



CLIENT EDUCATION BRIEFING

Foreign Earned Income Exclusion vs. Foreign Tax Credit

Two different tools for taxing income earned abroad, and why the choice is not automatic

Almost every U.S. citizen or green card holder living and working abroad has the option to reduce U.S. tax on that income in one of two ways: excluding it under the Foreign Earned Income Exclusion, or crediting the foreign tax already paid on it under the Foreign Tax Credit. The two mechanisms work very differently, they are not always interchangeable once elected, and the better choice depends on where a client lives, how the income is earned, and what happens to that election over the following several years.

The Foreign Earned Income Exclusion

Qualifying foreign earnings are removed from the return before U.S. tax is calculated.

The FEIE, claimed on Form 2555 under Internal Revenue Code Section 911, lets a qualifying taxpayer exclude foreign earned income from gross income entirely, up to an annual cap. To qualify, the taxpayer must have a tax home in a foreign country and satisfy either the bona fide residence test or the physical presence test. Only earned income counts — wages and self-employment income for services actually performed abroad. Interest, dividends, capital gains, pensions, and rental income never qualify, no matter where the taxpayer lives.

A qualifying taxpayer may also exclude or deduct a portion of foreign housing costs above a base amount, calculated before the FEIE itself is applied. The housing benefit is not available to someone who deliberately underclaims it to preserve income for a foreign tax credit claim instead, and it does nothing to reduce self-employment tax for a self-employed filer.



The Foreign Tax Credit

Tax already paid to a foreign government offsets U.S. tax dollar for dollar.

The FTC, claimed on Form 1116, credits foreign income taxes a taxpayer has paid or accrued against the U.S. tax on the same income. There is no foreign residence test to meet and no dollar cap on the income involved — the limitation instead runs through a statutory formula applied separately to each income category, primarily general category income (typically wages) and passive category income (interest and dividends). A credit generated in one category cannot be used to offset U.S. tax in another.

Foreign tax that cannot be used in the current year is not lost: excess credits may be carried back one year and forward ten, tracked separately by category and by the year in which they arose.

The Numbers for 2026

The exclusion and the housing figures both move most years; 2026 raised them again.

The maximum foreign earned income exclusion for 2026 is \$132,900 per qualifying person — income above that amount is still subject to U.S. tax, whichever method is used for the excluded portion. The related housing figures for 2026 are a base housing amount of \$21,264, a general housing expense ceiling of \$39,870, and a resulting maximum housing benefit of \$18,606 before any higher-cost-location adjustment. None of these dollar limits apply to the Foreign Tax Credit, which has no cap of its own.

How the Two Interact: The Stacking Rule

Excluding income for tax purposes is not the same as making it disappear for rate purposes.

When the FEIE is used, the excluded income is still treated as sitting underneath the taxpayer's remaining taxable income for purposes of figuring the tax rate that applies to what is left. In practice, this stacking effect pushes the non-excluded income into higher brackets than it would otherwise reach, which increases the U.S. tax on that remaining amount compared to a return with no exclusion at all.

The FEIE also has a cost on the credit side: foreign tax paid on the excluded portion of income cannot be claimed as a credit. Where no directly related expenses need to be allocated, a simplified approach allocates the disallowed foreign tax in proportion to excluded wages over total foreign wages; Publication 514 sets out a more complete method where deductions must be divided between excluded and taxable income.



Three Situations, Three Different Answers

The right method changes with the client's numbers, not with a rule of thumb.

A low- or zero-tax country, salary only: with no foreign tax paid, the Foreign Tax Credit has nothing to offset and the full salary would otherwise be taxed by the United States. The FEIE typically wins outright by excluding the income before any U.S. tax is calculated.

A high-tax country, salary only: once the foreign tax rate is high enough, the Foreign Tax Credit alone can eliminate current U.S. tax on the full salary while also preserving a larger, more useful carryover than the combination of the FEIE plus a credit on the stacked remainder — because the FEIE would disallow the foreign tax attributable to the excluded portion.

Mixed income — salary plus passive income taxed at a different rate: a hybrid approach can outperform either method used alone, by excluding the lower-taxed salary under the FEIE while crediting the separately taxed passive income under its own Form 1116 category.

A comparison run for a single year can miss the better multi-year answer. The right measure is which method produces the stronger result across several years, after accounting for the stacking effect, the credit limitations by category, the housing benefit, refundable credits, and self-employment tax.

Points That Are Easy to Miss

Both elections address federal income tax only — several other pieces of a return are unaffected.

- Neither the FEIE nor the FTC reduces self-employment tax; only a U.S. totalization agreement with the country involved can shift or eliminate that obligation, and only where its specific terms apply.
- A taxpayer who files Form 2555 cannot claim the refundable additional child tax credit on the excluded income, though the nonrefundable child tax credit may still be available.
- Both methods can be used in the same year on different income — what is not permitted is crediting foreign tax on income that has already been excluded under the FEIE.
- Mixed income requires separate sourcing and category work for each type of income; a foreign tax credit generated in one category cannot erase U.S. tax owed in another, and the foreign levy itself must meet the IRS's creditability rules.



Changing the Election Later

One of these two choices is far easier to walk back than the other.

Once elected, the FEIE remains in effect for later years unless the taxpayer formally revokes it by statement attached to a return. Revoking it generally bars re-electing the FEIE for five years without IRS consent, even if the taxpayer's circumstances change during that window. A year with no foreign earned income does not by itself require a revocation.

The Foreign Tax Credit is far more flexible from year to year, and a taxpayer may switch between claiming it as a credit or a deduction within a separate ten-year amendment period. That flexibility does not reach back and undo the five-year Section 911 restriction if the FEIE has already been revoked — the two rules run independently of each other.

A Six-Step Way to Decide

A careful comparison takes more than one year of numbers and one line item.

- Confirm the foreign tax home and which residence test — bona fide residence or physical presence — the taxpayer actually meets.
- Map every item of income to its U.S. or foreign source and, for Form 1116 purposes, to its correct category.
- Verify which foreign levies qualify for the credit and whether they were paid or merely accrued.
- Calculate the housing benefit first, then the FEIE, then the stacked U.S. tax on what remains, then the foreign tax disallowed on the excluded portion, then the Form 1116 limitation for each category.
- Compare current-year tax, refundable and nonrefundable credits, self-employment tax, and carryover value across several years, not just the current return.
- Check the FEIE revocation and five-year re-election rule before recommending a change from one method to the other.



How Crossbridge Global Tax Can Help

The best time to run this analysis is before the first return abroad is filed, not after an election is already locked in.

We can help you:

- Model the Foreign Earned Income Exclusion and the Foreign Tax Credit side by side against your actual country of residence, income mix, and multi-year plans
- Prepare Form 2555 or Form 1116, including the housing calculation and the category-by-category credit limitation
- Track foreign tax credit carryovers by category and vintage year so unused amounts are not left to expire
- Advise on the five-year re-election restriction before you revoke an existing FEIE election, and coordinate the choice with self-employment tax, retirement contributions, and child tax credit eligibility

Crossbridge Global Tax provides tax planning and compliance services and does not provide investment or legal advice. This briefing is educational in nature, summarizes general federal rules in effect for 2026, and does not address state tax treatment, totalization agreements, or specific income tax treaty provisions. Please consult your Crossbridge advisor before making or changing a Section 911 election.

Source: Internal Revenue Service, Publication 54 (Tax Guide for U.S. Citizens and Resident Aliens Abroad), Publication 514, and the Instructions to Forms 2555 and 1116, IRS.gov.