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FOREIGN EARNED INCOME EXCLUSION

By Victor Sy, CPA, MBA

There are some of us who cannot resist the appeal of foreign travel especially if it is coupled with the prospects of better employment abroad. Over the years, especially during the emergence of the Middle East with the power of controlling vast reserves of oil through the recession that hit us until a couple of years back, some of our friends and clients relocated to foreign countries such as Saudi Arabia, Kuwait, Hongkong, Australia and other countries. When you do go out of this country, are your pockets still within the reach of Uncle Sam? Unfortunately, yes. The income of US citizens and residents are subject to tax regardless of where it is earned, paid, or received.

Fortunately, there is a law that allows you to **exclude foreign earned income**.

Let us learn a few exclusion rules:

1. You may exclude up to **\$92,900 for 2011** of foreign **earned income**. To qualify for the exclusion, your tax home must be in a foreign country and you must meet either one of the following tests:

The bonafide residence test: You must be a resident of a foreign country for an uninterrupted period covering a complete tax year. You must show intention to establish residence even if there are temporary absences for short trips back to the US.

Physical presence test: This test is met if you are physically present in a foreign country for at least 330 full days during any consecutive twelve-month period.

2. Both of these tests may be waived if you leave the foreign country on account of civil unrest or adverse conditions similar to the conditions in Iraq or Afghanistan.
3. In addition to the foreign income exclusion, you may also **exclude housing** amounts including rent, fair rental value of housing provided by your employer and included in your income, insurance, rentals of furnishings, and utilities (but not telephone).
4. You may elect the exclusion by filing Form 2555 or 2555 EZ with your income tax return.

If you were outside the United States on April 15, the due date is automatically extended to June 15 without the need to file an extension form.

CAVEAT: California does **not** have a similar exclusion so you have to pay state taxes on your foreign income. But here's a TIP: claim non-residency if you are abroad for 18 consecutive months. Take advantage of a new Safe Harbor Rule that allows individuals domiciled in California but are outside the State on an employment-related contract.