



# Internal Revenue Service

DEPARTMENT OF THE TREASURY

## LB&I Process Unit

|                         |                                                    |                                              |
|-------------------------|----------------------------------------------------|----------------------------------------------|
| <b>Unit Name</b>        | Foreign Earned Income Exclusion - Audit Techniques |                                              |
| <b>Primary UIL Code</b> | 9431.02                                            | U.S. citizens and resident aliens - Taxation |

|                       |                                       |
|-----------------------|---------------------------------------|
| <b>Library Level</b>  | <b>Title</b>                          |
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| <b>Book</b>           | Jurisdiction to Tax                   |
| <b>Chapter</b>        | Credits/Exclusions/Special Treatments |

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# Process Overview

## Foreign Earned Income Exclusion – Audit Techniques

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 only apply to wages or self-employment 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 against (such as the foreign tax credit) 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, and/or the foreign housing deduction, an individual must:

- Make a valid election,
- Have foreign earned income,
- Be a bona fide resident of a foreign country or physically present for 330-days in a foreign country or countries, and
- Have a tax home in a foreign country, (i.e. abode was not in the United States).

This Practice Unit will focus on audit techniques for examiners assigned Foreign Earned Income Exclusion cases.



**CAUTION:** Be sure to consider all the above requirements.

### Audit Tips

Verify computation of foreign earned income exclusion, foreign housing exclusion, and/or foreign housing deduction.

# Summary of Process Steps

## Foreign Earned Income Exclusion – Audit Techniques

### Process Steps

In order to qualify for the foreign earned income exclusion and/or exclude or deduct foreign housing amounts, an individual must meet all the requirements set forth in IRC 911.

|                        |                                                        |
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| <a href="#">Step 1</a> | Verify Valid Election(s) Was(Were) Made                |
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# Summary of Process Steps (cont'd)

## Foreign Earned Income Exclusion – Audit Techniques

### Process Steps

In order to qualify for the foreign earned income exclusion and/or exclude or deduct foreign housing amounts, an individual must meet all the requirements set forth in IRC 911.

|                        |                                                                                |
|------------------------|--------------------------------------------------------------------------------|
| <a href="#">Step 5</a> | Verify Foreign Tax Home Was in a Foreign Country and Abode Was Not in the U.S. |
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# Step 1: Verify Valid Election(s) Was (Were) Made

## Foreign Earned Income Exclusion – Audit Techniques

### Step 1

Verify valid election(s) was(were) made.

| Considerations                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         | Resources                                                                                                                                                                                                                              |
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| <ul style="list-style-type: none"> <li>▪ Making the Election: The election to exclude foreign earned income and the election to exclude the cost of foreign housing are separate elections. A taxpayer may make one or both elections.</li> <li>▪ These elections are made by attaching Form 2555, or a comparable form, for each election to the taxpayer's income tax return for the first taxable year that the election is effective.</li> <li>▪ These elections must be made with               <ul style="list-style-type: none"> <li>– A timely filed return (including any extensions),</li> <li>– A return amending a timely filed return during the claim period, or</li> <li>– A late-filed return filed within one year from the original due date of the return (determined without regard to any extensions).</li> </ul> </li> </ul> <p>In addition, the elections may be made on a return filed after the periods described above, provided certain conditions are met.</p> <p>Refer to Practice Unit, <i>IRC 911 Election and Revocation</i>, for further details.</p> | <ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.911-7(a)(1)</li> <li>▪ Form 2555 - <i>Foreign Earned Income</i></li> <br/> <li>▪ IRC 6511(a)</li> <br/> <li>▪ Practice Unit - <i>IRC 911 Election and Revocation</i></li> </ul> |

