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

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Tax Court Development Of The Exclusion: The Recent Cases

In Part I of this series, we began to analyze the Foreign Earned Income Exclusion ("FEIE") under Section 911 of the Internal Revenue Code and its interpretive challenges. We concentrated on two qualification requirements in particular, namely the vocation-focused "tax home" requirement and the personal-residence-focused "abode" requirement. Both concepts have received a lot of interpretive attention over the years in the Tax Court and other federal courts in large part due to their inexact nature.

In the oil rig and airline employee cases, we saw that the courts made some strides in providing taxpayers with a more definitive framework for applying the "abode" requirement. In the oil rig cases, in brief, the maintenance of a US residence combined with a lack of effort to develop personal ties in a foreign country were enough to convince the courts to affirm the IRS's rejection of the FEIE claim. In the airline cases, however, the maintenance of a personal residence in the United States did not tip the scales against a taxpayer when he paid his own way while in the foreign country without the financial support from his US employer.

In this Part II, we focus on the more recent cases decided in the US Tax Court, which have added new and important layers of interpretation to the tax home and abode requirements.[1] In these cases, one can begin to see the Tax Court taking its first steps in confronting the challenge of applying the FEIE requirements within the context of an increasingly global work environment.

The Defense Contractor Cases

In a series of cases decided over the last several years, the Tax Court analyzed the FEIE in the context of taxpayers living in Iraq and/or Afghanistan and working under their employers' contracts with the Department of Defense. Like the airline cases, the defense contractor cases achieved mixed results in the Court.

In *Daly v. Commissioner*,[2] a 2013 case, the taxpayer lived and worked on US military bases in Iraq and Afghanistan. He was not permitted to leave the bases, nor was his family permitted to live with him on the bases. Instead, his wife lived in and worked in Utah. He also worked in his employer's Utah offices when not deployed abroad. In this case, the Tax Court held, perhaps unsurprisingly, that the taxpayer's "abode" was in the United States, because his ties to Iraq and Afghanistan were "severely limited and transitory," whereas his ties to the United States remained strong during the years at issue.[3]

In contrast, in *Eram v. Commissioner*,[4] decided a year later, the taxpayer grew up in Iraq prior to moving to the United States at the age of 19. During the years at issue, he worked for a defense contractor, providing translation services in Iraq. He lived for a time in the so-called "Green Zone" (a designated safe area for government contractors) until forced to leave by the Iraqi government, and he assisted as an interpreter during missions in and around Baghdad. During his off-time, he interacted with co-workers, including local Iraqis, and spent some time with his extended family in Iraq as well. His children, however, remained in the United States during his deployment.

Under these circumstances, the Tax Court held that the taxpayer's abode was in Iraq and not in the United States. The Court pointed out that the taxpayer had no physical home in the United States and emphasized that due to the taxpayer's divorce, his ties to his family in the United States had significantly weakened. Also, the taxpayer made an effort to spend time with his extended family in Iraq and interacted regularly with Iraqi locals. These were strong enough facts to persuade the Court to rule in favor of allowing the FEIE claim.

In the most recent defense contractor case, *Qunell v. Commissioner*,[5] decided at the end of 2016, the Tax Court addressed facts more closely resembling the *Daly* case than the *Eram* case. During the years at issue, while the taxpayer worked in Afghanistan, he maintained his home in Illinois where his wife and children lived. While abroad, he lived on a military facility; his family did not visit him there, and he apparently did not travel within Afghanistan other than as required by his

employment. Because he did not establish any family or personal ties in Afghanistan, the Court found Qunell's abode to be in the United States and disallowed the taxpayer's FEIE claim.

In deciding the defense contractor cases, the Tax Court considered, as in the past, whether or not the taxpayer kept a physical home in the United States while abroad.[6] However, in deciding these cases, the Court did seem to also add a layer of contextual complexity to its "abode" analysis. While all three taxpayers had immediate family who stayed in the United States, the Court distinguished Eram, whose relationship with his immediate family in the US had weakened over time. Thus, in interpreting the "abode" requirement, the Court took into account not only the existence of the taxpayer's personal ties, but also the quality of those ties.

