Department of the Treasury

Internal Revenue Service

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

For use in preparing

2000 Returns

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Contents

Important Changes

Foreign earned income exclusion increased. For 2000, the maximum amount of foreign earned income that you may be able to exclude from your U.S. gross income has increased to $76,000.

Paid preparer authorization. Beginning with your return for 2000, you can check a box and authorize the IRS to discuss your tax return with the paid preparer who signed it. If you check the "Yes" box in the signature area of your return, the IRS can call your paid preparer to answer any questions that may arise during the processing. Also, you are authorizing your paid preparer to perform certain actions. See your income tax package for details.

Photographs of missing children. The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling **1–800–THE–LOST (1–800–843–5678)** if you recognize a child.

Important Reminders

Social security numbers for dependents. You generally must list on Form 1040 or Form 1040A the social security number (SSN) of any person for whom you claim an exemption. You do not need an SSN for a child who was born in 2000 and died in 2000. Instead of an SSN, attach a copy of the child's birth certificate and write *Died* in column (2) of line 6c of your Form 1040 or Form 1040A.

If your dependent does not have and is not eligible to get an SSN, you must list the dependent's individual taxpayer identification number (ITIN) instead of an SSN. See *Social security number* under *Exemptions* in chapter 5.

Form 2555–EZ. Instead of the longer Form 2555, *Foreign Earned Income,* you may be able to file Form 2555–EZ, *Foreign Earned Income Exclusion,* if:

- You had foreign earned income of $76,000 or less, and
- Your return is not for a short year.

Form 2555–EZ has fewer lines than Form 2555. For more information, see *Form 2555–EZ* in chapter 4.

Foreign income tax withheld. If your employer withheld foreign taxes from your pay, you cannot claim those taxes on your U.S. income tax return as federal income tax withheld.

You may be able to claim a foreign tax credit or a foreign tax deduction based on the amount withheld and paid to a foreign tax authority. See *Taxes of Foreign Countries and U.S. Possessions* in chapter 5.

Change of address. If you change your mailing address, be sure to notify the Internal Revenue Service using Form 8822, *Change of Address.* Mail it to the Internal Revenue Service Center for your old address (addresses for the Service Centers are on the back of the form). If you are changing both your home and business addresses, you need to complete two forms.

Introduction

This publication discusses special tax rules for U.S. citizens and resident aliens who work abroad or who have income earned in foreign countries. As a U.S. citizen or resident alien, your worldwide income generally is subject to U.S. income tax, regardless of where you are living. Also, you are subject to the same income tax filing requirements that apply to U.S. citizens or residents living in the United States.

Filing information. Chapter 1 contains general filing information, such as:

- Whether you must file a U.S. tax return,
- When and where to file your return,
- How to report your income if it is paid in foreign currency,
- How to determine your filing status if your spouse is a nonresident alien, and
- Whether you must pay estimated tax.

If you own stock in a foreign corporation or have an interest in a foreign partnership, you may have to file information returns. See the instructions under *Information Returns and Reports* in chapter 1.

Withholding tax. Chapter 2 discusses the withholding of income taxes and social security and Medicare taxes from the pay of U.S. citizens and resident aliens. It will help you determine if the correct amounts of taxes are being withheld and how to adjust your withholding if too much or too little is being withheld.

Self-employment tax. Chapter 3 discusses who must pay self-employment tax and who is exempt from self-employment tax.

Foreign earned income exclusion and housing exclusion and deduction. Chapter 4 discusses income tax benefits that might apply if you meet certain requirements while living abroad. You may qualify to treat up to $76,000 of your income as not taxable by the United States. You may also be able to either deduct part of your housing expenses from your income or treat a limited amount of income used for housing expenses as not taxable by the United States. These benefits are called the foreign earned income exclusion and the foreign housing deduction and exclusion.

To qualify for either of the exclusions or the deduction, you must have a tax home in a foreign country and earn income from personal services performed in a foreign country. These rules are explained in chapter 4.

If you are going to exclude or deduct your income as discussed above, you must file Form 2555 or Form 2555–EZ. You will find an example with filled-in Forms 2555 and 2555–EZ in this publication.

Exemptions, deductions and credits. Chapter 5 discusses exemptions, deductions and credits you may be able to claim on your return. These are generally the same as if you were living in the United States. However, if you choose to exclude foreign earned income or housing amounts, you cannot deduct or exclude any item or take a credit for any item that is related to the amounts you exclude. Among the topics discussed in chapter 5 are:

- Exemptions you can claim,
- Contributions you can deduct,
- Moving expenses you can deduct, and
- Foreign taxes you can either deduct or take a credit for.

Tax treaty benefits. Chapter 6 discusses some benefits that are common to most tax treaties and explains how to get help if you think you are not getting a treaty benefit to which you are entitled. It also explains how to get copies of tax treaties.

How to get tax help. Chapter 7 is an explanation of how to get information and assistance from the IRS.

Questions and answers. Answers to frequently asked questions are presented in the back of the publication.

Comments and suggestions. We welcome your comments about this publication and your suggestions for future editions.

You can e-mail us while visiting our web site at **www.irs.gov/help/email2.html**.

You can write to us at the following address:

Internal Revenue Service
Technical Publications Branch
W:CAR:MP:FP:P
1111 Constitution Ave. NW
Washington, DC 20224

We respond to many letters by telephone. Therefore, it would be helpful if you would include your daytime phone number, including the area code, in your correspondence.

1. Filing Information

Topics

This chapter discusses:

- Whether you have to file a return,
- When to file your return and pay any tax due,
- How to treat foreign currency,
- Where to file your return,
- When you can treat your nonresident spouse as a resident,
- When you may have to make estimated tax payments, and
- Information returns and reports you may have to file.

Useful Items

You may want to see:

Publication

- ☐ **3** Armed Forces' Tax Guide
- ☐ **501** Exemptions, Standard Deduction, and Filing Information
- ☐ **505** Tax Withholding and Estimated Tax
- ☐ **519** U.S. Tax Guide for Aliens
- ☐ **520** Scholarships and Fellowships

Form (and Instructions)

- ☐ **1040–ES** Estimated Tax for Individuals
- ☐ **1040X** Amended U.S. Individual Income Tax Return
- ☐ **2350** Application for Extension of Time To File U.S. Income Tax Return
- ☐ **2555** Foreign Earned Income
- ☐ **2555–EZ** Foreign Earned Income Exclusion
- ☐ **2688** Application for Additional Extension of Time To File U.S. Individual Income Tax Return
- ☐ **4868** Application for Automatic Extension of Time To File U.S. Individual Income Tax Return
- ☐ **5471** Information Return of U.S. Persons With Respect To Certain Foreign Corporations
- ☐ **8822** Change of Address
- ☐ **SS–5** Application for a Social Security Card
- ☐ **TD F 90–22.1** Report of Foreign Bank and Financial Accounts
- ☐ **W–7** Application for IRS Individual Taxpayer Identification Number

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

Filing Requirements

If you are a U.S. citizen or resident alien living or traveling outside the United States, you generally are required to file income tax returns, estate tax returns, and gift tax returns and pay estimated tax in the same way as those residing in the United States.

Your income, filing status, and age generally determine whether you must file a return. Generally, you must file a return for 2000 if your gross income from worldwide sources is at least the amount shown for your filing status in the following table:

Filing Status	Amount
Single	$7,200
65 or older	$8,300
Head of household	$9,250
65 or older	$10,350
Qualifying widow(er)	$10,150
65 or older	$11,250
Married filing jointly	$12,950
Not living with spouse at end of year	$2,800
One spouse 65 or older	$13,800
Both spouses 65 or older	$14,650
Married filing separately	$2,800

If you are the dependent of another taxpayer, see the instructions for Form 1040 for more information on whether you must file a return.

Gross income. This includes all income you receive in the form of money, goods, property, and services that is not exempt from tax.

In determining whether you must file a return, you must consider as gross income any income that you exclude as foreign earned income or as a foreign housing amount. If you must file a return and you exclude all or part of your income under these rules, you must prepare Form 2555, discussed later. You may be able to file Form 2555–EZ if you are claiming only the foreign earned income exclusion.

Self-employed individuals. If you are self-employed, your gross income includes the amount on line 7 of Schedule C (Form 1040), *Profit or Loss From Business,* or line 1 of Schedule C–EZ (Form 1040), *Net Profit From Business.*

CAUTION *If your net self-employment income is $400 or more, you must file a return even if your gross income is below the amount for filing purposes listed above.*

65 or older. You are 65 on the day before your 65th birthday. If your 65th birthday is on January 1, you would be 65 on December 31 of the previous year.

When To File and Pay

If you file on the calendar year basis, the due date for filing your return is April 15 of the following year. (Because April 15, 2001, falls on Sunday, the due date for your 2000 return will be April 16.) If you file on a fiscal year basis (a year ending on the last day of any month except December), the due date is 3 months and 15 days after the close of your fiscal year. In general, the tax shown on your return should be paid by the due date of the return, without regard to any extension of time for filing the return.

CAUTION *A tax return delivered by the U.S. mail or a designated delivery service that is postmarked or dated by the delivery service on or before the due date is considered to have been filed on or before that date.*

You can use certain private delivery services designated by the IRS to meet the "timely mailing as timely filing/paying" rule for tax returns and payments. See your Form 1040 or Form 1040A instructions for a list of designated delivery services.

Extensions

You can be granted an extension of time to file your return. In some circumstances, you can also be granted an extension of time to file and pay any tax due.

However, if you pay the tax due after the regular due date, interest will be charged from the regular due date until the date the tax is paid.

Automatic 2-month extension. You may be allowed an automatic 2-month extension to file your return and pay any federal income tax that is due. You will be allowed the extension if you are a U.S. citizen or resident and on the regular due date of your return:

1) You are living outside of the United States and Puerto Rico and your main place of business or post of duty is outside the United States and Puerto Rico, ***or***

2) You are in military or naval service on duty outside the United States and Puerto Rico.

If you use a calendar year, the regular due date of your return is April 15.

Service in a combat zone. If you served in a combat zone or qualified hazardous duty area, see *Extension of deadline* in Publication 3.

Married taxpayers. If you file a joint return, either you or your spouse can qualify for the automatic extension. If you and your spouse file separate returns, this automatic extension applies only to the spouse who qualifies.

How to get the extension. To use this automatic 2-month extension, you must attach a statement to your return explaining which of the two situations listed earlier qualified you for the extension.

4-month extension. If you are not able to file your 2000 return by the due date, you may be able to get an automatic 4-month extension of time to file. To get this automatic extension, you must file Form 4868 or pay the tax due by credit card (see the form instructions).

CAUTION **You may not be eligible.** *You cannot use the automatic 4-month extension of time to file if:*

- *You want the IRS to figure your tax, or*
- *You are under a court order to file by the regular due date.*

When to file. Generally, you must request the 4-month extension by the regular due date for your return.

Previous 2-month extension. If you are unable to file your return within the automatic 2-month extension period, you may be able to get an additional 2-month extension of time to file your return, for a total of 4 months. The automatic 2-month and the 4-month extension start at the same time. You do not have to request the 4-month extension until the new due date allowed by the first extension, but the total combined extension will still only be 4 months from the regular due date.

Time to pay not extended. A 4-month extension of time to file is not an extension of time to pay. You must make an accurate estimate of your tax and send any necessary payment with your Form 4868 or pay the tax due by credit card. If you find you cannot pay the full amount due with Form 4868, you can still get the extension. You will owe interest on the unpaid amount.

You also may be charged a penalty for paying the tax late unless you have reasonable cause for not paying your tax when due. Interest and penalties are assessed (charged) from the original due date of your return.

Extension beyond the 4 months. If you qualify for the 4-month extension and you later find that you are not able to file within the 4-month extension period, you may be able to get 2 more months to file, for a total of 6 months.

You can apply for an extension beyond the 4-month extension either by sending a letter to the IRS or by filing **Form 2688**. You should request the extension early so that, if refused, you still will be able to file on time. Except in cases of undue hardship, Form 2688 or a request by letter will not be accepted until you have first used the 4-month extension. Form 2688 or your letter will not be considered if you send it after the extended due date.

To get an extension beyond the automatic 4-month extension, you must give all the following information.

- The reason for requesting the extension.
- The tax year to which the extension applies.

- The length of time needed for the extension.
- Whether another extension for time to file has already been requested for this tax year.

You can sign the request for this extension, or it can be signed by your attorney, CPA, enrolled agent, or a person with a power of attorney. If you are unable to sign the request because of illness or for another good reason, a person in close personal or business relationship to you can sign the request.

Extension granted. If your application for this extension is approved, you will be notified by the IRS.

If an extension is granted and the IRS later determines that the statements made on your request for this extension are false or misleading and an extension would not have been granted based on the true facts, the extension is null and void. You may have to pay the failure-to-file penalty if you file after the regular due date.

Extension not granted. If your application for this extension is not approved, you must file your return by the extended due date of the automatic extension. You may be allowed to file within 10 days of the date of the notice you get from the IRS if the end of the 10-day period is later than the due date. The notice will tell you if the 10-day grace period is granted.

Further extensions. You generally cannot get an extension of more than 6 months. However, if you are outside the United States and meet certain tests, you may be able to get a longer extension.

You can get an extension of time to file your tax return if you need the time to meet either the bona fide residence test or the physical presence test to qualify for either the foreign earned income exclusion or the foreign housing exclusion or deduction. The tests, the exclusions, and the deduction are explained in chapter 4.

You should request an extension if all three of the following apply.

1) You are a U.S. citizen or resident.
2) You expect to meet either the bona fide residence test or the physical presence test, but not until after your tax return is due.
3) Your tax home is in a foreign country (or countries) throughout your period of bona fide residence or physical presence, whichever applies.

Generally, if you are granted an extension, it will be to 30 days beyond the date on which you can reasonably expect to qualify under either the bona fide residence test or the physical presence test. However, if you have moving expenses that are for services performed in 2 years, you may be granted an extension to 90 days beyond the close of the year following the year of first arrival in the foreign country.

How to get an extension. To obtain an extension, you should file Form 2350 with the Internal Revenue Service Center, Philadelphia, PA 19255–0002, the local IRS representative, or other IRS employee.

You must file Form 2350 by the due date for filing your return. Generally, if both your tax home and your abode are outside the United States and Puerto Rico on the regular due date of your return and you file on a calendar year basis, the due date for filing your return is June 15.

What if tests are not met. If you obtain an extension of time and unforeseen events make it impossible for you to satisfy either the bona fide residence test or the physical presence test, you should file your income tax return as soon as possible because you must pay interest on any tax due after the regular due date of the return (even though an extension was granted).

CAUTION *You should make any request for an extension early, so that if it is denied you still can file your return on time. Otherwise, if you file late and additional tax is due, you may be subject to a penalty.*

Return filed before test is met. If you file a return before you meet the bona fide residence test or the physical presence test, you must include all income from both U.S. and foreign sources and pay the tax on that income. If you later qualify for the foreign earned income exclusion, the foreign housing exclusion, or the foreign housing deduction under the bona fide residence or physical presence rules, you can file a claim for refund of tax on Form 1040X. The refund will be the difference between the amount of tax already paid and the tax liability as figured after the exclusion or deduction.

Foreign Currency

You must express the amounts you report on your U.S. tax return in U.S. dollars. If you receive all or part of your income or pay some or all of your expenses in foreign currency, you must translate the foreign currency into U.S. dollars. How you do this depends on your functional currency. Your ***functional currency*** generally is the U.S. dollar unless you are required to use the currency of a foreign country.

You must make all federal income tax determinations in your functional currency. The U.S. dollar is the functional currency for all taxpayers except some qualified business units. A qualified business unit is a separate and clearly identified unit of a trade or business that maintains separate books and records. Unless you are self-employed, your functional currency is the U.S. dollar.

Even if you are self-employed and have a qualified business unit, your functional currency is the dollar if any of the following apply.

- You conduct the business in dollars.
- The principal place of business is located in the United States.
- You choose to or are required to use the dollar as your functional currency.
- The business books and records are not kept in the currency of the economic environment in which a significant part of the business activities is conducted.

If your functional currency is the U.S. dollar, you must immediately translate into dollars all items of income, expense, etc. (including taxes), that you receive, pay, or accrue in a foreign currency and that will affect computation of your income tax. Use the exchange rate prevailing when you receive, pay, or accrue the item. If there is more than one exchange rate, use the one that most properly reflects your income. You can generally get exchange rates from banks and U.S. Embassies.

If your functional currency is not the U.S. dollar, make all income tax determinations in your functional currency. At the end of the year, translate the results, such as income or loss, into U.S. dollars to report on your income tax return.

Blocked Income

You generally must report your foreign income in terms of U.S. dollars and, with one exception (see *Fulbright grants,* later), you must pay taxes due on it in U.S. dollars.

If, because of restrictions in a foreign country, your income is not readily convertible into U.S. dollars or into other money or property that is readily convertible into U.S. dollars, your income is “blocked” or “deferrable” income. You can report this income in one of two ways:

1) Report the income and pay your federal income tax with U.S. dollars that you have in the United States or in some other country, or
2) Postpone the reporting of the income until it becomes unblocked.

If you choose to postpone the reporting of the income, you must file an information return with your tax return. For this information return, you should use another Form 1040 labeled “Report of Deferrable Foreign Income, pursuant to Rev. Rul. 74–351.” You must declare on the information return that the deferrable income will be included in taxable income in the year that it becomes unblocked. You also must state that you waive any right to claim that the deferrable income was includible in income for any earlier year.

You must report your income on your information return using the foreign currency in which you received that income. If you have blocked income from more than one foreign country, include a separate information return for each country.

Income becomes unblocked and reportable for tax purposes when it becomes convertible, or when it is converted, into dollars or into other money or property that is convertible into U.S. currency. Also, if you use blocked income for your personal expenses or dispose of it by gift, bequest, or devise, you must treat it as unblocked and reportable.

If you have received blocked income on which you have not paid the tax, you should check to see whether that income is still blocked. If it is not, you should take immediate steps to pay the tax on it, file a declaration or amended declaration of estimated tax, and include the income on your tax return for the year in which the income became unblocked.

If you choose to postpone reporting blocked income and in a later tax year you wish to begin including it in gross income although it is still blocked, you must obtain the permission of the IRS to do so. To apply for permission, file Form 3115, *Application for Change in Accounting Method.* You also must request permission from the IRS on Form 3115 if you have not chosen to defer the reporting of blocked income in the past, but now wish to begin reporting blocked income under the deferred method. See the instructions for Form 3115 for information.

Fulbright grants. All income must be reported in U.S. dollars. In most cases, the tax must also be paid in U.S. dollars. If, however, at least 70% of your Fulbright grant has been paid in nonconvertible foreign currency (blocked income), you can use the currency of the host country to pay the part of the U.S. tax that is based on the blocked income. To determine the amount of the tax that you can pay in foreign currency, get Publication 520. You may also be able to get details of these arrangements from the U.S. Educational Foundations or Commissions in foreign countries.

Where To File

If any of the following situations apply to you, file your return with the:

Internal Revenue Service Center
Philadelphia, PA 19255–0215.

1) You claim the foreign earned income exclusion.
2) You claim the foreign housing exclusion or deduction.
3) You claim the exclusion of income for bona fide residents of American Samoa.
4) You live in a foreign country or U.S. possession and have no legal residence or principal place of business in the United States.

The exclusions and the deduction are explained in chapter 4.

If you do not know where your legal residence is and you do not have a principal place of business in the United States, you can file with the Philadelphia Service Center. The address for the Philadelphia Service Center is shown above.

However, you should not file with the Philadelphia Service Center if you are a bona fide resident of the Virgin Islands or a resident of Guam or the Commonwealth of the Northern Mariana Islands on the last day of your tax year.

Resident of Virgin Islands

If you are a bona fide resident of the Virgin Islands on the last day of your tax year (even if your legal residence or principal place of business is in the United States), you generally are not required to file a U.S. return. However, you must file a return with the Virgin Islands and pay your tax on income you have from all sources to the:

Virgin Islands Bureau of Internal Revenue
9601 Estate Thomas
Charlotte Amalie
St. Thomas, Virgin Islands 00802.

Non-Virgin Islands resident with Virgin Islands Income. If you are a U.S. citizen or resident and you have income from sources in the Virgin Islands or income effectively connected with the conduct of a trade or business in the Virgin Islands, and you are not a bona fide resident of the Virgin Islands on the last day of your tax year, you must file identical tax returns with the United States and the Virgin Islands. File the original return with the United States and file a copy of the U.S. return (including all attachments, forms, and schedules) with the Virgin Islands Bureau of Internal Revenue.

The amount of tax you must pay to the Virgin Islands is figured by the following computation:

$$\text{Total tax on U.S. return (after certain adjustments)} \times \frac{\text{V.I. AGI}}{\text{Worldwide AGI}}$$

Form 8689, *Allocation of Individual Income Tax to the Virgin Islands,* is used for this computation. You must complete this form and attach it to your return. You should pay any tax due to the Virgin Islands when you file your return with the Virgin Islands Bureau of Internal Revenue.

You should file your U.S. return with the Internal Revenue Service Center, Philadelphia, PA 19255–0215.

See Publication 570, *Tax Guide for Individuals With Income From U.S. Possessions,* for information about the filing requirements for residents of the Virgin Islands.

Resident of Guam

If you are a resident of Guam on the last day of your tax year, you should file a return with Guam and pay your tax on income you have from all sources to the:

Department of Revenue and Taxation
Government of Guam
P.O. Box 23607
GMF, GU 96921.

However, if you are a resident of the United States on the last day of your tax year, you should file a return with the United States and pay your tax on income you have from all sources to the Internal Revenue Service Center, Philadelphia, PA 19255–0215.

See Publication 570, *Tax Guide for Individuals With Income From U.S. Possessions,* for information about the filing requirements for residents of Guam.

Resident of the Commonwealth of the Northern Mariana Islands

If you are a resident of the Commonwealth of the Northern Mariana Islands on the last day of your tax year, you should file a return with the Northern Mariana Islands and pay your tax on income you have from all sources to the:

Division of Revenue and Taxation
Commonwealth of the Northern Mariana Islands
P.O. Box 5234, CHRB
Saipan, MP 96950.

However, if you are a resident of the United States on the last day of your tax year, you should file a return with the United States and pay your tax on income you have from all sources to the Internal Revenue Service Center, Philadelphia, PA 19255–0215.

See Publication 570 for information about the filing requirements for residents of the Commonwealth of the Northern Mariana Islands.

Terrorist or Military Action

U.S. income taxes are forgiven for U.S. Government military or civilian employees who die as a result of wounds or injuries sustained outside the United States in a terrorist or military action directed against the United States or its allies. The taxes are forgiven for the deceased employee's tax years beginning with the year immediately before the year in which the injury or wounds were incurred and ending with the year of death.

If the deceased government employee and the employee's spouse had a joint income tax liability for those years, the tax must be divided between the spouses to determine the amount forgiven.