# Step 1: Verify Valid Election(s) Was (Were) Made (cont'd)

## Foreign Earned Income Exclusion – Audit Techniques

### [Step 1](#)

| Considerations                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | Resources                                                                                                                         |
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| <p><u>Audit Tips</u></p> <ul style="list-style-type: none"> <li>▪ Review the filing history and determine if the year under examination is the election year.</li> </ul> <p><u>EXAMPLE:</u> L, a qualified individual, made a valid election and properly excluded foreign earned income for the tax years 2017 and 2018. L returned to the United States in 2018 and then moved abroad again in 2020. Because a move from the foreign country back to the United States is not considered a revocation of the foreign earned income exclusion, L would not have to reelect the exclusion. However, L would need to meet the other criteria under section 911 in order to exclude foreign earned income and/or the cost of foreign housing (i.e., have a tax home in a foreign country and either meet the bona fide residence or physical presence test).</p> <ul style="list-style-type: none"> <li>▪ Determine if a prior valid election was revoked by determining whether the taxpayer           <ul style="list-style-type: none"> <li>– Filed a statement with the income tax return or amended return for the taxable year for which the revocation is to take effect, or</li> <li>– Took a return position that is inconsistent with the election to claim the foreign earned income exclusion. For example, claiming a credit or deduction for foreign taxes paid or accrued allocable to amounts that could have been excluded may serve to revoke either or both the foreign earned income exclusion and the foreign housing exclusion or deduction. Note: Once an election is revoked, the individual may not make another election before the sixth taxable year after the first year for which the revocation was effective, unless consent to reelect was granted by the IRS.</li> </ul> </li> </ul> | <ul style="list-style-type: none"> <li>▪ IRC 911(e)(2)</li> <li>▪ Treas. Reg. 1.911-7(b)(1)</li> <li>▪ Rev. Rul. 90-77</li> </ul> |

# Step 1: Verify Valid Election(s) Was (Were) Made (cont'd)

## Foreign Earned Income Exclusion – Audit Techniques

### [Step 1](#)

| Considerations                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | Resources                                                                                                |
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| <p><u>Audit Tips (cont'd)</u></p> <p><u>EXAMPLE:</u> In 2018, S, an individual, late filed a return electing the foreign earned income exclusion. In 2019 S's employer moved S to a high tax country. S elected to claim the foreign tax credit for 2019. S's election to claim the foreign tax credit for 2019 served to revoke the election to exclude foreign earned income. S may not make another election until taxable year 2025. If S wants to reelect the foreign earned income exclusion before then, S must obtain permission from the IRS.</p> <ul style="list-style-type: none"> <li>▪ Late Elections Permitted in Certain Situations: The elections may be made on a return filed after the periods described previously, provided:           <ul style="list-style-type: none"> <li>– The individual owes no federal income tax after taking the exclusion(s) into account, or</li> <li>– The individual owes federal income tax after taking the exclusion(s) into account <i>but</i> files a return electing the exclusion before the IRS discovers that the individual failed to make the election.</li> </ul> </li> </ul> <p><u>EXAMPLE:</u> A Substitute for Return was issued for year 20XX. The taxpayer responded by filing a delinquent return electing the foreign earned income exclusion. The delinquent return reflected additional federal income tax due after consideration of the foreign earned income exclusion. Since the taxpayer made the election after the IRS discovered the failure to elect the foreign earned income exclusion and there was additional tax due, the late election was not valid.</p> | <ul style="list-style-type: none"> <li>▪ Treas. Reg.1.911-7(a)(2)(i)</li> <li>▪ CCA 200226010</li> </ul> |

# Step 2: Verify Excluded Income is Foreign Earned

## Foreign Earned Income Exclusion – Audit Techniques

### Step 2

Ensure that the excluded income was received for performing services in a foreign country during a period in which the taxpayer had a tax home in a foreign country and met either the physical presence test or bona fide residence test.

| Considerations                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | Resources                                                                                                                                                                                                                                     |
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| <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> <b>CAUTION:</b> 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 are not “foreign country” for purposes of the foreign earned income exclusion.</p> <p><u>EXAMPLE:</u> A flight crew member flies from Amsterdam to Beijing. One-third of the distance is traveled over international waters and two-thirds is over foreign countries. Only the portion of income earned while the taxpayer is in or over a foreign country is included in “foreign earned income.” Therefore, only two-thirds of the salary received from the airline is foreign earned income.</p> <ul style="list-style-type: none"> <li>Foreign earned income includes salaries, professional fees, and other compensation received for personal services performed in a foreign country or countries (including noncash income and allowances or reimbursements).</li> </ul> | <ul style="list-style-type: none"> <li>IRC 911(b)(1)</li> <li>Treas. Reg. 1.911-3</li> <li>Treas. Reg. 1.911-2(g)</li> <li>Treas. Reg. 1.911-2(h)</li> <li>Pub. 54 - <i>Tax Guide for U.S. Citizens and Resident Aliens Abroad</i></li> </ul> |

