

IRS Tax Tips on Foreign Earned Income

If you are living and working abroad you may be entitled to the Foreign Earned Income Exclusion. Here are five important facts from the IRS about the exclusion:

1. **The Foreign Earned Income Exclusion** United States Citizens and resident aliens who live and work abroad may be able to exclude all or part of their foreign salary or wages from their income when filing their U.S. federal tax return. They may also qualify to exclude compensation for their personal services or certain foreign housing costs.
2. **The General Rules** To qualify for the foreign earned income exclusion, a U.S. citizen or resident alien must have a tax home in a foreign country and income received for working in a foreign country, otherwise known as foreign earned income. The taxpayer must also meet one of two tests: the bona fide residence test or the physical presence test.
3. **The Exclusion Amount** The foreign earned income exclusion is adjusted annually for inflation. For 2012, the maximum exclusion is up to \$95,100 per qualifying person. See IRS [Foreign Earned Income Exclusion](#) for more detailed information.
4. **Claiming the Exclusion** The foreign earned income exclusion and the foreign housing exclusion or deductions are claimed using Form 2555, Foreign Earned Income, which should be attached to the taxpayer's Form 1040. A shorter Form 2555-EZ, Foreign Earned Income Exclusion, is available to certain taxpayers claiming only the foreign income exclusion.
5. **Taking Other Credits or Deductions** Once the foreign earned income exclusion is chosen, a foreign tax credit or deduction for taxes cannot be claimed on the excluded income. If a foreign tax credit or tax deduction is taken on any of the excluded income, the foreign earned income exclusion will be considered revoked.

For more information about the Foreign Earned Income Exclusion see Publication 54, Tax Guide for U.S. Citizens and Resident Aliens Abroad and the instructions for Form 2555 or Form 2555-EZ. Forms and publications are available at IRS.gov or by calling 800-TAX-FORM (800-829-3676).

[IRS Publication 54](#), Tax Guide for U.S. Citizens and Resident Aliens Abroad:

Definition of Earned Income:

- Salaries and wages, commissions, bonuses, professional fees, tips
- Noncash income - Fair market value of property or facilities provided by your employer in the form of the following:
 - lodging,
 - meals,
 - or use of a car
- Allowances or reimbursements – Includes allowances or reimbursements you receive, such as the following amounts:
 - Cost of living allowance
 - Overseas differential
 - Family allowance
 - Reimbursement for education or education allowance
 - Home leave allowance
 - Quarters allowance

Exclusion of Meals and Lodging from income only if the following conditions are met:

- The meals are furnished on the business premises of your employer, and for the convenience of your employer.
- Lodging is furnished on the business premises of your employer, for the convenience of your employer, and as a condition of your employment.

If the above conditions are met, do not include the value of the meals or lodging in income. These exclusions are not foreign earned income, and not included in the total reported on the W-2 in box 1 as wages

Choosing the Foreign Earned Income Exclusion:

To claim the foreign earnings income exclusion, the foreign housing exclusion, or the foreign housing deduction, you must meet all three of the following requirements:

- Your tax home must be in a foreign country
- You must have foreign earned income.
- You must be either:
 - A U.S. citizen who is a bona fide resident of a foreign country or countries for an uninterrupted period that includes an entire tax year,
 - A U.S. resident alien who is a citizen or national of a country with which the U.S. has an income tax treaty in effect and who is a bona fide resident of a foreign country or countries for an uninterrupted period that includes an entire tax year, or
 - A U.S. citizen or a U.S. resident alien who is physically present in a foreign country or countries for at least 330 full days during any period of 12 consecutive months.

If you qualify, the foreign income exclusion is voluntary and tax withholding can be stopped once you complete and submit IRS Form 673, or similar statement, to your employer. Form 673 can be used by U.S. citizens only. The foreign earned income exclusion remains in effect for that year, and all subsequent years until you revoke it.

If you claim the foreign earned income exclusion, you cannot claim a deduction or credit for any item that can be allocated to or charged against the excluded income, specifically a foreign tax credit.

Foreign Housing Exclusion and Deduction:

In addition to the foreign earned income exclusion, you can also claim exclusion for your housing amount if your tax home is in a foreign country and you qualify under either the bona fide residence test or the physical presence test. There are limits to the amount that can be claimed as a foreign housing exclusion, and IRS provides the calculation on form 2555.

The housing exclusion applies only to amounts considered paid for with employer-provided amounts. The housing deduction applies only to amounts paid for with self-employment earnings.

- **No Double Benefit:** You cannot include in housing expenses the value of meals or lodging that you exclude from gross income or that you deduct as moving expenses.

Foreign Tax Credit:

If you plan to take a foreign tax credit, **instead of foreign earned income exclusion**, you may be eligible for additional withholding allowances on form W-4. You can take these additional withholding allowances only for foreign tax credits attributable to taxable salary or wage income. The foreign tax credit is intended to relieve you of a double tax burden when you foreign source income is taxed by both the U.S. and the foreign country. Generally, if the foreign tax rate is higher than the U.S. rate, there will be no U.S. tax on the foreign income.

Foreign taxes that qualify for the credit: Generally four tests must be met for any foreign tax to qualify for the credit.

- The tax must be imposed on you.
- You must have paid or accrued the tax.
- The tax must be the legal and actual foreign tax liability.
- The tax must be an income tax (or a tax in lieu of an income tax).

See [IRS publication 514](#), **Foreign Tax Credit for Individuals** for more information.

In a nutshell...

Expatriate Employee's tax options:

The tax option chosen by the expatriate employee will depend upon whether the employee fits the requirements and elects the Foreign Earned Income and/or Foreign Housing Exclusions, or whether the employee qualifies for and chooses to file for a foreign tax credit.

- **Foreign Earned Income Exclusion** – to qualify, must meet the criteria outlined above and in IRS Publication 54.
 - Submit IRS Form 673 or similar statement to the University's Payroll Services to stop withholding income tax on excluded income. The 2010 exclusion limit is \$91,500
 - Complete and submit IRS form 2555 or 2555-EZ with your form 1040 tax return.
 - Form 2555-EZ is only used if you do not claim the Foreign Housing Exclusion
- **Foreign Tax Credit** – Cannot be used if you claim the foreign Earned Income Exclusion
 - Four tests must be met to claim the Foreign Tax Credit. See above and IRS publication 514 for more information.
 - Complete and submit a new Form W-4 to claim additional allowances for the foreign tax credit.
 - See [IRS Publication 919, How Do I Adjust My Tax Withholding?](#) For information on how to “convert credits to withholding allowances”.