The Remote Employee Case

In another 2016 FEIE decision, *Hirsch v. Commissioner*,[7] the Tax Court addressed a case that departs from its recent predecessors in several respects. First, from a factual perspective, the *Hirsch* case involved a taxpayer who worked abroad for personal reasons and not at the behest of his employer. Second, perhaps as a result of this factual distinction, the Court, in contrast to the other recent FEIE cases, paid more attention to the "tax home" requirement than the "abode" requirement.

In the *Hirsch* case, the taxpayer lived in Israel and worked as an investment adviser with Merrill Lynch during the years at issue. Mr. Hirsch had lived in Israel for over a decade prior to joining Merrill Lynch in 2005. Merrill Lynch did not require him to live in Israel (in fact it identified its New Jersey office as Mr. Hirsch's authorized work location), but for personal reasons, he split his work time between Israel and the United States, spending approximately two-thirds of his time in Israel. He was limited by firm policy and industry licensing as to where he could conduct business, so his ability, for instance, to contact and solicit clients was severely restricted while abroad. While in Israel, Mr. Hirsch instead performed investment management research and portfolio management work on a firm laptop that gave him full access to Merrill Lynch's system and files.

Under these facts, the Tax Court disallowed the taxpayer's FEIE claim. In the taxpayer's favor, it found that Mr. Hirsch's abode was in fact in Israel, because his home and family were in Israel, and his social ties to Israel were strong.

Most of the Court's interpretive energy, however, was spent demonstrating that Mr. Hirsch's "tax home" was in the United States. It reasoned that: (i) Merrill Lynch designated his authorized work location to be in the United States, (ii) he worked abroad solely for personal reasons,[8] and (iii)

he was restricted in his ability to perform his main job duties while abroad. Further, the Court noted that while he performed work tasks on his laptop in Israel, "there was nothing about the nature of his work or Merrill Lynch's requirements that necessitated his conducting the research while in Israel." [9]

In taking the *Hirsch* decision at face value, there seems to be an interpretive door left open for remote workers who have more favorable facts than Mr. Hirsch. An employee, for instance, who doesn't work abroad at the behest of his employer, but also has the blessing of his employer to do so, would seemingly require further analysis. Or, for instance, an employee who could perform all of his work functions on his laptop, or who works in an industry where remote employment is the standard practice, would seemingly require a further tweaking of the "tax home" interpretive parameters.

The recent FEIE cases in the Tax Court serve as important developments in the judicial struggle to properly and consistently interpret the FEIE requirements in increasingly complex taxpayer circumstances. The "abode" requirement was enhanced with a more qualitative analysis, and the "tax home" requirement was applied in the context of a remote work environment.

In Part III of this series, we will use the judicial precedent developed in both the historical and recent FEIE cases to consider the "digital nomad," a modern case study further highlighting the FEIE's many colors of interpretation.

Endnotes

1 We have not included in this article an analysis of another fairly recent oil rig employee case, ***Evans v. Commissioner***, TC Memo 2015-12, because it generally follows the fact pattern, conclusion and reasoning of the historical oil rig employee cases. The high frequency of FEIE cases over the last several years perhaps forebodes a more aggressive approach by the IRS to challenge FEIE claims in the future.

2 TC Memo 2013-147.

3 *Id*, at 12.

4 TC Memo 2014-60.

5 TC Summary Opinion 2016-86.

6 In this regard, 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."

7 TC Summary Opinion 2016-37.

[8] *Id*, at 14–17. It is interesting to note that because the taxpayer worked from abroad solely for personal reasons, the Court also disallowed the taxpayer's claimed travel expense deduction under Section 162 of the Code. *Id*, at 17–20. While taxpayers on assignment abroad often benefit either from the FEIE or the travel expense deduction, Mr. Hirsch was not allowed to benefit from either item.

[9] *Id*, at 15.