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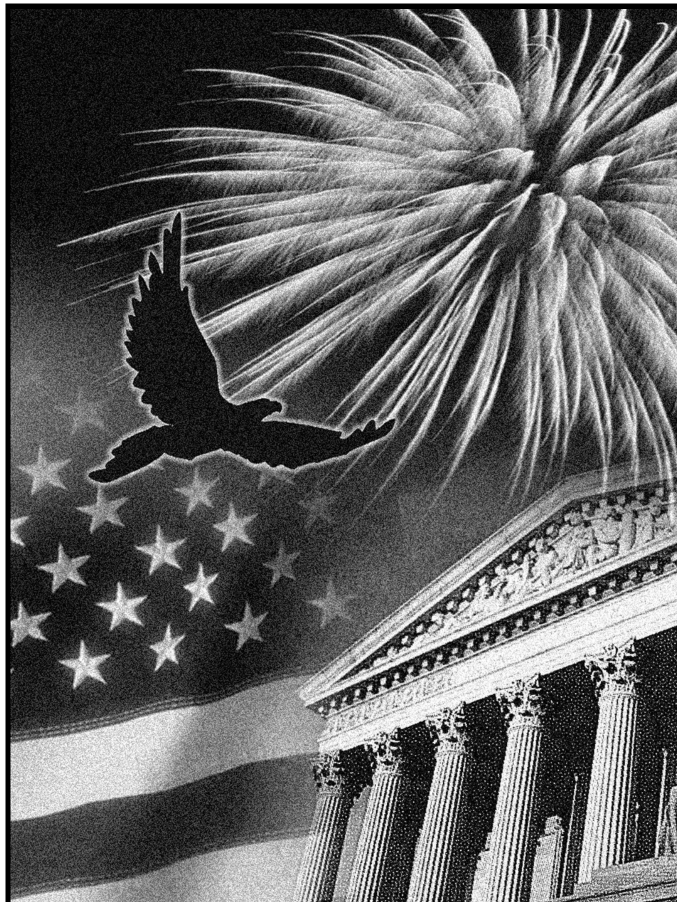
Tax Guide for U.S. Citizens and Resident Aliens Abroad

For use in preparing

2009 Returns



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Dec 09, 2009

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What's New

Exclusion amount. The maximum foreign earned income exclusion is now adjusted annually for inflation. For 2009, the maximum exclusion has increased to $91,400. See *Limit on Excludable Amount* under *Foreign Earned Income Exclusion* in chapter 4.

Housing expenses—base amount. The computation of the base housing amount (line 32 of Form 2555) is tied to the maximum foreign earned income exclusion. The amount is 16

are generally the same whether you are living in the United States or abroad.

The self-employment tax is a social security and Medicare tax on net earnings from self-employment. You must pay self-employment tax if your net earnings from self-employment are at least $400.

For 2009, the maximum amount of net earnings from self-employment that is subject to the social security portion of the tax is $106,800. All net earnings are subject to the Medicare portion of the tax.

Employed by a U.S. Church

If you were employed by a U.S. church or a qualified church-controlled organization that chose exemption from social security and Medicare taxes and you received wages of $108.28 or more from the organization, the amounts paid to you are subject to self-employment tax. However, you can choose to be exempt from social security and Medicare taxes if you are a member of a recognized religious sect. See Publication 517 for more information about church employees and self-employment tax.

Effect of Exclusion

You must take all of your self-employment income into account in figuring your net earnings from self-employment, even income that is exempt from income tax because of the foreign earned income exclusion.

Example. You are in business abroad as a consultant and qualify for the foreign earned income exclusion. Your foreign earned income is $95,000, your business deductions total $27,000, and your net profit is $68,000. You must pay self-employment tax on all of your net profit, including the amount you can exclude from income.

Members of the Clergy

If you are a member of the clergy, you are treated as self-employed for self-employment tax purposes. Your U.S. self-employment tax is based upon net earnings from self-employment figured without regard to the foreign earned income exclusion or the foreign housing exclusion.

You can receive exemption from coverage for your ministerial duties if you conscientiously oppose public insurance due to religious reasons or if you oppose it due to the religious principles of your denomination. You must file Form 4361 to apply for this exemption.

This subject is discussed in further detail in Publication 517.

Income From U.S. Possessions

If you are a U.S. citizen or resident alien and you own and operate a business in Puerto Rico, Guam, the Commonwealth of the Northern Mariana Islands, American Samoa, or the U.S. Virgin Islands, you must pay tax on your net earnings from self-employment (if they are $400 or more) from those sources. You must pay the self-employment tax whether or not the income is exempt from U.S. income taxes (or whether or not you must otherwise file a U.S. income tax return). Unless your situation is described below, attach Schedule SE (Form 1040) to your U.S. income tax return.

If you do not have to file Form 1040 with the United States and you are a resident of any of the U.S. possessions listed in the preceding paragraph, figure your self-employment tax on Form 1040-SS. Residents of Puerto Rico may file the Spanish-language Form 1040-PR.

You must file these forms with the:

Department of the Treasury
Internal Revenue Service Center
Austin, TX 73301-0215

Exemption From Social Security and Medicare Taxes

The United States may reach agreements with foreign countries to eliminate dual coverage and dual contributions (taxes) to social security systems for the same work. See *Bilateral Social Security (Totalization) Agreements* in chapter 2 under *Social Security and Medicare Taxes.* As a general rule, self-employed persons who are subject to dual taxation will only be covered by the social security system of the country where they reside. For more information on how any specific agreement affects self-employed persons, contact the United States Social Security Administration, as discussed under *Bilateral Social Security (Totalization) Agreements* in chapter 2.

If your self-employment earnings should be exempt from foreign social security tax and subject only to U.S. self-employment tax, you should request a certificate of coverage from the U.S. Social Security Administration, Office of International Programs. The certificate will establish your exemption from the foreign social security tax.

Send the request to the:

Social Security Administration
Office of International Programs
P.O. Box 17741
Baltimore, MD 21235-7741

4. Foreign Earned Income and Housing: Exclusion – Deduction

Topics

This chapter discusses:

- Who qualifies for the foreign earned income exclusion, the foreign housing exclusion, and the foreign housing deduction,
- The requirements that must be met to claim either exclusion or the deduction,
- How to figure the foreign earned income exclusion, and
- How to figure the foreign housing exclusion and the foreign housing deduction.

Useful Items

You may want to see:

Publication

- ❏ **519** U.S. Tax Guide for Aliens
- ❏ **570** Tax Guide for Individuals With Income from U.S. Possessions
- ❏ **596** Earned Income Credit (EIC)

Form (and Instructions)

- ❏ **1040X** Amended U.S. Individual Income Tax Return
- ❏ **2555** Foreign Earned Income
- ❏ **2555-EZ** Foreign Earned Income Exclusion

