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Congress has provided substantial tax benefits for foreign workers, including missionaries. In 2014, an eligible foreign worker can exclude up to $99,200 of income from income tax.

This Memo provides the basic requirements for claiming the foreign earned income exclusion, plus some additional information. We cover:

1. What income can be excluded
2. Foreign housing allowance
3. Tests for eligibility
   a. Bona fide resident
   b. Physical presence
4. Claiming the exclusion
5. Common questions
6. Additional resources

1. What Income Can Be Excluded?

The foreign earned income exclusion only excludes income earned for work performed in a foreign country. It does not matter where the employer is located, as long as the work is performed in a foreign country. “Foreign earnings” do not include earnings for work done for the mission in deputation or furlough before or after the work in the foreign country.

For this exclusion, “foreign earnings” do not include earnings from a bank account or other investments, regardless of the location of the investment.

If a pay period covers both time in the United States and time in a foreign country, the pay for that period is allocated based on the number of days in each location.

2. Foreign Housing

The foreign housing exclusion essentially allows the exclusion of some overseas housing expenses that exceed a calculated threshold from income. The foreign housing exclusion is in addition to the foreign earned income exclusion.

For the foreign housing calculation, the base household expense amount is 16% of the foreign earned income exclusion ($99,200 x 16%=$15,872, in 2014), so housing costs of less than $15,872 are not excludible. The maximum amount of the foreign housing exclusion is limited to 30% of the foreign earned income amount ($99,200 x 30%= $29,760).

For 2014, housing costs in excess of $15,872 but less than $29,760 can be excluded in addition to the foreign earned income exclusion.

- A missionary whose taxable compensation is less than $99,200 already has all of his or her income excluded by the foreign earned income exclusion.
- A missionary who has taxable compensation of more than $99,200 but housing costs of less than $15,872 does not have sufficient housing costs to claim an additional exclusion for housing cost.
- A missionary whose housing is excluded by the minister's housing allowance already excludes housing costs from income. (There is no minimum threshold.)
- A missionary who is required to reside on the mission's business premises in order to perform their job (house parent at a mission school, for instance) already has the value of their housing excluded from income.
- A missionary whose taxable compensation is more than $99,200, who does not qualify for minister's housing allowance, and whose housing costs exceed $15,872, may claim an additional exclusion for housing, but only $13,888 in excess of the base housing costs.

3. Tests for Eligibility

There are two tests for determining whether a worker is outside the U.S. long enough to qualify. A worker in a foreign country only has to qualify under one of the tests. During a foreign stay of four years, for instance, the same test may not apply every year.

Bona Fide Residence: The worker established residence in a foreign country for a period that includes an entire tax year.

Physical Presence: The worker was present in the foreign country for 330 full days during a continuous 12-month period.

3a. Bona Fide Residence Test

Bona fide residence requires intent to stay in the foreign country for an extended or indefinite stay. It does not require a plan to live there for the rest of the missionary's life.

The intent must be demonstrated by factors that show the missionary has made a longer-term or indefinite commitment, though there are no specific factors always required. IRS publications include these factors as often being relevant:

Term of foreign assignment	Over a year is good
Presence of immediate family	Having them with the missionary is good
Living arrangement	Long-term lease or purchase is good; short-term lease would be poor
Amount of time outside the U.S.	More is better, but time for this test could be less than the 330 days in 12 months needed for the physical presence test
Claiming a nonresident status with local government (usually to avoid local taxes)	Claim of nonresident status with foreign government disqualifies use of this test. (Might still qualify under physical presence.)
Bank accounts, driver's license, church membership	If in foreign country, good; if only in U.S., poor

To qualify under the bona fide residence test, a missionary must be a resident for a full calendar year. If you meet the one-tax-year requirement, however, compensation for services outside of the U.S. before and after the period may also qualify.

***Example*:**

> A missionary staff member without a husband or dependents arrives in France on November 1, 2005, planning to stay for four years. She rents an apartment with a one-year renewable lease, obtains a French driver's license, and files taxes in France as a resident. She takes a two-week vacation annually back to the U.S., but otherwise lives in France until May 30, 2007, when for personal reasons she returns to the U.S. to live. She was a resident of France for all of 2006, and her compensation from November 1, 2005 until May 30, 2007 will qualify for the foreign earned income exclusion.

3b. Physical Presence Test

A full statement of the physical presence test has three elements:

1. **Physically present in the foreign country or countries –** Travel time to and from the foreign country, and any return trips to the U.S., would not be included in foreign physical presence. The time does not have to all be in the same country.
2. **For 330 full days –** This does not have to be continuous. A 10-day return trip to the U.S. would not be included in the foreign physical presence, but would not disqualify as long as sufficient time was in the foreign country. A full day is 24 hours, so partial days are not counted.
3. **During any 12 months in a row –** This does not all have to be in the same tax year.

4. Claiming the Exclusion

A missionary must file the right form to claim the foreign earned income exclusion. Form 2555 (or Form 2555-EZ) is filed with the tax return for the year in which the missionary had the qualifying income. The information required for the form will demonstrate how the missionary met one of the above requirements, and the amount of income that was not taxed because of the foreign earned income exclusion.

5. Common Questions

If I qualify for the foreign earned income exclusion, why do I still have to pay Social Security taxes such as FICA/Medicare or SECA if I'm a minister?

The foreign earned income exclusion does not exempt income from Social Security taxes.

If I will qualify for the foreign earned income exclusion, how do I avoid having so much withheld from my check?

Form 673 may be used to allow a mission to stop withholding income tax.

If I have to file my tax return before completing my period of physical presence or tax year of residency, what do I do?

If you are working outside the U.S., your return is not due until June 15. You may get additional extensions — in some cases as late as October 15 — by applying for them before the prior extension expires. If you still do not qualify, you must file the return and pay tax without claiming the foreign earned income exclusion. When you do qualify, you can file an amended return and get a refund of the extra tax.

What if I must return to the United States before qualifying?

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. If you leave for personal reasons before meeting the requirements, you will not be able to use the foreign earned income exclusion.

What other tax issues might apply?

Several other tax-related items beyond the scope of this article may affect some missionaries:

- Some foreign countries may tax your income.
- If foreign earned income exceeds $99,200, you may benefit from the foreign tax credit, foreign housing allowance, other deductions, and tax treaties. Discuss this with your tax advisor.
- Investment or other income earned in the U.S. while working in a foreign assignment will still be subject to the normal tax rules.
- Most states base taxation on residency in the state, and generally exempt income if it would qualify for the federal foreign earned income exclusion. You should consult the tax laws in your home state.

6. Additional Resources

The following resources are available from the IRS website at www.irs.gov:

- IRS Publication 54, *Tax Guide for U.S. Citizens and Resident Aliens Abroad*
- Forms 2555 and 2555 EZ, *Foreign Earned Income* and their instructions
- Form 673, *Statement For Claiming Benefits Provided by Section 911 of the Internal Revenue Code*

Please do not hesitate to contact us if you have any questions about foreign earned income exclusion:

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