THE TEXAS LAWBOOK

SERVING BUSINESS LAWYERS IN TEXAS

For US Expats, Income Tax Exclusion Depends on Their 'Abode'

By David Ellis of Baker McKenzie – (March 14, 2017) – Since many Texas companies send employees on international assignment, they should be mindful that federal income tax rules don't apply to everyone in the same way.

A case in point is a recent Tax Court Memorandum decision, *Qunell v. Commissioner of Internal Revenue*. In that case, the Tax Court held that even though the taxpayer was employed in Afghanistan for 16 months, he was not entitled to exclude income earned in Afghanistan for 2011 from federal income tax because he was deemed to have a United States abode.

David Ellis

For those who have only a high-level understanding of the foreign-earned income exclusion under Section 911 of the Internal Revenue Code, this result may not be obvious. Many people are aware that under Section 911 a qualified individual may elect to exclude from gross income, subject to limitations, foreign-earned income and a housing cost amount.

For 2017, maximum excludable foreign-earned income is $102,100. To be entitled to this exclusion, a taxpayers must satisfy two requirements. First, they must show that their tax home are in foreign countries. Second, they must either be bona fide residents of one or more foreign countries or be physically present in such countries during at least 330 days in a 12-month period.

However, as demonstrated in Qunell, even if a taxpayer otherwise qualifies for the Section 911 exclusion, an individual is not treated as having a tax home in a foreign country for any period for which the abode is within the United States. That will be a surprise to a number of people.

So, what is an "abode"?

Well, it is not the taxpayer's regular or principal place of business, which is the definition of "tax home" in Section 162(a) of the I.R.C., and is the definition that most people are familiar with. By contrast, an "abode" has been defined as one's home, habitation, residence, domicile, or place of dwelling. It has a domestic rather than a vocational meaning.

In Qunell, the Tax Court held that while an exact definition of "abode" depends on the context in which the word is used, it clearly does not mean one's principal place of business. A taxpayer's abode is generally in the country in which the taxpayer has the strongest economic, family and personal ties.

The taxpayer in this case owned a home in Illinois where his wife and children lived, and he maintained bank accounts in the United States. He lived on a military facility in Kabul, Afghanistan, his family did not visit him there and nothing in the record suggests that he traveled within Afghanistan other than as required by his employment.

In early 2001 he left Afghanistan and traveled to the U.S. He was married in the U.S. on Feb. 14, 2011. He returned to Afghanistan without his wife a short time later.

The Tax Court concluded that the taxpayer's economic, family and personal ties to the U.S. were sufficiently strong to consider the U.S. the location of his abode for 2011. Accordingly, the wages earned by the taxpayer in Afghanistan during 2011 were not excludable from his income under Section 911. >

The result in Qunell is consistent with other similar cases, including *Daly v. Commissioner of Internal Revenue,* where the Tax Court found that a military contractor who worked in Iraq and Afghanistan also had an abode in the U.S. The result in Qunell also mirrors the result in *Evans v. Commissioner of Internal Revenue,* where a rotator for a Texas-based drilling company worked on Sakhalin Island in Russia on a 30-days-on-30-days-off rotational schedule. The same result occurred in *Lemay v. Commissioner of Internal Revenue,* where an employee who worked for an oil company in Tunisia was on a 28-days-on-28-days-off rotational schedule.

In each of those rotator cases, the Tax Court concluded that the taxpayer's economic, family or personal ties remained within the U.S. during his assignment. This result is likely in the case of rotators who, like the taxpayer in Qunell, do not travel with family and typically live in employer-provided housing. Such taxpayers live in foreign countries only to work and return to home and family in between rotations. In such cases, a rotator has few if any facts tending to show that his "abode" is in the foreign country where he works, thus depriving him of the ability to exclude foreign earned income under Section 911.

Would the result in Qunell have been different if the taxpayer, who was not a rotator, did not live on a military facility but instead found his own housing off-base? Or what if his wife and children had lived with him for at least part of the year? If he maintained at least one bank account in Afghanistan? It is difficult to say whether any one or more of these alternative facts would have changed the Tax Court's conclusion, but with slightly better facts perhaps the taxpayer would have been successful.

It is best practice for Texas companies to anticipate the tax liabilities that will result from any international assignment or from any work outside the U.S. Reviewing the likely federal income tax situation in advance, preferably with the help from an experienced tax advisor, will help determine, for example, whether the foreign earned income exclusion of Section 911 will even be available, and will help the taxpayer's employer determine the appropriate amount of any tax withholding.

While the facts of each case is different, special attention should be paid to the following four categories of international assignments or non-U.S. work where the taxpayer's abode is likely to be within the U.S.:

1. Rotational assignments (as in Evans and Lemay)
2. Short-term assignments (less than 12 months)
3. Frequent business travel outside of the U.S.
4. Commuting from a home in the U.S. to work in another country

Note that even if the foreign earned income exclusion of Section 911 is unavailable, a taxpayer may nonetheless be entitled to a foreign tax credit against his or her U.S. income tax for any foreign income taxes paid on compensation earned while working outside the U.S. While the Section 911 exclusion is generally perceived as more valuable, a foreign tax credit – if available – is better than nothing.

Also note that many U.S. taxpayers who work outside the country are covered by their employers' tax equalization or tax protection programs. These programs are designed to protect employees from the potentially higher taxes that may result from working outside the U.S.

So, in cases where the Section 911 exclusion is not available, the employee will worry less about it since the employer's program will protect the employee from any additional income tax resulting from the assignment. It is unclear whether the taxpayer in Qunell was covered by such a program. Even if he was, this case ›

is a cautionary tale that understanding the tax consequences of international assignments in advance is always helpful.

David Ellis is a partner in Baker McKenzie's Houston office and part of the Firm's North American Employment & Compensation Law Practice Group. He regularly contributes to the Firm's Texas labor and employment blog, The Lone Star Employer Report.

Please visit www.texaslawbook.net for more articles on business law in Texas.