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The Foreign Earned Income Exclusion – A Coat Of Many Colors: Part I

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Part I – Introduction To The Foreign Earned Income Exclusion And Its Interpretive Challenges

For US persons living abroad, the Foreign Earned Income Exclusion ("FEIE") under Section 911(a)(1) of the Internal Revenue Code provides a significant measure of tax relief against the US government's unique system of citizenship-based taxation. However, despite its practical influence and prevalence, the provisions of Section 911 leave much to interpretation. In this regard, the Ninth Circuit Court of Appeals, in a moment of Biblical reflection, described its construal as having an "evasive way about it, with as many colors as Joseph's coat." [1]

At the conceptual level, the exclusion can be described in simple terms: A US person living outside the United States can exclude a certain portion of his or her compensation each year for personal services performed outside the United States. The exclusion amount is adjusted annually for inflation.[2] For tax year 2016, the amount is USD101,300 per qualifying person, which can double if the filing individuals are married earners qualifying for the exclusion.[3]

As with many US federal income tax concepts however, the exclusion presents a number of interpretive challenges, due to the loosely defined qualification requirements set out in Section 911 and the regulations thereunder.

While there are several features of the exclusion worthy of focused analysis, two aspects have garnered particular attention by the Tax Court and other federal courts, due largely to their inexact

nature. These are the qualification requirements that the individual's "tax home" be in a foreign country and the individual's "abode" not be within the United States.

In this series, we examine the "tax home" and "abode" requirements of the FEIE within the context of the modern workplace. In Part I of this three-part series, we set out the interpretive challenges presented by the "tax home" and "abode" requirements. In Part II, we will review some of the recent case law analyzing the requirements under particular circumstances, and in Part III, we will consider the "digital nomad," a modern case study highlighting the FEIE's many colors of interpretation.

The FEIE Qualification Requirements

Section 911(a)(1) of the Code allows a "qualified individual" to utilize the FEIE to exclude his or her earned income up to the exclusion amount. Under Section 911(d)(1), a "qualified individual" means an individual whose "tax home" is in a foreign country and who is:

> (A) A citizen of the United States and establishes to the satisfaction of the Secretary that he has been a *bona fide* resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year (the "*bona fide* residence test");[4] or
>
> (B) A citizen or resident of the United States and who, during any period of 12 consecutive months, is present in a foreign country or countries during at least 330 full days in such period (the "330-day physical presence test").

Under Section 911(d)(2), the term "earned income" generally means wages, salaries or professional fees, and other amounts received as compensation for personal services actually rendered by the taxpayer.

The "Tax Home" Requirement

As described above, in order for an individual to qualify for the FEIE, his or her "tax home" must be in a foreign country. The Code and regulations offer limited guidance in defining this key term. Under Section 911(d)(3), the term "tax home" is defined generally to mean an individual's home for purposes of Section 162(a)(2), relating to deducting travel expenses while away from home.

Treas. Reg. §1.911-2(b), borrowing conceptually from Section 162(a)(2), states that an individual's tax home is considered to be located at his "regular or principal (if more than one regular) place of business" or, if the individual has no regular or principal place of business because

of the nature of the business, then at his "regular place of abode in a real and substantial sense." The regulation caveats that the "maintenance of a dwelling in the United States, whether or not that dwelling is used by the individual's spouse and dependents, does not necessarily mean that the individual's abode is in the United States." Courts have further held that a taxpayer who has neither a principal place of employment nor a permanent place of abode is considered to be an "itinerant" worker whose tax home moves with him from place to place.[5]

The IRS has also used Section 162(a)(2) concepts to apply the tax home rule to temporary and indefinite assignments.[6] IRS Publication 54 states that in the case of a work assignment abroad, the location of your tax home "often depends on the whether your assignment is temporary or indefinite." If you expect your employment away from home in a single location to last, and it does last, for one year or less, it is "temporary" unless facts and circumstances indicate otherwise. If you expect it to last for more than one year, it is indefinite.

With these timing rules in place, Publication 54 continues by seemingly making qualifying for the FEIE and qualifying for travel expense deductions while abroad mutually exclusive. It states that if you are "temporarily absent from your tax home in the United States on business," then your away-from-home expenses may be deductible, but you do not qualify for the FEIE. In contrast, if you are on assignment for an indefinite period, you will not be able to deduct any of the related travel expenses that you have in the general area of your new tax home, but you potentially qualify for the FEIE.

The "Abode" Requirement

Under Section 911(d)(3) of the Code, the "tax home" rule is subject to an important overriding exception – an individual is not considered to have a tax home in a foreign country for any period during which the individual's "abode" is in the United States.

Thus, a taxpayer's abode plays two roles in the tax home definitional labyrinth. First, if there is no regular or principal place of business, then the location of the taxpayer's abode is the deciding factor. Second, even if a taxpayer has a regular or principal place of business in a foreign country, the tax home requirement is not satisfied if the taxpayer has an abode within the United States.