For more information on how to have the tax forgiven or how to claim a refund of tax already paid, see Publication 559, *Survivors, Executors, and Administrators.*

Nonresident Spouse Treated as a Resident

If, at the end of your tax year, you are married and one spouse is a U.S. citizen or a resident alien and the other is a nonresident alien, you can choose to treat the nonresident as a U.S. resident. This includes situations in which one of you is a nonresident alien at the beginning of the tax year, but a resident alien at the end of the year, and the other is a nonresident alien at the end of the year.

If you make this choice, the following two rules apply.

1) You and your spouse are treated, for income tax purposes, as residents for all tax years that the choice is in effect.
2) You must file a joint income tax return for the year you make the choice.

This means that neither of you can claim tax treaty benefits as a resident of a foreign country for a tax year for which the choice is in effect. You can file joint or separate returns in years after the year in which you make the choice.

Example 1. Pat Smith has been a U.S. citizen for many years. She is married to Norman, a nonresident alien. Pat and Norman make the choice to treat Norman as a resident alien by attaching a statement to their joint return. Pat and Norman must report their worldwide income for the year they make the choice and for all later years unless the choice is ended or suspended. Although Pat and Norman must file a joint return for the year they make the choice, they can file either joint or separate returns for later years.

Example 2. Bob and Sharon Williams are married and both are nonresident aliens. In June of last year, Bob became a resident alien and remained a resident for the rest of the year. Bob and Sharon both choose to be treated as resident aliens by attaching a statement to their joint return for last year. Bob and Sharon must report their worldwide income for last year and all later years unless the choice is ended or suspended. Bob and Sharon must file a joint return for last year, but they can file either joint or separate returns for later years.

Social Security Number (SSN)

If your spouse is a nonresident alien and you file a joint or separate return, your spouse must have either an SSN or an individual taxpayer identification number (ITIN).

To get an SSN for your spouse, apply at a social security office or U.S. consulate. You must complete Form SS–5. You must also provide original or certified copies of documents to verify your spouse's age, identity, and citizenship.

If your spouse is not eligible to get an SSN, he or she can file Form W–7 with the IRS to apply for an ITIN.

How To Make the Choice

Attach a statement, signed by both spouses, to your joint return for the first tax year for which the choice applies. It should contain the following:

1) A declaration that one spouse was a nonresident alien and the other spouse a U.S. citizen or resident alien on the last day of your tax year, and that you choose to be treated as U.S. residents for the entire tax year, and
2) The name, address, and social security number (or individual taxpayer identification number) of each spouse. (If one spouse died, include the name and address of the person making the choice for the deceased spouse.)

You generally make this choice when you file your joint return. However, you can also make the choice by filing a joint amended return on Form 1040 or Form 1040A. Be sure to write the word “Amended” across the top of the amended return. If you make the choice with an amended return, you and your spouse must also amend any returns that you may have filed after the year for which you made the choice.

You generally must file the amended joint return within 3 years from the date you filed your original U.S. income tax return or 2 years from the date you paid your income tax for that year, whichever is later.

Suspending the Choice

The choice to be treated as a resident alien does not apply to any later tax year if neither of you is a U.S. citizen or resident alien at any time during the later tax year.

Example. Dick Brown was a resident alien on December 31, 1997, and married to Judy, a nonresident alien. They chose to treat Judy as a resident alien and filed a joint 1997 income tax return. On January 10, 1999, Dick became a nonresident alien. Judy had remained a nonresident alien. Dick and Judy can file joint or separate returns for 1999. Neither Dick nor Judy is a resident alien at any time during 2000 and their choice is suspended for that year. For 2000, both are treated as nonresident aliens. If Dick becomes a resident alien again in 2001, their choice is no longer suspended and both are treated as resident aliens.

Ending the Choice

Once made, the choice to be treated as a resident applies to all later years unless suspended (as explained above) or ended in one of the ways shown in *Figure 1–A*.

If the choice is ended for any of the reasons listed in *Figure 1–A*, neither spouse can make a choice in any later tax year.

TIP *If you do not choose to treat your nonresident spouse as a U.S. resident, you may be able to use head of household filing status. To use this status, you must pay more than half the cost of maintaining a household for certain dependents or relatives other than your nonresident alien spouse. For more information, see Publication 501.*

Estimated Tax

The requirements for determining who must pay estimated tax are the same for a U.S. citizen or resident abroad as for a taxpayer in the United States. For current instructions on making your estimated tax payments, see Form 1040–ES.

If you had a tax liability for 2000, you may have to pay estimated tax for 2001. Gener-

Figure 1-A. **Ending the Choice**

Revocation	• Either spouse can revoke the choice for any tax year.
	• The revocation must be made by the due date for filing the tax return for that tax year.
	• The spouse who revokes must attach a signed statement declaring that the choice is being revoked.
	• The statement revoking the choice must include the following:
	  • The name, address, and social security number (or taxpayer identification number) of each spouse.
	  • The name and address of any person who is revoking the choice for a deceased spouse.
	  • A list of any states, foreign countries, and possessions that have community property laws in which either spouse is domiciled or where real property is located from which either spouse receives income.
	• If the spouse revoking the choice must file a return, attach the statement to the return for the first year the revocation applies.
	• If the spouse revoking the choice does not have to file a return, but does file a return (for example, to obtain a refund), attach the statement to the return.
	• If the spouse revoking the choice does not have to file a return and does not file a claim for refund, send the statement to the Internal Revenue Service Center where the last joint return was filed.

Death	• The death of either spouse ends the choice, beginning with the first tax year following the year the spouse died. • If the surviving spouse is a U.S. citizen or resident and is entitled to the joint tax rates as a surviving spouse, the choice will not end until the close of the last year for which these joint rates may be used. • If both spouses die in the same tax year, the choice ends on the first day after the close of the tax year in which the spouses died.
Legal separation	• A legal separation under a decree of divorce or separate maintenance ends the choice as of the beginning of the tax year in which the legal separation occurs.
Inadequate records	• The Internal Revenue Service can end the choice for any tax year that either spouse has failed to keep adequate books, records, and other information necessary to determine the correct income tax liability, or to provide adequate access to those records.

ally, you must make estimated tax payments for 2001 if you expect to owe at least $1,000 in tax for 2001 after subtracting your withholding and credits, and you expect your withholding and credits to be less than the smaller of:

1) 90% of the tax to be shown on your 2001 tax return, or
2) 100% of the tax shown on your 2000 tax return. (The return must cover all 12 months.)

If less than two thirds of your gross income for 2000 or 2001 is from farming or fishing and your adjusted gross income for 2000 is more than $150,000 ($75,000 if you are married and file separately), substitute 110% for 100% in (2) above. See Publication 505 for more information.

The first installment of estimated tax is due on April 15, 2001. Because April 15, 2001, falls on Sunday, the first installment for 2001 is due on April 16.

When figuring your estimated gross income, subtract amounts you expect to exclude under the foreign earned income exclusion and the foreign housing exclusion. In addition, you can reduce your income by your estimated foreign housing deduction. However, if the actual amount of the exclusion or deduction is less than you estimate, you may have to pay a penalty on the underpayment of estimated tax.

Information Returns and Reports

If you acquire or dispose of stock in a foreign corporation, own a controlling interest in a foreign corporation, or acquire or dispose of any interest in a foreign partnership, you may have to file an information return. You also may have to file an information return if you transfer property to a foreign trust, or if you have transferred property to a foreign trust with at least one U.S. beneficiary. You may have to file reports if you ship currency to or from the United States or if you have an interest in a foreign bank or financial account.

Form 5471. Form 5471 must generally be filed by certain U.S. shareholders of controlled foreign corporations and by certain shareholders, officers, and directors of foreign personal holding companies. Form 5471 must also be filed by officers, directors, and shareholders of U.S. entities that acquire, dispose of, or are involved in the reorganization of a foreign corporation.

If Form 5471 is required, you must file it at the time you file your income tax return. More information about the filing of Form 5471 can be found in the instructions for this information return.

Form 3520. Form 3520, *Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts*, is used to report:

- Certain transactions with foreign trusts, and
- Receipt of certain large gifts or bequests from certain foreign persons.

It must be filed by:

- U.S. persons that are treated as owners of any portion of a foreign trust for U.S. income tax purposes under sections 671 through 679 (the “grantor trust rules”) to report certain information,
- U.S. persons to provide information about distributions received from foreign trusts, and
- Other individuals as listed in the Form 3520 instructions.

You must file the form by the due date (including extensions) of your return. Send Form 3520 to the Internal Revenue Service Center, Philadelphia, PA 19255.

Form 4790. Form 4790, *Report of International Transportation of Currency or Monetary Instruments,* must be filed by each person who physically transports, mails, ships, or causes to be physically transported, mailed, or shipped, into or out of the United States, currency or other monetary instruments totaling more than $10,000 at one time. The filing requirement also applies to any person who attempts to transport, mail, or ship the currency or monetary instruments or attempts to cause them to be transported, mailed, or shipped. Form 4790 must also be filed by certain recipients of currency or monetary instruments.

The term “monetary instruments” includes coin and currency of the United States or of any other country, money orders, traveler's checks, investment securities in bearer form or otherwise in such form that title passes upon delivery, and negotiable instruments (except warehouse receipts or bills of lading) in bearer form or otherwise in such form that title passes upon delivery. The term includes bank checks, and money orders that are signed, but on which the name of the payee has been omitted. The term does not include bank checks, or money orders made payable to the order of a named person that have not been endorsed or that bear restrictive endorsements.

A transfer of funds through normal banking procedures (wire transfer) which does not involve the physical transportation of currency or bearer monetary instruments is **not** required to be reported on Form 4790.

Recipients. Each person who receives currency or other monetary instruments from a place outside the United States for which a report has not been filed by the shipper must file Form 4790.

It must be filed within 15 days after receipt with the Customs officer in charge at any port of entry or departure, or by mail with the:

Commissioner of Customs
Attention: Currency Transportation Reports
Washington, DC 20229.

Shippers or mailers. If the currency or other monetary instrument does not accompany a person entering or departing the United States, Form 4790 can be filed by mail with the Commissioner of Customs at the above address. It must be filed by the date of entry, departure, mailing, or shipping.

Travelers. Travelers carrying currency or other monetary instruments with them must file Customs Form 4790 with the Customs officer in charge at any Customs port of entry or departure when entering or departing the United States.

Penalties. Civil and criminal penalties are provided for failure to file a report, supply information, and for filing a false or fraudulent report. Also, the entire amount of the currency or monetary instrument may be subject to seizure and forfeiture.

More information about the filing of Form 4790 can be found in the instructions on the back of the form.

Form TD F 90–22.1. Form TD F 90–22.1 must be filed if you had any financial interest in, or signature or other authority over, a bank, securities, or other financial account in a foreign country. You do not have to file the report if the assets are with a U.S. military banking facility operated by a U.S. financial institution or if the combined assets in the account(s) are $10,000 or less during the entire year.

You must file this form by June 30 each year with the Department of the Treasury at the address shown on the form. Form TD F 90–22.1 is not a tax return, so do not attach it to your Form 1040.

2. Withholding Tax

Topics

This chapter discusses:

- Withholding income tax from the pay of U.S. citizens,
- Withholding tax at a flat rate, and
- Social security and Medicare taxes.

Useful Items

You may want to see:

Publication

- ☐ **505** Tax Withholding and Estimated Tax

Form (and Instructions)

- ☐ **673** Statement For Claiming Benefits Provided by Section 911 of the Internal Revenue Code
- ☐ **W–4** Employee's Withholding Allowance Certificate

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

Withholding

U.S. employers generally must withhold U.S. income tax from the pay of U.S. citizens performing services in a foreign country unless the employer is required by foreign law to withhold foreign income tax.

Your employer, however, is not required to withhold U.S. income tax from the portion of your wages earned abroad that are equal to the foreign earned income exclusion and foreign housing exclusion if your employer

Form **673**
(Rev. March 1997)

Department of the Treasury – Internal Revenue Service

Statement For Claiming Benefits Provided by Section 911 of the Internal Revenue Code

(See Instructions on Reverse)

OMB No. 1545-1022

The following statement, when completed and furnished by a citizen of the United States to his or her employer, permits the employer to exclude from income tax withholding all or a part of the wages paid for services performed outside the United States.

Name *(please print)*	**Social security number**

I expect to qualify for the foreign earned income exclusion under either the bona fide residence or physical presence test for calendar year ____________ or fiscal year ____________ beginning ____________ and ending ____________ .

Please check applicable box

☐ **Bona Fide Residence Test**

I am a citizen of the United States. I have been a bona fide resident of and my tax home has been located in ______________________ (foreign country or countries) for an uninterrupted period which includes an entire tax year that began on ______________________ ,19 ____.
(date)

I expect to remain a bona fide resident and retain my tax home in a foreign country (or countries) until the end of the tax year for which this statement is made. Or if not that period, from the date of this statement until ______________________ , 19____.
(date within tax year)

I have not stated to the authorities of any foreign country named above that I an not a resident of that country. Or, if I made such a statement, the authorities of that country thereafter made a determination to the effect that I am a resident of that country.

Based on the facts in my case, I have good reason to believe that for this period of foreign residence I will satisfy the tax home and the bona fide foreign residence requirements prescribed by the section 911(d)(1)(A) of the Internal Revenue Code and qualify for the exclusion Code section 911(a) allows.

☐ **Physical Presence Test**

I am a citizen of the United States. Except for occasional absences that won't disqualify me for the benefit of section 911(a) of the Internal Revenue Code, I expect to be present in and maintain my tax home in ______________________(foreign country or countries) for a 12-month period that includes the entire tax year ____________ . Or, if not the entire year, for the part of the tax year beginning on ______________ ,19____, and ending on ____________ , 19____ .

Based on the facts in my case, I have good reason to believe that for this period of presence in a foreign country or countries, I will satisfy the tax home and the 330 full-day requirements within a 12-month period under section 911(d)(1)(B).

Estimated Housing Cost

(1) Rent . . . . ____________
(2) Utilities (other than telephone Charges) . . . . ____________
(3) Real & Personal Property Insurance . . . . ____________
(4) Occupancy tax not deductible under section 164 . . . . ____________
(5) Nonrefundable fees paid for securing a leasehold . . . . ____________
(6) Household Repairs . . . . ____________
(7) Add lines 1 through 6 . . . . ____________
(8) Estimated Base Housing Amount for my qualifying period is . . . . ____________
(9) Subtract line 8 from line 7. This is your estimated housing cost amount . . . . ____________

I understand that this total, plus the total reported on any other statements outstanding with other employers, should not be more than my expected housing cost amount exclusion.

If I become disqualified for the exclusions, I will immediately notify my employer and advise what part, if any, of the period I am qualified for.

I understand that any exemption form income tax withholding permitted by reason of furnishing this statement is not a determination by the Internal Revenue that any amount paid to me for any services performed during the tax year is excludable form gross income under the provisions of Code section 911(a).

Your Signature	Date

Cat. No. 10183Y

Form **673** Page 1 (Rev. 03-97)

has good reason to believe that you will qualify for these exclusions.

Statement. You can give a statement to your employer indicating that you will meet either the bona fide residence test or the physical presence test and indicating your estimated housing cost exclusion.

Form 673 is an acceptable statement. You can use Form 673 only if you are a U.S. citizen. You do not have to use the form. You can prepare your own statement. See the previous page for a copy of Form 673.

Give the statement to your employer and not to the IRS.

Generally, the receipt of a signed statement from you that includes a declaration under penalties of perjury is considered authority for your employer to discontinue withholding. However, if your employer has reason to believe that you will not qualify for an exclusion of income, your employer must disregard the statement and withhold the tax.

If your employer has information about pay you received from any other source outside the United States, it must be considered in determining whether your foreign earned income is more than the limit on the exclusion.

Your employer should withhold taxes from any wages you earn for working in the United States.

Foreign tax credit. If you plan to take a foreign tax credit, you may be eligible for additional withholding allowances on Form W–4. You can take these additional withholding allowances only for foreign tax credits attributable to taxable salary or wage income. See Publication 505 for further information.

Withholding from pension payments. U.S. payers of benefits from employer deferred compensation plans, individual retirement plans, and commercial annuities generally must withhold income tax from the payments or distributions they make to you. Withholding will apply unless you choose exemption from withholding. You cannot choose either exemption unless you:

1) Provide the payer of the benefits with a residence address in the United States or a U.S. possession, or
2) Certify to the payer that you are not a U.S. citizen or resident alien or someone who left the United States to avoid tax.

Checking your withholding. Before you report U.S. income tax withholding on your tax return, you should carefully review all information documents, such as Form W–2 and Form 1099. Compare other records, such as final pay records or bank statements, with Form W–2 or Form 1099 to verify the withholding on these forms. Check your U.S. income tax withholding even if you pay someone else to prepare your tax return. You may be assessed penalties and interest if you claim more than your correct amount of withholding.

30% Flat Rate Withholding

Generally, U.S. payers of income other than wages, such as dividends and royalties, are required to withhold tax at a flat 30% (or lower treaty) rate on nonwage income paid to nonresident aliens. If you are a U.S. citizen or resident and this tax is withheld in error from payments to you because you have a foreign address, you should notify the payer of the income to stop the withholding. Use Form W–9, *Request for Taxpayer Identification Number and Certification*, to notify the payer.

You can claim the tax withheld in error as a withholding credit on your tax return if the amount is not adjusted by the payer.

Social Security and Medicare Taxes

Social security and Medicare taxes may apply to wages paid to an employee regardless of where the services are performed.

General Information

In general, U.S. social security and Medicare taxes do not apply to wages for services you perform as an employee outside of the United States unless one of the following exceptions applies:

1) You perform the services on or in connection with an American vessel or aircraft ***and*** either:
   a) You entered into your employment contract within the United States, or
   b) The vessel or aircraft touches at a U.S. port while you are employed on it.
2) You are working in one of the countries with which the United States has entered into a ***binational social security agreement*** (discussed later),
3) You are working for an American employer (defined later), or
4) You are working for a foreign affiliate of an American employer under a voluntary agreement entered into between the American employer and the U.S. Treasury Department.

American vessel or aircraft. An American vessel is any vessel documented or numbered under the laws of the United States, and any other vessel whose crew is employed solely by one or more U.S. citizens or residents or U.S. corporations. An American aircraft is an aircraft registered under the laws of the United States.

American employer. An American employer includes any of the following employers.

1) The U.S. Government or any of its instrumentalities.
2) An individual who is a resident of the United States.
3) A partnership of which at least two-thirds of the partners are U.S. residents.
4) A trust of which all the trustees are U.S. residents.
5) A corporation organized under the laws of the United States, any U.S. state, or the District of Columbia, Puerto Rico, the Virgin Islands, Guam, or American Samoa.

Foreign affiliate. A foreign affiliate of an American employer is any foreign entity in which the American employer has at least a 10% interest, directly or through one or more entities. For a corporation, the 10% interest must be in its voting stock, and for any other entity the 10% interest must be in its profits.

Form 2032, *Contract Coverage Under Title II of the Social Security Act,* is used by American employers to extend social security coverage to U.S. citizens and residents working abroad for foreign affiliates of the American employers. Coverage under an agreement in effect on or after June 15, 1989, cannot be terminated.

Excludable meals and lodging. Social security tax does not apply to the value of meals and lodging provided to you for the convenience of your employer and excluded from your income.

Binational Social Security (Totalization) Agreements

The United States has entered into agreements with several foreign countries to coordinate social security coverage and taxation of workers who are employed in those countries. These agreements are commonly referred to as totalization agreements and are in effect with the following countries.

- Austria.
- Belgium.
- Canada.
- Finland.
- France.
- Germany.
- Greece.
- Ireland.
- Italy.
- Luxembourg.
- The Netherlands.
- Norway.
- Portugal.
- Spain.
- Sweden.
- Switzerland.
- The United Kingdom.

Under these agreements, dual coverage and dual contributions (taxes) for the same work are eliminated. The agreements generally make sure that you pay social security taxes to only one country.

Generally, under these agreements, you will only be subject to social security taxes in the country where you are working. However, if you are temporarily sent to work in a foreign country, and your pay would otherwise be subject to social security taxes in both the United States and that country, you generally can remain covered only by U.S. social security. You can get more information on any specific agreement by contacting the United States Social Security Administration. If you have access to the Internet, you can get more information at:

http://www.ssa.gov/international

To establish that your pay in a foreign country is subject only to U.S. social security tax and is exempt from foreign social security tax, your employer in the United States should write to the:

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

Your employer should include the following information in the letter.

1) Your name.
2) Your U.S. social security number.
3) Your date and place of birth.
4) The country of which you are a citizen.
5) The country of your permanent residence.
6) The name and address of your employer in the United States and in the foreign country.
7) The date and place you were hired.
8) The beginning date and the expected ending date of your employment in the foreign country.

If you are permanently working in a foreign country with which the United States has a social security agreement and, under the agreement, your pay is exempt from U.S. social security tax, you or your employer should get a statement from the authorized official or agency of the foreign country verifying that your pay is subject to social security coverage in that country.

If the authorities of the foreign country will not issue such a statement, either you or your employer should get a statement from the U.S. Social Security Administration, Office of International Programs, at the above address, that your wages are not covered by the U.S. social security system.

This statement should be kept by your employer because it establishes that your pay is exempt from U.S. social security tax. Only wages paid on or after the effective date of the agreement can be exempt from U.S. social security tax.

3.

Self-Employment Tax

Topics

This chapter discusses:

- Who must pay self-employment tax, and
- Who is exempt from self-employment tax.

Useful Items

You may want to see:

Publication

- ☐ **517** Social Security and Other Information for Members of the Clergy and Religious Workers
- ☐ **533** Self-Employment Tax

Form (and Instructions)

- ☐ **Form 4361** Application for Exemption From Self-Employment Tax for Use by Ministers, Members of Religious Orders and Christian Science Practitioners
- ☐ **Form 1040–PR** Planilla Para La Declaración de la Contribución Federal Sobre el Trabajo por Cuenta Propia
- ☐ **Form 1040–SS** U.S. Self-Employment Tax Return
- ☐ **Schedule SE (Form 1040)** Self-Employment Tax

See chapter 7 for information about getting these publications.

Who Must Pay Self-Employment Tax?

If you are abroad and you are a self-employed U.S. citizen or resident, other than a U.S. citizen employee of an international organization, foreign government, or wholly owned instrumentality of a foreign government, you generally are subject to the self-employment tax. This is a social security and Medicare tax on net earnings from self-employment of $400 or more a year. For 2000 the tax is on net earnings of $400 or more up to $76,200 for the social security portion. All net earnings are subject to the Medicare portion. Your net self-employment income is used to figure your net earnings from self-employment. Net self-employment income usually includes all business income less all business deductions allowed for income tax purposes. Net earnings from self-employment is a portion of net self-employment income. This amount is figured on Schedule SE (Short Schedule SE (Section A), line 4, or Long Schedule SE (Section B), line 6). The actual self-employment tax is figured on net earnings from self-employment.

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.

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 social security tax and Medicare tax on all of your net profit, including the amount you can exclude from income.