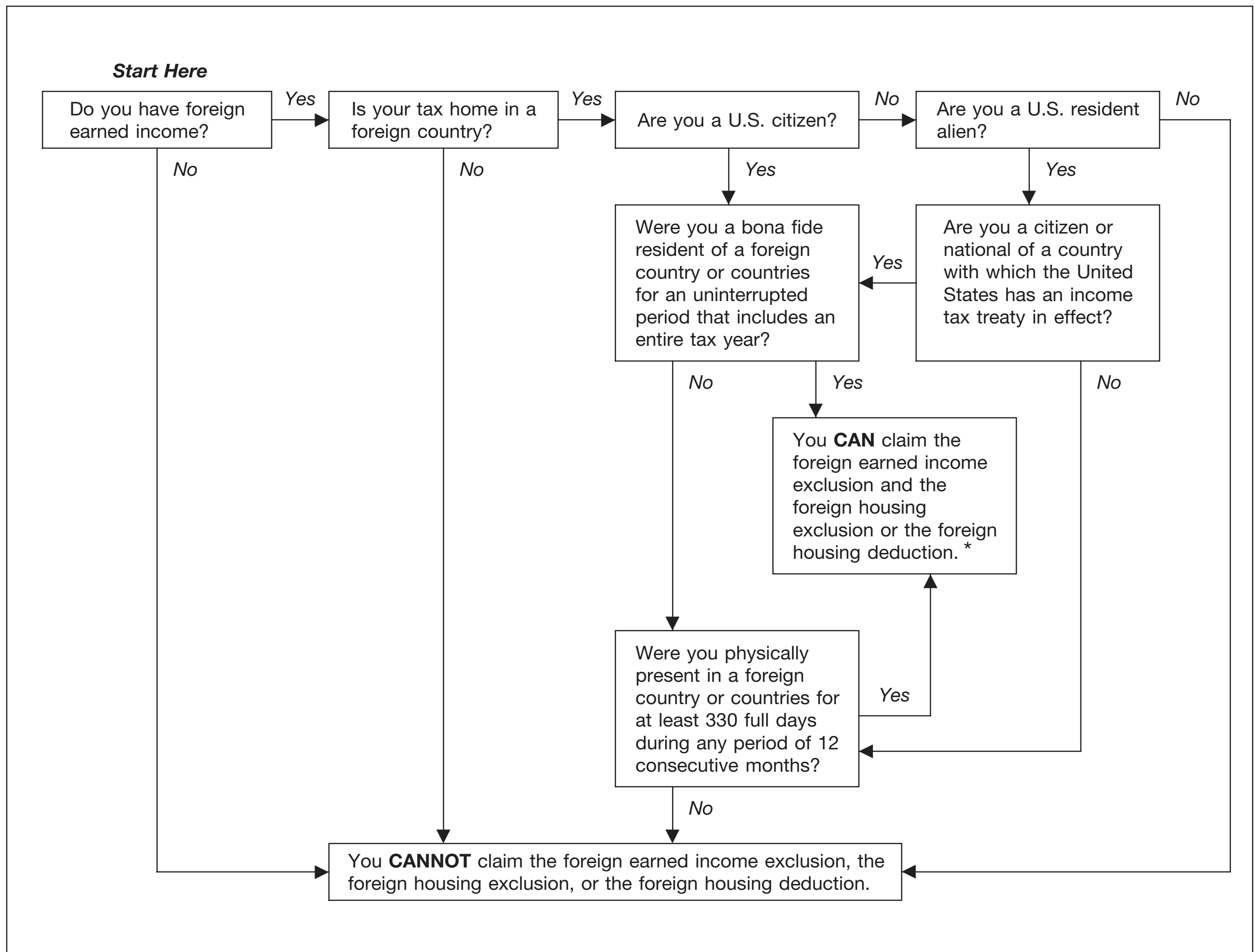
See chapter 7 for information about getting these publications and forms.

Who Qualifies for the Exclusions and the Deduction?

If you meet certain requirements, you may qualify for the foreign earned income and foreign housing exclusions and the foreign housing deduction.

If you are a U.S. citizen or a resident alien of the United States and you live abroad, you are taxed on your worldwide income. However, you may qualify to exclude from income up to $91,400 of your foreign earnings. In addition,

Figure 4–A. **Can I Claim Either Exclusion or the Deduction?**



* Foreign housing exclusion applies only to employees. Foreign housing deduction applies only to the self-employed.

you can exclude or deduct certain foreign housing amounts. See *Foreign Earned Income Exclusion* and *Foreign Housing Exclusion and Deduction,* later.

You may also be entitled to exclude from income the value of meals and lodging provided to you by your employer. See *Exclusion of Meals and Lodging,* later.

Requirements

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

1. Your tax home must be in a foreign country.
2. You must have foreign earned income.
3. You must be either:
   a. 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,
   b. A U.S. resident alien who is a citizen or national of a country with which the United States 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
   c. 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.

See Publication 519 to find out if you are a U.S. resident alien for tax purposes and whether you keep that alien status when you temporarily work abroad.

If you are a nonresident alien married to a U.S. citizen or resident alien, and both you and your spouse choose to treat you as a resident alien, you are a resident alien for tax purposes. For information on making the choice, see the discussion in chapter 1 under *Nonresident Alien Spouse Treated as a Resident.*

Waiver of minimum time requirements. The minimum time requirements for bona fide residence and physical presence can be waived if you must leave a foreign country because of war, civil unrest, or similar adverse conditions in that country. This is fully explained under *Waiver of Time Requirements,* later.

See Figure 4-A and information on the following pages to determine if you are eligible to claim either exclusion or the deduction.

Tax Home in Foreign Country

To qualify for the foreign earned income exclusion, the foreign housing exclusion, or the foreign housing deduction, your tax home must be in a foreign country throughout your period of bona fide residence or physical presence abroad. Bona fide residence and physical presence are explained later.

Tax Home

Your tax home is the general area of your main place of business, employment, or post of duty, regardless of where you maintain your family home. Your tax home is the place where you are permanently or indefinitely engaged to work as

an employee or self-employed individual. Having a "tax home" in a given location does not necessarily mean that the given location is your residence or domicile for tax purposes.

If you do not have a regular or main place of business because of the nature of your work, your tax home may be the place where you regularly live. If you have neither a regular or main place of business nor a place where you regularly live, you are considered an itinerant and your tax home is wherever you work.

You are not considered to have a tax home in a foreign country for any period in which your abode is in the United States. However, your abode is not necessarily in the United States while you are temporarily in the United States. Your abode is also not necessarily in the United States merely because you maintain a dwelling in the United States, whether or not your spouse or dependents use the dwelling.

"Abode" has been variously defined as one's home, habitation, residence, domicile, or place of dwelling. It does not mean your principal place of business. "Abode" has a domestic rather than a vocational meaning and does not mean the same as "tax home." The location of your abode often will depend on where you maintain your economic, family, and personal ties.

Example 1. You are employed on an offshore oil rig in the territorial waters of a foreign country and work a 28-day on/28-day off schedule. You return to your family residence in the United States during your off periods. You are considered to have an abode in the United States and do not satisfy the tax home test in the foreign country. You cannot claim either of the exclusions or the housing deduction.

Example 2. For several years, you were a marketing executive with a producer of machine tools in Toledo, Ohio. In November of last year, your employer transferred you to London, England, for a minimum of 18 months to set up a sales operation for Europe. Before you left, you distributed business cards showing your business and home addresses in London. You kept ownership of your home in Toledo but rented it to another family. You placed your car in storage. In November of last year, you moved your spouse, children, furniture, and family pets to a home your employer rented for you in London.

Shortly after moving, you leased a car and you and your spouse got British driving licenses. Your entire family got library cards for the local public library. You and your spouse opened bank accounts with a London bank and secured consumer credit. You joined a local business league and both you and your spouse became active in the neighborhood civic association and worked with a local charity. Your abode is in London for the time you live there. You satisfy the tax home test in the foreign country.

Temporary or Indefinite Assignment

The location of your tax home often depends on whether your assignment is temporary or indefinite. If you are temporarily absent from your tax home in the United States on business, you may be able to deduct your away-from-home expenses (for travel, meals, and lodging), but you would not qualify for the foreign earned income exclusion. If your new work assignment is for an indefinite period, your new place of employment becomes your tax home and you would not be able to deduct any of the related expenses that you have in the general area of this new work assignment. If your new tax home is in a foreign country and you meet the other requirements, your earnings may qualify for the foreign earned income exclusion.

If you expect your employment away from home in a single location to last, and it does last, for 1 year or less, it is temporary unless facts and circumstances indicate otherwise.

If you expect it to last for more than 1 year, it is indefinite.

