion is based on the total number of days during the year in question that fall within the individual's chosen 12-month measurement period. So long as that 12-month period contains 330 full days of presence in a foreign country or countries it may also include days when the individual was not physically present in a foreign country and on which he or she did not maintain a tax home in a foreign country.▪ An individual may maximize the number of qualifying days in the tax year by sliding a 12-month period forward or backward up to 35 days, so long as it still contains 330 full days of presence in a foreign country or countries. Also, 12-month qualifying periods may overlap. If this overlap occurs, count each day only once, even if it falls within more than one qualifying period.	<ul style="list-style-type: none">▪ Treas. Reg. 1.911-3(d)(3)

Step 2: Count Qualifying Days (cont'd)

Physical Presence Test for Purposes of Qualifying for IRC 911 Tax Benefits

[Step 2](#)

Considerations	Resources
<ul style="list-style-type: none">▪ Example 2: An individual arrives in a foreign country on May 1 of year 1 and remains there through September 30 of year 2, departing on October 1 of that year. The first full day of presence was May 2 of year 1. For year 1, the individual may choose, as the qualifying period, March 28 of year 1 through March 27 of year 2 for a total of 279 qualifying days in year 1. For year 2, the individual may choose as the qualifying period, November 4 of year 1 through November 3 of year 2 for a total of 307 qualifying days in year 2.	<ul style="list-style-type: none">▪ Treas. Reg. 1.911-2(d)(3)

Step 3: Determine Excludable FEIE

Physical Presence Test for Purposes of Qualifying for IRC 911 Tax Benefits

Step 3

Determine the maximum amount of excludable foreign earned income based on the total number of qualifying days during the tax year in question.

Considerations	Resources
<ul style="list-style-type: none"> ▪ The maximum amount of foreign earned income that an individual may exclude is the lesser of: <ol style="list-style-type: none"> (1) Total foreign earned income allocable to the qualifying period(s) during the year in question minus the housing cost amount (if any) that was excluded or deducted. (2) The product of A x B, where A equals the number of qualifying days during the tax year in question divided by total days in the tax year in question and B equals the maximum foreign earned income exclusion for the year in question, as indexed for inflation (\$99,200 for 2014; \$100,800 for 2015). ▪ Example: A U.S. citizen and calendar year taxpayer, whose tax home was in a foreign country, was physically present in that foreign country for 330 days during the period from July 4, 2013 through July 3, 2014. The number of qualifying days in 2014 is 184. In 2014, the individual received \$100,000 attributable to services performed in the foreign country in 2014. The individual excluded foreign housing costs of \$7,001 for 2014. ▪ The individual's foreign earned income limitation is \$50,008, which is the lesser of: <ol style="list-style-type: none"> (1) $\\$100,000 - \\$7,001 = \\$92,999$ (2) $184/365 \times \\$99,200 = \\$50,008$ 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.911-2(d)(2) ▪ Rev. Proc. 2013-35 ▪ Instructions for Form 2555 ▪ Practice Unit, "Foreign Housing Exclusion (IRC 911)," DCN:JTO/9431.06_16(2016)



Step 3: Determine Excludable FEIE (cont'd)

Physical Presence Test for Purposes of Qualifying for IRC 911 Tax Benefits

[Step 3](#)

Considerations	Resources
<ul style="list-style-type: none"> ▪ NOTE: For further details on calculating the foreign housing deduction or exclusion and the foreign earned income exclusion, see related Practice Units: <ul style="list-style-type: none"> - Foreign Housing Exclusion (IRC 911) - Foreign Housing Deduction (IRC 911) - Calculating Foreign Earned Income Exclusion – Employee - Calculating Foreign Earned Income Exclusion – Self-Employed Individual 	<ul style="list-style-type: none"> ▪ Practice Unit, "Foreign Housing Exclusion (IRC 911)," DCN:JTO/9431.06_16(2016) ▪ Practice Unit, "Foreign Housing Deduction (IRC 911)," DCN:JTO/P/09_06_06-17 ▪ Practice Unit, "Calculating Foreign Earned Income Exclusion – Employee," DCN:JTO/9431.06_12(2015) ▪ Practice Unit, "Calculating Foreign Earned Income Exclusion – Self-Employed Individual," DCN:JTO/9431.06_13(2015)

Other Considerations / Impact to Audit

Physical Presence Test for Purposes of Qualifying for IRC 911 Tax Benefits	
Considerations	Resources
<ul style="list-style-type: none"> AUDIT TIP: The burden is on the taxpayer to prove that he or she was physically present in a foreign country or countries by means of passport entries/stamps and/or other reliable third-party documentation. 	<ul style="list-style-type: none"> Title 26, Appendix – Rule 142(a)
<ul style="list-style-type: none"> Individuals who claim the foreign earned income exclusion, housing exclusion, and/or 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)
<p> 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 choice to exclude foreign earned income may be considered revoked.</p> <p>NOTE: An individual may be able to reelect the IRC 911 tax benefits after revocation.</p>	<ul style="list-style-type: none"> IRC 911(d)(6) Treas. Reg. 1.911-6(a) Rev. Rul. 90-77 Treas. Reg. 1.911-7(b)(2) PLR 201433002 - Individual May Reelect Foreign Earned Income Exclusion
<ul style="list-style-type: none"> 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)
<p> CAUTION: For taxable years ending after December 31, 2014, an individual who excludes any foreign earned income under IRC 911 is ineligible for the refundable Additional Child Tax Credit.</p>	<ul style="list-style-type: none"> IRC 24(d)(5)