# Step 2: Verify Excluded Income is Foreign Earned (cont'd)

## Foreign Earned Income Exclusion – Audit Techniques

### [Step 2](#)

| Considerations                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             | Resources                                                                                                                                                                                                                                                                                                                                                 |
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| <ul style="list-style-type: none"> <li>▪ Foreign earned income does not include pensions or annuities (including social security benefits), nor does it include compensation paid to an employee by an employer which is the U.S. government or any U.S. government agency or instrumentality.</li> <li>▪ 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 (but no more than 30% of the individual's share of net profit) for personal services actually performed by the individual in a foreign country (or countries) is considered foreign earned income.</li> <li>▪ 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. Please refer to the Practice Unit, <i>Calculating Foreign Earned Income Exclusion - Partner in a Partnership with Foreign Earned Income</i> for further details.</li> </ul> <p>Please refer to the Practice Unit, <i>Foreign Earned Income for Purposes of IRC 911</i>, for further details on the definition of foreign earned income.</p> | <ul style="list-style-type: none"> <li>▪ IRC 911(d)(2)(B)</li> <li>▪ Treas. Reg. 1.911-3(b)(2)</li> <br/> <li>▪ IRC 707(c)</li> <li>▪ Practice Unit - <i>Calculating Foreign Earned Income Exclusion - Partner in a Partnership with Foreign Earned Income</i></li> <li>▪ Practice Unit - <i>Foreign Earned Income for Purposes of IRC 911</i></li> </ul> |

# Step 2: Verify Excluded Income is Foreign Earned (cont'd)

## Foreign Earned Income Exclusion – Audit Techniques

### [Step 2](#)

| Considerations                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | Resources |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------|
| <p><u>Audit Tips</u></p> <ul style="list-style-type: none"><li>▪ Review employment contracts detailing days worked inside a foreign country or countries and note any time spent over international water/airspace as well as time spent in the United States.</li><li>▪ Review copies of payroll records which breakdown total compensation including wages, bonuses, stock options, compensation earned in prior year(s), and other categories of earned income such as excess life insurance, equity compensation, cost of living adjustment, foreign housing (rent and other apartment fees), hypothetical tax, home leave, mobility premiums, dependent education (school fees, language lessons for spouse and taxpayer), tax equalization, foreign taxes paid (current year and/or prior year), tax preparation fees and tax gross-ups.</li></ul> <p> <b>CAUTION:</b> Most returns may already have the compensation breakdown as statement to Form 1116 or Form 2555 (form for claiming the foreign earned income exclusion). So, check the return first before asking for a copy from the taxpayer.</p> <ul style="list-style-type: none"><li>▪ Review appointment books.</li><li>▪ Review copies of passports and visas (current and expired).</li><li>▪ Review travel records and documents such as airline tickets, hotel receipts, etc.</li><li>▪ Review ship logs, flight logs, or other records to show time spent in international airspace or waters.</li></ul> |           |

# Step 3: If Applicable, Ensure Physical Presence Test Was Met

## Foreign Earned Income Exclusion – Audit Techniques

### Step 3

If applicable, determine if the physical presence test is met by ensuring the taxpayer was physically present in a country or countries for at least 330 full days during the chosen 12 consecutive month period(s).

| Considerations                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                | Resources                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
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| <ul style="list-style-type: none"> <li>▪ 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.</li> <li>▪ 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.</li> <li>▪ A full day means 24 continuous hours, starting at midnight and ending the following midnight.</li> </ul> <p>Refer to Practice Unit, <i>Physical Presence Test for Purposes of Qualifying for IRC 911 Tax benefits</i>, for examples relating to the Physical Presence Test time requirements.</p> <p> <b>CAUTION:</b> Income that an individual earns in a foreign country while there in violation of U.S. law (U.S. travel restrictions) does not qualify as foreign earned income; housing expenses within that country (or outside) for a spouse and/or dependents) while in violation of the law cannot be included in figuring foreign housing amounts. However, civilian individuals performing services at the U.S. Naval Base in Guantanamo Bay, Cuba, are eligible to exclude income provided the income is not paid by the U.S. government to the individual who is a U.S. government employee.</p> | <ul style="list-style-type: none"> <li>▪ IRC 911(d)(1)(B)</li> <li>▪ Treas. Reg. 1.911-2(d)(1)</li> <li>▪ Treas. Reg. 1.911-2(d)(2)</li> </ul><br><ul style="list-style-type: none"> <li>▪ Practice Unit - <i>Physical Presence Test for Purposes of Qualifying for IRC 911 Tax benefits</i></li> <li>▪ IRC 911(d)(8)(A)</li> </ul><br><ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.911-2(h)</li> <li>▪ Pub. 54 - <i>Tax Guide for U.S. Citizens and Resident Aliens Abroad</i></li> </ul> |