If you expect it to last for 1 year or less, but at some later date you expect it to last longer than 1 year, it is temporary (in the absence of facts and circumstances indicating otherwise) until your expectation changes. Once your expectation changes, it is indefinite.

Foreign Country

To meet the bona fide residence test or the physical presence test, you must live in or be present in a foreign country. A foreign country includes any territory under the sovereignty of a government other than that of the United States.

The term "foreign country" includes the country's airspace and territorial waters, but not international waters and the airspace above them. It also includes the seabed and subsoil of those submarine areas adjacent to the country's territorial waters over which it has exclusive rights under international law to explore and exploit the natural resources.

The term "foreign country" does not include Antarctica or U.S. possessions such as Puerto Rico, Guam, the Commonwealth of the Northern Mariana Islands, the U.S. Virgin Islands, and Johnston Island. For purposes of the foreign earned income exclusion, the foreign housing exclusion, and the foreign housing deduction, the terms "foreign," "abroad," and "overseas" refer to areas outside the United States and those areas listed or described in the previous sentence.

American Samoa, Guam, and the Commonwealth of the Northern Mariana Islands

Residence or presence in a U.S. possession does not qualify you for the foreign earned income exclusion. You may, however, qualify for an exclusion of your possession income on your U.S. return.

American Samoa. There is a possession exclusion available to individuals who are bona fide residents of American Samoa for the entire tax year. Gross income from sources within American Samoa may be eligible for this exclusion. Income that is effectively connected with the conduct of a trade or business within American Samoa also may be eligible for this exclusion. Use Form 4563, Exclusion of Income for Bona Fide Residents of American Samoa, to figure the exclusion.

Guam and the Commonwealth of the Northern Mariana Islands. An exclusion will be available to residents of Guam and the Commonwealth of the Northern Mariana Islands if, and when, new implementation agreements take effect between the United States and those possessions.

For more information, see Publication 570.

Puerto Rico and U.S. Virgin Islands

Residents of Puerto Rico and the U.S. Virgin Islands cannot claim the foreign earned income exclusion or the foreign housing exclusion.

Puerto Rico. Generally, if you are a U.S. citizen who is a bona fide resident of Puerto Rico for the entire tax year, you are not subject to U.S. tax on income from Puerto Rican sources. This does not include amounts paid for services performed as an employee of the United States. However, you are subject to U.S. tax on your income from sources outside Puerto Rico. In figuring your U.S. tax, you cannot deduct expenses allocable to income not subject to tax.

Bona Fide Residence Test

You meet the bona fide residence test if you are a bona fide resident of a foreign country or countries for an uninterrupted period that includes an entire tax year. You can use the bona fide residence test to qualify for the exclusions and the deduction only if you are either:

- A U.S. citizen, or
- A U.S. resident alien who is a citizen or national of a country with which the United States has an income tax treaty in effect.

You do not automatically acquire bona fide resident status merely by living in a foreign country or countries for 1 year. If you go to a foreign country to work on a particular job for a specified period of time, you ordinarily will not be regarded as a bona fide resident of that country even though you work there for 1 tax year or longer. The length of your stay and the nature of your job are only two of the factors to be considered in determining whether you meet the bona fide residence test.

Bona fide residence. To meet the bona fide residence test, you must have established a bona fide residence in a foreign country.

Your bona fide residence is not necessarily the same as your domicile. Your domicile is your permanent home, the place to which you always return or intend to return.

Example. You could have your domicile in Cleveland, Ohio, and a bona fide residence in Edinburgh, Scotland, if you intend to return eventually to Cleveland.

The fact that you go to Scotland does not automatically make Scotland your bona fide residence. If you go there as a tourist, or on a short business trip, and return to the United States, you have not established bona fide residence in Scotland. But if you go to Scotland to work for an indefinite or extended period and you set up permanent quarters there for yourself and your family, you probably have established a bona fide residence in a foreign country, even though you intend to return eventually to the United States.

You are clearly not a resident of Scotland in the first instance. However, in the second, you are a resident because your stay in Scotland appears to be permanent. If your residency is not as clearly defined as either of these illustrations, it may be more difficult to decide whether you have established a bona fide residence.

Determination. Questions of bona fide residence are determined according to each individual case, taking into account factors such as your intention, the purpose of your trip, and the nature and length of your stay abroad.

To meet the bona fide residence test, you must show the Internal Revenue Service (IRS) that you have been a bona fide resident of a foreign country or countries for an uninterrupted period that includes an entire tax year. The IRS decides whether you are a bona fide resident of a foreign country largely on the basis of facts you report on Form 2555. IRS cannot make this determination until you file Form 2555.

Statement to foreign authorities. You are not considered a bona fide resident of a foreign country if you make a statement to the authorities of that country that you are not a resident of that country, and the authorities:

- Hold that you are not subject to their income tax laws as a resident, or
- Have not made a final decision on your status.

Special agreements and treaties. An income tax exemption provided in a treaty or other international agreement will not in itself prevent you from being a bona fide resident of a foreign country. Whether a treaty prevents you from becoming a bona fide resident of a foreign country is determined under all provisions of the treaty, including specific provisions relating to residence or privileges and immunities.

Example 1. You are a U.S. citizen employed in the United Kingdom by a U.S. employer under contract with the U.S. Armed Forces. You are not subject to the North Atlantic Treaty Status of Forces Agreement. You may be a bona fide resident of the United Kingdom.

Example 2. You are a U.S. citizen in the United Kingdom who qualifies as an "employee" of an armed service or as a member of a "civilian component" under the North Atlantic Treaty Status of Forces Agreement. You are not a bona fide resident of the United Kingdom.

Example 3. You are a U.S. citizen employed in Japan by a U.S. employer under contract with the U.S. Armed Forces. You are subject to the agreement of the Treaty of Mutual Cooperation and Security between the United States and Japan. Being subject to the agreement does not make you a bona fide resident of Japan.

Example 4. You are a U.S. citizen employed as an "official" by the United Nations in Switzerland. You are exempt from Swiss taxation on the salary or wages paid to you by the United Nations. This does not prevent you from being a bona fide resident of Switzerland.

Effect of voting by absentee ballot. If you are a U.S. citizen living abroad, you can vote by absentee ballot in any election held in the United States without risking your status as a bona fide resident of a foreign country.

However, if you give information to the local election officials about the nature and length of your stay abroad that does not match the information you give for the bona fide residence test, the information given in connection with absentee voting will be considered in determining your status, but will not necessarily be conclusive.

Uninterrupted period including entire tax year. To meet the bona fide residence test, you must reside in a foreign country or countries for an uninterrupted period that includes an entire tax year. An entire tax year is from January 1 through December 31 for taxpayers who file their income tax returns on a calendar year basis.

During the period of bona fide residence in a foreign country, you can leave the country for brief or temporary trips back to the United States or elsewhere for vacation or business. To keep your status as a bona fide resident of a foreign country, you must have a clear intention of returning from such trips, without unreasonable delay, to your foreign residence or to a new bona fide residence in another foreign country.

Example 1. You arrived with your family in Lisbon, Portugal, on November 1, 2007. Your assignment is indefinite, and you intend to live there with your family until your company sends you to a new post. You immediately established residence there. You spent April of 2008 at a business conference in the United States. Your family stayed in Lisbon. Immediately following the conference, you returned to Lisbon and continued living there. On January 1, 2009, you completed an uninterrupted period of residence for a full tax year (2008), and you meet the bona fide residence test.

Example 2. Assume the same facts as in *Example 1,* except that you transferred back to the United States on December 13, 2008. You would not meet the bona fide residence test because your bona fide residence in the foreign country, although it lasted more than a year, did not include a full tax year. You may, however, qualify for the foreign earned income exclusion or the housing exclusion or deduction under the physical presence test (discussed later).