Optional method. You can use the nonfarm optional method if you are self-employed and your net nonfarm profits are less than $1,733 and less than 72.189% of your gross nonfarm income. You must have had $400 of net self-employment earnings in at least 2 of the 3 immediately preceding tax years. You cannot choose to report less than your actual net earnings from nonfarm self-employment. You cannot use the nonfarm optional method for more than 5 tax years. Use Long Schedule SE (Section B). For more details get Publication 533.

Members of the clergy. Although members of the clergy may be employees in performing their ministerial services, they are treated as self-employed for self-employment tax purposes. Their 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.

Members of the clergy are covered automatically by social security and Medicare. 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.

Puerto Rico, Guam, Commonwealth of the Northern Mariana Islands, American Samoa, or Virgin Islands. If you are a U.S. citizen or resident and you own and operate a business in Puerto Rico, Guam, the Commonwealth of the Northern Mariana Islands, American Samoa, or the 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:

- Puerto Rico,
- Guam,
- The Commonwealth of the Northern Mariana Islands,
- American Samoa, or
- The Virgin Islands,

figure your self-employment tax on either Form 1040–PR or Form 1040–SS, whichever applies.

You must file these forms with the Internal Revenue Service Center, Philadelphia, PA 19255–0215.

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 *Binational 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 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.

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,
- 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
- ☐ **596** Earned Income Credit

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 $76,000 of your foreign earnings. In addition, you can exclude or deduct certain foreign housing amounts. See *Foreign Earned Income Exclusion* and *Foreign Housing Exclusion or 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 have foreign earned income, your tax home must be in a foreign country, and you must be one of the following:

- 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,
- 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
- 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 qualify as 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, and both you and your spouse choose to treat you as a resident, you are a resident alien for tax purposes. For information on making the choice, see the discussion in chapter 1 under *Nonresident 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. See *Waiver of Time Requirements* under *Exceptions to Tests,* later.

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.

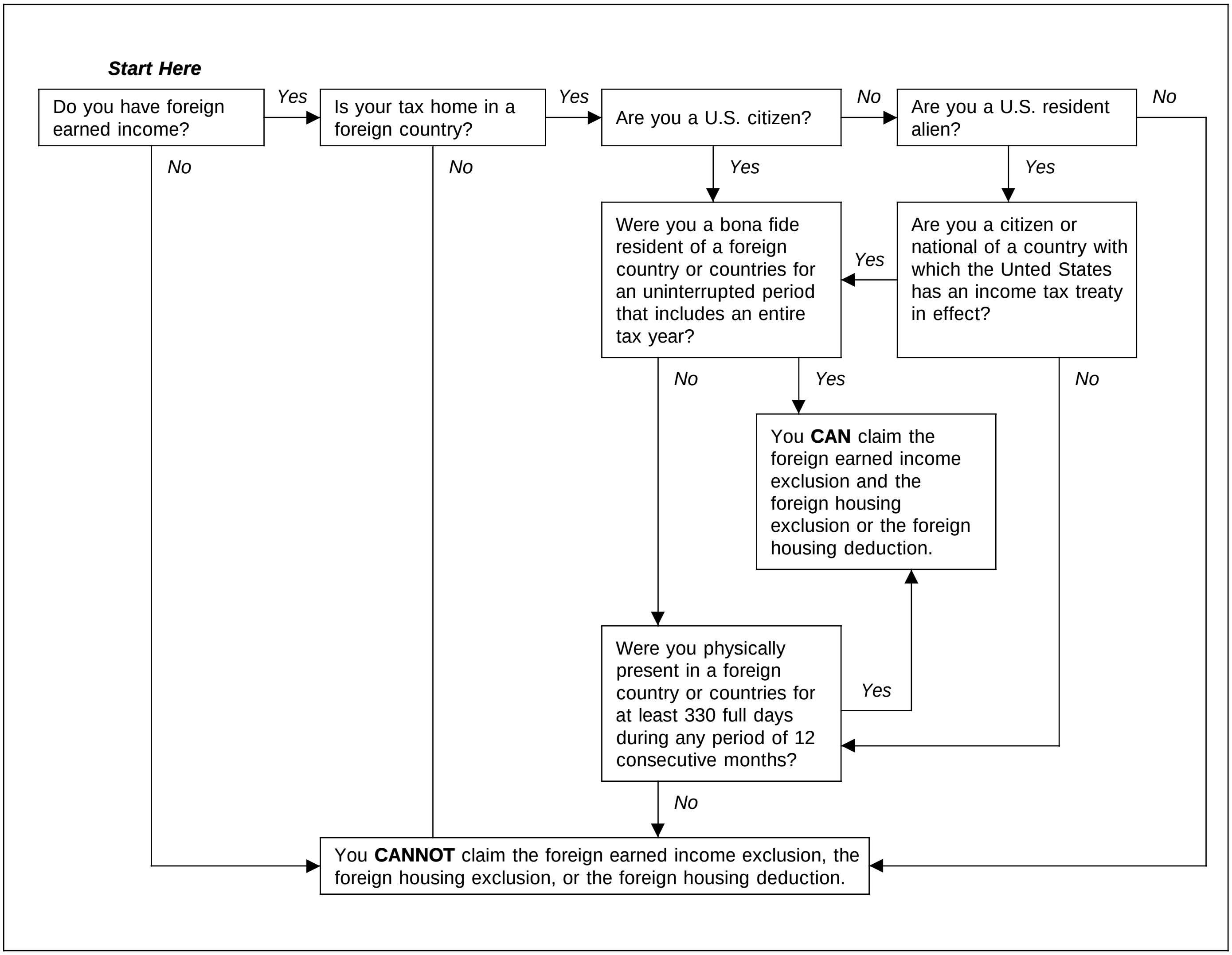
“Abode” has been variously defined as one's home, habitation, residence, domicile, or place of dwelling. It does not mean your principal place of business. “Abode” has a domestic rather than a vocational meaning and does not mean the same as “tax home.” The location of your abode often will depend on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

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



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, and 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.

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 usually is any territory (including the air space and territorial waters) under the sovereignty of a government other than that of the United States.

The term "foreign country" includes the seabed and subsoil of those submarine areas adjacent to the territorial waters of a foreign country and over which the foreign country has exclusive rights under international law to explore and exploit the natural resources.

The term "foreign country" does ***not*** include Puerto Rico, Guam, the Commonwealth of the Northern Mariana Islands, the Virgin Islands, or U.S. possessions such as American Samoa. 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, American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, Puerto Rico, the Virgin Islands, and the Antarctic region.

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 the possession exclusion.

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, Guam, or the Commonwealth of the Northern Mariana Islands may be eligible for this exclusion. Income that is effectively connected with the conduct of a trade or business within those possessions 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. A possession 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 Virgin Islands

Residents of Puerto Rico and the Virgin Islands are not entitled to the possession exclusion (discussed above) or to the exclusion of foreign earned income or the exclusion or deduction of foreign housing amounts under the bona fide residence or physical presence rules discussed later.

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. You cannot deduct expenses allocable to the exempt income.

Bona Fide Residence Test

The bona fide residence test applies to U.S. citizens and to any 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.

Bona fide residence. To see if you meet the test of bona fide residence in a foreign country, you must find out if you have established such a 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 London if you intend to return eventually to Cleveland.

The fact that you go to London does not automatically make London 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 London. But if you go to London 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 London in the first instance. However, in the second, you are a resident because your stay in London 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 such factors as your intention or the purpose of your trip and the nature and length of your stay abroad.

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 qualify as 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.

If you have made such a statement and the authorities have not made a final decision on your status, you are not considered to be a bona fide resident of that foreign country.

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 do not qualify for special status under the North Atlantic Treaty Status of Forces Agreement. You are subject to United Kingdom income taxes and ***may*** qualify as a bona fide resident.

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 do ***not*** qualify as a bona fide resident.

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. You do ***not*** qualify as a bona fide resident.

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 qualifying as a bona fide resident if you meet ***all*** the requirements for that status.

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 qualify for bona fide residence, you must reside in a foreign country 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 are the Lisbon representative of a U.S. employer. You arrived with your family in Lisbon on November 1, 1998. 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. On April 1, 1999, you arrived in the United States to meet with your employer, leaving your family in Lisbon. You returned to Lisbon on May 1, and continue living there. On January 1, 2000, you completed an uninterrupted period of residence for a full tax year (1999), and you may qualify as a bona fide resident of a foreign country.

Example 2. Assume that in *Example 1,* you transferred back to the United States on December 13, 1999. You would not qualify under 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 residence status not automatic. You do not automatically acquire bona fide resident status merely by living in a foreign country or countries for 1 year.

Example. If you go to a foreign country to work on a particular construction 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 one tax year or longer. The length of your stay and the nature of your job are only some of the factors to be considered in determining whether you meet the bona fide residence test.

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 will qualify as a bona fide resident for the period starting with the date you actually began the residence and ending with the date you abandon the foreign residence. You could qualify as a bona fide resident for an entire tax year plus parts of 1 or 2 other tax years.

Example. You were a bona fide resident of England from March 1, 1998, through September 14, 2000. On September 15, 2000, you returned to the United States. Since you were a bona fide resident of a foreign country for all of 1999, you also qualify as a bona fide resident from March 1, 1998, through the end of 1998 and from January 1, 2000, through September 14, 2000.

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 France from October 1, 1999, through November 30, 2000. On December 1, 2000, 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, 2000, 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 1999 or 2000, you do not qualify under 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 France you were given a new assignment to England. On December 1, 2000, you and your family returned to the United States for a month's vacation. On January 2, 2001, you arrived in England for your new assignment. Because you did not interrupt your bona fide residence abroad, you qualify at the end of 2000 as a bona fide resident of a foreign country.

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 qualifying days do not have to be consecutive. The physical presence test applies to both U.S. citizens and resident aliens.

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. However, your intentions with regard to the nature and purpose of your stay abroad are relevant in determining whether you meet the tax home test explained earlier under *Tax Home in Foreign Country*.

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 the 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 time.

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. You must spend each of the 330 full days in a foreign country. 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 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 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 Spain. You pass over a part of France at 11:00 p.m. on June 10 and arrive in Spain 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. But if any part of your travel is not within a foreign country or countries and takes 24 hours or more, you will lose full days.

Example 1. You leave London by air at 11:00 p.m. on July 6 and arrive in Stockholm 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.

1) Your 12-month period can begin with any day of the month. It ends the day before the same calendar day, 12 months later.

2) 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.

3) You do not have to begin your 12-month period with your first full day in a foreign country or to end it with the day you leave. You can choose the 12-month period that gives you the greatest exclusion.

4) 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 Canada for a 20-month period from January 1, 1999, through August 31, 2000, except that you spend 28 days in February 1999 and 28 days in February 2000 on vacation in the United States. You are present in Canada 330 full days during each of the following two 12-month periods: January 1, 1999 — December 31, 1999, and September 1, 1999 — August 31, 2000. By overlapping the 12-month periods in this way, you meet the physical presence test for the whole 20-month period. See Table 4–1.

Exceptions to Tests

There are two exceptions to meeting the requirements under the bona fide residence and the physical presence tests.

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 also 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 2001, the IRS will publish in the Internal Revenue Bulletin a list of countries qualifying for the waiver for 2000 and the effective dates. If you left one of the countries on or after the date listed for each country, you can qualify for the bona fide residence test or physical presence test for 2000 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 Bulletins on the Internet at **www.irs.gov**. Select *Tax Info For You*. Or, you can get a copy of the list of countries by writing to:

Internal Revenue Service
International Returns 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.

Currently, the countries to which travel restrictions apply and the beginning dates of the restrictions are as follows:

Table 4-1. **How To Figure Overlapping 12-Month Periods**

This Table illustrates Example 2 under *How to figure the 12-month period.*

First Full 12-Month Period (Jan '99 – Dec '99)

Jan '99	Feb '99 *	Mar '99	Apr '99	May '99	Jun '99	Jul '99	Aug '99	Sep '99	Oct '99	Nov '99	Dec '99	Jan '00	Feb '00 *	Mar '00	Apr '00	May '00	Jun '00	Jul '00	Aug '00

Second Full 12-Month Period (Sep '99 – Aug '00)

* 28-day vacation in the United States

- Cuba — January 1, 1987
- Iraq — August 2, 1990
- Libya — January 1, 1987

The restrictions are still in effect in all three countries.

Foreign Earned Income

The foreign earned income exclusion, the foreign housing exclusion, and the foreign housing deduction are based on foreign earned income. For this purpose, foreign earned income is income you receive for services you perform in a foreign country during a period your tax home is in a foreign country and during which you meet either the bona fide residence test or the physical presence test, discussed earlier.

Foreign earned income does not include the following amounts.

1) The previously excluded value of meals and lodging furnished for the convenience of your employer.

2) Pension or annuity payments including social security benefits (see *Pensions and annuities,* later).

3) U.S. Government payments to its employees (see *U.S. Government Employees,* later).

4) Amounts included in your income because of your employer's contributions to a nonexempt employee trust or to a nonqualified annuity contract.

5) Recaptured unallowable moving expenses (see *Moving Expenses* in chapter 5).

6) Payments received after the end of the tax year following the tax year in which you performed the services that earned the income.

Earned income 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	
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 amounts paid to you as allowances or reimbursements for the following items.

- Cost of living.
- Overseas differential.
- Family.
- Education.
- Home leave.
- Quarters.
- Moving (unless excluded from income as discussed later).

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 performing personal services 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 France 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.

If you receive a specific amount for work done in the United States, you must report that amount as U.S. source income. If you cannot determine how much is for work done in the United States, or for work done partly in the United States and partly in a foreign country, determine the amount of U.S. source income using the method that most correctly shows the proper source of your income.

In most cases you can make this determination on a time basis. U.S. source income is the amount that results from multiplying your total pay (including allowances, reimbursements other than for foreign moves, and noncash fringe benefits) by a fraction. The numerator (top number) is the number of days you worked within the United States. The denominator (bottom number) is the total number of days of work for which you were paid.

Example. You are a U.S. citizen, a bona fide resident of Country A, 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 for work done in the United States during the year.

Number of days worked in the United States during the year (30) ÷ Number of days of work during the year for which payment was made (240) × Total income ($88,800) = $11,100.

Your U.S. source earned income is $11,100.

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. These types of income —specifically, income from sole proprietorships, partnerships, and corporations, stock options, pensions and annuities, royalties, rents, and fringe benefits—are further explained here. Income from sole proprietorships and partnerships is generally treated differently than income from corporations.

Trade or business—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.

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 Algeria 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.

Trade or business—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 Canada. 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 devote 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 option stock 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 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:

1) For the transfer of property rights of the writer in the writer's product, or

2) 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 is earned income if you painted the pictures yourself.

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, you must add the fair market value of that right to your pay. ***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 must be included in earned income.

These rules do ***not*** apply to straight-commission salespersons or other individuals who are employees and have arrangements with their employers under which, for withholding tax purposes, their employers consider a percentage of the commissions to be attributable to the expenses of the employees and do not withhold taxes on that percentage.

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

1) The expenses covered under the plan must have a business connection.

2) The employee must adequately account to the employer for these expenses within a reasonable period of time.

3) The employee must return any excess reimbursement or allowance within a reasonable period of time.

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

1) Any reimbursements of, or payments for, nondeductible moving expenses,

2) Reimbursements that are more than your deductible expenses and that you do not return to your employer,

3) 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

4) 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 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 your tax home is in a foreign country and you qualify under the bona fide residence test or physical presence test for at least 120 days during that tax year.

If you do not qualify under either test for 120 days during the year of the move, the reimbursement is considered earned in the year of the move and 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 1999 that you were being transferred to a foreign country. You arrived in the foreign country on December 15, 1999, and you qualify as a bona fide resident for the remainder of 1999 and all of 2000. Your employer reimbursed you $2,000 in January 2000 for the part of the moving expense that you were not allowed to deduct. Because you did not qualify as a bona fide resident for at least 120 days last year (the year of the move), the reimbursement is considered pay for services performed in the foreign country for both 1999 and 2000.

You figure the part of the moving expense reimbursement for services performed in the foreign country in 1999 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 365. The remaining part of the reimbursement is for services performed in the foreign country in 2000.

This computation is used ***only*** to determine when the reimbursement is considered earned. You would report the amount you include in income in this tax year, the year you received it.

Move between foreign countries. If you move between foreign countries and you qualify for at least 120 days during the tax year under the bona fide residence test or the physical presence test, the moving expense reimbursement that you must include in income is considered earned in the tax 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 tax year of the move if you qualify under the bona fide residence test or the physical presence test for at least 120 days during that tax 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, 2000, 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 2000, your former employer reimbursed you $2,000 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 for at least 120 days last year (the year of the move), the includible reimbursement is considered pay for services performed in the foreign country for both 2000 and 1999.

You figure the part of the moving expense reimbursement for services performed in the foreign country last year 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 or 366). The remaining part of the includible reimbursement is for services performed in the foreign country in 1999. You report the amount of the includible reimbursement on your Form 1040 for 2000, the tax year you received it.

TIP *In this example, if you qualify to exclude income under the physical presence test instead of the bona fide residence test for last year, you may have had more than 120 qualifying days in the year of the move because you can choose the 12-month qualifying period that is most advantageous to you. (See* Physical presence test, *later, under* Part-year exclusion.*) If so, the moving expense reimbursement would be considered earned entirely in the year of the move (2000).*

Storage expense reimbursements. If you are reimbursed for storage expenses, the reimbursement is for services you perform during the period you are in the foreign country.

U.S. Government Employees

For purposes of the foreign earned income exclusion and the foreign housing exclusion or deduction, foreign earned income does not include any amounts paid by the United States or any of its agencies to its employees. Payments to employees of nonappropriated fund activities are not foreign earned income. Nonappropriated fund activities include the following employers.

1) Armed forces post exchanges.
2) Officers' and enlisted personnel clubs.
3) Post and station theaters.
4) Embassy commissaries.

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 the 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.*

Panama Canal Commission. U.S. employees of the Panama Canal Commission are employees of a U.S. Government agency and are not eligible for the foreign earned income exclusion on their salaries from that source. Furthermore, no provision of the Panama Canal Treaty or Agreement exempts their income from U.S. taxation. Employees of the Panama Canal Commission and civilian employees of the Defense Department of the United States stationed in Panama can exclude certain foreign-area and cost-of-living allowances. See Publication 516, *U.S. Government Civilian Employees Stationed Abroad,* for more information.

These employees cannot exclude any overseas tropical differential they receive.

American Institute in Taiwan. Amounts paid by the American Institute in Taiwan are not considered foreign earned income for purposes of the exclusion of foreign earned income or the exclusion or deduction of foreign housing amounts. 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. See Publication 516 for more information. Post differentials are wages that must be included in gross income, regardless of the Act of Congress under which they are paid.

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:
   a) Furnished on the business premises of your employer, and
   b) Furnished for the convenience of your employer.
2) The lodging is:
   a) Furnished on the business premises of your employer,
   b) Furnished for the convenience of your employer, and
   c) A condition of your employment. (You are required to accept it).

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

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. Meals or lodging provided to you and your family by your employer will be considered provided for your employer's convenience if there is a good business reason for providing the meals or lodging, other than to give you more pay.

If your employer has a good business reason for providing the meals or lodging, do not include their value in your income, even though your employer may also intend them as part of your pay. You can exclude the value of meals or lodging from your income even if a law or your employment contract says that they are provided as compensation.

On the other hand, if meals or lodging are provided to you or your family by your employer 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.

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.

Foreign camps. If you are provided lodging by or for your employer in a camp located in a foreign country, the camp is considered to be part of your employer's business premises. For this purpose, a camp is lodging that is:

1) 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,

2) Located as close as reasonably possible in the area where you render services, and

3) 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 is defined earlier. You cannot deduct expenses directly connected with the earning of excluded income. See chapter 5.

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

Limit on Excludable Amount

You may be able to exclude up to $76,000 of income earned in 2000. See *Table 4.2* for the maximum amount excludable for other years.

Limits. For 2000, you cannot exclude more than the smaller of:

1) $76,000, or

2) 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 you each meet either the bona fide residence test or the physical presence test, you can each choose the foreign earned income exclusion. It is possible for a married couple together to exclude as much as $152,000.

TIP *These limits apply to the foreign earned income exclusion only; you may also qualify for the foreign housing exclusion.*

If you perform services one year but do not get paid for those services until the following year, the income is generally considered earned in the year you performed the services. If you report your income on the cash basis, you report the income on your return for the year you receive it. You can exclude as much of the income in the year you receive it as you could have excluded in the year you performed the services had you received the income that year.

Example. You qualify as a bona fide resident of a foreign country for all of last year and this year. You report your income on the cash basis. You received $65,000 last year for services you performed last year in the foreign country. You can exclude all of the $65,000.

This year you will receive $87,000: $10,000 for services performed in the foreign country last year and $77,000 for services performed in the foreign country this year. You can exclude $9,000 of the $10,000 received for services performed last year. This is the $74,000 maximum exclusion allowable last year minus the $65,000 you excluded last year. You must include the remaining $1,000 in income (this year) because you could not have excluded that income last year had you received it then. You can also exclude $76,000 of the $77,000 received for services performed during this year.

Your total foreign earned income excluded on your return for this year would be $85,000 ($9,000 attributable to last year and $76,000 attributable to this year). You would have $2,000 of includible income.

Table 4.2. The maximum amount you can exclude depends on the calendar year.

Year	Maximum Excludable Amount
1997 and earlier	$70,000
1998	$72,000
1999	$74,000
2000	$76,000
2001	$78,000
2002 and later	$80,000

Year-end payroll period. There is an exception to the rule that you exclude income in the year you earn it. If you are a cash basis taxpayer, a salary or wage payment that you receive after the end of the tax year in which you perform the services is considered earned entirely in the year you ***receive*** it if all four of the following apply.

1) The period for which the payment is made is a normal payroll period of your employer that regularly applies to you.

2) The payroll period includes the last day of your tax year.

3) The payroll period is not longer than 16 days.

4) 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.

Income earned over more than 1 year. Regardless of when you actually receive income, you must credit it to the tax year in which you earned it in figuring your excludable amount for that year. For example, a bonus that you receive in 1 year may be based on services you performed over several tax years. You determine the amount of the bonus that is considered earned in a particular tax year by dividing the bonus by the number of calendar months in the period when you performed the services that resulted in the bonus and then multiplying the result by the number of months you performed these services during the tax 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 tax year following the tax year in which you perform the services that earned it.

Example. You qualify as a bona fide resident of a foreign country for 1998, 1999, and 2000. You report your income on the cash basis. You received $65,000 for 1998 and $70,000 for 1999 for services performed in the foreign country. You excluded $65,000 on your 1998 federal income tax return and $70,000 for your 1999 return.

In 2000 you receive $90,000; $80,000 for services performed in the foreign country during 2000, and $10,000 for services performed in the foreign country in 1998. You cannot exclude any of the $10,000 received for services performed in 1998 because you received it after the year following the year in which you earned it. You must include the $10,000 in income. You can exclude $76,000 of the $80,000 received for services performed in 2000.