# Step 3: If Applicable, Ensure Physical Presence Test Was Met (cont'd)

## Foreign Earned Income Exclusion – Audit Techniques

### [Step 3](#)

| Considerations                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | Resources |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------|
| <p><u>Audit Tips</u></p> <ul style="list-style-type: none"><li>▪ 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 individual 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.</li><li>▪ Review travel records such as copies of passports and visas (current and expired) to identify dates of entry and departure.</li><li>▪ Request employer statement(s) indicating the period taxpayer was in a foreign country performing services.</li><li>▪ Inspect airline tickets, hotel receipts, meal receipts, ship logs, flight logs, or other records to confirm days spent in and out of the United States.</li></ul> |           |

# Step 4: If Applicable, Ensure Bona Fide Residence Test Was Met

## Foreign Earned Income Exclusion – Audit Techniques

### Step 4

If applicable, determine if the bona fide residence test is met.

| Considerations                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           | Resources                                                                                                                                                                                                                                                      |
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| <ul style="list-style-type: none"> <li>▪ 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 1<sup>st</sup> through December 31<sup>st</sup> (except for brief temporary visits to U.S. or elsewhere).</li> <li>▪ An individual can meet the bona fide residence test for the year in which they arrive or depart the foreign country if they qualified as a bona fide resident in the year following or preceding the applicable year. For the year of arrival, this is accomplished by either filing a request for an extension on IRS Form 2350, Application for Extension of Time to File U.S. Income Tax Return, or filing an amended return once the following year has concluded.</li> <li>▪ Since bona fide resident status is based on the individual's facts and circumstances, a number of factors are considered.</li> <li>▪ An individual is not considered a bona fide resident of a foreign country if             <ol style="list-style-type: none"> <li>1. The individual submitted a statement to the authorities of that country claiming to be a nonresident of that country, and</li> <li>2. The individual's income is not subject to tax in that country because he or she is a nonresident of that country or such a determination has not yet been resolved.</li> </ol> </li> </ul> | <ul style="list-style-type: none"> <li>▪ IRC 911(d)(1)(A)</li> <li>▪ Treas. Reg. 1.911-2(c)</li> <br/> <li>▪ Treas. Reg. 1.911-7(c)</li> <br/> <li>▪ <i>Sochurek v. Commissioner</i> - 300 F. 2d34; (7th Cir., 1962)</li> <br/> <li>▪ IRC 911(d)(5)</li> </ul> |

# Step 4: If Applicable, Ensure Bona Fide Residence Test Was Met (cont'd)

## Foreign Earned Income Exclusion – Audit Techniques

### [Step 4](#)

| Considerations                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          | Resources                                                                                                                                               |
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| <p><b>T TREATY IMPLICATION:</b> 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.</p> <p>Refer to the Practice Unit, <i>Bona Fide Residence Test for Purposes of Qualifying for IRC 911 Tax Benefits</i>, for examples relating to the Bona Fide Resident Test.</p> <p><u>Audit Tips</u></p> <ul style="list-style-type: none"> <li>▪ Conduct an in-depth interview with the taxpayer.</li> <li>▪ Request and review records of foreign leases, utility bills, and living expenses.</li> <li>▪ Request and review credit card statements.</li> <li>▪ Request and review copies of foreign tax returns.</li> <li>▪ Request and review passports, travel records, and a copy of the taxpayer's foreign visa(s).</li> <li>▪ Determine if the individual submitted a statement to the authorities of a foreign country claiming to be a nonresident of that country.</li> <li>▪ If foreign-based documents are not provided, these records can be requested in a formal document request.</li> <li>▪ If domestic records are not provided, consider third party contacts or summons.</li> </ul> | <ul style="list-style-type: none"> <li>▪ Practice Unit - <i>Bona Fide Residence Test for Purposes of Qualifying for IRC 911 Tax Benefits</i></li> </ul> |

