

International Tax Structures

for Americans Living Abroad

Foreign Earned Income Exclusion Structure #7

Offshore Consultants (Foreign Salary from BVI Entity with S-Corporation Agreement)

Co-owners of an S-Corporation (with a foreign subsidiary) provide consulting services while working overseas to claim the Foreign Earned Income Exclusion, and the foreign housing exclusion, from their salaries paid from the foreign corporation in the British Virgin Islands.

This is an ideal structure for owners of an S-Corporation claiming the Foreign Earned Income Exclusion, and who prefer to be compensated from a foreign corporation in order to be exempt from U.S. Social Security Taxes on their salary.

Summary of the the Foreign Earned Income Exclusion (\$911)

The Foreign Earned Income Exclusion (FEIE) allows U.S. citizens or resident aliens living and working abroad to exclude a certain amount of foreign-earned income from U.S. federal income tax. To qualify, you must have a tax home in a foreign country and meet either the bona fide residence test or the physical presence test.



Prepared By
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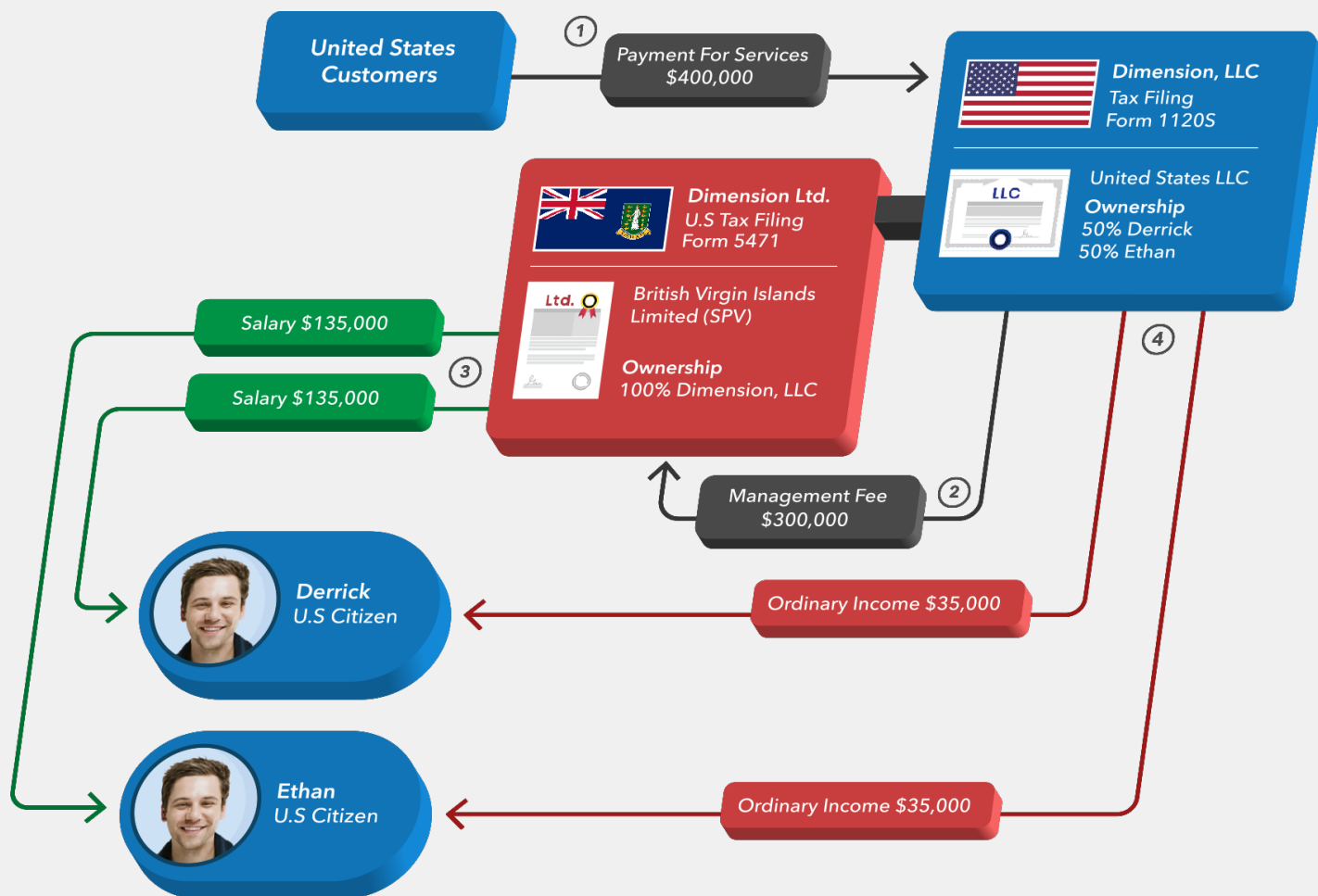
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Structure Background

Dimension, LLC (owned 50% by Ethan and 50% by Derrick, brothers who are U.S. citizens) is taxed as an S-Corporation per Internal Revenue Code §1361 and received payment from U.S. customers for consulting services.

