



Internal Revenue Service

DEPARTMENT OF THE TREASURY

LB&I Concept Unit

Unit Name	Foreign Earned Income for Purposes of IRC 911	
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General Overview

Foreign Earned Income for Purposes of IRC 911

The United States taxes its citizens and resident aliens on their worldwide income regardless of where they live or work. Qualifying individuals may be eligible to reduce their U.S. taxable income by claiming the foreign earned income exclusion, the foreign housing exclusion, and/or the foreign housing deduction. These benefits apply to income earned for personal services performed in a foreign country or countries, and are claimed on IRS Form 2555. If the foreign earned income is excluded, an individual cannot also deduct, exclude, or claim a credit (such as the foreign tax credit) or any item that can be allocated to or charged against the excluded amounts.

In order to claim the foreign earned income exclusion, the foreign housing exclusion or the foreign housing deduction, the taxpayer must:

- Have foreign earned income,
- Have a tax home in a foreign country,
- Either be a bona fide resident of a foreign country or physically present in a foreign country or countries for 330 days, and
- Make a valid election.

This unit focuses on the definition of foreign earned income for purposes of Internal Revenue Code (IRC) section 911. The other requirements are discussed in detail in other Practice Units, which are listed on the “Index of Related Practice Units” slide.

Detailed Explanation of the Concept

Foreign Earned Income for Purposes of IRC 911

Foreign earned income is income received for services performed in a foreign country during a period in which an individual qualifies for the foreign earned income exclusion.

Analysis	Resources
<p>The definition of foreign earned income for purposes of Section 911 is found in Internal Revenue Code (IRC) section 911(b)(1). Only income that is attributable to services performed by an individual in a foreign country (or countries) is considered foreign earned income.</p> <p> CAUTION: Not all overseas locations are “foreign countries” – for example, Antarctica, U.S. territories and insular areas, and certain other locations such as international waters and the air space above them.</p> <p><u>What Is Foreign Earned Income for Purposes of IRC 911?</u></p> <ul style="list-style-type: none"> ▪ Salaries, professional fees and other compensation received for personal services performed in a foreign country or countries (including noncash income and allowances or reimbursements). ▪ Any portion of a scholarship or fellowship grant that is paid for teaching, research, or other services performed in a foreign country or countries, if it is included in gross income. ▪ Income from the sale of artistic works or pieces that are the result of the individual's personal efforts performed in a foreign country or countries. ▪ That portion of royalties received by a writer for the transfer of property rights in the writer's product or under a contract to write a book or series of articles that is allocable to services performed in a foreign country or countries. 	<ul style="list-style-type: none"> ▪ IRC 911(b)(1) ▪ Treas. Reg. 1.911-3(a) ▪ Treas. Reg. 1.911-2(g) ▪ Treas. Reg. 1.911-2(h) ▪ Pub. 54 - <i>Tax Guide for U.S. Citizens and Resident Aliens Abroad</i> ▪ Treas. Reg. 1.911-3(b)(1) ▪ Rev. Rul. 58-222 ▪ Rev. Rul. 79-85 ▪ <i>Tobey v. Commissioner</i> - 60 T.C. 227 (1973)

Detailed Explanation of the Concept (cont'd)

Foreign Earned Income for Purposes of IRC 911	
Analysis	Resources
<p><u>What Is Foreign Earned Income for Purposes of IRC 911? (Cont'd)</u></p> <ul style="list-style-type: none"> ▪ Proceeds received in connection with a wage discrimination suit for services performed in a foreign country or countries, as they are restitution for unpaid wages. ▪ In the case of an individual engaged in a trade or business (other than in corporate form) where capital investment is an important part of producing income, a reasonable allowance as compensation for personal services actually performed by the individual in a foreign country (or countries) is considered foreign earned income. <p> CAUTION: If capital investment is an important part of producing income, no more than 30% of the individual's share of net profit from the business, after the deduction on Form 1040 for one-half of self-employment tax, is considered earned income. Of that, only the portion that represents compensation for personal services performed in a foreign country or countries is considered foreign earned income.</p> <ul style="list-style-type: none"> ▪ Generally, rental income is unearned income. However if personal services are performed in connection with the production of rent, up to 30% of the net rental income can be considered earned income. For example, J, a U.S. citizen living in England, owns and operates a rooming house in London. If he is operating the rooming house as a business that requires capital and personal services, he can consider up to 30% of net rental income as earned income. On the other hand, if he just owns the rooming house and performs no personal services connected with its operation, except perhaps making minor repairs and collecting rents, none of his net income from the house is considered earned income. It is all unearned income. 	<ul style="list-style-type: none"> ▪ <i>Johnson V. Commissioner - T.C. Memo 1977-377</i> ▪ Treas. Reg. 1.911-3(b)(2) ▪ IRC 911(d)(2)(B) ▪ Pub. 54 - <i>Tax Guide for U.S. Citizens and Resident Aliens Abroad</i>