Bona fide resident for part of a year. Once you have established bona fide residence in a foreign country for an uninterrupted period that includes an entire tax year, you are a bona fide resident of that country for the period starting with the date you actually began the residence and ending with the date you abandon the foreign residence. Your period of bona fide residence can include an entire tax year plus parts of 2 other tax years.

Example. You were a bona fide resident of Singapore from March 1, 2007, through September 14, 2009. On September 15, 2009, you returned to the United States. Since you were a bona fide resident of a foreign country for all of 2008, you were also a bona fide resident of a foreign country from March 1, 2007, through the end of 2007 and from January 1, 2009 through September 14, 2009.

Reassignment. If you are assigned from one foreign post to another, you may or may not have a break in foreign residence between your assignments, depending on the circumstances.

Example 1. You were a resident of Pakistan from October 1, 2008, through November 30, 2009. On December 1, 2009, you and your family returned to the United States to wait for an assignment to another foreign country. Your household goods also were returned to the United States.

Your foreign residence ended on November 30, 2009, and did not begin again until after you were assigned to another foreign country and physically entered that country. Since you were not a bona fide resident of a foreign country for the entire tax year of 2008 or 2009, you do not meet the bona fide residence test in either year. You may, however, qualify for the foreign earned income exclusion or the housing exclusion or deduction under the physical presence test, discussed later.

Example 2. Assume the same facts as in *Example 1,* except that upon completion of your assignment in Pakistan you were given a new assignment to Turkey. On December 1, 2009, you and your family returned to the United States for a month's vacation. On January 2, 2010, you arrived in Turkey for your new assignment. Because you did not interrupt your bona fide residence abroad, you meet the bona fide residence test.

Physical Presence Test

You meet the physical presence test if you are physically present in a foreign country or countries 330 full days during a period of 12 consecutive months. The 330 days do not have to be consecutive. Any U.S. citizen or resident alien can use the physical presence test to qualify for the exclusions and the deduction.

The physical presence test is based only on how long you stay in a foreign country or countries. This test does not depend on the kind of residence you establish, your intentions about returning, or the nature and purpose of your stay abroad.

330 full days. Generally, to meet the physical presence test, you must be physically present in a foreign country or countries for at least 330 full days during a 12-month period. You can count days you spent abroad for any reason. You do not have to be in a foreign country only for employment purposes. You can be on vacation.

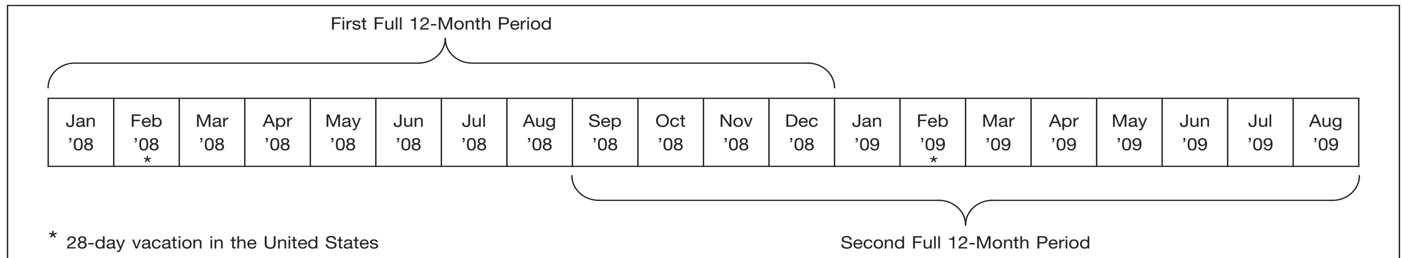
You do not meet the physical presence test if illness, family problems, a vacation, or your employer's orders cause you to be present for less than the required amount of time.

Exception. You can be physically present in a foreign country or countries for less than 330 full days and still meet the physical presence test if you are required to leave a country because of war or civil unrest. See *Waiver of Time Requirements,* later.

Full day. A full day is a period of 24 consecutive hours, beginning at midnight.

Travel. When you leave the United States to go directly to a foreign country or when you return directly to the United States from a foreign

Figure 4–B. **How To Figure Overlapping 12-Month Periods**
This figure illustrates Example 2 under *How to figure the 12-month period.*



country, the time you spend on or over international waters does not count toward the 330-day total.

Example. You leave the United States for France by air on June 10. You arrive in France at 9:00 a.m. on June 11. Your first full day of physical presence in France is June 12.

Passing over foreign country. If, in traveling from the United States to a foreign country, you pass over a foreign country before midnight of the day you leave, the first day you can count toward the 330-day total is the day following the day you leave the United States.

Example. You leave the United States by air at 9:30 a.m. on June 10 to travel to Kenya. You pass over western Africa at 11:00 p.m. on June 10 and arrive in Kenya at 12:30 a.m. on June 11. Your first full day in a foreign country is June 11.

Change of location. You can move about from one place to another in a foreign country or to another foreign country without losing full days. If any part of your travel is not within any foreign country and takes less than 24 hours, you are considered to be in a foreign country during that part of travel.

Example 1. You leave Ireland by air at 11:00 p.m. on July 6 and arrive in Sweden at 5:00 a.m. on July 7. Your trip takes less than 24 hours and you lose no full days.

Example 2. You leave Norway by ship at 10:00 p.m. on July 6 and arrive in Portugal at 6:00 a.m. on July 8. Since your travel is not within a foreign country or countries and the trip takes more than 24 hours, you lose as full days July 6, 7, and 8. If you remain in Portugal, your next full day in a foreign country is July 9.

In United States while in transit. If you are in transit between two points outside the United States and are physically present in the United States for less than 24 hours, you are not treated as present in the United States during the transit. You are treated as traveling over areas not within any foreign country.

How to figure the 12-month period. There are four rules you should know when figuring the 12-month period.

- Your 12-month period can begin with any day of the month. It ends the day before the same calendar day, 12 months later.
- Your 12-month period must be made up of consecutive months. Any 12-month period can be used if the 330 days in a foreign country fall within that period.
- You do not have to begin your 12-month period with your first full day in a foreign country or end it with the day you leave. You can choose the 12-month period that gives you the greatest exclusion.
- In determining whether the 12-month period falls within a longer stay in the foreign country, 12-month periods can overlap one another.

Example 1. You are a construction worker who works on and off in a foreign country over a 20-month period. You might pick up the 330 full days in a 12-month period only during the middle months of the time you work in the foreign country because the first few and last few months of the 20-month period are broken up by long visits to the United States.

Example 2. You work in New Zealand for a 20-month period from January 1, 2008, through August 31, 2009, except that you spend 28 days in February 2008 and 28 days in February 2009 on vacation in the United States. You are present in New Zealand 330 full days during each of the following two 12-month periods: January 1, 2008 – December 31, 2008 and September 1, 2008 – August 31, 2009. By overlapping the 12-month periods in this way, you meet the physical presence test for the whole 20-month period. See Figure 4-B above.

Waiver of Time Requirements

Both the bona fide residence test and the physical presence test contain minimum time requirements. The minimum time requirements can be waived, however, if you must leave a foreign country because of war, civil unrest, or similar adverse conditions in that country. You must be able to show that you reasonably could have expected to meet the minimum time requirements if not for the adverse conditions. To qualify for the waiver, you must actually have your tax home in the foreign country and be a bona fide resident of, or be physically present in, the foreign country on or before the beginning date of the waiver.

Early in 2010, the IRS will publish in the Internal Revenue Bulletin a list of the only countries that qualify for the waiver for 2009 and the effective dates. If you left one of the countries on or after the date listed for each country, you can meet the bona fide residence test or physical presence test for 2009 without meeting the minimum time requirement. However, in figuring your exclusion, the number of your qualifying days of bona fide residence or physical presence includes only days of actual residence or presence within the country.