Community income. The maximum exclusion applies individually 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 you qualify under either the bona fide residence test or the physical presence test for only part of the tax year, you must adjust the maximum limit based on the number of qualifying days in your tax year. The number of qualifying days in your tax year is the number of days within the period on which you both have your tax home in a foreign country and meet either 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 your tax year.

Example. You report your income on the calendar-year basis and you qualified under the bona fide residence test for 75 days in 2000. You can exclude a maximum of 75/366 of $76,000, or $15,574, of your foreign earned income for 2000. If you qualify under the bona fide residence test for all of 2001, you can exclude your foreign earned income up to the full $78,000 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 under the physical presence test for part of a tax 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, 1999, through September 29, 2000, except for 15 days in December 1999 when you were on vacation in the United States. You figure the maximum exclusion for 1999 as follows:

1) Beginning with June 1, 1999, count forward 330 full days. Do not count the 15 days you spent in the United States. The 330th day, May 10, 2000, is the last day of a 12-month period.
2) Count backward 12 months from May 10, 2000, to find the first day of this 12-month period, May 11, 1999. This 12-month period runs from May 11, 1999, through May 10, 2000.
3) Count the total days during 1999 that fall within this 12-month period. This is 235 days (May 11, 1999—December 31, 1999).
4) Multiply $74,000 by the fraction 235/365 to find your maximum exclusion for 1999 ($47,644).

You figure the maximum exclusion for 2000 in the opposite manner:

1) Beginning with your last full day, September 29, 2000, count backward 330 full days. Do not count the 15 days you spent in the United States. That day, October 21, 1999, is the first day of a 12-month period.
2) Count forward 12 months from October 21, 1999, to find the last day of this 12-month period, October 20, 2000. This 12-month period runs from October 21, 1999, through October 20, 2000.
3) Count the total days during 2000 that fall within this 12-month period. This is 294 days (January 1, 2000—October 20, 2000).
4) Multiply $76,000, the maximum limit, by the fraction 294/366 to find your maximum exclusion for 2000 ($61,049).

Choosing the Exclusion

The foreign earned income exclusion is voluntary. You can separately choose the foreign earned income exclusion and the foreign housing exclusion by completing the appropriate parts of Form 2555. Your initial choice of the exclusions on Form 2555 or Form 2555–EZ generally must be made with a timely filed return (including any extensions), a return amending a timely filed return, or a late-filed 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 provided 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 provided 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 must request a private letter ruling under Revenue Procedure 92–85 (as modified by Revenue Procedure 93–28).

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. You can buy the C.B. containing a particular revenue procedure from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

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

Revocation. You can revoke your choice for any tax 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 tax years again wish to choose the same exclusion, you must apply for IRS approval. You do this by requesting a ruling from the Internal Revenue Service.

Mail your request for a ruling in duplicate to:

Associate Chief Counsel (International)
Internal Revenue Service
CC:INTL
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 2000–1, which is published in Internal Revenue Bulletin No. 2000–1.

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 tax credit. Once you choose to exclude either foreign earned income or foreign housing costs, you cannot take a foreign tax credit for taxes on income you can exclude. If you do take the credit, one or both of the choices may be considered revoked. See *Credit for Foreign Income Taxes* in chapter 5 for more information.

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

Foreign Housing Exclusion or 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 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 Living Apart,* later.

Housing Amount

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

Base amount. The base amount is 16% of the annual salary of a GS–14, step 1, U.S. Government employee, figured on a daily basis, times the number of days during the year that you meet the bona fide residence test or the physical presence test. The annual salary is determined on January 1 of the year in which your tax year begins.

On January 1, 2000, the GS–14 salary was $63,567 per year; 16% of this amount comes to $10,171 or $27.79 per day. To figure your base amount if you are a calendar-year taxpayer, multiply $27.79 by the number of your qualifying days during 2000 (see *Limit on Excludable Amount,* earlier). Subtract the result from your total housing expenses for 2000 to find your housing amount.

Example. You qualify under the physical presence test for all of 2000. During the year, you spend $12,500 for your housing. Your housing amount is $12,500 minus $10,171, or $2,329.

U.S. Government allowance. You must reduce your housing amount by any U.S. Government allowance or similar nontaxable allowance intended to compensate you or your spouse for the expenses of housing during the period for which you claim a foreign housing exclusion or deduction.

Housing expenses. Housing expenses include your reasonable expenses paid or incurred for housing in a foreign country for you and (if they live with you) for your spouse and dependents.

Consider only housing expenses for the part of the tax year that your tax home is in a foreign country and that you meet either the bona fide residence test or the physical presence test.

Housing expenses include:

- Rent,
- The fair rental value of housing provided in kind by your employer,
- Repairs,
- Utilities (other than telephone charges),
- Real and personal property insurance,
- Nondeductible occupancy taxes,
- Nonrefundable fees for securing a leasehold,
- Rental of furniture and accessories, and
- Residential parking.

Housing expenses ***do not*** include:

- Expenses that are lavish or extravagant under the circumstances,
- Deductible interest and taxes (including deductible interest and taxes of a tenant-stockholder in a cooperative housing corporation),
- The cost of buying property, including principal payments on a mortgage,
- The cost of domestic labor (maids, gardeners, etc.),
- Pay television subscriptions,
- Improvements and other expenses that increase the value or appreciably prolong the life of property,
- Purchased furniture or accessories, or
- Depreciation or amortization of property or improvements.

No double benefit. *You cannot include in housing expenses any amounts that you exclude from gross income as meals or lodging provided for your employer's convenience on the business premises (see* Exclusion of Meals and Lodging*, earlier) or that you deduct as moving expenses.*

Second foreign household. Ordinarily, if you maintain two foreign households, your reasonable foreign housing expenses include only costs for the household that bears the closer relationship (not necessarily geographic) to your tax home. However, if you maintain a second, separate household outside the United States for your spouse or dependents because living conditions near your tax home are dangerous, unhealthful, or otherwise adverse, include the expenses for the second household in your reasonable foreign housing expenses. You cannot include expenses for more than one second foreign household at the same time.

If you maintain two households and you exclude the value of one because it is provided by your employer, you can still include the expenses for the second household in figuring a foreign housing exclusion or deduction.

Adverse living conditions include a state of warfare or civil insurrection in the general area of your tax home and conditions under which it is not feasible to provide family housing (for example, if you must live on a construction site or drilling rig).

Foreign Housing Exclusion

If you do not have self-employment income, all of your earnings are employer-provided amounts and your entire housing amount is considered paid for with those employer-provided amounts. This means that you can exclude (up to the limits) the entire amount.

Employer-provided amounts include any amounts paid to you or paid or incurred on your behalf by your employer that are taxable foreign earned income (without regard to the foreign earned income exclusion) to you for the tax year. This includes:

1) Your salary,
2) Any reimbursement for housing expenses,
3) Amounts your employer pays to a third party for your housing,
4) The fair rental value of company-owned housing furnished to you unless that value is excluded from your income because it is provided for your employer's convenience,
5) Amounts paid to you by your employer as part of a tax equalization plan, and
6) Amounts paid to you or a third party by your employer for the education of your dependents.

Choosing the exclusion. You can choose the housing exclusion by completing the appropriate parts of Form 2555. Follow the rules explained earlier in *Choosing the Exclusion,* under *Foreign Earned Income Exclusion.* You cannot use Form 2555–EZ to claim the housing exclusion.

Your housing exclusion is the lesser of:

- That part of your housing amount paid for with employer-provided amounts, or
- Your foreign earned income.

If you choose the housing exclusion, you must figure it ***before*** figuring your foreign earned income exclusion. You cannot claim less than the full amount of the housing exclusion to which you are entitled.

Foreign tax credit. *Once you choose to exclude either foreign earned income or foreign housing costs, you cannot take a foreign tax credit for taxes on income you can exclude. If you do take the credit, one or both of the choices may be considered revoked.*

Foreign Housing Deduction

If you do not have self-employment income, you cannot take a foreign housing deduction.

How you figure your housing deduction depends on whether you have only self-employment income or both self-employment income and employer-provided income. In either case, the amount you can deduct is subject to the limit explained below.

Self-employed — no employer-provided amounts. If none of your housing amount is considered paid for with employer-provided amounts, such as when all of your income is from self-employment, you can deduct your housing amount, subject to the limit below, in figuring your adjusted gross income.

Take the deduction by including it in the total on line 32 of Form 1040. Write the amount and “Form 2555” on the dotted line next to line 32.

Self-employed and employer-provided amounts. If you are both an employee and a self-employed individual during the year, you can deduct part of your housing amount and exclude part of it. To find the part that you can take as a housing exclusion, multiply your housing amount by the employer-provided amounts (discussed earlier) and then divide the result by your foreign earned income. The balance of the housing amount can be deducted, subject to the limit below.

Example. Your housing amount for the year is $12,000. During the year, your total foreign earned income is $80,000, of which half ($40,000) is from self-employment and half is from your services as an employee. Half ($40,000/$80,000) of your housing amount ($12,000/2) is considered provided by your employer. You can exclude $6,000 as a housing exclusion. You can deduct the remaining $6,000 as a housing deduction subject to the following limit.

Limit

Your housing deduction cannot be more than your foreign earned income minus the total of:

1) Your foreign earned income exclusion, plus
2) Your housing exclusion.

You can carry over to the next year any part of your housing deduction that is not allowed because of this limit.

Carryover. You are allowed to carry over your excess housing deduction to the next year only. If you cannot deduct it in the next year, you cannot carry it over to any other year. You deduct the carryover in figuring adjusted gross income. The amount of carryover you can deduct is limited to your foreign earned income for the year of the carryover minus the total of your foreign earned income exclusion, housing exclusion, and housing deduction for that year.

Married Couples Living Apart

If you and your spouse live apart and maintain separate households, you both may be able to claim the foreign housing exclusion or the foreign housing deduction. You can do this if you have different tax homes that are not within reasonable commuting distance of each other and neither spouse's residence is within reasonable commuting distance of the other spouse's tax home. Otherwise, only you or your spouse can exclude or deduct a housing amount.

TIP *If you both claim the housing exclusion or the housing deduction, neither of you can claim the expenses for a qualified second foreign household maintained for the other. If one of you qualifies for but does not claim the exclusion or the deduction, the other spouse can claim the expenses for a qualified second household maintained for the first spouse. This would usually result in a larger total housing exclusion or deduction since you would apply only one base amount against the combined housing expenses.*

If you and your spouse live together, both of you claim a foreign housing exclusion or a foreign housing deduction, and you file a joint return, you can figure your housing amounts either separately or jointly. If you file separate returns, you must figure your housing amounts separately. In figuring your housing amounts separately, you can allocate your housing expenses between yourselves in any proportion you wish, but each spouse must use his or her full base amount.

In figuring your housing amount jointly, you can combine your housing expenses and figure one base amount. If you figure your housing amount jointly, only one spouse can claim the housing exclusion or housing deduction. Either spouse can claim the exclusion or deduction. However, if you and your spouse have different periods of residence or presence and the one with the shorter period of residence or presence claims the exclusion or deduction, you can claim as housing expenses only the expenses for that shorter period.

Example. Tom and Jane live together and file a joint return. Tom was a bona fide resident of, and had his tax home in, a foreign country from August 17, 2000, through December 31, 2001. Jane was a bona fide resident of, and had her tax home in, the same foreign country from September 15, 2000, through December 31, 2001.

During 2000 Tom received $75,000 of foreign earned income, and Jane received $50,000 of foreign earned income. Tom paid $10,000 for housing expenses in 2000, of which $7,500 was for expenses incurred from September 15 through the end of the year. Jane paid $3,000 for housing expenses in 2000, all of which were incurred during her period of foreign residence.

Tom and Jane can choose to figure their housing amount jointly. If they do so, and Tom claims the housing exclusion, their housing expenses would be $13,000 and their base amount, using Tom's period of residence (Aug. 11—Dec. 31, 2000), would be $3,807 ($27.79 × 137 days). Tom's housing amount would be $9,193 ($13,000 – $3,807). If, instead, Jane claims the housing exclusion, their housing expenses would be limited to $10,500 ($7,500 + $3,000) and their base amount, using Jane's period of residence (Sept. 15—Dec. 31, 2000), would be $3,001 ($27.79 × 108 days). Jane's housing amount would be $7,499 ($10,500 – $3,001).

If Tom and Jane choose to figure their housing amounts separately, then Tom's separate base amount would be $3,807 and Jane's separate base amount would be $3,001. They could divide their total $13,000 housing expenses between them in any proportion they wished.

Housing exclusion. Each spouse claiming a housing exclusion must figure separately the part of the housing amount that is attributable to employer-provided amounts, based on his or her separate foreign earned income.

Form 2555 and Form 2555–EZ

Form 2555 can be used to claim the foreign earned income exclusion. It must be used to claim the foreign housing exclusion or deduction. In some circumstances you can use Form 2555–EZ to claim the foreign earned income exclusion.

You must attach Form 2555 to your Form 1040 or 1040X if you claim the foreign housing exclusion or the foreign housing deduction. If you cannot use Form 2555–EZ, you must attach Form 2555 if you claim the foreign earned income exclusion. Form 2555 shows how you qualify for the bona fide residence test or physical presence test, how much of your earned income is excluded, and how to figure the amount of your allowable housing exclusion or deduction. Do not submit Form 2555 or Form 2555–EZ by itself. See the instructions for the forms if you are not sure about the information requested.

Form 2555–EZ

Form 2555–EZ is a form that has fewer lines than Form 2555. You can use this form if all seven of the following apply.

1) You are a U.S. citizen or a resident alien.
2) Your total foreign earned income for the year is $76,000 or less.
3) All of your foreign earned income for the year is reported on Form 1040, line 7.
4) You are filing a calendar year return that covers a 12-month period.
5) You did not have any self-employment income for the year.
6) You did not have any business or moving expenses for the year.
7) You are not claiming the foreign housing exclusion or deduction.

Form 2555

If you claim exclusion under the bona fide residence test, you should fill out Parts II, IV, and V of Form 2555 as well as Part I. In filling out Part II, be sure to give your visa type and the period of your bona fide residence. Frequently, these items are overlooked.

If you claim exclusion under the physical presence test, you should fill out Parts III, IV, and V of Form 2555 as well as Part I. When filling out Part III, be sure to insert the beginning and ending dates of your 12-month period and the dates of your arrivals and departures as requested in the travel schedule.

In addition, you must fill out Part VI if you are claiming an exclusion or deduction of foreign housing amounts. Also fill out Part IX if you are claiming the foreign housing deduction. If you are claiming the foreign earned income exclusion, fill out Part VII. Finally, if you are claiming the foreign earned income exclusion, the foreign housing exclusion, or both, fill out Part VIII.

If you and your spouse each qualify under the bona fide residence test or the physical presence test to claim the foreign earned income exclusion, the foreign housing exclusion, or the foreign housing deduction, **you must each file** a separate Form 2555 to claim these benefits. See the discussion earlier under *Married Couples Living Apart.*

Illustrated Example

Jim and Judy Adams are married and have two dependent children. They are both U.S. citizens and they file a joint U.S. income tax return. Each one has a tax home in a foreign country and each meets the physical presence test for all of 2000. They both can exclude their foreign earned income up to the limit.

Jim is a petroleum engineer. He works primarily in the Persian Gulf region. For 2000, his salary, which was entirely from foreign sources, amounted to $71,000. In addition, his employer provided him an annual housing allowance of $18,000, which he used to maintain a rented apartment at his tax home in Country X for the period he was not working at remote drilling sites.

At various times during the year, Jim worked at remote oil drilling sites in nearby countries. While he worked at these remote sites, his employer provided him lodging and meals at nearby camps. Satisfactory housing was not available on the open market near these drilling sites, and the lodging was provided in common areas that normally accommodated 10 or more employees and were not available to the general public. The fair market value of the lodging he was provided in these camps was $2,000, and the value of the meals was $1,000.

After he made an adequate accounting, Jim was reimbursed by his employer for part of his travel expenses and other employee business expenses. Jim had $2,500 of unreimbursed employee business expenses for travel, meals, and lodging that were allocable to his foreign earned income.

Because of adverse conditions in Country X, Judy and the children lived in Paris, France, while Jim worked in the Middle East. Judy had a job as an executive secretary with a U.S. company in Paris. Her earnings from this job were $44,000. These earnings were subject to French income tax.

The Adams family rented an apartment in Paris during 2000 for Judy and the children. They paid $1,000 a month rent, including utilities, or $12,000 for the year. The Adamses choose to treat the expenses for the Paris apartment as those for a qualified second foreign household, because conditions at Jim's tax home in Country X are considered to be adverse. They include the $12,000 Paris housing expenses with Jim's $18,000 Country X housing expenses and this results in a larger total housing exclusion.

Jim and Judy had taxable U.S. interest and dividend income of $7,500 for the year. The Adamses had no other income for the year and do not itemize deductions.

The Adamses report their income, figure their foreign earned income exclusions and foreign housing exclusion, as shown on the accompanying filled-in forms.

First, they list their income on the front of Form 1040. Their combined salaries, including Jim's $18,000 housing allowance, amount to $133,000. They enter this on line 7 and their interest and dividend income of $7,500 on lines 8a and 9.

At this point, Jim will complete Form 2555 and Judy will complete Form 2555–EZ to figure their foreign earned income and housing exclusions.

Jim's Form 2555. On Jim's Form 2555, Part IV, he lists his salary on line 19, his housing allowance on line 22e, and the fair market value of meals and lodging provided in camps by his employer on lines 21a and 21b. The entries on lines 21a and 21b are not shown as income on Form 1040. Jim enters the total of these two entries on line 25 of Form 2555.

Jim combines his housing expenses, $18,000, with the qualified expenses for the second household that he maintains for his wife and children, $12,000, and enters total housing expenses of $30,000 on line 28. He puts a base amount of $10,171 on line 30 and subtracts that amount to arrive at a total foreign housing amount of $19,829 on line 31. He figures an exclusion of $19,829 for amounts provided by his employer on line 34.

TIP *Although Judy could claim a separate housing exclusion for the expenses of the Paris apartment rather than combining those expenses with Jim's housing expenses, she does not do so because she would have to reduce her expenses by a separate base housing amount. Also, her foreign earned income is less than the $76,000 maximum foreign earned income exclusion, so claiming a separate housing exclusion would not result in any tax benefit.*

Jim figures his foreign earned income exclusion in Part VII of Form 2555. Because his foreign earned income minus his housing exclusion is less than the maximum exclusion of $76,000, Jim is only entitled to exclude $69,171 for 2000 ($89,000 – $19,829).

When Jim combines the exclusion of $69,171 with his housing exclusion of $19,829 he comes up with a total exclusion of $89,000 in Part VIII.

None of his unreimbursed employee business expenses are allowable because they are all allocable to excluded income. However, the Adamses are still entitled to the full standard deduction for a married couple filing jointly.

Judy's Form 2555–EZ. Judy completes a Form 2555–EZ to figure her foreign earned income exclusion. Her foreign earned income is less than the maximum excludable amount ($76,000). On Judy's Form 2555–EZ, Part IV, she lists her salary on line 17. She figures an exclusion of $44,000 on line 18.

The Adamses enter their combined exclusions of $133,000 on line 21, Form 1040. They identify this item to the left of the entry space. Their adjusted gross income on line 33 is $7,500, their investment income, which does not qualify for exclusion.

Form **1040** Department of the Treasury—Internal Revenue Service
U.S. Individual Income Tax Return **2000**

IRS Use Only—Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 2000, or other tax year beginning , 2000, ending , 20 | OMB No. 1545-0074

Label

(See instructions on page 19.)

Use the IRS label. Otherwise, please print or type.

LABEL HERE

Your first name and initial: James M.	Last name: Adams	**Your social security number**: 111 : 00 : 1111
If a joint return, spouse's first name and initial: Judith E.	Last name: Adams	**Spouse's social security number**: 222 : 00 : 2222
Home address (number and street). If you have a P.O. box, see page 19.: 21 Rue Reynaud	Apt. no.	
City, town or post office, state, and ZIP code. If you have a foreign address, see page 19.: Paris, France		

▲ Important! ▲ You **must** enter your SSN(s) above.

Presidential Election Campaign (See page 19.)

Note. Checking "Yes" will not change your tax or reduce your refund.
Do you, or your spouse if filing a joint return, want $3 to go to this fund? ▶ **You** ☑ **Yes** ☐ **No** **Spouse** ☑ **Yes** ☐ **No**

Filing Status

Check only one box.

1 ☐ Single
2 ☑ Married filing joint return (even if only one had income)
3 ☐ Married filing separate return. Enter spouse's social security no. above and full name here. ▶
4 ☐ Head of household (with qualifying person). (See page 19.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶
5 ☐ Qualifying widow(er) with dependent child (year spouse died ▶). (See page 19.)

Exemptions

6a ☑ **Yourself.** If your parent (or someone else) can claim you as a dependent on his or her tax return, **do not** check box 6a

b ☑ **Spouse**

No. of boxes checked on 6a and 6b: 2

c **Dependents:**

(1) First name Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) ✓ if qualifying child for child tax credit (see page 20)
Chris T. Adams	333 : 00 : 3333	Daughter	☑
Stephen F. Adams	444 : 00 : 4444	Son	☑
			☐
			☐
			☐
			☐

If more than six dependents, see page 20.

No. of your children on 6c who:
- lived with you: 2
- did not live with you due to divorce or separation (see page 20)

Dependents on 6c not entered above

d Total number of exemptions claimed — Add numbers entered on lines above ▶ **4**

Income

Attach Forms W-2 and W-2G here. Also attach Form(s) 1099-R if tax was withheld.

If you did not get a W-2, see page 21.

Enclose, but do not attach, any payment. Also, please use **Form 1040-V.**

7	Wages, salaries, tips, etc. Attach Form(s) W-2		7	133,000
8a	**Taxable** interest. Attach Schedule B if required		8a	7,500
b	**Tax-exempt** interest. **Do not** include on line 8a	8b		
9	Ordinary dividends. Attach Schedule B if required		9	
10	Taxable refunds, credits, or offsets of state and local income taxes (see page 22)		10	
11	Alimony received		11	
12	Business income or (loss). Attach Schedule C or C-EZ		12	
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐		13	
14	Other gains or (losses). Attach Form 4797		14	
15a	Total IRA distributions	15a	15b	b Taxable amount (see page 23)
16a	Total pensions and annuities	16a	16b	b Taxable amount (see page 23)
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E		17	
18	Farm income or (loss). Attach Schedule F		18	
19	Unemployment compensation		19	
20a	Social security benefits	20a	20b	b Taxable amount (see page 25)
21	Other income. List type and amount (see page 25) Forms 2555 & 2555-EZ		21	(133,000)
22	Add the amounts in the far right column for lines 7 through 21. This is your **total income** ▶		22	7,500

Adjusted Gross Income

23	IRA deduction (see page 27)	23		
24	Student loan interest deduction (see page 27)	24		
25	Medical savings account deduction. Attach Form 8853	25		
26	Moving expenses. Attach Form 3903	26		
27	One-half of self-employment tax. Attach Schedule SE	27		
28	Self-employed health insurance deduction (see page 29)	28		
29	Self-employed SEP, SIMPLE, and qualified plans	29		
30	Penalty on early withdrawal of savings	30		
31a	Alimony paid b Recipient's SSN ▶	31a		
32	Add lines 23 through 31a		32	-0-
33	Subtract line 32 from line 22. This is your **adjusted gross income** ▶		33	7,500

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 56. Cat. No. 11320B Form **1040** (2000)

Form **2555**

Department of the Treasury
Internal Revenue Service

Foreign Earned Income

▶ See separate instructions. ▶ Attach to Form 1040.