# Step 5: Verify Foreign Tax Home and Abode Not in U.S.

## Foreign Earned Income Exclusion – Audit Techniques

### Step 5

Verify tax home was maintained in a foreign country and abode was not in the U.S.

| Considerations                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         | Resources                                                                                                                                                                                                                                                                                                                                                    |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> <li>▪ An individual's tax home is considered to be located at the individual's regular or principal place of business. For purposes of foreign earned income exclusion, the term "tax home" has the same meaning which it has for purposes of IRC 162(a)(2) (relating to travel expenses away from home).</li> <li>▪ An individual cannot have two tax homes at the same time.</li> <li>▪ If an individual does not have a regular or principal place of business, the individual's tax home is at his or her place of abode in a real and substantial sense.</li> <li>▪ If an individual has neither a regular place of business nor an abode in a real and substantial sense, he or she is an itinerant whose tax home is located wherever the taxpayer is physically located from day to day.</li> <li>▪ An individual's abode is in the United States if his or her familial, economic, and social ties to the United States are stronger than his or her ties to a foreign country.</li> </ul> | <ul style="list-style-type: none"> <li>▪ IRC 911(d)(3)</li> <li>▪ IRC 162(a)(2)</li> <li>▪ <i>Andrews v. Commissioner</i>, 931 F.2d 132 (1st Circuit, 1991).</li> <li>▪ Treas. Reg. 1.911-2(b)</li> <li>▪ <i>Struck v. Commissioner</i>, T.C. Memo. 2007-42</li> <li>▪ PL 115-97</li> <li>▪ <i>Harrington v. Commissioner</i>, 93 T.C. 297 (1989)</li> </ul> |

# Step 5: Verify Foreign Tax Home and Abode Not in U.S. (cont'd)

## Foreign Earned Income Exclusion – Audit Techniques

### [Step 5](#)

| Considerations                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | Resources                                                                                                  |
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| <p> <b>CAUTION:</b> An individual is not considered to have a tax home in a foreign country for any period in which the individual's abode was in the United States. However, for tax years beginning after December 31, 2017, a taxpayer serving in support of the U.S. Armed Forces in an area designated as a combat zone and who otherwise qualifies for the foreign earned income exclusion, will not be disqualified merely due to having a U.S. abode.</p> <p>Refer to Practice Unit, <i>Tax Home for Purposes for IRC 911</i>.</p> <p><u>Audit Tips</u></p> <p>Establish whether the taxpayer had a tax home in a foreign country and determine the location of the taxpayer's abode — i.e., where the familial, economic, and personal ties were strongest by:</p> <ul style="list-style-type: none"><li>▪ Requesting and reviewing employment contracts and other records.</li><li>▪ Considering nature and length of foreign assignment.</li><li>▪ Interviewing the taxpayer.</li><li>▪ Considering participation in community, social, and cultural activities; foreign language skills, reasons and nature for absences from foreign country and location of family.</li></ul> | <ul style="list-style-type: none"><li>▪ Practice Unit - <i>Tax Home for Purposes for IRC 911</i></li></ul> |

# Step 5: Verify Foreign Tax Home and Abode Not in U.S. (cont'd)

## Foreign Earned Income Exclusion – Audit Techniques

### [Step 5](#)

| Considerations                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | Resources |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------|
| <p><u>Audit Tips (cont'd)</u></p> <ul style="list-style-type: none"><li>▪ Determining general work area of the taxpayer; verify the addresses in foreign country or countries. If the lodging location is not on land, verify the description of lodging, name of the body of water and number of miles from shore.</li><li>▪ Requesting and reviewing records for real estate and vehicles owned.</li><li>▪ Requesting and reviewing bank statements for both domestic and foreign accounts.</li><li>▪ Requesting and reviewing records relating to other sources of income, such as rental properties, businesses, and pensions to assist in determining where economic ties are strongest.</li><li>▪ Requesting and reviewing copies of driver licenses and other permits such as fishing, guns, etc.</li><li>▪ Requesting and reviewing voter registration cards.</li><li>▪ Requesting and reviewing records for foreign living expenses such as mortgage, car payments, insurance, bills, storage facilities, etc.</li><li>▪ Considering where the family and extended family live, and the nature of the relationships between the taxpayer and the family.</li></ul> |           |

# Step 6: If Applicable, Verify Computation of Foreign Earned Income Exclusion

## Foreign Earned Income Exclusion – Audit Techniques

### Step 6

If applicable, verify the accuracy of the computation and amount of income excluded.

