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

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FEIE And The Digital Nomad: A Modern Case Study

In Parts I and II of this series, we analyzed the foreign earned income exclusion ("FEIE") under Section 911 of the Internal Revenue Code and its interpretive challenges. We looked at both historical and recent case law interpreting two of the FEIE's qualification requirements in particular – the "tax home" and "abode" requirements.

In a general sense, the older case law developed a framework of interpretation under scenarios where the nature of the taxpayers' employment required travel between the United States and abroad. In the case of oil rig workers and airline employees, the courts focused on the "abode" requirement, and analyzed the quality of the taxpayers' social ties and personal involvement with their surroundings.

A recent US Tax Court decision, *Hirsch v. Commissioner*,¹ represents a factual and analytical departure from the historical approach to the FEIE requirements. The *Hirsch* case involved a taxpayer who worked abroad simply for personal reasons. As a result of this factual distinction, the Tax Court, in contrast to the older FEIE cases, denied the taxpayer's FEIE claim based on a "tax home" analysis. The Court concluded that Mr. Hirsch's tax home was in the United States based on a number of unfavorable factors, including the facts that Mr. Hirsch's employer designated his authorized work location to be in the United States, and that Mr. Hirsch was restricted in his ability to perform his main job duties while abroad.

While the *Hirsch* case offered the Tax Court an important opportunity to test the FEIE requirements in the context of a taxpayer who worked abroad for personal reasons, we believe that courts will soon need to expand their interpretive horizons in order to properly analyze the "tax home" requirement in the context of a changing global work environment where remote working is becoming a normative employment practice. In order to give this notion a more practical setting, in this Part III of our series, we analyze the FEIE requirement in the context of the so-called "digital nomad."

The Case Of The Digital Nomad

The term "digital nomad" generally describes a person who relies on digital telecommunication technologies to make a living as an employee or freelancer. These individuals use technologies such as the internet to work remotely, and tend to move around the world in a "nomadic" fashion. A digital nomad is often a young millennial with no particular social ties to any location, and is technologically skilled enough to work entirely using a laptop or other mobile device.

While the "digital nomad" is not an entirely new concept, working remotely overseas has become increasingly popular for Americans over the last several years. More US companies are adding remote working options in order to benefit from a broader talent pool and give employees more lifestyle choices. The increased availability of Wi-Fi in foreign countries and broadband cellular networks accessible via affordable mobile devices, in addition to the advent of cloud services, have enabled digital nomads to work for their US employers or clients while living abroad without sacrificing efficiency.

In recent years, new programs have also become available, which provide year-long organized trips for American employees and freelancers to live in multiple cities abroad. Participants in such programs, for example, travel in groups to live in multiple cities throughout Europe, Asia and South America, for one month each over a year period before returning to their more stationary lifestyle. Program participants can rent office space, equipment, and printers if needed in each city.

The Digital Nomad And The FEIE

In analyzing the FEIE in the case of the digital nomad, as a preliminary matter, the taxpayer would need to pass several hurdles in order to qualify for the exclusion. The first couple of hurdles, however, seem to bear little interpretive fruit. Passing the 330-day "physical presence" test is generally a matter of counting days.² Further, assuming the taxpayer is a young millennial, for instance, with little to no residential, habitational, or social ties to the United States, the digital nomad should have strong support for passing the "abode" test.³

In our view, the crux of a court's FEIE analysis involving a digital nomad will, like the *Hirsch* case, involve the issue of the "tax home" requirement.

At first glance, the language of the Tax Court in the *Hirsch* decision seems discouraging, at least in the case of a digital nomad working for a US employer, who, solely for personal reasons, chooses to work abroad instead of working at his or her employer's US office. In the *Hirsch* case, the Tax Court found the taxpayer's home to be in the United States (where the employer was based) and not in Israel (where the taxpayer lived and worked on his laptop), because "there was nothing about the nature of his work or Merrill Lynch's requirements that necessitated his conducting the research while in Israel." ⁴

A digital nomad claiming the FEIE would certainly have factual distinctions in his or her legal arsenal. While Mr. Hirsch's employer designated his authorized work location to be in the United States and restricted his ability to perform his main job duties while abroad, digital nomads often work abroad with the blessing or even encouragement of their US employers, and often with no restrictions on their abilities to perform their work duties.

Beyond these factual nuances, however, we believe that the digital nomad phenomenon represents a shift in the workplace model that will require courts to revisit the concept of the "tax home." Some flexibility has already been given in this regard under certain circumstances. A taxpayer is considered to have a tax home abroad, for instance, if he or she is on "assignment" in a particular country for more than one year. ⁵ Also, so-called "itinerant" workers with no principal place of employment have been considered to have tax homes that follow them from location to location. ⁶ However, both of these concepts seem to assume that movement is necessitated by a work demand rather than a personal preference.

In today's information age, the decision of where to work is becoming less a matter of job necessity and more a matter of personal choice. If an individual's entire workload can easily be handled on a laptop anywhere in the world, and such is the common practice in that taxpayer's particular industry, it seems that a strong argument can be made that like the itinerant worker, the "tax home" should follow the digital nomad from location to location.

Presumably, on a spectrum of legal strength, a career digital nomad who freelances from country to country with no ties to any office would represent a stronger case than a normally office-bound employee of a US employer who works remotely for a limited period of time before returning

to his or her US office setting, but there are sure to be many flavors of circumstances in between these two hypothetical extremes.

The many colors of interpretation of the FEIE certainly provide flexibility in interpreting the exclusion. It remains to be seen whether courts will find the FEIE to be a "coat of many colors" that ultimately fits on the shoulders of the digital nomad. As workplace models continue to evolve, courts will inevitably face the challenge of analyzing the qualification requirements of the FEIE in new thought-provoking contexts.

ENDNOTES

¹ TC Summary Opinion 2016-37.

² As an alternative to the "physical presence" test, the "*bona fide* residence" test may be available for purposes of qualifying for the FEIE. However, this test (in contrast to the "abode" test) generally requires *bona fide* residence in a foreign country or countries, not non-residence in the United States. See *Jose v. Ferrer*, 50 TC 177, 182 (1968); *Douglas L. Hoppes*, P-H TC Memo para. 89,228 1074 (1989). In the case of a digital nomad who does not create strong residential ties to any particular foreign country, it will likely prove difficult to satisfy the *bona fide* residence test.

³ Steps can presumably be taken by a digital nomad to strengthen the argument that he or she has no abode in the United States, for instance if the individual has a permanent residence in the United States, he or she could rent out the residence to a third party.

⁴ TC Summary Opinion 2016-37, at *15.

⁵ See IRS Publication 54.

⁶ *Deamer v. Commissioner*, 752 F.2d 337 (8th Cir. 1985).