

Foreign Earned Income and Housing Cost Exclusions
for U.S. Citizens and Resident Aliens Living Abroad

Dear Client:

You are a U.S. citizen (or U.S. resident alien) who plans on relocating to a foreign country for employment and would like to know whether income you earn from services you will perform abroad can be excluded from your gross income for U.S. tax purposes.

Although U.S. citizens and U.S. resident aliens are generally taxed on their world-wide income, a portion of your foreign earned income and part of your foreign housing costs may be excluded from gross income if you have a tax home in a foreign country and are either (i) a *bona fide* foreign resident, or (ii) physically present in the foreign country for 330 full days during any consecutive 12 month period (a "qualified individual").

A taxpayer has a tax home in a foreign country if expenses in traveling away from that country on business would be deductible under Code Sec. 162(a)(2). An employee's tax home is considered to be located at his regular or principal (if more than one regular) place of business.

For 2014, the foreign earned income exclusion allows up to \$99,200 of foreign earned income to be excluded from your taxable income (\$97,600 for 2013). If both you and your spouse qualify, exclusion is separately determined for each of you. To determine the amount of your exclusion in any year multiply the maximum earned income exclusion (\$99,200) by a fraction the numerator of which is the number of days you were a qualified individual and the denominator of which is the number of days in the year.

If you are a qualified individual, you may also elect to exclude your housing cost amount from gross income. The house cost amount equals the amount by which housing expenses exceed 16% of the maximum earned income exclusion (i.e., \$15,872) computed on a daily basis if the taxpayer was a qualified individual for less than an entire year. The housing cost amount is capped at 30% of the maximum earned income exclusion which is \$29,760. Thus, for 2014, the maximum excludible housing cost amount is \$13,888. For purposes of the exclusion, housing expenses are those reasonable expenses paid or incurred during the tax year by the individual's employer on behalf of the individual for housing for the individual (and, if they reside with him, for his spouse and dependents) in a foreign country. The total of the foreign earned income exclusion and the housing cost exclusion may not exceed your foreign earned income.

IRS provides a higher adjusted limitation on housing expenses for a qualified individual incurring housing expenses in one or more of the high cost localities.

The exclusion is not automatic but must be elected by attaching a Form 2555 or Form 2555EZ to your return for the first tax year that you want the election to be effective.

Example: In 2014, U.S. citizen A's tax home is in Country X and A meets the *bona fide* residence test. A is a qualified individual for 181 days in 2014 and receives \$100,000 attributable to services performed in Country X during 2014. A can exclude \$49,192 of foreign earned income, i.e., the lesser of \$100,000 or \$49,192 ($\$99,200 \times 181 / 365$).

Assume that in addition, U.S. citizen A receives a \$15,000 foreign housing allowance from his employer. A may exclude \$7,129 from taxable income, the excess of his housing cost expenses of \$15,000 over the base amount of \$7,871 (16% of $\$99,200 \times 181 / 365$). A's foreign earned income exclusion is reduced to \$42,063 because both exclusions together may not exceed \$49,192 ($\$99,200 \times 181 / 365$).

The above is a simplified discussion of the foreign earned income and housing cost exclusions. If you are contemplating making one or both of these elections in the future, please contact my office so that we can discuss whether you will qualify for these exclusions, and what the tax consequences of these elections may be.

Sincerely yours,

Thomas Mangold, CPA / ABV / CITP / CGMA
President