| Considerations                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          | Resources                                                                                                                                                                                       |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> <li>▪ Qualified individuals may exclude the lesser of (1) the limitation amount (maximum of \$105,900 in 2019) 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.</li> <li>▪ For purposes of the foreign earned income exclusion, foreign earned income is considered to be earned in the taxable year in which the services that gave rise to it were performed.</li> <li>▪ The amount of foreign earned income eligible for exclusion is determined by multiplying the limitation amount for the year by the number of days during the tax year that the individual was a qualified individual divided by the total number of days in the tax year:</li> </ul> $\text{Max limitation for year} \times \frac{\text{Qualifying days in tax year}}{\text{Total days in the tax year}}$ | <ul style="list-style-type: none"> <li>▪ IRC 911 (b)(2)(D)</li> <li>▪ Rev. Proc. 2019-44</li> <li>▪ Notice 2020-13</li> <li>▪ IRC 911 (b)(2)(B)</li> <li>▪ Treas. Reg. 1.911-3(d)(2)</li> </ul> |

# Step 6: If Applicable, Verify Computation of the Foreign Earned Income Exclusion (cont'd)

## Foreign Earned Income Exclusion – Audit Techniques

### [Step 6](#)

| Considerations                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | Resources                                                                                                                                                                                                                                                                       |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>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.</p> <p>Refer to Practice Units, <i>Calculating Foreign Earned Income Exclusion - Employee</i> and <i>Calculating Foreign Earned Income Exclusion - Self-Employed Individual</i>.</p> <p><u>Audit Tips</u></p> <ul style="list-style-type: none"> <li>▪ Review employment contracts indicating the period of time the taxpayer was in a foreign country performing services.</li> <li>▪ Review Form 2555 to verify accuracy of computation and amount of income excluded.</li> <li>▪ Ensure that tax was figured on the remaining non-excluded income using the tax rates that would have applied had neither of the exclusion(s) nor the housing deduction been claimed. See the Foreign Earned Income Tax Worksheet in the Form 1040 Instructions. If the taxpayer was required to complete and attach Form 6251, <i>Alternative Minimum Tax-Individuals</i>, see the worksheet in the Form 6251 Instructions.</li> </ul> | <ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.911-3(d)(3)</li> <li>▪ Practice Unit - <i>Calculating Foreign Earned Income Exclusion - Employee</i></li> <li>▪ Practice Unit - <i>Calculating Foreign Earned Income Exclusion - Self-Employed Individual</i></li> </ul> |

# Step 6: If Applicable, Verify Computation of the Foreign Earned Income Exclusion (cont'd)

## Foreign Earned Income Exclusion – Audit Techniques

### [Step 6](#)

| Considerations                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | Resources                 |           |                     |                 |                       |           |                                                                                                                     |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------|-----------|---------------------|-----------------|-----------------------|-----------|---------------------------------------------------------------------------------------------------------------------|
| <p>A sole proprietor may elect to exclude foreign earned income in the same manner as an individual with foreign-source wages. Because the exclusion is, by the terms of the statute, an exclusion from gross income, the sole proprietor must apply the exclusion against his gross receipts.</p> <p><u>Example:</u> S, a self-employed individual, was a qualified individual for the entire 2019 taxable year and elected to exclude his foreign earned income. In 2019, S earned \$200,000 for consulting services rendered in a foreign country. In performing the consulting services, S incurred expenses of \$50,000.</p> <p>S had no other foreign earned income in 2019. For 2019, S's taxable earnings from self-employment are computed as follows:</p> <p>Service Business-all business is foreign source:</p> <table data-bbox="91 982 712 1093"> <tr> <td>Schedule C Gross Receipts</td> <td>\$200,000</td> </tr> <tr> <td>Schedule C Expenses</td> <td><u>(50,000)</u></td> </tr> <tr> <td>Schedule C Net Income</td> <td>\$150,000</td> </tr> </table> <p>Self Employment (SE) Tax: \$20,497<br/>           Deduction for ½ SE Tax: \$10,249</p> | Schedule C Gross Receipts | \$200,000 | Schedule C Expenses | <u>(50,000)</u> | Schedule C Net Income | \$150,000 | <ul style="list-style-type: none"> <li>▪ IRC 911(d)(1)</li> <li>▪ IRC 911(a)(1)</li> <li>▪ IRC 911(b)(2)</li> </ul> |
| Schedule C Gross Receipts                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         | \$200,000                 |           |                     |                 |                       |           |                                                                                                                     |
| Schedule C Expenses                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               | <u>(50,000)</u>           |           |                     |                 |                       |           |                                                                                                                     |
| Schedule C Net Income                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             | \$150,000                 |           |                     |                 |                       |           |                                                                                                                     |