OMB No. 1545-0067

2000

Attachment Sequence No. **34**

For Use by U.S. Citizens and Resident Aliens Only

Name shown on Form 1040: James M. Adams

Your social security number: 111 00 1111

Part I **General Information**

1 Your foreign address (including country): 10 Wadi Abu Hassan, City A, Country X

2 Your occupation: Engineer

3 Employer's name ▶ Pan American Oil Company

4a Employer's U.S. address ▶ N/A

b Employer's foreign address ▶ 65 Sheik Hussein Street, City A, Country X

5 Employer is (check any that apply): ▶ **a** ☒ A foreign entity **b** ☐ A U.S. company **c** ☐ Self **d** ☐ A foreign affiliate of a U.S. company **e** ☐ Other (specify) ▶

6a If, after 1981, you filed Form 2555 to claim either of the exclusions or Form 2555-EZ to claim the foreign earned income exclusion, enter the last year you filed the form. ▶ 1999

b If you did not file Form 2555 or 2555-EZ after 1981 to claim either of the exclusions, check here ▶ ☐ and go to line 7 now.

c Have you ever revoked either of the exclusions? . . . ☐ **Yes** ☑ **No**

d If you answered "Yes," enter the type of exclusion and the tax year for which the revocation was effective. ▶

7 Of what country are you a citizen/national? ▶ United States

8a Did you maintain a separate foreign residence for your family because of adverse living conditions at your tax home? See **Second foreign household** on page 3 of the instructions . . . ☑ **Yes** ☐ **No**

b If "Yes," enter city and country of the separate foreign residence. Also, enter the number of days during your tax year that you maintained a second household at that address. ▶ Paris, France 366 days

9 List your tax home(s) during your tax year and date(s) established. ▶ City A, Country X 6-9-94

Next, complete either Part II or Part III. If an item does not apply, enter "NA." If you do not give the information asked for, any exclusion or deduction you claim may be disallowed.

Part II **Taxpayers Qualifying Under Bona Fide Residence Test** (See page 2 of the instructions.)

10 Date bona fide residence began ▶ , and ended ▶

11 Kind of living quarters in foreign country ▶ **a** ☐ Purchased house **b** ☐ Rented house or apartment **c** ☐ Rented room **d** ☐ Quarters furnished by employer

12a Did any of your family live with you abroad during any part of the tax year? . . . ☐ **Yes** ☐ **No**

b If "Yes," who and for what period? ▶

13a Have you submitted a statement to the authorities of the foreign country where you claim bona fide residence that you are not a resident of that country? (See instructions.). . . ☐ **Yes** ☐ **No**

b Are you required to pay income tax to the country where you claim bona fide residence? (See instructions.) ☐ **Yes** ☐ **No**

If you answered "Yes" to 13a and "No" to 13b, you do not qualify as a bona fide resident. Do not complete the rest of this part.

14 If you were present in the United States or its possessions during the tax year, complete columns **(a)–(d)** below. **Do not** include the income from column **(d)** in Part IV, but report it on Form 1040.

(a) Date arrived in U.S.	**(b)** Date left U.S.	**(c)** Number of days in U.S. on business	**(d)** Income earned in U.S. on business (attach computation)	**(a)** Date arrived in U.S.	**(b)** Date left U.S.	**(c)** Number of days in U.S. on business	**(d)** Income earned in U.S. on business (attach computation)

15a List any contractual terms or other conditions relating to the length of your employment abroad. ▶

b Enter the type of visa under which you entered the foreign country. ▶

c Did your visa limit the length of your stay or employment in a foreign country? If "Yes," attach explanation ☐ **Yes** ☐ **No**

d Did you maintain a home in the United States while living abroad? . . . ☐ **Yes** ☐ **No**

e If "Yes," enter address of your home, whether it was rented, the names of the occupants, and their relationship to you. ▶

For Paperwork Reduction Act Notice, see page 4 of separate instructions. Cat. No. 11900P Form **2555** (2000)

Part III **Taxpayers Qualifying Under Physical Presence Test** (See page 2 of the instructions.)

16 The physical presence test is based on the 12-month period from ▶ 1-1-00 through ▶ 12-31-00

17 Enter your principal country of employment during your tax year. ▶ Country X

18 If you traveled abroad during the 12-month period entered on line 16, complete columns **(a)–(f)** below. Exclude travel between foreign countries that did not involve travel on or over international waters, or in or over the United States, for 24 hours or more. If you have no travel to report during the period, enter "Physically present in a foreign country or countries for the entire 12-month period." **Do not** include the income from column **(f)** below in Part IV, but report it on Form 1040.

(a) Name of country (including U.S.)	**(b)** Date arrived	**(c)** Date left	**(d)** Full days present in country	**(e)** Number of days in U.S. on business	**(f)** Income earned in U.S. on business (attach computation)
Physically present in foreign countries during entire 12 month period					

Part IV **All Taxpayers**

Note: *Enter on lines 19 through 23 all income, including noncash income, you earned and actually or constructively received during your 2000 tax year for services you performed in a foreign country. If any of the foreign earned income received this tax year was earned in a prior tax year, or will be earned in a later tax year (such as a bonus), see the instructions.* ***Do not*** *include income from line 14, column* ***(d),*** *or line 18, column* ***(f).*** *Report amounts in U.S. dollars, using the exchange rates in effect when you actually or constructively received the income.*

If you are a cash basis taxpayer, report on Form 1040 all income you received in 2000, no matter when you performed the service.

2000 Foreign Earned Income				**Amount (in U.S. dollars)**
19 Total wages, salaries, bonuses, commissions, etc.			**19**	71,000
20 Allowable share of income for personal services performed (see instructions):				
a In a business (including farming) or profession			**20a**	
b In a partnership. List partnership's name and address and type of income. ▶			**20b**	
21 Noncash income (market value of property or facilities furnished by employer—attach statement showing how it was determined):				
a Home (lodging)			**21a**	2,000
b Meals			**21b**	1,000
c Car			**21c**	
d Other property or facilities. List type and amount. ▶			**21d**	
22 Allowances, reimbursements, or expenses paid on your behalf for services you performed:				
a Cost of living and overseas differential	**22a**			
b Family	**22b**			
c Education	**22c**			
d Home leave	**22d**			
e Quarters	**22e**	18,000		
f For any other purpose. List type and amount. ▶	**22f**			
g Add lines 22a through 22f			**22g**	18,000
23 Other foreign earned income. List type and amount. ▶			**23**	
24 Add lines 19 through 21d, line 22g, and line 23			**24**	92,000
25 Total amount of meals and lodging included on line 24 that is excludable (see instructions)			**25**	3,000
26 Subtract line 25 from line 24. Enter the result here and on line 27 on page 3. This is your **2000 foreign earned income** ▶			**26**	89,000

Form **2555** (2000)

Part V All Taxpayers

27 Enter the amount from line 26	27	89,000	

Are you claiming the housing exclusion or housing deduction?

☐ **Yes.** Complete Part VI.

☐ **No.** Go to Part VII.

Part VI Taxpayers Claiming the Housing Exclusion and/or Deduction

28	Qualified housing expenses for the tax year (see instructions)			28	30,000
29	Number of days in your qualifying period that fall within your 2000 tax year (see instructions)	29	366 **days**		
30	Multiply $27.79 by the number of days on line 29. If 366 is entered on line 29, enter $10,171.00 here			30	10,171
31	Subtract line 30 from line 28. If the result is zero or less, do not complete the rest of this part or any of Part IX			31	19,829
32	Enter employer-provided amounts (see instructions)	32	89,000		
33	Divide line 32 by line 27. Enter the result as a decimal (rounded to at least three places), but do not enter more than "1.000"			33	× 1. 00
34	**Housing exclusion.** Multiply line 31 by line 33. Enter the result but do not enter more than the amount on line 32. Also, complete Part VIII ▶			34	19,829

Note: *The housing deduction is figured in Part IX. If you choose to claim the foreign earned income exclusion, complete Parts VII and VIII before Part IX.*

Part VII Taxpayers Claiming the Foreign Earned Income Exclusion

35	Maximum foreign earned income exclusion			35	$76,000	00
36	• If you completed Part VI, enter the number from line 29. • All others, enter the number of days in your qualifying period that fall within your 2000 tax year (see the instructions for line 29).	36	366 **days**			
37	• If line 36 and the number of days in your 2000 tax year (usually 366) are the same, enter "1.000." • Otherwise, divide line 36 by the number of days in your 2000 tax year and enter the result as a decimal (rounded to at least three places).			37	× 1. 00	
38	Multiply line 35 by line 37			38	76,000	
39	Subtract line 34 from line 27			39	69,171	
40	**Foreign earned income exclusion.** Enter the **smaller** of line 38 or line 39. Also, complete Part VIII ▶			40	69,171	

Part VIII Taxpayers Claiming the Housing Exclusion, Foreign Earned Income Exclusion, or Both

41	Add lines 34 and 40	41	89,000	
42	Deductions allowed in figuring your adjusted gross income (Form 1040, line 33) that are allocable to the excluded income. See instructions and attach computation	42		
43	Subtract line 42 from line 41. Enter the result here and in parentheses on **Form 1040, line 21.** Next to the amount enter "Form 2555." On Form 1040, subtract this amount from your income to arrive at total income on Form 1040, line 22. ▶	43	89,000	

Part IX Taxpayers Claiming the Housing Deduction—Complete this part only if (a) line 31 is more than line 34 and (b) line 27 is more than line 41.

44	Subtract line 34 from line 31	44		
45	Subtract line 41 from line 27	45		
46	Enter the **smaller** of line 44 or line 45	46		

Note: *If line 45 is **more than** line 46 and you could not deduct all of your 1999 housing deduction because of the 1999 limit, use the worksheet on page 4 of the instructions to figure the amount to enter on line 47. Otherwise, go to line 48.*

47	Housing deduction carryover from 1999 (from worksheet on page 4 of the instructions)	47		
48	**Housing deduction.** Add lines 46 and 47. Enter the total here and on Form 1040 to the left of line 32. Next to the amount on Form 1040, enter "Form 2555." Add it to the total adjustments reported on that line ▶	48		

Form **2555** (2000)

Form **2555-EZ**

Department of the Treasury
Internal Revenue Service

Foreign Earned Income Exclusion

▶ See separate instructions. ▶ Attach to Form 1040.

OMB No. 1545-1326
2000
Attachment Sequence No. **34A**

Name shown on Form 1040	Your social security number
Judith E. Adams	222 : 00 : 2222

You May Use This Form If You:

- Are a U.S. citizen or a resident alien.
- Earned wages/salaries in a foreign country.
- Had total foreign earned income of $76,000 or less.
- Are filing a calendar year return that covers a 12-month period.

And You:

- Do not have self-employment income.
- Do not have business/moving expenses.
- Do not claim the foreign housing exclusion or deduction.

Part I Tests To See If You Can Take the Foreign Earned Income Exclusion

1 Bona Fide Residence Test

a Were you a bona fide resident of a foreign country or countries for a period that includes an entire tax year (see page 2 of the instructions)? . . . ☐ **Yes** ☑ **No**

- If you answered "Yes," you meet this test. Fill in line 1b and then go to line 3.
- If you answered "No," you **do not** meet this test. Go to line 2 to see if you meet the Physical Presence Test.

b Enter the date your bona fide residence began ▶ ________, and ended (see instructions) ▶ ________.

2 Physical Presence Test

a Were you physically present in a foreign country or countries for at least 330 full days during—
{ 2000 **or** any other period of 12 months in a row starting or ending in 2000? } . . . ☑ **Yes** ☐ **No**

- If you answered "Yes," you meet this test. Fill in line 2b and then go to line 3.
- If you answered "No," you **do not** meet this test. You **cannot** take the exclusion unless you meet the Bona Fide Residence Test above.

b The physical presence test is based on the 12-month period from ▶ 1-1-00 through ▶ 12-31-00.

3 Tax Home Test. Was your tax home in a foreign country or countries throughout your period of bona fide residence or physical presence, whichever applies? . . . ☑ **Yes** ☐ **No**

- If you answered "Yes," you can take the exclusion. Complete Part II below and then go to page 2.
- If you answered "No," you **cannot** take the exclusion. **Do not** file this form.

Part II General Information

4 Your foreign address (including country)	5 Your occupation
21 Rue Reynaud Paris, France	Secretary

6 Employer's name	7 Employer's U.S. address (including ZIP code)	8 Employer's foreign address
A B Insurance Co., Inc.	2645 Pewter Place Anytown, Anystate, U.S.A.	40 Rue Royale Paris, France

9 Employer is (check any that apply):
a A U.S. business . . . ☑
b A foreign business . . . ☐
c Other (specify) ▶ ________ ☐

10a If you filed Form 2555 or 2555-EZ after 1981, enter the last year you filed the form. ▶ 1999
b If you did not file Form 2555 or 2555-EZ after 1981, check here ▶ ☐ and go to line 11a now.
c Have you ever revoked the foreign earned income exclusion? . . . ☐ **Yes** ☐ **No**
d If you answered "Yes," enter the tax year for which the revocation was effective. ▶ ________
11a List your tax home(s) during 2000 and date(s) established. ▶ France 6-1-94
b Of what country are you a citizen/national? ▶ United States

For Paperwork Reduction Act Notice, see page 3 of separate instructions. Cat. No. 13272W Form **2555-EZ** (2000)

Form 2555-EZ (2000) Page **2**

Part III Days Present in the United States—Complete this part if you were in the United States or its possessions during 2000.

12 (a) Date arrived in U.S.	(b) Date left U.S.	(c) Number of days in U.S. on business	(d) Income earned in U.S. on business (attach computation)

Part IV Figure Your Foreign Earned Income Exclusion

		Line	Amount
13	Maximum foreign earned income exclusion . . .	13	$76,000 00
14	Enter the number of days in your qualifying period that fall within 2000 — 14: 366 days		
15	Did you enter 366 on line 14? ☐ **Yes.** Enter "1.000." ☐ **No.** Divide line 14 by 366 and enter the result as a decimal (rounded to at least three places).	15	× 1. 000
16	Multiply line 13 by line 15 . . .	16	76,000
17	Enter, in U.S. dollars, the total foreign earned income you earned and received in 2000 (see instructions). Be sure to include this amount on Form 1040, line 7 . . .	17	44,000
18	**Foreign earned income exclusion.** Enter the **smaller** of line 16 or line 17 here and in parentheses on **Form 1040, line 21.** Next to the amount enter "2555-EZ." On Form 1040, subtract this amount from your income to arrive at total income on Form 1040, line 22 . . . ▶	18	44,000

Form **2555-EZ** (2000)

5.

Exemptions, Deductions, and Credits

Topics

This chapter discusses:

- Items related to excluded income,
- The exemption for a nonresident alien spouse or dependent,
- Contributions to a foreign charitable organization,
- Moving expenses,
- Contributions to individual retirement arrangements (IRAs),
- Taxes of foreign countries and U.S. possessions, and
- How to report deductions.

Useful Items

You may want to see:

Publication

☐ **501** Exemptions, Standard Deduction, and Filing Information

☐ **514** Foreign Tax Credit for Individuals

☐ **521** Moving Expenses

☐ **523** Selling Your Home

☐ **590** Individual Retirement Arrangements (IRAs) (Including Roth IRAs and Education IRAs)

☐ **597** Information on the United States–Canada Income Tax Treaty

Form (and Instructions)

☐ **1116** Foreign Tax Credit (Individual, Estate, Trust, or Nonresident Alien Individual)

☐ **2106** Employee Business Expenses

☐ **2555** Foreign Earned Income

☐ **2555–EZ** Foreign Earned Income Exclusion

☐ **3903** Moving Expenses

☐ **Schedule A (Form 1040)** Itemized Deductions

☐ **Schedule C (Form 1040)** Profit or Loss From Business

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

Exclusion vs. Deduction

U.S. citizens and resident aliens living outside the United States generally are allowed the same deductions as citizens and residents living in the United States.

If you choose to exclude foreign earned income or housing amounts, 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 that are allocable to the excluded income. You can deduct only those expenses connected with earning includible income.

These rules apply only to items definitely related to the excluded earned income and they do not apply to other items that are not definitely related to any particular type of gross income. These rules do not apply to items such as personal exemptions, qualified retirement contributions, alimony payments, charitable contributions, medical expenses, mortgage interest, or real estate taxes on your personal residence. For purposes of these rules, your housing deduction is not treated as allocable to your excluded income, but the deduction for self-employment tax is.

If you receive foreign earned income in a tax year after the year in which you earned it, you may have to file an amended return for the earlier year to properly adjust the amounts of deductions, credits, or exclusions allocable to your foreign earned income and housing exclusions.

Example. If you excluded all of your $74,000 foreign earned income in 1999, you would not have been able to claim any deductions allocable to that excluded income. If you then receive a bonus of $10,000 in 2000 for work you did abroad in 1999, you cannot exclude it because it exceeds the foreign earned income exclusion limit in effect for 1999. (You have no housing exclusion.) But, you can file an amended return for 1999 to claim the 10/80 of your allocable deductions that are now allowable ($10,000 included foreign earned income over $80,000 total foreign earned income).

Exemptions

You can claim an exemption for your nonresident alien spouse on your separate return, provided your spouse has no gross income for U.S. tax purposes and is not the dependent of another U.S. taxpayer.

You can also claim exemptions for dependents who qualify under all the dependency tests. The dependent must be a U.S. citizen or national, or must be a resident of the United States, Canada, or Mexico for some part of the calendar year in which your tax year begins.

Social security number. You must include on your return the social security number of each dependent for whom you claim an exemption. To get a social security number for a dependent, apply at a Social Security office or U.S. consulate outside the United States. You must provide original or certified copies of documents to verify the dependent's age, identity, and citizenship and complete Form SS–5.

If your dependent is a nonresident alien who is not eligible to get a social security number, you must apply for an IRS Individual Taxpayer Identification Number (ITIN). To apply for an ITIN, file Form W–7 with the IRS. It usually takes 30 days to get an ITIN. Enter your dependent's ITIN wherever an SSN is requested on your tax return.

Children. Children usually are citizens or residents of the same country as their parents. If you were a U.S. citizen when your child was born, your child generally is a U.S. citizen. This is true even if the child's other parent is a nonresident alien, the child was born in a foreign country, and the child lives abroad with the other parent.

If you are a U.S. citizen living abroad and have a legally adopted child who is not a U.S. citizen or resident, you can claim an exemption for the child as a dependent if your home is the child's main home and the child is a member of your household for your entire tax year. For more information, see Publication 501.

Contributions

If you make contributions directly to a foreign church or other foreign charitable organization, you cannot deduct the contributions (unless you make them to certain Canadian, Israeli, or Mexican organizations). However, you can deduct contributions to a U.S. organization that transfers funds to a charitable foreign organization if the U.S. organization controls the use of the funds by the foreign organization, or if the foreign organization is just an administrative arm of the U.S. organization.

Under income tax treaties, you can deduct contributions to certain Canadian, Israeli, and Mexican charitable organizations. These organizations must meet the qualifications that a U.S. charitable organization must meet under U.S. tax law. The organization can tell you whether it qualifies. If you are unable to get this information from the organization itself, contact IRS at the address below.

You cannot deduct more than the percentage limit on charitable contributions applied to your Canadian, Israeli, or Mexican source income. If you or a member of your family is enrolled at a Canadian college or university, the limit does not apply to gifts to that school. For additional information on the deduction of contributions to Canadian charities, see Publication 597.

For more information on these treaty provisions, write to:

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

Moving Expenses

If you moved to a new home in 2000 because of your job or business, you may be able to deduct the expenses of your move. To be deductible, the moving expenses must have been paid or incurred in connection with starting work at a new job location.

Requirements

You may be able to deduct moving expenses if you meet the following requirements.

Distance

The distance from your new job location to your former home must be *at least 50 miles* more than the distance from your old job location to your former home. If you did not have an old job location, your new job location must be at least 50 miles from your former home.

Time

You must work full time for at least ***39 weeks during the first 12 months*** after you move. If you are self-employed, you must work full time for at least ***39 weeks during the first 12 months AND*** for at least **78 weeks during the first 24 months** after you move.

Retirees. You can deduct your allowable moving expenses if you move to the United States when you permanently retire if your principal place of work and former home were outside the United States and its possessions. You do not have to meet the time test. The other requirements must be met.

Survivors. You can deduct moving expenses for a move to a home in the United States if you are the spouse or dependent of a person whose principal place of work at the time of death was outside the United States or its possessions. The move must begin within 6 months after the decedent's death and must be from the decedent's former home outside the United States in which you lived with the decedent at the time of death. You are not required to meet the time test. The other requirements must be met.

Closely Related to the Start of Work

Your move must be closely related, both in time and in place, to the start of work at your new job location.

Closely related in time. In general, moving expenses incurred within one year from the date you first reported to work at the new location are considered closely related in time to the start of work.

If you do not move within one year, you ordinarily cannot deduct the expenses unless you can show that circumstances existed that prevented the move within that time.

Example. Your family moved more than a year after you started work at a new location. Their move was delayed because you allowed your child to complete high school. You can deduct your allowable moving expenses.

Closely related in place. A move is generally considered closely related in place to the start of work if the distance from your new home to the new job location is not more than the distance from your former home to the new job location. A move that does not meet this requirement may qualify if you can show that:

1) A condition of employment requires you to live at your new home, or
2) You will spend less time or money commuting from your new home to your new job.

Deductible Expenses

You can only deduct certain expenses.

Reasonable expenses. You can only deduct expenses that are reasonable for the circumstances of your move. The cost of traveling from your former home to your new one should be by the shortest, most direct route available by conventional transportation.

Reimbursements. If you are reimbursed by your employer for allowable moving expenses, these reimbursements may have been excluded from your income. You cannot deduct moving expenses for which you were reimbursed by your employer unless the reimbursement was included in your income.

Deductible moving expenses. Some of the moving expenses that you may be able to deduct include the reasonable costs of:

1) Moving household goods and personal effects (including packing, crating, in-transit storage, and insurance) of both you and ***members of your household***. For ***foreign moves***, costs of moving household goods and personal effects include reasonable expenses of moving the items to and from storage and storing them while your new place of work abroad is your principal place of work.
2) Transportation and lodging for yourself and members of your household for one trip from your former home to your new home (including costs of getting passports).

Members of your household. A member of your household includes anyone who has both your former and new home as his or her home. It does not include a tenant or employee unless that person is your dependent.