Other Considerations / Impact to Audit (cont'd)

Physical Presence Test for Purposes of Qualifying for IRC 911 Tax Benefits	
Considerations	Resources
<ul style="list-style-type: none">▪ 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 excluding foreign earned income and/or excluding 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 an individual's income, as under pre-2006 law.	<ul style="list-style-type: none">▪ IRC 911(f)
<ul style="list-style-type: none">▪ Since most U.S. citizens and resident aliens working outside the U.S. will have a foreign bank account and perhaps a foreign pension plan that may or may not be equivalent to a U.S. qualified plan, there may be information reporting requirements, such as the Report of Foreign Bank and Financial Accounts (FBAR).	<ul style="list-style-type: none">▪ FinCEN Form 114 - <i>Report of Foreign Bank and Financial Accounts</i>

Index of Referenced Resources

Physical Presence Test for Purposes of Qualifying for IRC 911 Tax Benefits
IRC 24
IRC 32
IRC 911
Treas. Reg. 1.911-2
Treas. Reg. 1.911-3
Treas. Reg. 1.911-6
Treas. Reg. 1.911-7
Rev. Rul. 90-77
Rev. Proc. 2013-35
Rev. Proc. 2014-25
Rev. Proc. 2015-25
PLR 201433002 - Individual May Reelect Foreign Earned Income Exclusion
Form 1040 - <i>U.S. Individual Income Tax Return</i>
Form 2555 - <i>Foreign Earned Income</i>
Form 2555 Instructions
Form 2555-EZ - <i>Foreign Earned Income Exclusion</i>
Title 26, Appendix – Rule 142(a)

Index of Referenced Resources (cont'd)

Physical Presence Test for Purposes of Qualifying for IRC 911 Tax Benefits
FinCEN Form 114 - <i>Report of Foreign Bank and Financial Accounts</i>
Practice Unit, "Bona Fide Residence Test for Purposes of Qualifying for IRC 911 Tax Benefits," DCN:JTO/9431.06_14(2015)
Practice Unit, "Calculating Foreign Earned Income Exclusion – Employee," DCN:JTO/9431.06_12(2015)
Practice Unit, "Calculating Foreign Earned Income Exclusion – Self-Employed Individual," DCN:JTO/9431.06_13(2015)
Practice Unit, "Foreign Housing Deduction (IRC 911)," DCN:JTO/P/09_06_06-17
Practice Unit, "Foreign Housing Exclusion (IRC 911)," DCN:JTO/9431.06_16(2016)
Practice Unit, "IRC 911 Election and Revocation," DCN:JTO/CU/C_09.6.5_08(2014)
Practice Unit, "Tax Home for Purposes of IRC Section 911," DCN:JTO/CU/P_9.6_05(2013)

Training and Additional Resources

Physical Presence Test for Purposes of Qualifying for IRC 911 Tax Benefits	
Type of Resource	Descriptions
Saba Meeting Sessions	<ul style="list-style-type: none"> ▪ IIC Session: 911 and FTC – 2011 Centra
White Papers / Guidance	<ul style="list-style-type: none"> ▪ Application of Foreign Earned Income Exclusion and the Combat Zone Exclusion to ▪ IRS AM 2009003 - Civilian Contractors Working in Combat Zones ▪ CCA 200202072 ▪ CCA 200226010 ▪ IRM 3.38.147.5 - <i>Foreign Earned Income/Form 2555-EZ, Foreign Earned Income Exclusion</i> ▪ IRM 21.8.1.2 - <i>Foreign Earned Income</i> ▪ Pub. 54 - <i>Tax Guide for U.S. Citizens and Resident Aliens Abroad</i>
Databases / Research Tools	<ul style="list-style-type: none"> ▪ BNA Tax Management Int'l Portfolios, <i>Foreign Income Series: Taxation of US Person's Foreign Income</i>, 918-2nd Sec. 911

Glossary of Terms and Acronyms

Term/Acronym	Definition
AM	Advice Memorandum
CCA	Chief Counsel Advice
CPE	Continuing Professional Education
DCN	Document Control Number
FBAR	Report of Foreign Bank and Financial Accounts
FEIE	Foreign Earned Income Exclusion
FinCEN	Financial Crimes Enforcement Network
FTC	Foreign Tax Credit
IIC	International Individual Compliance
IRC	Internal Revenue Code
IRM	Internal Revenue Manual
JTO	Jurisdiction to Tax (Individual Outbound)
LB&I	Large Business & International
PLR	Private Letter Ruling
UIL	Uniform Issue List

Index of Related Practice Units

Associated UILs	Related Practice Unit	DCN
9431.02-06	Calculating Foreign Earned Income Exclusion – Partner in a Partnership with Foreign Earned Income	JTO/P/09_06_05-19