You can read the Internal Revenue Bulletin on the Internet at www.irs.gov. Or, you can get a copy of the list of countries by writing to:

Internal Revenue Service
International Section
P.O. Box 920
Bensalem, PA 19020-8518

U.S. Travel Restrictions

If you are present in a foreign country in violation of U.S. law, you will not be treated as a bona fide resident of a foreign country or as physically present in a foreign country while you are in violation of the law. Income that you earn from sources within such a country for services performed during a period of violation does not qualify as foreign earned income. Your housing expenses within that country (or outside that country for housing your spouse or dependents) while you are in violation of the law cannot be included in figuring your foreign housing amount.

For 2009, the only country to which travel restrictions applied was Cuba. The restrictions applied for the entire year.

However, individuals working at the U.S. Naval Base at Guantanamo Bay in Cuba are not in violation of U.S. law. Personal service income earned by individuals at the base is eligible for the foreign earned income exclusion provided the other requirements are met.

Foreign Earned Income

To claim the foreign earned income exclusion, the foreign housing exclusion, or the foreign housing deduction, you must have foreign earned income.

Foreign earned income generally is income you receive for services you perform during a period in which you meet both of the following requirements.

- Your tax home is in a foreign country.
- You meet either the bona fide residence test or the physical presence test.

To determine whether your tax home is in a foreign country, see *Tax Home in Foreign Country,* earlier. To determine whether you meet either the bona fide residence test or the physical presence test, see *Bona Fide Residence Test* and *Physical Presence Test,* earlier.

Foreign earned income does not include the following amounts.

- The value of meals and lodging that you exclude from your income because it was furnished for the convenience of your employer.
- Pension or annuity payments you receive, including social security benefits (see *Pensions and annuities,* later).
- Pay you receive as an employee of the U.S. Government. (See *U.S. Government Employees,* later.)
- Amounts you include in your income because of your employer's contributions to a nonexempt employee trust or to a nonqualified annuity contract.
- Any unallowable moving expense deduction that you choose to recapture as explained under *Moving Expense Attributable to Foreign Earnings in 2 Years* in chapter 5.
- Payments you receive after the end of the tax year following the tax year in which you performed the services that earned the income.

Earned income. This is pay for personal services performed, such as wages, salaries, or professional fees. The list that follows classifies many types of income into three categories. The column headed *Variable Income* lists income that may fall into either the earned income category, the unearned income category, or partly into both. For more information on earned and unearned income, see *Earned and Unearned Income,* later.

Earned Income	Unearned Income	Variable Income
Salaries and wages	Dividends	Business profits
Commissions	Interest	Royalties
Bonuses	Capital gains	Rents
Professional fees	Gambling winnings	Scholarships and fellowships
Tips	Alimony	
	Social security benefits	
	Pensions	
	Annuities	

In addition to the types of earned income listed, certain noncash income and allowances or reimbursements are considered earned income.

Noncash income. The fair market value of property or facilities provided to you by your employer in the form of lodging, meals, or use of a car is earned income.

Allowances or reimbursements. Earned income includes allowances or reimbursements you receive, such as the following amounts.

- Cost of living allowances.
- Overseas differential.
- Family allowance.
- Reimbursement for education or education allowance.
- Home leave allowance.
- Quarters allowance.
- Reimbursement for moving or moving allowance (unless excluded from income as discussed later in *Reimbursement of employee expenses* under *Earned and Unearned Income*).

Source of Earned Income

The source of your earned income is the place where you perform the services for which you received the income. Foreign earned income is income you receive for working in a foreign country. Where or how you are paid has no effect on the source of the income. For example, income you receive for work done in Austria is income from a foreign source even if the income is paid directly to your bank account in the United States and your employer is located in New York City.

Example. You are a U.S. citizen, a bona fide resident of Canada, and working as a mining engineer. Your salary is $76,800 per year. You also receive a $6,000 cost of living allowance, and a $6,000 education allowance. Your employment contract did not indicate that you were entitled to these allowances only while outside the United States. Your total income is $88,800. You work a 5-day week, Monday through Friday. After subtracting your vacation, you have a total of 240 workdays in the year. You worked in the United States during the year for 6 weeks (30 workdays). The following shows how to figure the part of your income that is for work done in Canada during the year.

$$\frac{\text{Number of days worked in Canada during the year (210)}}{\text{Number of days of work during the year for which payment was made (240)}} \times \text{Total income (\$88,800)} = \$77,700$$

Your foreign source earned income is $77,700.

Earned and Unearned Income

Earned income was defined earlier as pay for personal services performed. Some types of income are not easily identified as earned or unearned income. Some of these types of income are further explained here.

Income from a sole proprietorship or partnership. Income from a business in which capital investment is an important part of producing the income may be unearned income. If you are a sole proprietor or partner and your personal services are also an important part of producing the income, the part of the income that represents the value of your personal services will be treated as earned income.

Capital a factor. If capital investment is an important part of producing income, no more than 30% of your share of the net profits of the business is earned income.

If you have no net profits, the part of your gross profit that represents a reasonable allowance for personal services actually performed is considered earned income. Because you do not have a net profit, the 30% limit does not apply.

Example 1. You are a U.S. citizen and meet the bona fide residence test. You invest in a partnership based in Cameroon that is engaged solely in selling merchandise outside the United States. You perform no services for the partnership. At the end of the tax year, your share of the net profits is $80,000. The entire $80,000 is unearned income.

Example 2. Assume that in *Example 1* you spend time operating the business. Your share of the net profits is $80,000, 30% of your share of the profits is $24,000. If the value of your services for the year is $15,000, your earned income is limited to the value of your services, $15,000.

Capital not a factor. If capital is not an income-producing factor and personal services produce the business income, the 30% rule does not apply. The entire amount of business income is earned income.

Example. You and Lou Green are management consultants and operate as equal partners in performing services outside the United States. Because capital is not an income-producing factor, all the income from the partnership is considered earned income.

Income from a corporation. The salary you receive from a corporation is earned income only if it represents a reasonable allowance as compensation for work you do for the corporation. Any amount over what is considered a reasonable salary is unearned income.

Example 1. You are a U.S. citizen and an officer and stockholder of a corporation in Honduras. You perform no work or service of any kind for the corporation. During the tax year you receive a $10,000 "salary" from the corporation. The $10,000 clearly is not for personal services and is unearned income.

Example 2. You are a U.S. citizen and work full time as secretary-treasurer of your corporation. During the tax year you receive $100,000 as salary from the corporation. If $80,000 is a reasonable allowance as pay for the work you did, then $80,000 is earned income.

Stock options. You may have earned income if you disposed of stock that you got by exercising a stock option granted to you under an employee stock purchase plan.

If your gain on the disposition of stock you got by exercising an option is treated as capital gain, your gain is unearned income.

However, if you disposed of the stock less than 2 years after you were granted the option or less than 1 year after you got the stock, part of the gain on the disposition may be earned income. It is considered received in the year you disposed of the stock and earned in the year you performed the services for which you were

granted the option. Any part of the earned income that is due to work you did outside the United States is foreign earned income.

See Publication 525, Taxable and Nontaxable Income, for a discussion of the treatment of stock options.

Pensions and annuities. For purposes of the foreign earned income exclusion, the foreign housing exclusion, and the foreign housing deduction, amounts received as pensions or annuities are unearned income.

Royalties. Royalties from the leasing of oil and mineral lands and patents generally are a form of rent or dividends and are unearned income.

Royalties received by a writer are earned income if they are received:

- For the transfer of property rights of the writer in the writer's product, or
- Under a contract to write a book or series of articles.

Rental income. Generally, rental income is unearned income. If you perform personal services in connection with the production of rent, up to 30% of your net rental income can be considered earned income.

