THE TAX IMPLICATIONS OF TEACHING OVERSEAS

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Abstract. Teaching in another country can have tax advantages both for U.S. professors teaching overseas and for our foreign professors teaching in the United States. This paper examines relevant tax law and treaty provisions that can exempt teaching income from taxation or permit certain living expenses to be deducted. With careful planning, professors may be able to shield up to two years of income from taxation.

As the academic world grows smaller, business professors often have opportunities to teach in foreign countries. These appointments can range from short seminars to actual long-term tenure track employment. In addition to allowing individuals to combine foreign travel and vacation with professional activities, these positions can have very attractive tax implications. Depending upon the circumstances, a U.S. professor may be able to deduct personal living expenses or even exclude up to $80,000 ($70,000 after 1986) from U.S. taxable income. Furthermore, tax treaties with certain countries exempt U.S. professors teaching abroad from foreign taxes and residents of U.S. treaty partner nations teaching in the U.S. from U.S. taxes.

This paper examines U.S. income tax laws and treaties related to U.S. professors teaching abroad and foreign professors teaching in the U.S. in order to provide guidance to the proper structuring of overseas employment so as to achieve the maximum tax benefit. The paper begins with an analysis of U.S. tax law relevant to U.S. professors teaching abroad and then examines U.S. tax law relevant to foreign professors teaching in the U.S.

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FOREIGN EARNED INCOME EXCLUSION

Unlike most nations, the United States taxes its citizens on their worldwide income regardless of country of residence. Since foreign countries will probably also tax expatriates' income earned in that country, United States citizens working abroad are faced with a potential double tax burden.

This scheme of taxation had the effect of making U.S. expatriates uncompetitive in foreign job markets. In order to change this situation, Congress has passed various laws excluding a portion of foreign source earned income from taxation. The most recent, and by far the most liberal, was passed in the Economic Recovery Act of 1981. This provision excludes up to $80,000 ($70,000 after 1986) of foreign earned income for expatriates not working for the U.S. government.

The requirements for the exclusion are very specific. Two criteria must be met:

1. The tax home must have moved to a foreign country, and
2. the taxpayer must be a bona fide resident of a foreign country or maintain a physical presence abroad of a minimum duration.

These criteria are discussed in turn.

Location of Tax Home

The tax home is basically the principal place of employment rather than the location of the taxpayer's residence. The first prerequisite for obtaining the foreign earned income exclusion is for the tax home to have shifted to the foreign school.

In order for a foreign school to be a principal place of employment, the teaching position must be "indefinite and not temporary".

In its most recent ruling on tax homes, the IRS announced that jobs exceeding two years will automatically be considered permanent whereas those of less than one year will automatically be considered temporary. Since many professors teach overseas during a sabbatical or leave of absence, a two-year time period is not practical. There is no clearcut rule for the crucial period of greater than one but less than two years.

If the foreign employment exceeds one year, but is less than two, the IRS will consider this an indefinite stay unless it can prove the following:

a) The employment is expected to last less than two years, and
b) the taxpayer expects to return to his claimed tax home (regular place of abode in a real and substantial sense) after the end of employment.

Both of the above statements must be true for a position to be temporary. To demonstrate that the employment is indefinite, a taxpayer must show that either is false. Since employment will probably last less than two years, a professor must try to prove that he had not retained his "regular