Foreign moves. A foreign move is a move in connection with the start of work at a new job location outside the United States and its possessions. A foreign move does not include a move back to the United States or its possessions.

Allocation of Moving Expenses

When your new place of work is in a foreign country, your moving expenses are directly connected with the income earned in that foreign country. If all or part of the income that you earn at the new location is excluded under the foreign earned income exclusion or the housing exclusion, the part of your moving expense that is allocable to the excluded income is ***not*** deductible.

Also, if you move from a foreign country to the United States and:

- You are reimbursed for your move by your employer,
- You are able to treat the reimbursement as compensation for services performed in the foreign country, and
- You choose to exclude your foreign earned income,

you cannot deduct the part of the moving expense that is related to the excluded income.

The moving expense is connected with earning the income (including reimbursements, as discussed in chapter 4 under *Reimbursement of moving expenses*) either entirely in the year of the move or in 2 years. It is connected with earning the income entirely in the year of the move if you qualify under the bona fide residence test or physical presence test for at least 120 days during that tax year.

If you do not qualify under either the bona fide residence test or the physical presence test for at least 120 days during the year of the move, the expense is connected with earning the income in 2 years. The moving expense is connected with the year of the move and the following year if the move is from the United States to a foreign country, ***or*** the year of the move and the preceding year if the move is from a foreign country to the United States.

To figure the amount of your moving expense that is allocable to your excluded foreign earned income (and not deductible), you must multiply your total moving expense deduction by a fraction. The numerator (top number) of the fraction is your total excluded foreign earned income and housing amounts for both years and the denominator (bottom number) of the fraction is the total foreign earned income for both years.

Example. You are transferred by your employer as of November 1, 1999, to a foreign country. Your tax home is in the foreign country, and you qualify as a bona fide resident for the entire tax year 2000. In 1999 you paid $6,000 for allowable moving expenses for your move from the United States to the foreign country. You were fully reimbursed (under a nonaccountable plan) for these expenses in the same year. The reimbursement is included in your income. Your only other income consists of $14,000 wages earned in 1999 after the date of your move, and $80,000 wages earned in the foreign country for the entire year 2000. You exclude the maximum amount under the foreign earned income exclusion and have no housing exclusion.

Because you did not meet the bona fide residence test for at least 120 days during 1999, the year of the move, the moving expenses are for services you performed in both 1999 and the following year, 2000. Your total foreign earned income for both years is $100,000, consisting of $14,000 wages for 1999, $80,000 wages for 2000, and $6,000 moving expense reimbursement for both years.

Of this total, $88,367 is excluded, consisting of the $76,000 full-year exclusion for 2000 and a $12,367 part-year exclusion for 1999 ($74,000 times the fraction of 61 qualifying bona fide residence days over 365 total days in the year). To find the part of your moving expenses that is not deductible, multiply your $6,000 total expenses by the fraction $88,367 over $100,000. The result, $5,302, is your nondeductible amount.

CAUTION *You must report the full amount of the moving expense reimbursement in the year in which you received the reimbursement. In the preceding example, this year was 2000. You attribute the reimbursement to both 1999 and 2000* ***only*** *to figure the amount of foreign earned income eligible for exclusion for each year.*

Move between foreign countries. If you move between foreign countries and you qualified under the bona fide residence test or the physical presence test for at least 120 days during the year of the move, your moving expense is allocable to the income earned in the year of the move.

New place of work in U.S. If your new place of work is in the United States, the deductible moving expenses are directly connected with the income earned in the United States. If you treat a reimbursement from your employer as foreign earned income (see the discussion in chapter 4), you must allocate deductible moving expenses to foreign earned income.

Storage expenses. These expenses are attributable to services you perform during the year in which the storage expenses are incurred. The amount allocable to excluded income is not deductible.

Recapture of Moving Expense Deduction

If your moving expense deduction is attributable to your foreign earnings in 2 years (the year of the move and the following year), you should request an extension of time to file your return for the year of the move until after the end of the following year. You should then have all the information needed to properly figure the moving expense deduction. See *Extensions* under *When To File and Pay* in chapter 1.

If you do not request an extension, you should figure the part of the entire moving expense deduction that is disallowed. You do this by multiplying the moving expense by a fraction, the numerator (top number) of which is your excluded foreign earned income for the year of the move, and the denominator (bottom number) of which is your total foreign earned income for the year of the move. Once you know your foreign earnings and exclusion for the following year, you must either:

1) Adjust the moving expense deduction by filing an amended return for the year of the move, or
2) Recapture any additional unallowable amount as income on your return for the following year.

If, after you make the final computation, you have an additional amount of allowable moving expense deduction, you can claim this only on an amended return for the year of the move. You cannot claim it on the return for the second year.

Forms to file. Report your moving expenses on Form 3903. Report your moving expense deduction on line 26 of Form 1040. If you must reduce your moving expenses by the amount allocable to excluded income as explained later under *How To Report Deductions*, attach a statement to your return showing how you figured this amount.

For more information about figuring moving expenses, see Publication 521.

Individual Retirement Arrangements

Contributions to your individual retirement arrangements (IRAs) that are traditional IRAs or Roth IRAs are generally limited to the lesser of $2,000 or your compensation that is includible in your gross income for the tax year. Therefore, do not take into account compensation up to the amount of your foreign earned income exclusion and foreign housing exclusion, if any. Do not reduce your compensation by the foreign housing deduction.

If you are covered by an employer retirement plan at work, your deduction for your contributions to your traditional IRAs are generally limited based on your modified adjusted gross income. This is your adjusted gross income figured without taking into account the foreign earned income exclusion, the foreign housing exclusion, or the foreign housing deduction. Other modifications are also required. For more information on IRAs, see Publication 590.

Taxes of Foreign Countries and U.S. Possessions

You can take either a credit or a deduction for income taxes imposed on you by a foreign country or a U.S. possession. Taken as a deduction, foreign income taxes reduce your taxable income. Taken as a credit, foreign income taxes reduce your tax liability. You must treat all foreign income taxes in the same way. You generally cannot deduct some foreign income taxes and take a credit for others. However, regardless of whether you take a credit for foreign income taxes, you may be able to deduct other foreign taxes. See *Deduction for Other Foreign Taxes,* later.

There is no rule to determine whether it is to your advantage to take a deduction or a credit for foreign income taxes. In most cases, it is to your advantage to take foreign income taxes as a tax credit, which you subtract directly from your U.S. tax liability, rather than as a deduction in figuring taxable income. However, if foreign income taxes were imposed at a high rate, and the proportion of foreign income to U.S. income is small, a lower final tax may result from taking the foreign income tax deduction. In any event, you should figure your tax liability both ways and then use the one that is better for you.

You can make or change your choice within 10 years from the due date for filing your U.S. tax return for the tax year for which you make the claim.

The terms “foreign country” and “foreign taxes” include possessions of the United States and the income taxes imposed by these possessions. See *Foreign Country,* in chapter 4.

Foreign income taxes. These are generally income taxes you pay to any foreign country.

The foreign income tax you can claim is the amount of foreign income tax that is the legal and actual tax liability you pay or accrue during the year. The amount you claim is not necessarily the amount of tax withheld by the foreign country. You cannot take a foreign tax credit or deduction for income tax you paid to a foreign country that would be refunded by the foreign country if you made a claim for refund.

Subsidies. If a foreign country returns your foreign tax payments to you in the form of a subsidy, you cannot claim these payments as taxes qualified for the foreign tax credit. This rule applies to a subsidy provided by any means that is determined, directly or indirectly, by reference to the amount of tax, or to the base used to figure the tax.

Some ways of providing a subsidy are refunds, credits, deductions, payments, or discharges of obligations. The credit is also not allowed if the subsidy is given to a person related to you, or persons who participated in a transaction or a related transaction with you.

Foreign income taxes on U.S. return. Foreign income taxes can only be taken as a credit on Form 1040, line 43, or as an itemized deduction on Schedule A. These amounts cannot be included as withheld income taxes on Form 1040, line 58.

Foreign taxes paid on excluded income. You cannot take a credit or deduction for foreign income taxes paid on income that is exempt from tax under the foreign earned income exclusion, the foreign housing exclusion, or the possession exclusion. If your wages are completely excluded, you cannot deduct or take a credit for any of the foreign taxes paid on these wages.

If only part of your wages is excluded, you cannot deduct or take a credit for the foreign income taxes allocable to the excluded part. You find the taxes allocable to your excluded wages by applying a fraction to the foreign taxes paid on foreign earned income received during the tax year. The numerator (top number) of the fraction is your excluded foreign earned income received during the tax year minus deductible expenses allocable to that income (not including the foreign housing deduction). The denominator (bottom number) of the fraction is your total foreign earned income received during the tax year minus all deductible expenses allocable to that income (including the foreign housing deduction).

If foreign law taxes both earned income and some other amount (for example, unearned income, earned income from U.S. sources, or a type of income not subject to U.S. tax), and the taxes on the other amount cannot be segregated, the denominator of the fraction is the total amount of income subject to foreign tax minus deductible expenses allocable to that income.

If you take a foreign tax credit for tax on income you could have excluded under your choice to exclude foreign earned income or your choice to exclude foreign housing costs, one or both of the choices may be considered revoked.

CAUTION *At the time this publication was being prepared for print, Congress was considering legislation that would replace the foreign sales corporation (FSC) provisions with an extraterritorial income exclusion. If the pending legislation is enacted, foreign taxes paid on excluded extraterritorial income will not qualify for the foreign tax credit or the deduction for foreign taxes. For more information about this and other important tax changes, see Publication 553,* Highlights of 2000 Tax Changes.

Credit for Foreign Income Taxes

If you take the foreign tax credit, you may have to file Form 1116 with Form 1040. Use Form 1116 to figure the amount of foreign tax paid or accrued that you can claim as a foreign tax credit. Do not include the amount of foreign tax paid or accrued as withheld federal income taxes on Form 1040, line 58.

Limit

The foreign tax credit is limited to the part of your total U.S. tax that is in proportion to your taxable income from sources outside the United States compared to your total taxable income. The allowable foreign tax credit cannot be more than your actual foreign tax liability.

Exemption from limit. You will not be subject to this limit and will not have to file Form 1116 if you meet all three of the following requirements.

1) Your only foreign source income for the tax year is passive income (dividends, interest, royalties, etc.) that is reported to you on a payee statement (such as a Form 1099–DIV or 1099–INT).
2) Your foreign taxes for the tax year that qualify for the credit are not more than $300 ($600 if filing a joint return) and are reported on a payee statement.
3) You elect this procedure for the tax year.

If you make this election, you cannot carry back or carry over any unused foreign tax to or from this tax year.

Separate limit. You must figure the limit on a separate basis with regard to each of the following categories of foreign source income (see the instructions for Form 1116).

- Passive income.
- High withholding tax interest.
- Financial services income.
- Shipping income.
- Certain dividends from a domestic international sales corporation (DISC) or former DISC.
- Certain distributions from a foreign sales corporation (FSC) or former FSC.
- Any lump-sum distributions from employer benefit plans for which a special averaging treatment is used to determine your tax.
- Section 901(j) income.
- Income resourced by treaty.
- All other income not included above (general limitation income).

Figuring the limit. In figuring taxable income in each category, you take into account only the amount that you must include in income on your federal tax return. Do not take any excluded amount into account.

To determine your taxable income in each category, deduct expenses and losses that are definitely related to that income.

Other expenses (such as itemized deductions or the standard deduction) not definitely related to specific items of income must be apportioned to the foreign income in each category by multiplying them by a fraction. The numerator (top number) of the fraction is your gross foreign income in the separate limit category. The denominator (bottom number) of the fraction is your gross income from all sources. For this purpose, gross income includes amounts that are otherwise exempt or excluded. You must use special rules for deducting interest expenses. For more information on allocating and apportioning your deductions, see Publication 514.

Exemptions. Do not take the deduction for exemptions for yourself, your spouse, or your dependents in figuring taxable income for purposes of the limit.

Recapture of foreign losses. If you have an overall foreign loss and the loss reduces your U.S. source income (resulting in a reduction of your U.S. tax liability), you must recapture the loss in later years when you have taxable income from foreign sources. This is done by treating a part of your taxable income from foreign sources in later years as U.S. source income. This reduces the numerator of the limiting fraction and the resulting foreign tax credit limit.

Foreign tax credit carryback and carryover. The amount of foreign income tax not allowed as a credit because of the limit can be carried back 2 years and carried forward 5 years.

More information on figuring the foreign tax credit can be found in Publication 514.

Deduction for Foreign Income Taxes

Instead of taking the foreign tax credit, you can deduct foreign income taxes as an itemized deduction on Schedule A (Form 1040).

You can claim a deduction ***only*** for those foreign income taxes paid on income that is subject to U.S. tax. You cannot claim a deduction for foreign taxes paid on income you exclude under the foreign earned income or housing exclusions.

Example. You are a U.S. citizen and qualify to exclude your foreign earned income. Your excluded wages in Country X are $70,000 on which you paid income tax of $10,000. You received dividends from Country X of $2,000 on which you paid income tax of $600.

You can claim a deduction for the $600 tax payment because the dividends relating to it are subject to U.S. tax. Because the wages are exempt from U.S. tax, you cannot claim a deduction for the income tax of $10,000.

If only a part of your earnings are excluded, see the earlier discussion under *Foreign taxes paid on excluded income.*

Deduction for Other Foreign Taxes

You can deduct real property taxes you pay that are imposed on you by a foreign country. You take this deduction on Schedule A (Form 1040). You cannot deduct other foreign taxes, such as personal property taxes, unless you incurred the expenses in a trade or business or in the production of income.

On the other hand, you generally can deduct personal property taxes when you pay them to U.S. possessions. But if you claim the possession exclusion, see Publication 570.

The deduction for foreign taxes other than foreign income taxes is not related to the foreign tax credit. You can take deductions for these miscellaneous foreign taxes and also claim the foreign tax credit for income taxes imposed by a foreign country.

How To Report Deductions

If you exclude foreign earned income or housing amounts, how you show your deductions on your tax return and how you figure the amount allocable to your excluded income depends on whether the expenses are used in figuring adjusted gross income (Form 1040, line 33) or are itemized deductions.

If you have deductions ***used in figuring adjusted gross income,*** enter the total amount for each of these items on the appropriate lines and schedules of Form 1040. Generally, you figure the amount of a deduction related to the excluded income by multiplying the deduction by a fraction, the numerator of which is your foreign earned income exclusion and the denominator of which is your foreign earned income. Enter the amount of the deduction(s) related to excluded income on line 42 of Form 2555.

If you have ***itemized deductions*** related to excluded income, enter on Schedule A (Form 1040) only the part not related to excluded income. You figure that amount by subtracting from the deduction the amount related to excluded income. Generally, you figure the amount that is related to the excluded income by multiplying the deduction by a fraction, the numerator of which is your foreign earned income exclusion and the denominator of which is your foreign earned income. Attach a statement to your return showing how you figured the deductible amount.

Example 1. You are a U.S. citizen employed as an accountant. Your tax home is in a foreign country for the entire tax year. You meet the physical presence test. Your foreign earned income for the year was $100,000, of which you choose to exclude $76,000. You have no housing exclusion. You had unreimbursed business expenses of $1,500 for travel and entertainment in earning your foreign income, of which $500 were for meals and entertainment. These expenses are deductible only as miscellaneous deductions on Schedule A (Form 1040). You also have $500 of miscellaneous expenses for managing investments that you enter on line 22 of Schedule A.

You must fill out Form 2106. On that form, reduce your deductible meal and entertainment expenses by 50% ($250). You must reduce the remaining $1,250 of travel and entertainment expenses by 76% ($950) because you excluded 76% ($76,000/$100,000) of your foreign earned income. You carry the remaining total of $300 to line 20 of Schedule A. Add the $300 to the $500 that you have on line 22 and enter the total ($800) on line 23.

On line 25 of Schedule A, enter $480, which is 2% of your adjusted gross income of $24,000 (line 34, Form 1040) and subtract it from the amount on line 23.

Enter $320 on line 26 of Schedule A.

Example 2. You are a U.S. citizen, have a tax home in a foreign country, and meet the physical presence test. You are self-employed and personal services produce the business income. Your gross income was $100,000, business expenses $60,000, and net income (profit) $40,000. You choose the foreign earned income exclusion and exclude $76,000 of your gross income. Since your excluded income is 76% of your total income, 76% of your business expenses are not deductible. Report your total income and expenses on Schedule C (Form 1040). On Form 2555 you will show the following:

1) Line 20a, $100,000, gross income
2) Lines 40 and 41, $76,000, foreign earned income exclusion
3) Line 42, $45,600 (76% × 60,000) business expenses attributable to the exclusion.

TIP *In this situation (Example 2), you cannot use Form 2555–EZ since you had self-employment income and business expenses.*

Example 3. Assume in *Example 2,* that both capital and personal services combine to produce the business income. No more than 30% of your net income, or $12,000, assuming that this amount is a reasonable allowance for your services, is considered earned and can be excluded. Your exclusion of $12,000 is 12% of your gross income ($12,000/$100,000). Because you excluded 12% of your total income, $7,200, or 12% of your business expenses, are attributable to the excluded income and are not deductible.

Example 4. You are a U.S. citizen, have a tax home in a foreign country, and meet the physical presence test. You are self-employed and both capital and personal services combine to produce business income. Your gross income was $146,000, business expenses were $172,000, and your net loss was $26,000. A reasonable allowance for the services you performed for the business is $77,000. Because you incurred a net loss, the earned income limit of 30% of your net profit does not apply. The $77,000 is foreign earned income. If you choose to exclude the maximum $76,000, you exclude 52% of your gross income ($76,000/$146,000), and 52% of your business expenses ($89,440) are attributable to that income and not deductible. Show your total income and expenses on Schedule C (Form 1040). On Form 2555, exclude $76,000 and show $89,440 on line 42. Subtract line 42 from line 41, and enter the difference as a negative (in parentheses) on line 43. Because this amount is negative, enter it as a positive (no parentheses) on line 21, Form 1040, and combine it with your other income to arrive at total income on line 22 of Form 1040.

TIP *In this situation (Example 4), you would probably not want to choose the foreign earned income exclusion if this was the first year you were eligible. If you had chosen the exclusion in an earlier year, you might want to revoke the choice for this year. To do so would mean that you could not claim the exclusion again for the next 5 tax years without IRS approval. See* Choosing the Exclusion, *in chapter 4.*

Example 5. You are a U.S. citizen, have a tax home in a foreign country, and meet the bona fide residence test. You have been performing services for clients as a partner in a firm that provides services exclusively in a foreign country. Capital investment is not material in producing the partnership's income. Under the terms of the partnership agreement, you are to receive 50% of the net profits. The partnership received gross income of $200,000 and incurred operating expenses of $80,000. Of the net profits of $120,000, you received $60,000 as your distributive share.

You choose to exclude $76,000 of your share of the gross income. Because you exclude 76% ($76,000/$100,000) of your share of the gross income, you cannot deduct $30,400, 76% of your share of the operating expenses (76% × $40,000). Report $60,000, your distributive share of the partnership net profit, on Schedule E (Form 1040). On Form 2555, exclude $76,000 and show $30,400 on line 42.

TIP *In this situation (Example 5), you would not use Form 2555–EZ since you had earned income other than salaries and wages and you had business expenses.*

6. Tax Treaty Benefits

Topics

This chapter discusses:

- Some common tax treaty benefits,
- How to get help in certain situations, and
- How to get copies of tax treaties.

Useful Items

You may want to see:

Publication

- ☐ **597** Information on the United States–Canada Income Tax Treaty
- ☐ **901** U.S. Tax Treaties

See chapter 7 for information about getting these publications.

Purpose of Tax Treaties

The United States has tax treaties or conventions with many countries under which citizens and residents of the United States who are subject to taxes imposed by foreign countries are entitled to certain credits, deductions, exemptions, and reductions in the rate of taxes of those foreign countries. If a foreign country with which the United States has a treaty imposes a tax on you, you may be entitled to benefits under the treaty. See *Table 6–1,* later.

Treaty benefits generally are available to residents of the United States. They generally are not available to U.S. citizens who do not reside in the United States. However, certain treaty benefits and safeguards, such as the nondiscrimination provisions, are available to U.S. citizens residing in the treaty countries. U.S. citizens residing in a foreign country may also be entitled to benefits under that country's tax treaties with third countries.

TIP *You should carefully examine the specific treaty articles that may apply to find if you are entitled to a tax credit, tax exemption, reduced rate of tax, or other treaty benefit or safeguard.*

Common Benefits

Some common tax treaty benefits are explained below. The credits, deductions, exemptions, reductions in rate, and other benefits provided by tax treaties are subject to conditions and various restrictions. Benefits provided by certain treaties are not provided by others.

1. Personal service income. If you are a U.S. resident who is in a treaty country for a limited number of days in the tax year and you meet certain other requirements, any pay you receive for personal services performed in that country may be exempt from that country's income tax.

2. Professors and teachers. If you are a U.S. resident, pay you receive for the first 2 or 3 years that you are teaching or doing research in a treaty country may be exempt from that country's income tax.

3. Students, trainees, and apprentices. If you are a U.S. resident, amounts you receive from the United States for study, research, or business, professional and technical training may be exempt from a treaty country's income tax.

Some treaties exempt grants, allowances, and awards received from governmental and certain nonprofit organizations. Also, under certain circumstances, a limited amount of pay received by students, trainees, and apprentices may be exempt from the income tax of many treaty countries.

4. Pensions and annuities. If you are a U.S. resident, any nongovernment pensions and annuities you receive may be exempt from the income tax of treaty countries.

Most treaties contain separate provisions for exempting government pensions and annuities from treaty country income tax, and some treaties provide exemption from the treaty country's income tax for social security payments.

5. Investment income. If you are a U.S. resident, investment income, such as interest and dividends, that you receive from sources in a treaty country may be exempt from that country's income tax or taxed at a reduced rate.

Several treaties provide exemption for capital gains (other than from sales of real property in most cases) if specified requirements are met.

6. Tax credit provisions. If you are a U.S. resident who receives income from or owns capital in a foreign country, you may be taxed on that income or capital by both the United States and the treaty country.

Most treaties allow you to take a credit against or deduction from the treaty country's taxes based on the U.S. tax on the income.