Example. Larry Smith, a U.S. citizen living in Australia, owns and operates a rooming house in Sydney. If he is operating the rooming house as a business that requires capital and personal services, he can consider up to 30% of net rental income as earned income. On the other hand, if he just owns the rooming house and performs no personal services connected with its operation, except perhaps making minor repairs and collecting rents, none of his net income from the house is considered earned income. It is all unearned income.

Professional fees. If you are engaged in a professional occupation (such as a doctor or lawyer), all fees received in the performance of these services are earned income.

Income of an artist. Income you receive from the sale of paintings you created is earned income.

Scholarships and fellowships. Any portion of a scholarship or fellowship grant that is paid to you for teaching, research or other services is considered earned income if you must include it in your gross income. If the payer of the grant is required to provide you with a Form W-2, Wage and Tax Statement, these amounts will be listed as wages.

Certain scholarship and fellowship income may be exempt under other provisions. See Publication 970, Tax Benefits for Education, chapter 1.

Use of employer's property or facilities. If you receive fringe benefits in the form of the right to use your employer's property or facilities, the fair market value of that right is earned income. Fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being required to buy or sell, and both having reasonable knowledge of all the necessary facts.

Example. You are privately employed and live in Japan all year. You are paid a salary of $6,000 a month. You live rent-free in a house provided by your employer that has a fair rental value of $3,000 a month. The house is not provided for your employer's convenience. You report on the calendar-year, cash basis. You received $72,000 salary from foreign sources plus $36,000 fair rental value of the house, or a total of $108,000 of earned income.

Reimbursement of employee expenses. If you are reimbursed under an accountable plan (defined below) for expenses you incur on your employer's behalf and you have adequately accounted to your employer for the expenses, do not include the reimbursement for those expenses in your earned income.

The expenses for which you are reimbursed are not considered allocable (related) to your earned income. If expenses and reimbursement are equal, there is nothing to allocate to excluded income. If expenses are more than the reimbursement, the unreimbursed expenses are considered to have been incurred in producing earned income and must be divided between your excluded and included income in determining the amount of unreimbursed expenses you can deduct. (See chapter 5.) If the reimbursement is more than the expenses, no expenses remain to be divided between excluded and included income and the excess reimbursement must be included in earned income.

These rules do not apply to the following individuals.

- Straight-commission salespersons.
- Employees who have arrangements with their employers under which taxes are not withheld on a percentage of the commissions because the employers consider that percentage to be attributable to the employees' expenses.

Accountable plan. An accountable plan is a reimbursement or allowance arrangement that includes all three of the following rules.

- The expenses covered under the plan must have a business connection.
- The employee must adequately account to the employer for these expenses within a reasonable period of time.
- The employee must return any excess reimbursement or allowance within a reasonable period of time.

Reimbursement of moving expenses. Reimbursement of moving expenses may be earned income. You must include as earned income:

- Any reimbursements of, or payments for, nondeductible moving expenses,
- Reimbursements that are more than your deductible expenses and that you do not return to your employer,
- Any reimbursements made (or treated as made) under a nonaccountable plan (any plan that does not meet the rules listed above for an accountable plan), even if they are for deductible expenses, and
- Any reimbursement of moving expenses you deducted in an earlier year.

This section discusses reimbursements that must be included in earned income. Publication 521, Moving Expenses, discusses additional rules that apply to moving expense deductions and reimbursements.

The rules for determining when the reimbursement is considered earned or where the reimbursement is considered earned may differ somewhat from the general rules previously discussed.

Although you receive the reimbursement in one tax year, it may be considered earned for services performed, or to be performed, in another tax year. You must report the reimbursement as income on your return in the year you receive it, even if it is considered earned during a different year.

Move from U.S. to foreign country. If you move from the United States to a foreign country, your moving expense reimbursement is generally considered pay for future services to be performed at the new location. The reimbursement is considered earned solely in the year of the move if you qualify for the exclusion for a period that includes at least 120 days during that tax year.

If you are neither a bona fide resident of nor physically present in a foreign country or countries for a period that includes 120 days during the year of the move, a portion of the reimbursement is considered earned in the year of the move and a portion is considered earned in the year following the year of the move. To figure the amount earned in the year of the move, multiply the reimbursement by a fraction. The numerator (top number) is the number of days in your qualifying period that fall within the year of the move, and the denominator (bottom number) is the total number of days in the year of the move.

The difference between the total reimbursement and the amount considered earned in the year of the move is the amount considered earned in the year following the year of the move. The part earned in each year is figured as shown in the following example.

Example. You are a U.S. citizen working in the United States. You were told in October 2008 that you were being transferred to a foreign country. You arrived in the foreign country on December 15, 2008, and you are a bona fide resident for the remainder of 2008 and all of 2009. Your employer reimbursed you $2,000 in January 2009 for the part of the moving expense that you were not allowed to deduct. Because you did not qualify for the exclusion under the bona fide residence test for at least 120 days in 2008 (the year of the move), the reimbursement is considered pay for services performed in the foreign country for both 2008 and 2009.

You figure the part of the reimbursement for services performed in the foreign country in 2008 by multiplying the total reimbursement by a fraction. The fraction is the number of days during which you were a bona fide resident during the year of the move divided by 366. The remaining part of the reimbursement is for services performed in the foreign country in 2009.

This computation is used only to determine when the reimbursement is considered earned.

You would include the amount of the reimbursement in income in 2009, the year you received it.

Move between foreign countries. If you move between foreign countries, any moving expense reimbursement that you must include in income will be considered earned in the year of the move if you qualify for the foreign earned income exclusion for a period that includes at least 120 days in the year of the move.

Move to U.S. If you move to the United States, the moving expense reimbursement that you must include in income is generally considered to be U.S. source income.

However, if under either an agreement between you and your employer or a statement of company policy that is reduced to writing before your move to the foreign country, your employer will reimburse you for your move back to the United States regardless of whether you continue to work for the employer, the includible reimbursement is considered compensation for past services performed in the foreign country. The includible reimbursement is considered earned in the year of the move if you qualify for the foreign earned income exclusion for a period that includes at least 120 days during that year. Otherwise, you treat the includible reimbursement as received for services performed in the foreign country in the year of the move and the year immediately before the year of the move.

See the discussion under *Move from U.S. to foreign country* (earlier) to figure the amount of the includible reimbursement considered earned in the year of the move. The amount earned in the year before the year of the move is the difference between the total includible reimbursement and the amount earned in the year of the move.

Example. You are a U.S. citizen employed in a foreign country. You retired from employment with your employer on March 31, 2009, and returned to the United States after having been a bona fide resident of the foreign country for several years. A written agreement with your employer entered into before you went abroad provided that you would be reimbursed for your move back to the United States.

In April 2009, your former employer reimbursed you $4,000 for the part of the cost of your move back to the United States that you were not allowed to deduct. Because you were not a bona fide resident of a foreign country or countries for a period that included at least 120 days in 2009 (the year of the move), the includible reimbursement is considered pay for services performed in the foreign country for both 2009 and 2008.

You figure the part of the moving expense reimbursement for services performed in the foreign country for 2009 by multiplying the total includible reimbursement by a fraction. The fraction is the number of days of foreign residence during the year (90) divided by the number of days in the year (365). The remaining part of the includible reimbursement is for services performed in the foreign country in 2008. You report the amount of the includible reimbursement in 2009, the year you received it.

In this example, if you met the physical presence test for a period that included at least 120 days in 2009, the moving expense reimbursement would be considered earned entirely in the year of the move.

Storage expense reimbursements. If you are reimbursed for storage expenses, the reimbursement is for services you perform during the period of time for which the storage expenses are incurred.

U.S. Government Employees

For purposes of the foreign earned income exclusion, the foreign housing exclusion, and the foreign housing deduction, foreign earned income does not include any amounts paid by the United States or any of its agencies to its employees. This includes amounts paid from both appropriated and nonappropriated funds.