The S-Corporation is a parent company of a foreign subsidiary, Dimension Ltd., a British Virgin Islands wholly owned subsidiary. The S-Corporation has an intracompany agreement to compensate the foreign subsidiary for management services provided on its behalf. Both Ethan and Derrick are employed by the foreign corporation, Dimension Ltd., and they receive wages, in addition to their ordinary income from the S-Corporation.

Both Ethan and Derrick are residents of Sudan, and also remain outside the United States for more than 330 days during the year, qualifying them for the Foreign Earned Income Exclusion under the physical presence test per Internal Revenue Code §911. While traveling and living abroad, they each incur a significant amount of housing expenses, which are also partially excludable per Treasury Regulation §1.911-7.



Offshore Consultants (Foreign Wages from BVI Entity with S-Corporation Agreement)

Monetary Transactions & Accounting

1. The total payments from U.S. customers for services were \$400,000 for the entire year. The business recognizes income under the cash basis of accounting.
2. There is an Intracompany Agreement between Dimension, LLC, and Dimension, Ltd. for an annual Management Fee of \$300,000 per year.
3. During the year, Dimension, Ltd. compensates both Ethan and Derrick \$135,000 each of an annual salary.
4. During the year, Dimension, LLC has \$70,000 of Net Income, and compensates Derrick and Ethan \$55,000 each, as to be shown on their Schedule K-1 as Ordinary Income.

U.S. Tax Filing Compliance

5. **Form 1120S (Dimension, LLC).** At the conclusion of the year, Dimension, LLC has Ordinary Net Income of \$70,000 (Revenue of \$400,000 less \$300,000 of Management Expenses, less \$30,000 of Administrative Expenses). As income is shared equally, Ethan receives a Schedule K-1 reporting \$35,000 of Ordinary Income, and Derrick receives a Schedule K-1 reporting \$35,000 of Ordinary Income as well.
6. **Form 5471 (Dimension Ltd.).** Form [5471, Information Return of U.S. Persons With Respect To Certain Foreign Corporations](#), is required to be reported as an attachment to the S-Corporation in relation to its ownership of Dimension, Ltd., to satisfy the reporting requirements of Internal Revenue Code §6038. The resulting Net Income of the Foreign Corporation is \$0.
7. **Form 1040 (MFJ Derrick).** On his Married Filing Joint tax return, Derrick reported a total income of \$250,000 (\$135,000 of wages from Dimension, Ltd., \$80,000 of wages from his spouse, and \$35,000 of Ordinary Income from Dimension LLC. He elects to claim the Foreign Earned Income Exclusion on [Form 2555, Foreign Earned Income](#), for a maximum exclusion of \$216,000. Additionally, their foreign housing costs are partially deductible, resulting in a foreign housing exclusion of \$16,000 (*total foreign housing expenses of \$32,000 were paid during the year). After also claiming the Standard Deduction of \$24,000, their taxable income is reduced to \$0. It will also be noted Ethan's tax situation is similar.

Offshore Consultants (Foreign Wages from BVI Entity with S-Corporation Agreement)

Summarized Tax Returns and Financial Statements

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Form 1040 (MFJ)

Derrick

Wages (Derrick)	\$135,000
Wages (Spouse)	\$80,000
Ordinary Income	\$35,000
Total Income	\$250,000
Foreign Earned Income Exclusion	- \$216,000
Foreign Housing Exclusion	- \$16,000*
Standard Deduction	- \$24,000
Taxable Income	\$0
U.S. Tax	\$0

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Form 1120-S

Dimension, LLC

Income	\$400,000
Management Expense	- \$300,000
Administrative Expenses	- \$30,000
Net Ordinary Income	<u>\$70,000</u>

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Form 5471

Dimension Ltd.

Management Income	\$300,000
Salary Expense	- \$270,000
Administrative Expenses	- \$30,000
Net Ordinary Income	<u>\$0</u>

Resulting Tax Implications

As a result of this structure, the U.S. tax liability of Derrick is \$0, after claiming the Foreign Earned Income Exclusion, Foreign Housing Exclusion, and Standard Deduction.



Compliance Warning. The deductible portion of the Management Fee paid to a foreign related party is subject to interpretation. Transfer Pricing rules and other factors should be considered when making this determination. A Base Erosion and Anti-Abuse Tax (BEAT) could apply if the IRS determines the Management Fee paid to a foreign related party is too high.

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Effective Tax Rate

Gross Income from All Sources	\$250,000
Gross Expenses from All Sources	\$0
Total Net Income	\$250,000
Federal Income Tax	\$0
Effective Tax Rate (Married Filing Jointly)	0%

About the Author



Marcus Marcial is a seasoned tax professional with experience predominantly dealing with International Taxation. Originally from Southern California, he attended Hunter College in New York City and has resided abroad for many years.

While employed at the IRS, he learned from examining and preparing tax returns for individuals residing and businesses operating offshore. After leaving the IRS, he started his own tax firm, helping various international clients with tax compliance, accounting, and consultation.



To schedule a consultation to discuss the structures and tax law references found in this document or for a custom structure, tax filing, planning, and strategy, visit <https://pacifico.tax/schedule-consultation>

DISCLAIMER

The International Tax Structures included in this publication are hypothetical structures and set of circumstances and tax rates that do not apply to any particular taxpayer and for any purpose. The information included in this tax structure is non-transferable or reusable, as each taxpayer's situation is factually unique.

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