Detailed Explanation of the Concept (cont'd)

Foreign Earned Income for Purposes of IRC 911	
Analysis	Resources
<p><u>What Is Foreign Earned Income for Purposes of IRC 911? (Cont'd)</u></p> <ul style="list-style-type: none"> ▪ Severance payments received by a terminated employee may be earned income when the payment is in the nature of compensation for past services and does not represent consideration for cancellation of an employment contract or in respect of a noncompete agreement. If that is the case, then only the portion of the severance payment that is allocable to services performed in a foreign country or countries is foreign earned income. ▪ Stock options may be earned income if the stock disposed of was stock received by exercise of a stock option granted under an employee stock purchase plan. If the gain on the disposition of stock by exercise of an option is treated as capital gain, the gain is unearned income. However, if the stock was disposed of in less than two years after the option was granted or less than one year after the stock was received, part of the gain on the disposition may be earned income. It is considered received in the year the stock was disposed of and earned in the year services were performed for which the option was granted. Only the portion that is due to services performed in a foreign country or countries is foreign earned income. ▪ That portion of amounts received as sick leave pay or vacation pay are considered foreign earned income to the degree they are allocable to services performed in a foreign country or countries. ▪ Commissions received by a retired individual upon the renewal of insurance policies that previously solicited by that individual represent compensation for personal services, even though the individual has retired and no longer services the policyholders. The portion of such commissions that is allocable to services performed in a foreign country or countries is foreign earned income. 	<ul style="list-style-type: none"> ▪ Rev. Rul. 79-6 ▪ Rev. Rul. 69-118 ▪ <i>Groetzinger v. Commissioner</i> - 87 T.C. 533 (1986) ▪ <i>Chidester v. U.S.</i> - 82 F. Supp. 322 (Ct. Cl.1949) ▪ Rev. Rul. 63-99

Detailed Explanation of the Concept (cont'd)

Foreign Earned Income for Purposes of IRC 911	
Analysis	Resources
<p><u>What Is Foreign Earned Income for Purposes of IRC 911? (Cont'd)</u></p> <ul style="list-style-type: none"> ▪ Research fellowships from private foundations may constitute foreign earned income where the fellowship stipend is designed to replace lost salary allocable to services performed in a foreign country or countries. ▪ A guaranteed payment received by a partner is considered foreign earned income if it was paid for services performed in a foreign country, regardless of whether the partnership has any profits. <ul style="list-style-type: none"> – The income is determined at the partnership level. Once the partnership's foreign earned income is determined, it is allocated among the partners based on the partnership agreement. This agreement must have substantial economic effect. ▪ The fair market value of fringe benefits, including the right to use an employer's property or facilities, is earned income. 	<ul style="list-style-type: none"> ▪ PLR 8619051 ▪ <i>Miller v. Commissioner</i> - 52 T.C. 752 (1969) ▪ IRC 704(a) ▪ IRC 704(b) ▪ IRC 707(c) ▪ Rev. Rul. 67-158 ▪ Treas. Reg. 1.704-1 ▪ Rev. Rul. 81-300 ▪ Rev. Rul. 81-301 ▪ Pub. 54 - <i>Tax Guide for U.S. Citizens and Resident Aliens Abroad</i>
<p><u>What Is NOT Foreign Earned Income for Purposes of IRC 911?</u></p> <ul style="list-style-type: none"> ▪ Dividends, interest, capital gains and alimony. ▪ Pension or annuity (included social security benefits). ▪ Compensation paid to an employee by an employer which is the U.S. government or any of its agencies or instrumentalities. 	<ul style="list-style-type: none"> ▪ IRC 911(b)(1)(B)(i) ▪ Treas. Reg. 1.911-3(c)(2) ▪ IRC 911(b)(1)(B)(ii) ▪ Treas. Reg. 1.911-3(c)(3)

Detailed Explanation of the Concept (cont'd)