7. Nondiscrimination provisions. Most U.S. tax treaties provide that the treaty country cannot discriminate by imposing more burdensome taxes on U.S. citizens who are residents of the treaty country than it imposes

Table 6-1. **Table of Tax Treaties** (Updated through December 31, 2000)

Country	Official Text Symbol[1]	General Effective Date	Citation	Applicable Treasury Explanations or Treasury Decision (T.D.)
Australia	TIAS 10773	Dec. 1, 1983	1986-2 C.B. 220	1986-2 C.B. 246
Austria	TIAS	Jan. 1, 1999		
Barbados	TIAS 11090	Jan. 1, 1984	1991-2 C.B. 436	1991-2 C.B. 466
Protocol	TIAS	Jan. 1, 1994		
Belgium	TIAS 7463	Jan. 1, 1971	1973-1 C.B. 619	
Protocol	TIAS 11254	Jan. 1, 1988		
Canada[2]	TIAS 11087	Jan. 1, 1985	1986-2 C.B. 258	1987-2 C.B. 298
Protocol	TIAS	Jan. 1, 1996		
China, People's Republic of	TIAS 12065	Jan. 1, 1987	1988-1 C.B. 414	1988-1 C.B. 447
Commonwealth of Independent States[3]	TIAS 8225	Jan. 1, 1976	1976-2 C.B. 463	1976-2 C.B. 475
Cyprus	TIAS 10965	Jan. 1, 1986	1989-2 C.B. 280	1989-2 C.B. 314
Czech Republic	TIAS	Jan. 1, 1993		
Denmark	TIAS	Jan. 1, 2001		
Egypt	TIAS 10149	Jan. 1, 1982	1982-1 C.B. 219	1982-1 C.B. 243
Estonia	TIAS	Jan. 1, 2000		
Finland	TIAS 12101	Jan. 1, 1991		
France	TIAS	Jan. 1, 1996		
Germany	TIAS	Jan. 1, 1990[4]		
Greece	TIAS 2902	Jan. 1, 1953	1958-2 C.B. 1054	T.D. 6109, 1954-2 C.B. 638
Hungary	TIAS 9560	Jan. 1, 1980	1980-1 C.B. 333	1980-1 C.B. 354
Iceland	TIAS 8151	Jan. 1, 1976	1976-1 C.B. 442	1976-1 C.B. 456
India	TIAS	Jan. 1, 1991		
Indonesia	TIAS 11593	Jan. 1, 1990		
Ireland	TIAS	Jan. 1, 1998		
Israel	TIAS	Jan. 1, 1995		
Italy	TIAS 11064	Jan. 1, 1985	1992-1 C.B. 442	1992-1 C.B. 473
Jamaica	TIAS 10207	Jan. 1, 1982	1982-1 C.B. 257	1982-1 C.B. 291
Japan	TIAS 7365	Jan. 1, 1973	1973-1 C.B. 630	1973-1 C.B. 653
Kazakstan	TIAS	Jan. 1, 1996		
Korea, Republic of	TIAS 9506	Jan. 1, 1980	1979-2 C.B. 435	1979-2 C.B. 458
Latvia	TIAS	Jan. 1, 2000		
Lithuania	TIAS	Jan. 1, 2000		
Luxembourg	TIAS 5726	Jan. 1, 1964	1965-1 C.B. 615	1965-1 C.B. 642
Mexico	TIAS	Jan. 1, 1994	1994-2 C.B. 424	1994-2 C.B. 489
Protocol	TIAS	Oct. 26, 1995		
Morocco	TIAS 10195	Jan. 1, 1981	1982-2 C.B. 405	1982-2 C.B. 427
Netherlands	TIAS	Jan. 1, 1994		
New Zealand	TIAS 10772	Nov. 2, 1983	1990-2 C.B. 274	1990-2 C.B. 303
Norway	TIAS 7474	Jan. 1, 1971	1973-1 C.B. 669	1973-1 C.B. 693
Protocol	TIAS 10205	Jan. 1, 1982	1982-2 C.B. 440	1982-2 C.B. 454
Pakistan	TIAS 4232	Jan. 1, 1959	1960-2 C.B. 646	T.D. 6431, 1960-1 C.B. 755
Philippines	TIAS 10417	Jan. 1, 1983	1984-2 C.B. 384	1984-2 C.B. 412
Poland	TIAS 8486	Jan. 1, 1974	1977-1 C.B. 416	1977-1 C.B. 427
Portugal	TIAS	Jan. 1, 1996		
Romania	TIAS 8228	Jan. 1, 1974	1976-2 C.B. 492	1976-2 C.B. 504
Russia	TIAS	Jan. 1, 1994		
Slovak Republic	TIAS	Jan. 1, 1993		
South Africa	TIAS	Jan. 1, 1998		
Spain	TIAS	Jan. 1, 1991		
Sweden	TIAS	Jan. 1, 1996		
Switzerland	TIAS	Jan. 1, 1998		
Thailand	TIAS	Jan. 1, 1998		
Trinidad and Tobago	TIAS 7047	Jan. 1, 1970	1971-2 C.B. 479	
Tunisia	TIAS	Jan. 1, 1990		
Turkey	TIAS	Jan. 1, 1998		
Ukraine	TIAS	Jan. 1, 2001		
United Kingdom	TIAS 9682	Jan. 1, 1975	1980-1 C.B. 394	1980-1 C.B. 455
Venezuela	TIAS	Jan. 1, 2000		

[1] (TIAS)—Treaties and Other International Act Series.
[2] Information on the treaty can be found in Publication 597, *Information on the United States—Canada Income Tax Treaty.*
[3] The U.S.—U.S.S.R. income tax treaty applies to the countries of Armenia, Azerbaijan, Belarus, Georgia, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan, and Uzbekistan.
[4] The general effective date for the area that was the German Democratic Republic is January 1, 1991.

on its own citizens in the same circumstances.

8. Saving clauses. U.S. treaties contain saving clauses that provide that the treaties do not affect the U.S. taxation of its own citizens and residents. As a result, U.S. citizens and residents generally cannot use the treaty to reduce their U.S. tax liability.

However, some treaties provide exceptions to saving clauses. It is important that you examine the applicable saving clause to determine if an exception applies.

Competent Authority Assistance

If you are a U.S. citizen or resident, you can request assistance from the U.S. competent authority if you think that the actions of the United States, a treaty country, or both, cause or will cause a tax situation not intended by the treaty between the two countries. You should read any specific treaty articles, including the mutual agreement procedure article, that apply in your situation.

If your request provides a basis for competent authority assistance, the U.S. competent authority will consult with the treaty country competent authority on how to resolve the situation.

The U.S. competent authority cannot consider requests involving countries with which the United States does not have an applicable tax treaty.

It is important that you make your request for competent authority consideration as soon as you have been denied treaty benefits or the actions of both the United States and the foreign country have resulted in double taxation or will result in taxation not intended by the treaty.

In addition to a timely request for assistance, you should take the following measures to protect your right to the review of your case by the competent authorities.

1) File a timely protective claim for credit or refund of U.S. taxes on Form 1040X to preserve your right to a foreign tax credit if you do not qualify for the treaty benefit in question.

2) Take appropriate action under the procedures of the foreign country to avoid the lapse or termination of your right of appeal under the foreign country's income tax law.

Your request for competent authority consideration should be addressed to:

Internal Revenue Service
Director, International
LM:IN:T
950 L'Enfant Plaza South, SW
Washington, DC 20024.

The request should contain all essential items of information including the following items.

- The facts from which the issue arises.
- The amounts of income and tax involved.
- A description of the issue and identification of the relevant treaty provisions.
- The respective positions taken by you and the foreign country.
- Copies of any protests, briefs, or other pertinent documents.

Additional details on the procedures for requesting competent authority assistance are included in Revenue Procedure 96–13, which is in Cumulative Bulletin 1996–1.

More information on treaties and problems. Publication 901 contains an explanation of treaty provisions that apply to amounts received by teachers, students, workers, and government employees and pensioners who are alien nonresidents or residents of the United States. Since treaty provisions generally are reciprocal, you can usually substitute "United States" for the name of the treaty country whenever it appears, and vice versa when "U.S." appears in the treaty exemption discussions in Publication 901.

Publication 597 contains an explanation of a number of frequently used provisions of the United States–Canada income tax treaty.

Obtaining Copies of Tax Treaties

Table 6–1 lists those countries with which the United States has income tax treaties. This table is updated through December 31, 2000.

You can get complete information about treaty provisions from the taxing authority in the country from which you receive income or from the treaty itself. The text of some of the treaties can be obtained from:

Department of Treasury
Office of Public Liaison
1500 Pennsylvania Ave. NW — Rm. 4418
Washington, DC 20220.

If you have specific questions about a treaty, you can get this information from most Internal Revenue Service offices or from:

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

7.
How To Get Tax Help

You can order free publications and forms, ask tax questions, and get more information from the IRS in several ways. By selecting the method that is best for you, you will have quick and easy access to tax help. Access to most of these services depends on whether you are inside or outside of the United States.

Services Available Inside the United States

You can get help with unresolved tax issues, order free publications and forms, ask tax questions, and get more information from the IRS in several ways. By selecting the method that is best for you, you will have quick and easy access to tax help.

Contacting your Taxpayer Advocate. If you have attempted to deal with an IRS problem unsuccessfully, you should contact your Taxpayer Advocate.

The Taxpayer Advocate represents your interests and concerns within the IRS by protecting your rights and resolving problems that have not been fixed through normal channels. While Taxpayer Advocates cannot change the tax law or make a technical tax decision, they can clear up problems that resulted from previous contacts and ensure that your case is given a complete and impartial review.

To contact your Taxpayer Advocate:

- Call the Taxpayer Advocate at **1–877–777–4778.**
- Call the IRS at **1–800–829–1040.**
- Call, write, or fax the Taxpayer Advocate office in your area.
- Call **1–800–829–4059** if you are a TTY/TDD user.

For more information, see Publication 1546, *The Taxpayer Advocate Service of the IRS.*

Free tax services. To find out what services are available, get Publication 910, *Guide to Free Tax Services.* It contains a list of free tax publications and an index of tax topics. It also describes other free tax information services, including tax education and assistance programs and a list of TeleTax topics.

Personal computer. With your personal computer and modem, you can access the IRS on the Internet at **www.irs.gov**. While visiting our web site, you can select:

- *Frequently Asked Tax Questions* (located under *Taxpayer Help & Ed)* to find answers to questions you may have.
- *Forms & Pubs* to download forms and publications or search for forms and publications by topic or keyword.
- *Fill-in Forms* (located under *Forms & Pubs)* to enter information while the form is displayed and then print the completed form.
- *Tax Info For You* to view Internal Revenue Bulletins published in the last few years.
- *Tax Regs in English* to search regulations and the Internal Revenue Code (under *United States Code (USC)).*
- *Digital Dispatch* and *IRS Local News Net* (both located under *Tax Info For Business)* to receive our electronic newsletters on hot tax issues and news.

- *Small Business Corner* (located under *Tax Info For Business)* to get information on starting and operating a small business.

You can also reach us with your computer using File Transfer Protocol at **ftp.irs.gov**.

TaxFax Service. Using the phone attached to your fax machine, you can receive forms and instructions by calling **703–368–9694.** Follow the directions from the prompts. When you order forms, enter the catalog number for the form you need. The items you request will be faxed to you.

Phone. Many services are available by phone.

- *Ordering forms, instructions, and publications.* Call **1–800–829–3676** to order current and prior year forms, instructions, and publications.
- *Asking tax questions.* Call the IRS with your tax questions at **1–800–829–1040.**
- *TTY/TDD equipment.* If you have access to TTY/TDD equipment, call **1–800–829–4059** to ask tax questions or to order forms and publications.
- *TeleTax topics.* Call **1–800–829–4477** to listen to pre-recorded messages covering various tax topics.

Evaluating the quality of our telephone services. To ensure that IRS representatives give accurate, courteous, and professional answers, we evaluate the quality of our telephone services in several ways.

- A second IRS representative sometimes monitors live telephone calls. That person only evaluates the IRS assistor and does not keep a record of any taxpayer's name or tax identification number.
- We sometimes record telephone calls to evaluate IRS assistors objectively. We hold these recordings no longer than one week and use them only to measure the quality of assistance.
- We value our customers' opinions. Throughout this year, we will be surveying our customers for their opinions on our service.

Walk-in. You can walk in to many post offices, libraries, and IRS offices to pick up certain forms, instructions, and publications. Also, some libraries and IRS offices have:

- An extensive collection of products available to print from a CD-ROM or photocopy from reproducible proofs.
- The Internal Revenue Code, regulations, Internal Revenue Bulletins, and Cumulative Bulletins available for research purposes.

Mail. You can send your order for forms, instructions, and publications to the Distribution Center nearest to you and receive a response within 10 workdays after your request is received. Find the address that applies to your part of the country.

- **Western part of U.S.:**
  Western Area Distribution Center
  Rancho Cordova, CA 95743–0001
- **Central part of U.S.:**
  Central Area Distribution Center
  P.O. Box 8903
  Bloomington, IL 61702–8903
- **Eastern part of U.S. and foreign addresses:**
  Eastern Area Distribution Center
  P.O. Box 85074
  Richmond, VA 23261–5074

CD-ROM. You can order IRS Publication 1796, *Federal Tax Products on CD-ROM,* and obtain:

- Current tax forms, instructions, and publications.
- Prior-year tax forms, instructions, and publications.
- Popular tax forms which may be filled in electronically, printed out for submission, and saved for recordkeeping.
- Internal Revenue Bulletins.

The CD-ROM can be purchased from National Technical Information Service (NTIS) by calling **1–877–233–6767** or on the Internet at **www.irs.gov/cdorders.** The first release is available in mid-December and the final release is available in late January.

IRS Publication 3207, *The Business Resource Guide,* is an interactive CD-ROM that contains information important to small businesses. It is available in mid-February. You can get one free copy by calling **1–800–829–3676.**

Services Available Outside the United States

During the filing period (January to mid-June), you can get the necessary federal tax forms and publications from U.S. Embassies and consulates. You can request Package 1040–7 for Overseas Filers, which contains special forms with instructions and Publication 54.

Also during the filing season, the IRS conducts an overseas taxpayer assistance program. To find out if IRS personnel will be in your area, you should contact the consular office at the nearest U.S. Embassy.

Phone. You can also call your nearest U.S. Embassy, consulate, or IRS office listed below to find out when and where assistance will be available. These IRS telephone numbers include the country and city codes required if you are outside the local dialing area.

Berlin, Germany	(49)	(30)	8305–1140
London, England	(44)	(207)	408–8077
Mexico City, Mexico	(52)	(5)	209–9100 Ext. 3557
Paris, France	(33)	(1)	4312–2555
Rome, Italy	(39)	(06)	4674–2560
Singapore	(65)		476–9413
Tokyo, Japan	(81)	(3)	3224–5466

Overseas taxpayers can also call the Puerto Rico site for help at (787) 759–5100.

If you are in Guam, the Bahamas, U.S. Virgin Islands, or Puerto Rico, you can call 1–800–829–1040.

Mail. For answers to technical or account questions, you can write to:

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

Personal computer. With your personal computer and modem, you can access the IRS on the Internet at **www.irs.gov**. For more information on the website, see *Personal computer* under *Services Available Inside the United States,* earlier.

Contacting your Taxpayer Advocate. If you have attempted to deal with an IRS problem unsuccessfully, you should contact your Taxpayer Advocate.

The Taxpayer Advocate represents your interests and concerns within the IRS by protecting your rights and resolving problems that have not been fixed through normal channels. While Taxpayer Advocates cannot change the tax law or make a technical tax decision, they can clear up problems that resulted from previous contacts and ensure that your case is given a complete and impartial review.

Mail. Persons living outside the United States may contact the Taxpayer Advocate at:

Internal Revenue Service
Taxpayer Advocate
P.O. Box 193479
San Juan, PR 00919.

You can also contact one of the IRS offices located abroad, listed earlier.

Phone. You can call the Taxpayer Advocate at (787)759–4501.

Fax. You can fax the Taxpayer Advocate at (787)759–4535.

This section answers tax-related questions commonly asked by taxpayers living abroad.

Filing Requirements—Where, When, and How

1) When are U.S. income tax returns due?

Generally, for calendar year taxpayers, U.S. income tax returns are due on April 15. If you are a U.S. citizen or resident and both your tax home and your abode are outside the United States and Puerto Rico on the regular due date, an automatic extension is granted to June 15 for filing the return. Interest will be charged on any tax due, as shown on the return, from April 15.

2) Where do I file my U.S. income tax return?

If you claim the foreign earned income exclusion, the foreign housing exclusion, or the foreign housing deduction on Form 2555, the foreign earned income exclusion on Form 2555–EZ, or an exclusion of income for bona fide residents of American Samoa on Form 4563, you should file your return with the:

Internal Revenue Service Center
Philadelphia, PA 19255-0215.

If you are not claiming one of the exclusions or the deduction, but are living in a foreign country or U.S. possession and have no legal residence or principal place of business in the United States, you should send your return to the address shown above.

If you are not sure of the place of your legal residence and have no principal place of business in the United States, you also can file with the Philadelphia Service Center. However, you should not file with the Philadelphia Service Center if you are a bona fide resident of the Virgin Islands or a resident of Guam or the Commonwealth of the Northern Mariana Islands on the last day of your tax year. See the discussion in chapter 1.

3) I am going abroad this year and expect to qualify for the foreign earned income exclusion. How can I secure an extension of time to file my return, when should I file my return, and what forms are required?

a) You should file Form 2350 by the due date of your return to request an extension of time to file. Form 2350 is a special form for those U.S. citizens or residents abroad who expect to qualify under either the bona fide residence test or physical presence test and would like to have an extension of time to delay filing until after they have qualified.

b) If the extension is granted, you should file your return after you qualify, but by the approved extension date.

c) You must file your Form 1040 with Form 2555 (or Form 2555–EZ).

4) My entire income qualifies for the foreign earned income exclusion. Must I file a tax return?

Maybe. Every U.S. citizen or resident must file a U.S. income tax return if certain income levels are reached. Income for filing requirement purposes is figured without regard to the foreign earned income exclusion. The income levels for filing purposes are discussed under *Filing Requirements* in chapter 1.

5) I was sent abroad by my company in November of last year. I plan to secure an extension of time on Form 2350 to file my tax return for last year because I expect to qualify for the foreign earned income exclusion under the physical presence test. However, if my company recalls me to the United States before the end of the qualifying period and I find I will not qualify for the exclusion, how and when should I file my return?

If your regular filing date has passed, you should file a return, Form 1040, as soon as possible for last year. Include a statement with this return noting that you have returned to the United States and will not qualify for the foreign earned income exclusion. You must report your worldwide income on the return. If you paid a foreign tax on the income earned abroad, you may be able to either deduct this tax or claim it as a credit against your U.S. income tax.

However, if you pay the tax due after the regular due date, interest will be charged from the regular due date until the date the tax is paid.

6) I am a U.S. citizen and have no taxable income from the United States, but I have substantial income from a foreign source. Am I required to file a U.S. income tax return?

Yes. All U.S. citizens and resident aliens, depending on the amount of the foreign source income, are subject to U.S. tax on their worldwide income. If you paid taxes to a foreign government on income from sources outside the United States, you may receive a foreign tax credit against your U.S. income tax liability for the foreign taxes paid. Form 1116 is used to figure the allowable credit.

7) I am a U.S. citizen who has retired, and I expect to remain in a foreign country. Do I have any further U.S. tax obligations?

Your U.S. tax obligation on your income is the same as that of a retired person living in the United States. (See the discussion in chapter 1 of this publication for filing requirements.) U.S. payers of certain pension benefits must withhold tax from payments unless the recipient provides a residence address in the United States or a U.S. possession.

8) I have been a bona fide resident of a foreign country for over 5 years. Is it necessary for me to pay estimated tax?

U.S. taxpayers overseas have the same requirements for paying estimated tax as those in the United States. See the discussion under *Estimated Tax* in chapter 1.

Overseas taxpayers should not include in their estimated income any income they receive that is, or will be, exempt from U.S. taxation.

Overseas taxpayers can deduct their estimated housing deduction in figuring their estimated tax.

The first installment of estimated tax is due on April 15 of the year for which the tax is paid.

9) Will a check payable in foreign currency be acceptable in payment of my U.S. tax?

Generally, only U.S. currency is acceptable for payment of income tax. However, if you are a Fulbright grantee, see the discussion under *Fulbright grants* in chapter 1.

10) I have met the test for physical presence in a foreign country and am filing returns for 2 years. Must I file a separate Form 2555 (or Form 2555–EZ) with each return?

Yes. A Form 2555 (or Form 2555–EZ) must be filed with each Form 1040 tax return on which the benefits of income earned abroad are claimed.

11) Does a Form 2555 (or 2555–EZ) with a Schedule C or Form W–2 attached constitute a return?

No. The Form 2555 (or 2555–EZ), Schedule C, and Form W–2 are merely attachments and do not relieve you of the requirement to file a Form 1040 to show the sources of income reported and the exclusions or deductions claimed.

12) On Form 2350, Application for Extension of Time to File U.S. Income Tax Return, I stated that I would qualify under the physical presence test. If I qualify under the bona fide residence test, can I file my return on that basis?

Yes. You can claim the foreign earned income exclusion and the foreign housing exclusion or deduction under either test as long as you meet the qualification requirements. You are not bound by the test indicated in the application for extension of time. You must be sure, however, that you file the Form 1040 return by the date approved on Form 2350, since a return filed after that date may be subject to a failure to file penalty.

If you will not qualify under the bona fide residence test until a date later than the extension granted under the physical presence rule, apply for a new extension to a date 30 days beyond the date you expect to qualify as a bona fide resident.

13) I am a U.S. citizen who worked in the United States for 6 months last year. I accepted employment overseas in July of last year and expect to qualify for the foreign earned income exclusion. Should I file a return and pay tax on the income earned in the United States during the first 6 months and then, when I qualify, file another return covering the last 6 months of the year?

No. You have the choice of one of the following two methods of filing your return:

a) You can file your return when due under the regular filing rules, report all your income without excluding your foreign earned income, and pay the tax due. After you have qualified for the exclusion, you can file an amended return, Form 1040X, accompanied by Form 2555 (or 2555–EZ), for a refund of any excess tax paid.

b) You can postpone the filing of your tax return by applying on Form 2350 for an extension of time to file to a date 30 days beyond the date you expect to qualify under either the bona fide residence test or the physical presence test, then file your return reflecting the exclusion of foreign earned income. This allows you to file only once and saves you from paying the tax and waiting for a refund. However, interest is charged on any tax due on the postponed tax return, but interest is not paid on refunds paid within 45 days after the return is filed. (If you have moving expenses that are for services performed in two years, you can be granted an extension to 90 days beyond the close of the year following the year of first arrival in the foreign country.)

14) I am a U.S. citizen. I have lived abroad for a number of years and have only recently realized that I should have been filing U.S. income tax returns. How do I correct this oversight in not having filed returns for these years?

File the late returns as soon as possible, stating your reason for filing late. For advice on filing the returns, you should contact the Internal Revenue Service representative serving your area, or the Internal Revenue official who travels through your area (details can be obtained from your nearest U.S. consulate or Embassy), or you can write to the:
Internal Revenue Service
International Returns Section
P.O. Box 920
Bensalem, PA 19020-8518.

15) In 1995 I qualified to exempt my income earned abroad, but I did not claim this exemption on the return I filed in 1996. I paid all outstanding taxes with the return. Can I file a claim for refund now?

It is too late to claim this refund since a claim for refund must be filed within 3 years from the date the return was filed or 2 years from the date the tax was paid, whichever is later. For this purpose, a return filed before the due date is considered filed on the due date.