# Step 6: If Applicable, Verify Computation of the Foreign Earned Income Exclusion (cont'd)

## Foreign Earned Income Exclusion – Audit Techniques

### [Step 6](#)

| Considerations                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                | Resources           |          |                             |               |  |          |                                                         |         |                                                                    |                   |                                                                                                                           |          |                                                                                            |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------|----------|-----------------------------|---------------|--|----------|---------------------------------------------------------|---------|--------------------------------------------------------------------|-------------------|---------------------------------------------------------------------------------------------------------------------------|----------|--------------------------------------------------------------------------------------------|
| <p><u>Example: (Cont'd)</u></p> <p>To Arrive at Expenses Allocable to Excluded Income:</p> <table border="0"> <tr> <td>Schedule C Expenses</td> <td style="text-align: right;">\$50,000</td> </tr> <tr> <td>Plus Deduction for ½ SE Tax</td> <td style="text-align: right;"><u>10,249</u></td> </tr> <tr> <td></td> <td style="text-align: right;">\$60,249</td> </tr> </table> <p>Multiplied by the ratio of Excluded Gross Income to Total Gross Income:</p> <p>\$60,249 x (\$105,900 / \$200,000) = \$31,902</p> <p>The \$31,902 goes on Line 44 of Form 2555.</p> <table border="0"> <tr> <td>Foreign earned income excluded on Line 42 of Form 2555:</td> <td style="text-align: right;">105,900</td> </tr> <tr> <td>Minus expenses allocable to excluded income(Line 44 of Form 2555):</td> <td style="text-align: right;"><u>(\$31,902)</u></td> </tr> <tr> <td>Equals amount to be included in reductions to total income on Schedule 1 (Form 1040), Line 21, with notation "Form 2555":</td> <td style="text-align: right;">\$73,998</td> </tr> </table> <p>S's foreign earned income exclusion for 2019 is limited to \$73,998.</p> | Schedule C Expenses | \$50,000 | Plus Deduction for ½ SE Tax | <u>10,249</u> |  | \$60,249 | Foreign earned income excluded on Line 42 of Form 2555: | 105,900 | Minus expenses allocable to excluded income(Line 44 of Form 2555): | <u>(\$31,902)</u> | Equals amount to be included in reductions to total income on Schedule 1 (Form 1040), Line 21, with notation "Form 2555": | \$73,998 | <ul style="list-style-type: none"> <li>▪ IRC 911(a)(1)</li> <li>▪ IRC 911(b)(2)</li> </ul> |
| Schedule C Expenses                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           | \$50,000            |          |                             |               |  |          |                                                         |         |                                                                    |                   |                                                                                                                           |          |                                                                                            |
| Plus Deduction for ½ SE Tax                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | <u>10,249</u>       |          |                             |               |  |          |                                                         |         |                                                                    |                   |                                                                                                                           |          |                                                                                            |
|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               | \$60,249            |          |                             |               |  |          |                                                         |         |                                                                    |                   |                                                                                                                           |          |                                                                                            |
| Foreign earned income excluded on Line 42 of Form 2555:                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | 105,900             |          |                             |               |  |          |                                                         |         |                                                                    |                   |                                                                                                                           |          |                                                                                            |
| Minus expenses allocable to excluded income(Line 44 of Form 2555):                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            | <u>(\$31,902)</u>   |          |                             |               |  |          |                                                         |         |                                                                    |                   |                                                                                                                           |          |                                                                                            |
| Equals amount to be included in reductions to total income on Schedule 1 (Form 1040), Line 21, with notation "Form 2555":                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | \$73,998            |          |                             |               |  |          |                                                         |         |                                                                    |                   |                                                                                                                           |          |                                                                                            |

