



## Foreign Housing Exclusion or Deduction

International Tax Gap Series

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If you are a United States citizen or a resident alien, you are taxed on your worldwide income, whether you live inside or outside of the United States. However, if you live and work abroad, you may be able to exclude all or part of your foreign earnings and, in addition, may qualify to exclude or deduct a foreign housing cost amount.

The May 2008 Foreign Earned Income Exclusion article, in this series of International Tax Gap articles, highlights the general rules for qualifying and claiming the exclusion of foreign earned salary, wages, or other compensation received for personal services. This article highlights the general rules associated with claiming the foreign housing cost exclusion or deduction.

A **qualified individual** with foreign earned **income** and **foreign housing expenses** may **elect** to exclude or deduct a foreign housing cost amount. The election to exclude or deduct a foreign housing cost amount applies only if the qualified individual files a U.S. Federal income tax return that reports foreign earned income.

### General Rule

To qualify for the foreign housing exclusion or deduction, you must:

- Be a U.S. citizen or resident alien (for federal tax purposes),
- Have foreign earned income (income received for working in a foreign country),
- Have a tax home in a foreign country,
- Meet either the bona fide residence test or the physical presence test, and
- Have paid (or incurred) foreign housing expenses.

### Foreign Housing Cost Amount

The housing cost amount is the total of your foreign housing expenses for the year minus a base housing amount.

The base housing amount is 16 percent of the maximum foreign earned income exclusion for the tax year, computed on a daily basis for the number of days in the qualifying period that fall within the tax year. For example, the maximum

amount a qualified individual can exclude as foreign earned income for 2008 is \$87,600 (\$91,400 for 2009). Thus, the base amount for 2008 is \$14,016 (16 percent of \$87,600), or \$38.30 per day.

### **Foreign Housing Expenses**

Housing expenses include reasonable expenses paid or incurred in the taxable year for housing in a foreign country for you, your spouse and your dependents. Only the housing expenses actually incurred or paid for the part of the year that you qualify for the foreign earned income exclusion are considered.

Eligible housing expenses include rent, the fair rental value of housing provided in kind by your employer, utilities (other than telephone charges), real and personal property insurance, rental of furniture and accessories, repairs, and residential parking.

Reasonable housing expenses do not include expenses that are lavish or extravagant under the circumstances, deductible interest or taxes, the cost of buying property, principle payments on a mortgage, the cost of domestic labor (maids, gardeners, etc.), purchased furniture or accessories, or improvements and other expenses that increase the value or appreciably prolong the life of property. You also cannot include in housing expenses the value of meals or lodging that you exclude from gross income (under the rules for the exclusion of meals and lodging), or that you deduct as moving expenses.

### **Foreign Housing Expense Limitation**

The amount of foreign housing expenses eligible to be considered in calculating the housing cost amount is limited.

Beginning with tax year 2006, the amount of foreign housing expenses in excess of the base amount that can be taken into account in computing the foreign housing cost amount is limited to a maximum foreign housing expense limitation. The maximum limitation on foreign housing expenses is 30 percent of the maximum foreign earned income exclusion for the corresponding year, computed on a daily basis. For 2008, 30 percent of the maximum foreign earned income exclusion is \$26,280, or \$71.80 per day.

However, the maximum foreign housing expense limit will vary depending on the location of your foreign tax home. Since 2006, the maximum limitations for certain high-cost localities are listed in official notices issued by the IRS. For 2008, the maximum limitations on qualified housing expenses incurred in over 275 high-cost foreign locations are included in Notice 2008-107.

Additionally, foreign housing expenses may not exceed your total foreign earned income for the taxable year.

### **Foreign Housing Exclusion Amount and Limits**

The foreign housing exclusion applies only to amounts considered paid for with employer-provided amounts. 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 to you for the year, such as wages, salary, reimbursement for housing expenses, payments by your employer as part of a tax equalization plan, and the fair rental value of company-owned housing

furnished to you (unless that value is excluded from income under the exclusions of meals and lodging rules).

Since the foreign housing cost amount exclusion is in addition to the foreign earned income exclusion, if you choose to exclude a foreign housing cost amount, you must figure the foreign housing exclusion before you figure the foreign earned income exclusion. The foreign housing exclusion is limited to the lesser of the foreign housing costs paid for with employer-provided amounts or your foreign earned income. Also, if you choose the foreign housing exclusion, you cannot claim less than the full amount of the housing exclusion to which you are entitled.

#### **Foreign Housing Deduction Amount and Limits**

The foreign housing deduction applies only to amounts paid for with self-employment earnings. If you do not have self-employment income, you cannot take the foreign housing deduction. 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, subject to the following limitation.

Your foreign housing deduction cannot be more than your foreign earned income less the total of your foreign earned income exclusion plus your housing exclusion.

Although the foreign housing exclusion and/or the deduction will reduce your regular income tax, they will not reduce your self-employment tax

#### **How to Claim the Foreign Housing Exclusion or Deduction**

Since the foreign housing exclusion and deduction is voluntary, qualified individuals must choose to claim the exclusion or deduction. The foreign housing exclusion and deduction are claimed and figured using Form 2555, Foreign Earned Income, which must be attached to Form 1040, U.S. Individual Income Tax Return. Form 2555-EZ cannot be used to claim the foreign housing exclusion or deduction.

#### **References and Links**

[Foreign Earned Income Exclusion article](#)

[Foreign Housing Expense Limitations](#)

[Form 2555, Foreign Earned Income \(pdf\)](#)

[Notice 2008-107, Determination of Housing Cost Amounts Eligible for Exclusion or Deduction for 2008](#)

[Publication 54, Tax Guide for U.S. Citizens and Resident Aliens Abroad](#)

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