The Code and regulations do not offer an objective meaning of the term "abode." As the Tax Court has also admitted, "… an exact definition of 'abode' depends upon the context in which the word is used." [7] It is clear that the term does not mean one's principal place of business, but

rather one's personal residence. Thus, in contrast to "tax home," "abode" has a domestic rather than vocational meaning.[8]

In trying to help taxpayers apply the "abode" requirement in the context of Section 162(a)(2), the IRS has set out three factors that can be used for determining the location of an individual's abode:

> (1) Whether the taxpayer performs a portion of his business in the vicinity of his claimed abode and uses such abode (for purposes of his lodging) while performing such business there;
>
> (2) Whether the taxpayer's living expenses incurred at his claimed abode are duplicated because his business requires him to be away therefrom; and
>
> (3) Whether the taxpayer: (a) has not abandoned the vicinity in which his historical place of lodging and his claimed abode are both located, (b) has a member or members of his family (marital or lineal only) currently residing at his claimed abode, or (c) uses his claimed abode frequently for purposes of his lodging.[9]

Historical Case Law Interpreting The "Tax Home" And "Abode" Requirements

With broad definitional boundaries in play, courts have been given a large interpretive space to analyze the "tax home" and "abode" requirements. Taxpayers with inherently mobile job descriptions, such oil rig workers and airplane pilots and staff,[10] have challenged courts to apply the conceptual requirements within the context of practical circumstances.[11]

In the oil rig worker cases, the fact pattern has typically involved taxpayers who work for certain periods on a rig in a foreign country and come home to their families during non-work periods. Courts have found that the abode requirement was not met in these cases because the taxpayers maintained strong personal ties to the US, particularly by keeping residences in the US where their families continued to reside.[12] Notably, as mentioned above, Treas. Reg. §1.911-2(b) caveats that the "maintenance of a dwelling in the United States, whether or not that dwelling is used by the individual's spouse and dependents, does not necessarily mean that the individual's abode is in the United States." However, because the taxpayers made no efforts to develop personal ties in the foreign country, they were found to have an abode in the United States.

Taxpayers in the airline industry, in contrast, have historically achieved mixed results. In *Jones v. Commissioner*,[13] for instance, the Fifth Circuit Court of Appeals found that an airline pilot

stationed in Japan had his abode in Japan (and therefore qualified for the FEIE), even though his spouse continued to live in their US home while the taxpayer was stationed overseas. Interestingly, the Court reasoned that the taxpayer's spouse could have moved to Japan, but declined in order to keep her US-based job. The Court also distinguished Jones, who paid his own way while in Japan, from the oil rig workers, who received employer-provided housing, meals and transportation back to the US during non-working periods.

In *Sislik v. Commissioner*,[14] however, the Tax Court found that a commercial pilot for Pan Am did not qualify for the FEIE, reasoning that the taxpayer's tax home was JFK airport in New York. Since the taxpayer's "base station," where his flights originated and returned, was JFK, and because the taxpayer was under the supervision of the base station when in flight, the Court held that Sislik's principal place of business was JFK and he therefore did not qualify for the FEIE.

These historical FEIE cases highlight the factual sensitivities that can make or break a taxpayer's FEIE claim. They also highlight that factual emphasis may differ from court to court.

In recent years, several new fact patterns have emerged, giving courts the opportunity to further develop and crystallize the FEIE qualification requirements. In Part II of this series, we will review some of the more recent cases that have interpreted the "tax home" and "abode" requirements of the FEIE.

Endnotes

1 *Weible v. United States*, 244 F.2d 158, 163 (Ninth Circuit 1957) (interpreting the "*bona fide* residence" requirement of the previous version of the FEIE under former Section 116 of the Code).

2 IRC Section 911(b)(2)(D).

3 Treas. Reg. §1.911-5. In addition to the FEIE, certain housing costs incurred in a foreign country can be excluded or deducted. *See* IRC Section 911(a)(2) and (c).

4 We note that the *bona fide* residence test has been analyzed in a number of court decisions and has its own interpretive challenges. Because, in our experience, our clients often meet the 330-day physical presence test, we have focused this article on the "tax home" and "abode" requirements.

5 *Deamer v. Commissioner*, 752 F.2d 337 (Eighth Circuit 1985).

6 *See* Rev. Rul. 93-86, 1993-2 CB 71 (applying Section 162(a)(2) in the context of work assignments).

7 *Bujol v. Commissioner*, TC Memo 1987-230.

8 *Id*.

9 Rev. Rul. 73-529, 1973-2 CB 37.

10 The tax home concept has been analyzed in the context of other professions as well, including, for example, the band musician. *See Bjornstad v. Commissioner*, TC Memo 2002-47, 2002 WL 238507.

[11] Ancillary issues that have recently emerged in FEIE cases include the parameters of the employer-employee relationship (*see*, *e.g.*, *Co v. Commissioner*, TC Memo 2016-19), and the application of the FEIE in the context of international waters (*see*, *e.g.*, *Wilson v. Commissioner*, TC Summary Opinion 2016-19).

[12] *See Bujol*, *supra*, note 7; *Lemay v. Commissioner*, TC Memo 1987-256, *aff'd*, 837 F.2d 681 (Fifth Circuit 1988).

[13] 927 F.2d 849 (Fifth Circuit 1991).

[14] TC Memo 1989-495, *aff'd per curiam*, 1992 US App. LEXIS 15691 (DC Circuit May 22, 1992).