Meeting the Requirements of Either the Bona Fide Residence Test or the Physical Presence Test

1) I recently came to Country X to work for the Orange Tractor Co., and I expect to be here for 5 or 6 years. I understand that upon the completion of 1 full year I will qualify under the bona fide residence test. Is this correct?

Not necessarily. The law provides that to qualify under this test for the foreign earned income exclusion, the foreign housing exclusion, or the foreign housing deduction, a person must be a “bona fide resident of a foreign country or countries for an uninterrupted period that includes an entire taxable year.”

If, like most U.S. citizens, you file your return on a calendar year basis, the taxable year referred to in the law would be from January 1 to December 31 of any particular year. Unless you established residence in Country X on January 1, it would be more than 1 year before you could qualify as a bona fide resident of a foreign country. Once you have completed your qualifying period, however, you are entitled to exclude the income or to claim the housing exclusion or deduction from the date you established bona fide residence.

2) I understand the physical presence test to be simply a matter of being physically present in a foreign country for at least 330 days within 12 consecutive months; but what are the criteria of the bona fide residence test?

To be a bona fide resident of a foreign country, you must show that you entered a foreign country intending to remain there for an indefinite or prolonged period and, to that end, you are making your home in that country. Consideration is given to the type of quarters occupied, whether your family went with you abroad, the type of visa, the employment agreement, and any other factor pertinent to show whether your stay in the foreign country is indefinite or prolonged.

To claim the foreign earned income exclusion or foreign housing exclusion or deduction under this test, the period of foreign residence must include 1 full tax year (usually January 1—December 31), but once you meet this time requirement, you figure the exclusions and the deduction from the date the residence actually began.

3) To meet the qualification of “an uninterrupted period which includes an entire taxable year” do I have to be physically present in a foreign country for the entire year?

No. Uninterrupted refers to the bona fide residence proper and not to the physical presence of the individual. During the period of bona fide residence in a foreign country, even during the first full year, you can leave the country for brief and temporary trips back to the United States or elsewhere for vacation, or even for business. To preserve your status as a bona fide resident of a foreign country, you must have a clear intention of returning from those trips, without unreasonable delay, to your foreign residence.

4) I am a U.S. citizen and during 1999 was a bona fide resident of Country X. On January 15, 2000, I was notified that I was to be assigned to Country Y. I was recalled to New York for 90 days orientation and then went to Country Y, where I have been since. Although I was not in Country X on January 1, I was a bona fide resident of Country X and was in Country Y on December 31, 2000. My family remained in Country X until completion of the orientation period, and my household goods were shipped directly to my new post. Can I qualify as a bona fide resident of a foreign country for 2000, or must I wait for the entire year of 2001 to qualify?

Since you did not break your period of foreign residence, you would continue to qualify as a bona fide resident for 2000.

5) Due to illness, I returned to the United States before I completed my qualifying period to claim the foreign earned income exclusion. Can I figure the exclusion for the period I resided abroad?

No. You are not entitled to any exclusion of foreign earned income since you did not complete your qualifying period under either the bona fide residence test or physical presence test. If you paid foreign tax on the income earned abroad, you may be able to claim that tax as a deduction or as a credit against your U.S. tax.

6) Can a resident alien of the United States qualify for an exclusion or deduction under the bona fide residence test or the physical presence test?

Resident aliens of the United States can qualify for the foreign earned income exclusion, the foreign housing exclusion, or the foreign housing deduction if they meet the requirements of the physical presence test. Certain resident aliens can qualify under the bona fide residence test.

7) On August 13 of last year I left the United States and arrived in Country Z to work for the Gordon Manufacturing Company. I expected to be able to exclude my foreign earned income under the physical presence test because I planned to be in Country Z for at least 1 year. However, I was reassigned back to the United States and left Country Z on July 1 of this year. Can I exclude any of my foreign earned income?

No. You cannot exclude any of the income you earned in Country Z because you were not in a foreign country for at least 330 full days as required under the physical presence test.

Foreign Earned Income

1) I am an employee of the U.S. Government working abroad. Can all or part of my government income earned abroad qualify for the foreign earned income exclusion?

No. The foreign earned income exclusion applies to your foreign earned income. Amounts paid by the United States or its agencies to their employees are not treated, for this purpose, as foreign earned income.

2) I qualify under the bona fide residence test. Does my foreign earned income include my U.S. dividends and the interest I receive on a foreign bank account?

No. The only income that is foreign earned income is income from the performance of personal services abroad. Investment income, including income from foreign investments, is not earned income. However, you must include it in gross income reported on your Form 1040.

3) My company pays my foreign income tax on my foreign earnings. Is this taxable compensation?

Yes. The amount is compensation for services performed. The tax paid by your company should be reported on Form 1040 and in item 22(f) of Part IV, Form 2555 (or line 17 of Part IV, Form 2555–EZ).

4) I live in an apartment in a foreign city for which my employer pays the rent. Should I include in my income the cost to my employer ($1,200 a month) or the fair market value of equivalent housing in the United States ($800 a month)?

No. You must include in income the fair market value (FMV) of the facility provided, where it is provided. This will usually be the rent your employer pays. Situations when the FMV is not included in income are discussed in chapter 4 under *Exclusion of meals and lodging*.

5) My U.S. employer pays my salary into my U.S. bank account. Is this considered U.S. income or foreign income?

If you performed the services to earn this salary outside the United States, your salary is considered earned abroad. It does not matter that you are paid by a U.S. employer or that your salary is deposited in a U.S. bank account in the United States. The source of salary, wages, commissions, and other personal service income is the place where you perform the services.

6) What is considered a foreign country?

For the purposes of the foreign earned income exclusion and the foreign housing exclusion or deduction, foreign country means any territory under the sovereignty of a country other than the United States. Possessions of the United States are not treated as foreign countries.

7) What is meant by the source of earned income?

The word “source” refers to the place where the work or personal services that produce earned income are performed. In other words, income received for work in a foreign country has its source in that country. The foreign earned income exclusion and the foreign housing exclusion or deduction are limited to earned income from sources within foreign countries.

Foreign Earned Income Exclusion

1) I qualify for the foreign earned income exclusion and earned more than $76,000 during the year. Am I entitled to the maximum $76,000 exclusion?

Not necessarily. Although you qualify for the foreign earned income exclusion, you may not have met either the bona fide residence test or the physical presence test for your entire tax year. If you did not meet either of these tests for your entire tax year, you must prorate the $76,000 maximum exclusion based on the number of days that you did meet either test during the year.

2) How do I qualify for the foreign earned income exclusion?

To be eligible, you must have a tax home in a foreign country and you must be a U.S. citizen or a resident alien who is a citizen or national of a country with which the United States has an income tax treaty in effect. You must be a bona fide resident of a foreign country or countries for an uninterrupted period that includes an entire tax year, or you must be a U.S. citizen or resident and be physically present in a foreign country or countries for at least 330 full days during any period of 12 consecutive months.

Your tax home must be in the foreign country or countries throughout your period of residence or presence. For this purpose, your period of physical presence is the 330 full days during which you are present in a foreign country, not the 12 consecutive months during which those days occur.

3) Is it true that my foreign earned income exclusion cannot exceed my foreign earned income?

Yes. The amount of the exclusion is limited each year to the amount of your foreign earned income after reducing that income by the foreign housing exclusion. The foreign earned income must be earned during the part of the tax year that you have your tax home abroad and meet either the bona fide residence test or the physical presence test.

4) My wife and I are both employed, reside together, and file a joint return. We meet the qualifications for claiming the foreign earned income exclusion. Do we each figure a separate foreign earned income exclusion and foreign housing exclusion?

You can each claim a foreign earned income exclusion since you both have foreign earned income. The amount of the exclusion for each of you cannot exceed your separate foreign earned incomes.

If you each have a housing amount, you can figure your housing exclusion either separately or jointly. See the discussion, *Married Couples Living Apart,* in chapter 4 for further details.

Exemptions and Dependency Allowances

1) I am a U.S. citizen married to a nonresident alien who has no income from U.S. sources. Can I claim an exemption for my spouse on my U.S. tax return?

Yes. You can claim an exemption for your nonresident alien spouse on your tax return if your spouse has no income from sources within the United States and is not the dependent of another U.S. taxpayer.

You must use the married filing separately column in the Tax Table or the Tax Rate Schedule for married individuals filing a separate return, unless you qualify as a head of household. (Also see Question 12 under *General Tax Questions, later.*)

A U.S. citizen or resident married to a nonresident alien also can choose to treat the nonresident alien as a U.S. resident for all federal income tax purposes. This allows you to file a joint return, but also subjects the alien's worldwide income to U.S. income tax.

2) What exemptions can be claimed by a U.S. citizen for a nonresident alien spouse who was blind and 65 years of age? The spouse did not have income from U.S. sources and was not a dependent of another U.S. taxpayer.

A U.S. taxpayer can generally claim one exemption for his or her spouse. In addition, if the U.S. taxpayer does not itemize deductions on Schedule A (Form 1040), the taxpayer may be entitled to a higher standard deduction if his or her spouse is age 65 or older or is blind at the end of the year.

3) I spend $375 a month to support my parents who live in Italy. I am sure this provides the bulk of their support. Can I claim exemptions for them?

It depends on whether they are U.S. citizens or residents. If your parents are not U.S. citizens or residents, you cannot claim exemptions for them even if you provide most of their support. To qualify as a dependent, a person generally must be either a citizen or national of the United States or a resident of the United States, Canada, or Mexico for some part of the tax year. The other tests of dependency also must be met.

4) Should I prorate my own personal exemption and the exemptions for my spouse and dependents, since I expect to exclude part of my income?

No. Do not prorate exemptions for yourself, your spouse, and your dependents. Claim the full amount for each exemption permitted.

Social Security and Railroad Retirement Benefits

1) Are U.S. social security benefits taxable?

Benefits received by U.S. citizens and resident aliens may be taxable, depending on the total amount of income and the filing status of the taxpayer.

Benefits similar to social security received from other countries by U.S. citizens or residents may be taxable. U.S. social security benefits are taxed by some foreign countries. (Refer to our tax treaties with various countries for any benefit granted by the treaty.)

2) As a U.S. citizen or resident, how do I figure the amount of my U.S. social security benefits to include in gross income?

See Publication 915, *Social Security and Equivalent Railroad Retirement Benefits,* to figure if any of your benefits are includible in income.

3) How are railroad retirement benefits taxed?

The part of a tier 1 railroad retirement benefit that is equivalent to the social security benefit you would have been entitled to receive if the railroad employee's work had been covered under the social security system rather than the railroad retirement system is treated the same as a social security benefit, discussed above.

The other part of a tier 1 benefit that is not considered a social security equivalent benefit is treated like a private pension or annuity, as are tier 2 railroad retirement benefits. Pensions and annuities are explained in chapter 4 under *Earned and Unearned Income.* Vested dual benefits and supplemental annuities are also treated like private pensions but are fully taxable.

The proper amounts of the social security equivalent part of tier 1 benefits and any special guaranty benefits are shown on the Form RRB–1099, *Payments by the Railroad Retirement Board,* that you receive from the Railroad Retirement Board. The taxable amounts of the non-social security equivalent part of tier 1, tier 2, vested dual benefits, and supplemental annuities are shown on the Form RRB–1099–R, *Annuities or Pensions by the Railroad Retirement Board,* that you receive from the Railroad Retirement Board.

Social Security Tax and Self-Employment Tax

1) I am a minister with earned income from abroad and expect to qualify for the foreign earned income exclusion. How do I pay the self-employment tax that results from social security coverage?

File a Form 1040 with Schedule SE and Form 2555. Figure your self-employment tax on Schedule SE and enter it on Form 1040 as the tax due with the return.

2) Because I expect to qualify for the foreign earned income exclusion, I have requested and received an extension of time until January 30, 2002, to file my 2000 return. However, since I will be paying self-employment tax on my spouse's income, should I file a 2000 return when due, pay the self-employment tax, and then file another return when I qualify for the exclusion?

No. You do not need to file a 2000 Form 1040 (the regular income tax return) when due if you have received an extension. To stop interest from accruing on the self-employment tax due for 2000, you can pay enough estimated tax to cover the self-employment tax and any income tax that would be due after taking out the amount of excludable income.

Income Tax Withholding

1) How can I get my employer to stop withholding federal income taxes from wages while I am overseas and eligible for the foreign earned income exclusion?

File a statement in duplicate with your employer stating that withholding should be reduced because you meet the bona fide residence test or physical presence test. See also the following question.

2) Does the Internal Revenue Service provide forms to be used by employees requesting employers to stop withholding income tax from wages they expect to be excluded as income earned abroad?

Yes. Form 673 is a sample statement that can be used by individuals who expect to qualify under the bona fide residence test or the physical presence test. A copy of this form is displayed in chapter 2. You can get this form by writing to the:
Internal Revenue Service
International Returns Section
P.O. Box 920
Bensalem, PA 19020-8518.

3) I am a U.S. citizen residing overseas, and I receive dividend and interest income from U.S. sources from which tax is being withheld at a rate of 30%. How can I have this situation corrected?

Write a letter in duplicate to the withholding agents who are paying you the dividends and interest and inform them you are a U.S. citizen residing abroad and are not subject to the withholding at source rules that apply to nonresident aliens. This letter is their authority to stop withholding the 30% income tax at the source on payments due you. They must withhold this tax on any payment of income going outside the United States unless they have the authority to do otherwise.

4) As a U.S. citizen receiving dividend and interest income from the United States from which tax has been withheld, do I report the net dividend and interest income on my return, or do I report the gross amount and take credit for the tax withheld?

You must report the gross amount of the income received and take a tax credit for the tax withheld. This is to your advantage since the tax withheld is deducted in full from the tax due. It is also advisable to attach a statement to your return explaining this tax credit so there will be no question as to the amount of credit allowable.

Deductions

1) Can I claim a foreign tax credit even though I do not itemize deductions?

Yes. You can claim the foreign tax credit even though you do not itemize deductions.

2) I had to pay customs duty on a few things I brought back with me from Europe last summer. Can I include customs fees with my other deductible taxes?

No. Customs duties, like federal excise taxes, are not deductible.

3) Some taxes paid in the United States are not deductible if I itemize my deductions. Which ones are they?

Sales taxes, as well as the state and local taxes levied specifically on cigarettes, tobacco, and alcoholic beverages are not deductible. In addition, no deduction can be taken for drivers' licenses or gasoline taxes. Auto registration fees cannot be deducted except when they qualify as personal property taxes. To qualify as personal property taxes they must be based on the value of the auto.

Some state and local taxes are deductible, such as those on personal property, real estate, and income.

4) What types of foreign taxes are deductible?

Generally, real estate and foreign income taxes are deductible as itemized deductions. Foreign income taxes are deductible only if you do not claim the foreign tax credit. Foreign income taxes paid on excluded income are not deductible as an itemized deduction.

Note. Foreign income taxes are usually claimed under the credit provisions, if they apply, because this is more advantageous in most cases.

5) I rented an apartment in the United Kingdom and had to pay a local tax called a “general rates” tax, which is based on occupancy of the apartment. Can I deduct this tax as a foreign real estate tax?

No. This tax does not qualify as a real estate tax since it is levied on the occupant of the premises rather than on the owner of the property.

Scholarship and Fellowship Grantees

1) I am a Fulbright grantee. What documentation must I attach to my return?

a) There are no special tax forms for Fulbright grantees. File on a regular Form 1040.

b) If you claim exemption as a scholarship or fellowship grantee, submit brochures and correspondence describing the grant and your duties.

c) If you are located in a foreign country and wish to pay tax in foreign currency, you should submit a certified statement showing that you were a Fulbright grantee and at least 70% of the grant was paid in nonconvertible foreign currency (see Publication 520).

2) I taught and lectured abroad under taxable grants. What expenses can I deduct?

You may be able to deduct your travel, meals, and lodging expenses if you are ***temporarily*** absent from your regular place of employment. For more information about deducting travel, meals, and lodging expenses, get Publication 463.

3) I am a professor who is teaching abroad while on sabbatical leave from my position in the United States. What records am I required to keep to prove my expenses? How do I allocate my meals and lodging if my wife and children live with me in an apartment and my wife does the cooking?

Keep a day-to-day record of expenses, with receipts where possible. Allocate meals by dividing the total expense by the number in your family and take your proportionate share. Generally, your deduction for rent will be limited to the amount you would have paid had you been abroad alone.

General Tax Questions

1) Will the Internal Revenue Service representatives at the Embassies and those who provide taxpayer assistance answer questions about tax laws of our home state and the laws of the foreign country

where we reside as well as U.S. federal income tax laws?

No. The IRS representatives are authorized only to answer tax questions on U.S. federal income tax. You should write your home state's tax office for state tax information and contact the tax officials of the country where you reside for information regarding their taxes.

2) Can Internal Revenue Service personnel recommend tax practitioners who prepare returns?

No. IRS employees are not permitted to recommend tax practitioners who prepare income tax returns.

3) I just filed my return. How long will it take to get my refund?

It may take up to 10 weeks to issue a refund on a return that is properly made out. A refund may take longer than that if the return is filed just before the filing deadline.

An error on the return will also delay the refund. Among the most common causes of delay in receiving refunds are ***unsigned*** returns and incorrect social security numbers.

4) I have not received my refund from last year's return. Can I claim the credit against this year's tax?

No. That would cause problems to both years' returns. If your last year's refund is overdue, write to the Internal Revenue Service Center where you filed your return and ask about the status of the refund. Be sure to include your social security number (or individual taxpayer identification number) in the letter.

5) I forgot to include interest income when I filed my return last week. What should I do?

To correct a mistake of this sort you should prepare Form 1040X. Complete this form, including the omitted interest income, refigure the tax, and send the form as soon as possible along with any additional tax due to the Internal Revenue Service Center where you filed your return. Form 1040X can be used to correct an individual Form 1040 income tax return filed for any year for which the period of limitation has not expired (usually 3 years after the due date of the return filed, or 2 years after the tax was paid, whichever is later).

6) I am a U.S. citizen and, because I expect to qualify for the foreign earned income exclusion, all my foreign income (which consists solely of salary) will be exempt from U.S. tax. Do I get any tax benefit from income tax I paid on this salary to a foreign country during the tax year?

No. You cannot take either a tax credit or a tax deduction for foreign income taxes paid on income that is exempt from U.S. tax because of the foreign earned income exclusion.

7) I am a U.S. citizen stationed abroad. I made a personal loan to a nonresident alien who later went bankrupt. Can I claim a bad debt loss for this money?

Yes. The loss should be reported as a short-term capital loss on Schedule D (Form 1040). You have the burden of proving the validity of the loan, the subsequent bankruptcy, and the recovery or nonrecovery from the loan.

8) With which countries does the United States have tax treaties?

Table 6–1 lists those countries with which the United States has income tax treaties.

9) I am a retired U.S. citizen living in Europe. My only income is from U.S. sources on which I pay U.S. taxes. I am taxed on the same income in the foreign country where I reside. How do I avoid double taxation?

If you reside in a country that has an income tax treaty with the United States, that country may allow a credit against the tax you owe them for the U.S. tax paid on U.S. source income. Nontreaty countries, depending on their laws, may give the same type of credit against the tax you owe them for the U.S. tax paid on U.S. source income.

If double taxation exists and you cannot resolve the problem with the tax authorities of the foreign country, you can contact the:

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

10) My total income after claiming the foreign earned income and housing exclusions consists of $5,000 taxable wages. Am I entitled to claim the refundable earned income credit?

No. If you claim the foreign earned income exclusion, the foreign housing exclusion, or the foreign housing deduction, you cannot claim the earned income credit.

11) Last May my employer transferred me to our office in Puerto Rico. I understand that my salary earned in Puerto Rico is tax exempt. Is this correct?

As long as your employer is not the U.S. Government, all income from sources within Puerto Rico is exempt from U.S. tax if you are a bona fide resident of Puerto Rico during the entire tax year. The income you received from Puerto Rican sources the year you moved to Puerto Rico is not exempt. The tax ***paid*** to Puerto Rico in the year you moved to Puerto Rico can be claimed as a foreign tax credit on Form 1116.

12) I am a U.S. citizen married to a nonresident alien. I believe I qualify to use the head of household tax rates. Can I use the head of household tax rates?

Yes. Although your nonresident alien spouse cannot qualify you as a head of household, you can qualify if (a) or (b) applies:

a) You paid more than half the cost of keeping up a home that was the principal home for the whole year for your mother or father for whom you can claim an exemption (your parent does not have to have lived with you), or

b) You paid more than half the cost of keeping up the home in which you lived and in which one of the following also lived for more than half the year:

- Your unmarried child, grandchild, stepchild, foster child, or adopted child. A foster child will qualify you for this status only if you can claim an exemption for the child.
- Your married child, grandchild, stepchild, or adopted child for whom you can claim an exemption, or for whom you could claim an exemption except that you signed a statement allowing the noncustodial parent to claim the exemption, or the noncustodial parent provides at least $600 support and claims the exemption under a pre-1985 agreement.
- Any relative listed below for whom you can claim an exemption.

Parent	Father-in-law
Grandparent	Brother-in-law
Brother	Sister-in-law
Half-brother	Half-sister
Sister	Son-in-law
Stepbrother	Daughter-in-law, or
Stepsister	If related by blood:
Stepmother	—Uncle
Stepfather	—Aunt
Mother-in-law	—Nephew
	—Niece

If your spouse was a nonresident alien at any time during the year and you do not choose to treat your nonresident spouse as a resident alien, then you are treated as unmarried for head of household purposes. You must have another qualifying relative and meet the other tests to be eligible to file as head of household. You can use the head of household column in the Tax Table or the head of household Tax Rate Schedule.

It may be advantageous to choose to treat your nonresident alien spouse as a U.S. resident and file a joint income tax return. Once you make the choice, however, you must report the worldwide income of both yourself and your spouse.

Penalties and Interest

1) Does the June 15 extended due date for filing my return because both my tax home and my abode are outside the United States and Puerto Rico on the regular due date relieve me from having to pay interest on tax not paid by April 15?

No. An extension, whether an automatic extension or one requested in writing, does not relieve you of the payment of interest on the tax due as of April 15 following the year for which the return is filed. The interest should be included in your payment.

2) If I wait to file my return until I qualify for the foreign earned income exclusion, I will be charged interest on the U.S. tax I will owe. To avoid being charged interest, can I file my return on time, reporting only my taxable income, excluding my salary for services abroad that will be exempt after I have met the qualifications?

No. If you file a return before you qualify for the exclusion, you must report all income, including all income for services performed abroad, and pay tax on all of it. After you meet the qualifications, you can file a claim for refund by excluding the income earned abroad. If you defer the filing of your return, you can avoid interest on tax due on your return to be filed by paying the tax you estimate you will owe with your request for an extension of time to file on Form 2350, or by paying enough estimated tax to cover any tax that you expect will be due on the return.

Index

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DSMKTA449E CELL '2' DOES NOT EXIST IN ROW 'BROW00'.
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