# Step 7: If Applicable, Verify Computation of Housing Exclusion or Deduction

|                                                                      |
|----------------------------------------------------------------------|
| <b>Foreign Earned Income Exclusion – Audit Techniques</b>            |
| <b>Step 7</b>                                                        |
| If applicable, verify computation of housing exclusion or deduction. |

| Considerations                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         | Resources                                                                                                                                                                                                                                                      |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> <li>▪ Qualified individuals must have eligible housing expenses in order to claim the foreign housing exclusion or deduction. Eligible housing expenses are reasonable expenses paid or incurred for housing in a foreign country for a qualified individual, his or her spouse, and/or his or her dependents.</li> <li>▪ An individual who qualifies for the foreign housing exclusion or deduction for only part of the year must consider only eligible housing expenses for the part of the year during which they qualified.</li> </ul> <p>Refer to Practice Units, <i>Foreign Housing Exclusion IRC Section 911</i> and <i>Foreign Housing Deduction IRC Section 911</i>.</p> | <ul style="list-style-type: none"> <li>▪ IRC 911(c)(3)</li> <li>▪ Treas. Reg. 1.911-4(b)(1)</li> <li>▪ Practice Unit - <i>Foreign Housing Exclusion IRC Section 911</i></li> <li>▪ Practice Unit - <i>Foreign Housing Deduction IRC Section 911</i></li> </ul> |

# Step 7: If Applicable, Verify Computation of Housing Exclusion or Deduction (cont'd)

## Foreign Earned Income Exclusion – Audit Techniques

### [Step 7](#)

| Considerations                                                                                                                                                                                                                                                                                                                                                                                                                                                          | Resources |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------|
| <p>Verify housing expense does not include lavish or extravagant expenses, deductible interest and taxes, cost of buying property including principal payments on a mortgage, cost of domestic labor, improvements, and purchased furniture by requesting and reviewing:</p> <ul style="list-style-type: none"><li>▪ Lease agreements.</li><li>▪ Homeowner/renter insurance policies.</li><li>▪ Utility statements.</li><li>▪ Residential parking agreements.</li></ul> |           |

# Other Considerations / Impact to Audit

## Foreign Earned Income Exclusion – Audit Techniques

| Considerations                                                                                                                                                                        | Resources                                                                                       |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"><li>An individual who has made either election may not take any deductions, elections, or credits with respect to the excluded amount(s).</li></ul> | <ul style="list-style-type: none"><li>Treas. Reg. 1.911-6(a)</li><li>Rev. Rul. 79-199</li></ul> |

# Index of Referenced Resources

## Foreign Earned Income Exclusion – Audit Techniques

IRC 162

IRC 707

IRC 911

IRC 6511

Treas. Reg. 1.911-2

Treas. Reg. 1.911-3

Treas. Reg. 1.911-4

Treas. Reg. 1.911-6

Treas. Reg. 1.911-7

Rev. Rul. 79-199

Rev. Rul. 90-77

Rev. Proc. 2019-44

Notice 2020-13

PL 115–97

*Andrews v. Commissioner* - 931 F.2d 132 (1st Circuit, 1991)

*Harrington v. Commissioner* - 93 T.C. 297 (1989)

*Sochurek v. Commissioner* - 300 F. 2d34; (7th Cir., 1962)

# Index of Referenced Resources (cont'd)

## Foreign Earned Income Exclusion – Audit Techniques

*Struck v. Commissioner* - T.C. Memo. 2007-42

CCA 200226010

Form 2555 - *Foreign Earned Income*

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

# Training and Additional Resources

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

# Glossary of Terms and Acronyms

| Term/Acronym | Definition                        |
|--------------|-----------------------------------|
| CPE          | Continuing Professional Education |
| DCN          | Document Control Number           |
| IRC          | Internal Revenue Code             |
| IRM          | Internal Revenue Manual           |
| IRS          | Internal Revenue Service          |
| PL           | Public Law                        |
| UIL          | Uniform Issue List                |

# Index of Related Practice Units

| Associated UIL(s) | Related Practice Unit                                                                                    |
|-------------------|----------------------------------------------------------------------------------------------------------|
| ▪ 9432            | <i>Sourcing of Salary and Compensation</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>Foreign Earned Income for Purposes of IRC 911</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 Qualifying for IRC 911 Tax Benefits</i>                        |
| ▪ 9431            | <i>Foreign Housing Exclusion IRC Section 911</i>                                                         |
| ▪ 9431            | <i>Foreign Housing Deduction IRC Section 911</i>                                                         |