The following organizations (and other organizations similarly organized and operated under United States Army, Navy, or Air Force regulations) are integral parts of the Armed Forces, agencies, or instrumentalities of the United States.

- United States Armed Forces exchanges.
- Commissioned and noncommissioned officers' messes.
- Armed Forces motion picture services.
- Kindergartens on foreign Armed Forces installations.

Amounts paid by the United States or its agencies to persons who are not their employees may qualify for exclusion or deduction.

If you are a U.S. Government employee paid by a U.S. agency that assigned you to a foreign government to perform specific services for which the agency is reimbursed by the foreign government, your pay is from the U.S. Government and does not qualify for exclusion or deduction.

If you have questions about whether you are an employee or an independent contractor, get Publication 15-A, Employer's Supplemental Tax Guide.

American Institute in Taiwan. Amounts paid by the American Institute in Taiwan are not foreign earned income for purposes of the foreign earned income exclusion, the foreign housing exclusion, or the foreign housing deduction. If you are an employee of the American Institute in Taiwan, allowances you receive are exempt from U.S. tax up to the amount that equals tax-exempt allowances received by civilian employees of the U.S. Government.

Allowances. Cost-of-living and foreign-area allowances paid under certain acts of Congress to U.S. civilian officers and employees stationed in Alaska and Hawaii or elsewhere outside the 48 contiguous states and the District of Columbia can be excluded from gross income. Post differentials are wages that must be included in gross income, regardless of the act of Congress under which they are paid.

More information. Publication 516, U.S. Government Civilian Employees Stationed Abroad, has more information for U.S. Government employees abroad.

Exclusion of Meals and Lodging

You do not include in your income the value of meals and lodging provided to you and your family by your employer at no charge if the following conditions are met.

1. The meals are furnished:
   a. On the business premises of your employer, and
   b. For the convenience of your employer.
2. The lodging is furnished:
   a. On the business premises of your employer,
   b. For the convenience of your employer, and
   c. As a condition of your employment.

If these conditions are met, do not include the value of the meals or lodging in your income, even if a law or your employment contract says that they are provided as compensation.

Amounts you do not include in income because of these rules are not foreign earned income.

If you receive a Form W-2, excludable amounts should not be included in the total reported in box 1 as wages.

Family. Your family, for this purpose, includes only your spouse and your dependents.

Lodging. The value of lodging includes the cost of heat, electricity, gas, water, sewer service, and similar items needed to make the lodging fit to live in.

Business premises of employer. Generally, the business premises of your employer is wherever you work. For example, if you work as a housekeeper, meals and lodging provided in your employer's home are provided on the business premises of your employer. Similarly, meals provided to cowhands while herding cattle on land leased or owned by their employer are considered provided on the premises of their employer.

Convenience of employer. Whether meals or lodging are provided for your employer's convenience must be determined from all the facts and circumstances. Meals furnished at no charge are considered provided for your employer's convenience if there is a good business reason for providing them, other than to give you more pay.

On the other hand, if your employer provides meals to you or your family as a means of giving you more pay, and there is no other business reason for providing them, their value is extra income to you because they are not furnished for the convenience of your employer.

Condition of employment. Lodging is provided as a condition of employment if you must accept the lodging to properly carry out the duties of your job. You must accept lodging to properly carry out your duties if, for example, you must be available for duty at all times or you

could not perform your duties if the lodging was not furnished.

Foreign camps. If the lodging is in a camp located in a foreign country, the camp is considered part of your employer's business premises. The camp must be:

- Provided for your employer's convenience because the place where you work is in a remote area where satisfactory housing is not available to you on the open market within a reasonable commuting distance,
- Located as close as reasonably possible in the area where you work, and
- Provided in a common area or enclave that is not available to the general public for lodging or accommodations and that normally houses at least ten employees.

Foreign Earned Income Exclusion

If your tax home is in a foreign country and you meet the bona fide residence test or the physical presence test, you can choose to exclude from your income a limited amount of your foreign earned income. Foreign earned income was defined earlier in this chapter.

You can also choose to exclude from your income a foreign housing amount. This is explained later under *Foreign Housing Exclusion.* If you choose to exclude a foreign housing amount, you must figure the foreign housing exclusion before you figure the foreign earned income exclusion. Your foreign earned income exclusion is limited to your foreign earned income minus your foreign housing exclusion.

If you choose to exclude foreign earned income, you cannot deduct, exclude, or claim a credit for any item that can be allocated to or charged against the excluded amounts. This includes any expenses, losses, and other normally deductible items allocable to the excluded income. For more information about deductions and credits, see chapter 5.

Limit on Excludable Amount

You may be able to exclude up to $91,400 of your foreign earned income in 2009.

You cannot exclude more than the smaller of:

- $91,400, or
- Your foreign earned income (discussed earlier) for the tax year minus your foreign housing exclusion (discussed later).

If both you and your spouse work abroad and each of you meets either the bona fide residence test or the physical presence test, you can each choose the foreign earned income exclusion. You do not both need to meet the same test. Together, you and your spouse can exclude as much as $182,800.

Paid in year following work. Generally, you are considered to have earned income in the year in which you do the work for which you receive the income, even if you work in one year but are not paid until the following year. If you report your income on a cash basis, you report the income on your return for the year you receive it. If you work one year, but are not paid for that work until the next year, the amount you can exclude in the year you are paid is the amount you could have excluded in the year you did the work if you had been paid in that year. For an exception to this general rule, see *Year-end payroll period,* later.

Example. You were a bona fide resident of Brazil for all of 2008 and 2009. You report your income on the cash basis. In 2008, you were paid $76,000 for work you did in Brazil during that year. You excluded all of the $76,000 from your income in 2008.

In 2009, you were paid $107,400 for your work in Brazil. $15,000 was for work you did in 2008 and $92,400 was for work you did in 2009. You can exclude $11,600 of the $15,000 from your income in 2009. This is the $87,600 maximum exclusion in 2008 minus the $76,000 actually excluded that year. You must include the remaining $3,400 in income in 2009 because you could not have excluded that income in 2008 if you had received it that year. You can exclude $91,400 of the $92,400 you were paid for work you did in 2009 from your 2009 income.

Your total foreign earned income exclusion for 2009 is $103,000 ($11,600 for work you did in 2008 and $91,400 for work you did in 2009). You would include in your 2009 income $4,400 ($3,400 for the work you did in 2008 and $1,000 for the work you did in 2009).

Year-end payroll period. There is an exception to the general rule that income is considered earned in the year you do the work for which you receive the income. If you are a cash-basis taxpayer, any salary or wage payment you receive after the end of the year in which you do the work for which you receive the pay is considered earned entirely in the year you receive it if all four of the following apply.

- The period for which the payment is made is a normal payroll period of your employer that regularly applies to you.
- The payroll period includes the last day of your tax year (December 31 if you figure your taxes on a calendar-year basis).
- The payroll period is not longer than 16 days.
- The payday comes at the same time in relation to the payroll period that it would normally come and it comes before the end of the next payroll period.

Example. You are paid twice a month. For the normal payroll period which begins on the first of the month and ends on the fifteenth of the month, you are paid on the sixteenth day of the month. For the normal payroll period that begins on the sixteenth of the month and ends on the last day of the month, you are paid on the first day of the following month. Because all of the above conditions are met, the pay you received on January 1, 2009, is considered earned in 2009.

Income earned over more than 1 year. Regardless of when you actually receive income, you must apply it to the year in which you earned it in figuring your excludable amount for that year. For example, a bonus may be based on work you did over several years. You determine the amount of the bonus that is considered earned in a particular year in two steps.

1. Divide the bonus by the number of calendar months in the period when you did the work that resulted in the bonus.
2. Multiply the result of (1) by the number of months you did the work during the year. This is the amount that is subject to the exclusion limit for that tax year.

Income received more than 1 year after it was earned. You cannot exclude income you receive after the end of the year following the year you do the work to earn it.

