Understanding the Physical Presence Test vs. Bona Fide Residency Test for the Foreign Earned Income Exclusion

The United States, Eritrea, and Philippines are the only nations in the world that tax your income based on your citizenship, not your country of residency. If you're a US citizen living abroad, you still must file a tax return every year and pay any taxes due. §911 of the tax code was enacted to provide expats with relief by granting the Foreign Earned Income Exclusion (FEIE) and foreign housing deduction that lends expats significant aid in avoiding double taxation on foreign jobs and self-employment income.

However, in order to qualify for FEIE, in addition to meeting the tax home test, you must meet the physical presence test or the bona fide residence test as described under §911.

What's the Difference Between the Physical Presence Test and the Bona Fide Residence Test?

The chief differences between the two tests are that the physical presence test relies more on the time spent outside of the United States while the bona fide residence test entails a closer examination of your intent and activity while living overseas. The physical presence test also does not require you to remain in the same country for the proscribed timeframe, you can spend time in multiple countries, but you must be out of the country for at least 330 days of the past 12 consecutive months though the days themselves don't have to be consecutive.

Satisfying the Physical Presence Test

Expats taking up "digital nomad" life or requiring frequent movement for their careers and/or personal lives are more likely to focus on the physical test. In addition, it is used more frequently in years of expatriation and repatriation due to the use of slide days, potential earlier filing, and the fact that it can also be used to green card holders whereas the bona fide residence test cannot.

While you are required to be in at least one foreign country for a minimum of 330 days, the intent of your stay doesn't matter since it it quantitative, not qualitative, in measure. The time you spend outside of the US doesn't need to be for work, it can be for vacation or other personal purposes. You don't need to prove attempts at establishing foreign residency and your intents on returning to the US also don't matter for the physical presence test, such as if you're taking a temporary foreign job or a personal voyage and you plan to return to US soil.

Ultimately, you must meet the following conditions to satisfy the physical presence test:

- US citizen or US resident alien
- Be in another country or countries for a minimum of 330 full days
- Purpose of your stay(s) doesn't matter

Full Days and Waived Time

A full day is a consecutive 24 hours for physical presence test purposes.

The minimum 330 full days must have been spent in a foreign country: the time spent traveling between the US and your destination doesn't count. For example, if your flight from New York to Italy leaves at 5PM on March 1 and arrives at 6AM March 2, your first full day would be March 3.

However, if you pass part of a foreign country before midnight then your full day would count. So if you took an earlier flight and the plane passed over France at 11PM March 1 so you arrived in Italy at 1AM, your first full day would be March 2.

Once you've left the US, you can move between foreign countries without losing full days provided that the travel takes less than 24 hours. So if you depart Milan June 1 for London, no full days are lost since the flight is 3 hours. But if you take a ship to Portugal on June 1 at 10AM and arrive June 3 at 3PM, you lose three full days (June 1-3) since the travel was by sea and not within a foreign country and it took more than 24 hours.

While the physical presence test is fairly liberal as far as residency and the purpose of your visits go, you must meet these strict full day requirements. If you can't meet the full 330-day minimum because of travel, illness, family emergencies, or an employer's orders then the IRS does not waive the minimum time.

The only exception allowed for a minimum time waiver under §911(d)(4) is if you must depart a foreign country because of civil unrest, war, and other related conditions. You must have proof that you otherwise would've met the minimum time if it wasn't for these conditions in addition to having a tax home and were physically present or a bona fide resident of this country prior to the date of unrest.

You otherwise must meet the 330-day minimum and ineligible travel days don't count.

Intent, Length of Stay, and the Bona Fide Residence Test

The bona fide residence test requires a more complex examination of your circumstances than the physical presence test, but doesn't abide by a fixed number of days. The landmark case *Sochurek v. Commissioner* laid out the twelve essential factors that establish bona fide residency in a foreign country:

Intent of your stay. Presence in a foreign country alone isn't sufficient. You must have some good faith intentions in changing residency for long-term purposes, such as a new job or caring for an ailing family member.

Establishing a home. Tax Court has had ambiguous interpretations on the meaning of "residency", but ultimately ruled that you can have only one permanent home although you can hold dual citizenship or multiple residencies. The type of accommodation you have in a foreign country is considered: is it temporary like a boarding house or longer term like leasing an apartment or buying a house?

Cultural and community participation. Your personal and social lives need to show good faith in integrating into the fabric of the foreign country in which you're trying to prove you're a bona fide resident of. Proof of assimilating to the environment shows good faith to maintain foreign residency, along with joining local houses of worship, clubs, or other places where you have a regular presence.

Nature, extent, and reasons for long absences from foreign residence. Unlike the physical presence test where you're freer to be more transient, proving bona fide residency needs to account for long absences from your new foreign home. Frequent absences can imply abandoning efforts to become a resident but there are exceptions for business travel, medical care, education, and infrequent vacations.

Foreign economic burden. The bona fide residence test is automatically failed if you file a nonresident tax return and have no income tax obligations in the foreign country. You must be expected to pay foreign income taxes, or not be obligated to report your activity as a nonresident. Since some countries require a nonresident tax return and/or do not impose income taxes, this doesn't preclude you from passing the test but additional information needs to be gathered on your specific tax immunity.

Nature and extent of special considerations granted in foreign country that are unavailable to that country's residents. Generally, you must have similar obligations, rights, and privileges as the foreign country's other residents and any specific jurisdictional immunities are subject to scrutiny unless there is an international agreement in place or similar exceptions.

Foreign residency status. Similar to establishing a home, transient status needs to be compared to residency if your stay is short with no permanent tax home or place of business.

Tax treatment by employer. The IRS looks at whether your employer deducts taxes from your paycheck at all, or at a different rate from residents, to determine if your tax residency was established.

Physical presence going by employment. Proximity to your workplace or principal area of business is examined and your presence is expected to align with the nature of your work.

Marital status and residence of relatives. If you relocate with your spouse and children, you're more likely to prove bona fide resident status than someone whose family remains in the US. However, if there are strong reasons for maintaining two separate homes such as adverse conditions abroad or a special needs child unable to make the trip, this factor can work in your favor.

Nature and duration of employment. The work you've been hired to do is typically linked to the type of visa you have and how much the employer restricts your activity. If you've been granted a finite amount of time, like a one-year contract job and subsequent one-year work visa, this doesn't prove bona fide residency opposed to permanent employment.

Good faith in the reasons for traveling abroad. You must have a valid reason to move to another country. Finding employment is a common reason but it can also be due to self-employment opportunities in new markets, education, medical care, marriage, or being near family and friends. If your primary purpose is to avoid taxes however, this generally isn't allowed for claiming bona fide residency.

Violation of US Laws

Under §911(d)(8), if you are present in a foreign country in violation of a US law, you will satisfy neither the physical presence nor bona fide residence tests. The chief expat tax benefits, FEIE and the foreign housing deduction, are also voided.