Foreign Earned Income for Purposes of IRC 911	
Analysis	Resources
<p><u>What Is NOT Foreign Earned Income for Purposes of IRC 911? (Cont'd)</u></p> <ul style="list-style-type: none"> ▪ Any amount 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. ▪ Income from gambling activities. ▪ Any portion of an amount paid by a corporation which represents a distribution of earnings and profits rather than a reasonable allowance as compensation for personal services actually rendered to the corporation. ▪ Income excluded from gross income as meals and lodging provided by an employer under IRC 119. ▪ Employee expenses reimbursed under an accountable plan for expenses incurred on the employer's behalf which have adequately been accounted for to the employer. ▪ Any amount received after the close of the first taxable year following the taxable year in which the services giving rise to that amount were performed. ▪ Royalties from the leasing of oil and mineral rights or patents. 	<ul style="list-style-type: none"> ▪ IRC 911(b)(1)(B)(iii) ▪ Treas. Reg. 1.911-3(c)(4) ▪ IRC 402(b) ▪ IRC 403(c) ▪ Rev. Rul. 55-171 ▪ Treas. Reg. 1.911-3(b)(1) ▪ Treas. Reg. 1.911-3(c)(1) ▪ Pub. 54 - <i>Tax Guide for U.S. Citizens and Resident Aliens Abroad</i> ▪ IRC 62 ▪ IRC 911(b)(1)(B)(iv) ▪ Treas. Reg. 1.911-3(c)(6)

Index of Referenced Resources

Foreign Earned Income for Purposes of IRC 911
IRC 62
IRC 402
IRC 403
IRC 704
IRC 707
IRC 911
Treas. Reg. 1.704-1
Treas. Reg. 1.911-2
Treas. Reg. 1.911-3
Rev. Rul. 55-171
Rev. Rul. 58-222
Rev. Rul. 63-99
Rev. Rul. 67-158
Rev. Rul. 69-118
Rev. Rul. 79-6
Rev. Rul. 79-85

Index of Referenced Resources (cont'd)

Foreign Earned Income for Purposes of IRC 911

Rev. Rul. 81-300

Rev. Rul. 81-301

Chidester v. U.S. - 82 F. Supp. 322 (Ct. Cl.1949)

Groetzing v. Commissioner - 87 T.C. 533 (1986)

Johnson V. Commissioner - T.C. Memo 1977-377

Miller v. Commissioner - 52 T.C. 752 (1969)

Tobey v. Commissioner - 60 T.C. 227 (1973)

PLR 8619051

Pub. 54 - *Tax Guide for U.S. Citizens and Resident Aliens Abroad*

Training and Additional Resources

Foreign Earned Income for Purposes of IRC 911	
Type of Resource	Description(s)
Saba Meeting Sessions	<ul style="list-style-type: none"> ▪ <i>Foreign Earned Income Exclusion - The Tax Home Test - 2015 CPE Saba Meeting</i>
White Papers / Guidance	<ul style="list-style-type: none"> ▪ IRM 21.8.1.2.4 - Foreign Earned Income Exclusion Form 2555 ▪ IRS.gov - <i>Foreign Earned Income Exclusion - What is Foreign Earned Income</i> https://www.irs.gov/individuals/international-taxpayers/foreign-earned-income-exclusion-what-is-foreign-earned-income ▪ IRS.gov - <i>Foreign Earned Income Exclusion</i> https://www.irs.gov/individuals/international-taxpayers/foreign-earned-income-exclusion
Databases / Research Tools	<ul style="list-style-type: none"> ▪ <i>BNA Tax Management Int'l Portfolio 918-2nd Sec. 911</i>

Glossary of Terms and Acronyms

Term/Acronym	Definition
CPE	Continuing Professional Education
DCN	Document Control Number
IRC	Internal Revenue Code
IRM	Internal Revenue Manual
PLR	Private Letter Ruling
UIL	Uniform Issue List

Index of Related Practice Units

Associated UIL(s)	Related Practice Unit
▪ 9431	<i>Foreign Earned Income Exclusion – Audit Techniques</i>
▪ 9431	<i>Tax Home for Purposes of IRC Section 911</i>
▪ 9431	<i>Calculating Foreign Earned Income Exclusion - Employee</i>
▪ 9431	<i>Calculating Foreign Earned Income Exclusion - Self-Employed Individual</i>
▪ 9431	<i>Calculating Foreign Earned Income Exclusion – Partner in a Partnership with Foreign Earned Income</i>
▪ 9431	<i>IRC 911 Election and Revocation</i>
▪ 9431	<i>Bona Fide Residence Test for Purposes of Qualifying for IRC 911 Tax Benefits</i>
▪ 9431	<i>Physical Presence Test for Purposes of IRC 911</i>
▪ 9431	<i>Foreign Housing Exclusion IRC Section 911</i>
▪ 9431	<i>Foreign Housing Deduction IRC Section 911</i>