Example. You were a bona fide resident of Sweden for 2007, 2008, and 2009. You report your income on the cash basis. In 2007, you were paid $69,000 for work you did in Sweden that year and in 2008 you were paid $74,000 for that year's work in Sweden. You excluded all the income on your 2007 and 2008 returns.

In 2009, you were paid $92,000; $82,000 for your work in Sweden during 2009, and $10,000 for work you did in Sweden in 2007. You cannot exclude any of the $10,000 for work done in 2007 because you received it after the end of the year following the year in which you earned it. You must include the $10,000 in income. You can exclude all of the $82,000 received for work you did in 2009.

Community income. The maximum exclusion applies separately to the earnings of a husband and wife. Ignore any community property laws when you figure your limit on the foreign earned income exclusion.

Part-year exclusion. If the period for which you qualify for the foreign earned income exclusion includes only part of the year, you must adjust the maximum limit based on the number of qualifying days in the year. The number of qualifying days is the number of days in the year within the period on which you both:

- Have your tax home in a foreign country, and
- Meet either the bona fide residence test or the physical presence test.

For this purpose, you can count as qualifying days all days within a period of 12 consecutive months once you are physically present and have your tax home in a foreign country for 330 full days. To figure your maximum exclusion, multiply the maximum excludable amount for the year by the number of your qualifying days in the year, and then divide the result by the number of days in the year.

Example. You report your income on the calendar-year basis and you qualified for the foreign earned income exclusion under the bona fide residence test for 75 days in 2009. You can exclude a maximum of 75/365 of $91,400, or $18,781, of your foreign earned income for 2009. If you qualify under the bona fide residence test for all of 2010, you can exclude your foreign earned income up to the 2010 limit.

Physical presence test. Under the physical presence test, a 12-month period can be any period of 12 consecutive months that includes

330 full days. If you qualify for the foreign earned income exclusion under the physical presence test for part of a year, it is important to carefully choose the 12-month period that will allow the maximum exclusion for that year.

Example. You are physically present and have your tax home in a foreign country for a 16-month period from June 1, 2008, through September 30, 2009, except for 16 days in December 2008 when you were on vacation in the United States. You figure the maximum exclusion for 2008 as follows.

1. Beginning with June 1, 2008, count forward 330 full days. Do not count the 16 days you spent in the United States. The 330th day, May 12, 2009, is the last day of a 12-month period.
2. Count backward 12 months from May 11, 2009, to find the first day of this 12-month period, May 12, 2008. This 12-month period runs from May 12, 2008, through May 11, 2009.
3. Count the total days during 2008 that fall within this 12-month period. This is 234 days (May 12, 2008 – December 31, 2008).
4. Multiply $87,600 (the maximum exclusion for 2008) by the fraction 234/366 to find your maximum exclusion for 2008 ($56,007).

You figure the maximum exclusion for 2009 in the opposite manner.

1. Beginning with your last full day, September 30, 2009, count backward 330 full days. Do not count the 16 days you spent in the United States. That day, October 19, 2008, is the first day of a 12-month period.
2. Count forward 12 months from October 19, 2008, to find the last day of this 12-month period, October 18, 2009. This 12-month period runs from October 19, 2008, through October 18, 2009.
3. Count the total days during 2009 that fall within this 12-month period. This is 291 days (January 1, 2009 – October 18, 2009).
4. Multiply $91,400, the maximum limit, by the fraction 291/365 to find your maximum exclusion for 2009 ($72,870).

Choosing the Exclusion

The foreign earned income exclusion is voluntary. You can choose the exclusion by completing the appropriate parts of Form 2555.

When You Can Choose the Exclusion

Your initial choice of the exclusion on Form 2555 or Form 2555-EZ generally must be made with one of the following returns.

- A return filed by the due date (including any extensions).
- A return amending a timely-filed return. Amended returns generally must be filed by the later of 3 years after the filing date of the original return or 2 years after the tax is paid.
- A return filed within 1 year from the original due date of the return (determined without regard to any extensions).

You can choose the exclusion on a return filed after the periods described above if you owe no federal income tax after taking into account the exclusion.

If you owe federal income tax after taking into account the exclusion, you can choose the exclusion on a return filed after the periods described above if you file before IRS discovers that you failed to choose the exclusion. You must type or legibly print at the top of the first page of the Form 1040 "Filed pursuant to section 1.911-7(a)(2)(i)(D)."

If you owe federal income tax after taking into account the foreign earned income exclusion and the IRS discovered that you failed to choose the exclusion, you may still be able to choose the exclusion. You must request a private letter ruling under Income Tax Regulation 301.9100-3 and Revenue Procedure 2009-1.

Revenue procedures are published in the Internal Revenue Bulletin (I.R.B.) and in the Cumulative Bulletin (C.B.), which are volumes containing official matters of the Internal Revenue Service. The I.R.B. is available on the Internet at *www.irs.gov*. To access Revenue Procedure 2009-1, enter Rev. Proc. 2009-1 in the search box.

Effect of Choosing the Exclusion

Once you choose to exclude your foreign earned income, that choice remains in effect for that year and all later years unless you revoke it.

Foreign tax credit or deduction. Once you choose to exclude foreign earned income, you cannot take a foreign tax credit or deduction for taxes on income you can exclude. If you do take a credit or deduction for any of those taxes, your choice to exclude foreign earned income may be considered revoked. See Publication 514, Foreign Tax Credit for Individuals, for more information.

Earned income credit. If you claim the foreign earned income exclusion, you will not qualify for the earned income credit for the year. For more information on this credit, see Publication 596.

Figuring tax on income not excluded. If you claim the foreign earned income exclusion, the housing exclusion (discussed later), or both, you must figure the tax on your nonexcluded income using the tax rates that would have applied had you not claimed the exclusions. See the instructions for Form 1040 and complete the *Foreign Earned Income Tax Worksheet* to figure the amount of tax to enter on Form 1040, line 44. If you must attach Form 6251, Alternative Minimum Tax — Individuals, to your return, use the *Foreign Earned Income Tax Worksheet* provided in the instructions for Form 6251.

Revoking the Exclusion

You can revoke your choice for any year. You do this by attaching a statement that you are revoking one or more previously made choices to the return or amended return for the first year that you do not wish to claim the exclusion(s). You must specify which choice(s) you are revoking. You must revoke separately a choice to exclude foreign earned income and a choice to exclude foreign housing amounts.

If you revoked a choice and within 5 years again wish to choose the same exclusion, you must apply for IRS approval. You do this by requesting a ruling from the IRS.

Mail your request for a ruling, in duplicate, to:

Associate Chief Counsel (International)
Internal Revenue Service
Attn: CC:PA:LPD:DRU
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Because requesting a ruling can be complex, you may need professional help. Also, the IRS charges a fee for issuing these rulings. For more information, see Revenue Procedure 2009-1, which is published in Internal Revenue Bulletin No. 2009-1.

In deciding whether to give approval, the IRS will consider any facts and circumstances that may be relevant. These may include a period of residence in the United States, a move from one foreign country to another foreign country with different tax rates, a substantial change in the tax laws of the foreign country of residence or physical presence, and a change of employer.

Foreign Housing Exclusion and Deduction

In addition to the foreign earned income exclusion, you can also claim an exclusion or a deduction from gross income for your housing amount if your tax home is in a foreign country and you qualify for the exclusions and deduction under either the bona fide residence test or the physical presence test.

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.

If you are married and you and your spouse each qualifies under one of the tests, see *Married Couples,* later.

Housing Amount

Your housing amount is the total of your housing expenses for the year minus the base housing amount.

Base housing amount. The computation of the base housing amount (line 32 of Form 2555) is tied to the maximum foreign earned income exclusion. The amount is 16% of the exclusion amount (computed on a daily basis), multiplied