

The Hidden Jewel

Form 2555- Foreign Earned Income Exclusion's Other Cousin

November 1, 2011

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The goal of this article is to provide a comprehensive checklist of information for the US person to consider prior to accepting an assignment outside the US. This article is not designed to teach you the technical competence required to perform self compliance; however it will certainly arm you with the knowledge to determine if your US tax preparer knows all that they should know to provide you with technically competent professional services.

The Foreign Housing Exclusion (HE) or Deduction (HD):

In addition to the FEIE there is a little known hidden jewel, the Foreign Housing Exclusion (HE) for employed persons or the Foreign Housing Deduction (HD) for self-employed persons. In addition to the above FEIE of \$95,100 for 2012 (\$92,900- for 2011 and \$91,500- for 2010), there is an opportunity to augment this basic earned income exclusion by an overseas taxpayer's reasonable qualified foreign housing expenses. Qualified foreign housing expenses are typically much higher than a taxpayer's taxable employer paid housing income/ allowance, or quarters.

The nice feature of the HE or HD is that the list of qualified housing costs are quite exhaustive, and include: Rent, fair Market Value (FMV) of employer provided housing, foreign real-estate or occupancy taxes, TV taxes, utilities but not telephone, real or personal property insurance, "key" money or other similar nonrefundable deposits paid to secure a lease, repairs and maintenance, furniture rental, temporary living expenses and residential parking.

However the truly remarkable feature about the HE or HD is that it does **not** matter who pays for these qualified housing expenses. Regardless of whether the employee directly pays for these costs or whether the employer directly pays (or reimburses the employee) these above costs, these costs are still includable as qualified foreign housing costs for the purposes of determining the HE or HD. However, these costs may also need to be included in the taxpayer's employment income, if paid directly or reimbursed by the employer, since they are considered taxable compensation as they relate to personal living expenses.

Effective January 1, 2006 as amended by IRC Sec. 515 of the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) this new law provides for two changes regarding the HE and HD:

- 1) the new base (or deductible) representing the amount that needs to be exceeded before any qualified housing costs are excluded or deducted, effective January 1, 2012 has risen from \$40.72 per day or \$14,864 for a full 365 days to \$41.69 per day or \$15,216 for a full 365 days, representing 16% of the amount of the FEIE or \$95,100 for 2012 (\$92,900- for 2011 and \$91,500- for 2010).
- 2) further TIPRA has placed an overall effective cap on the total qualified housing costs eligible for consideration for either the HE or HD, at 30% of the FEIE of \$95,100 for 2012 (\$92,900- for 2011 and \$91,500- for 2010) or for 2012 \$28,530 (30% * \$95,100) (for 2011- \$27,870= \$92,900* 30%). This cap had not existed prior to January 1, 2006.

Therefore the maximum excludable or deductible qualified housing expenses is the cap of \$28,530 less the deductible of \$15,216, which equals \$13,314 or \$36.48 per day.

Further to the ratification of TIPRA, the IRS issued IRS Notice 2006-87- which allows for certain

cities (of 52 countries worldwide) with very high housing costs a higher overall exclusion cap, effectively overriding the 30% limitation on the FEIE or \$28,530 cap. Please consult us on a list of these cities and amounts separately.

Other Interesting Form 2555- FEIE, HE and HD, Form 1116- FTC and General Facts:

- 1 The HE and HD are both subject to a base deduction or “Housing Norm” which for 2012 is \$41.69 per day (2011-\$40.72 per day). So if in 2012 the taxpayer were abroad a full 365 calendar tax year the taxpayer would first need to deduct \$15,216 prior to any of the Qualified Housing Costs counting towards the HE or HD.

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