[JOINT COMMITTEE PRINT]

GENERAL EXPLANATION

OF THE

FOREIGN EARNED INCOME ACT OF 1978

(H.R. 9251, 95TH CONGRESS; PUBLIC LAW 95-615)

PREPARED BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

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LETTER OF TRANSMITTAL

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON TAXATION,
Washington, D.C., February 23, 1979.

Hon. AL ULLMAN, *Chairman,*
Hon. RUSSELL B. LONG, *Vice Chairman,*
Joint Committee on Taxation,
U.S. Congress, Washington, D.C.

DEAR MESSRS. CHAIRMEN: While committee reports explain the position of the House Committee on Ways and Means, or the position of the Senate Committee on Finance, they do not in all cases explain the tax legislation as finally passed by the Congress. Because of the substantial differences between the House and Senate bills and the many changes made in conference, the Foreign Earned Income Act of 1978 is not fully explained by the committee reports.

This document represents the effort of the staff of the Joint Committee on Taxation to provide an explanation of the Foreign Earned Income Act of 1978 and is comparable to several similar documents prepared by the staff on other revenue acts in recent years. It contains a chronology of the legislative history of the Act and an explanation of its provisions, including reference to prior law, the reasons for change, and the estimated revenue effects. For the most part, where provisions which were unchanged in conference were described in either the House or Senate report, that explanation is carried over in this document. No attempt is made to carry the explanation further than is customary in the case of committee reports. Accordingly, this explanation does not deal with issues which are customarily explained in regulations or rulings.

This material was prepared by the Joint Committee staff, in consultation with the staffs of the House Committee on Ways and Means and the Senate Committee on Finance, after the Act was passed. It has not been reviewed by the tax committees and therefore only reflects the staff's view as to the intent of Congress.

Sincerely yours,

BERNARD M. (BOB) SHAPIRO,
Chief of Staff.

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LEGISLATIVE HISTORY OF THE FOREIGN EARNED INCOME ACT OF 1978

The following is a chronology of the legislative history of the Foreign Earned Income Act of 1978 (H.R. 9251, Public Law 95–615).

• ***Introduction of H.R. 9251***—September 22, 1977. As introduced, H.R. 9251 only dealt with a temporary prohibition of any IRS rulings or regulations dealing with certain commuting expenses.

• ***Markup by the House Committee on Ways and Means***—September 27, 1977. The Committee added several provisions to the bill: (1) temporary prohibition of any IRS rulings or regulations dealing with fringe benefits;[1] (2) postponing for one year the effective date of the changes made in the taxation of foreign earned income by the Tax Reform Act of 1976, from December 31, 1976, to December 31, 1977; (3) a two-year postponement of the effective date with respect to salary reduction plans, cash or deferred profit-sharing plans, and cafeteria plans under the Employee Retirement Income Security Act of 1974; (4) a one-year extension of the section 117 exclusion for Health Professions Scholarship Programs for members of the Uniformed Services;[2] (5) a one-year extension of 5-year amortization for low-income rental housing;[3] and (6) a two-year postponement of the application of the 1976 Act rules regarding certain carryovers of net operating losses for corporations.[4]

• ***H.R. 9251 reported by Committee on Ways and Means***—October 12, 1977 (House Report 95–697).

• ***House of Representatives floor action***—H.R. 9251 considered and passed (under suspension of the rules) on October 25, 1977.

• ***Markup by the Senate Committee on Finance on H.R. 9251***—February 3, 1978. The Finance Committee amended H.R. 9251 to provide special deductions for certain additional foreign living costs, and also added provisions dealing with State legislators' travel expenses[5] and the section 117 exclusion for National Service Research Awards.[6] It also deleted the provisions of the House bill dealing with Health Professions Scholarship Programs and 5-year amortization of low-income housing.

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[1] Provisions prohibiting IRS rulings and regulations regarding commuting expenses and fringe benefits (through 1979) were later enacted as part of H.R. 12841 (Public Law 95–427).

[2] This provision was later enacted as part of H.R. 3387 (Public Law 95–171). A further one-year extension was included in the Revenue Act of 1978 (Public Law 95–600).

[3] This provision was later enacted as part of H.R. 3387 (Public Law 95–171). A further 3-year extension was included in the Revenue Act of 1978.

[4] A similar provision was enacted in the Revenue Act of 1978.

[5] This provision was later enacted as part of H.R. 11055 (Public Law 95–258).

[6] A similar provision was enacted in the Revenue Act of 1978.

• ***Committee on Ways and Means hearings on foreign earned income***—On February 23–24, 1978, the Ways and Means Committee held hearings on the tax treatment of income earned abroad generally and the Finance Committee amendments to H.R. 9251 regarding foreign earned income.

• ***H.R. 9251 reported by the Senate Committee on Finance***—April 19, 1978 (Senate Report 95–746).

• ***Senate Committee on Finance hearings on foreign earned income***—On May 8, 1978, the Finance Committee held hearings on the taxation of Americans working abroad.

• ***Senate floor action on H.R. 9251***—H.R. 9251 was considered and passed by the Senate on May 11, 1978.

• ***Committee on Ways and Means consideration of foreign earned income***—The subject was referred by the Committee to the Miscellaneous Revenue Measures Subcommittee on May 25, 1978.

• ***Miscellaneous Revenue Measures Subcommittee markup on foreign earned income***—June 5, 6, 23, 28, and 29, 1978.

• ***Miscellaneous Revenue Measures Subcommittee bill approved for the full Committee***—June 29, 1978. The bill was introduced as H.R. 13488 on July 14, 1978.

• ***Markup on H.R. 13488 by the Committee on Ways and Means***—August 2, 1978.

• ***H.R. 13488 reported by the Committee on Ways and Means***—August 10, 1978 (House Report 95–1463).

• ***House Committee on Rules action on H.R. 13488***—September 13, 1978 (House Resolution 1346; House Report 95–1567).

• ***House of Representatives floor action on H.R. 13488***—The bill was considered and passed (under suspension of the rules) by the House on September 25, 1978. The provisions of H.R. 13488, as passed by the House, were then substituted for the Senate amendment to H.R. 9251 dealing with foreign earned income, and the House requested a conference with the Senate on H.R. 9251.

• ***Conference requested by the Senate on H.R. 9251, as amended by the House amendment to the Senate amendment***—September 28, 1978.

• ***House-Senate Conference on H.R. 9251***—The conference report was filed on October 15, 1978 (House Report 95–1798).

• ***House and Senate agreed to conference report on H.R. 9251***—October 15, 1978.

• ***H.R. 9251 signed by the President***—November 8, 1978 (Public Law 95–615).

EXPLANATION OF THE FOREIGN EARNED INCOME ACT OF 1978 (P.L. 95–615, H.R. 9251)

I. TAX TREATMENT OF INCOME EARNED ABROAD (SECS. 4 AND 201–209 OF THE ACT)

A. Prior Law

Law Prior to the Tax Reform Act of 1976

United States citizens and residents are generally taxed by the United States on their worldwide income with the allowance of a foreign tax credit for foreign taxes paid. However, for years prior to 1977, U.S. citizens working abroad could exclude up to $20,000 of earned income a year, if they were present in a foreign country for 17 out of 18 months or they were *bona fide* residents of a foreign country for a period which included an entire taxable year (sec. 911). In the case of individuals who had been *bona fide* residents of foreign countries for three years or more, the exclusion was increased to $25,000 of earned income. In addition, under the law prior to 1977, foreign taxes paid on the excluded income were creditable against the U.S. tax on any foreign income above the $20,000 (or $25,000) limit.

There were 140,000 individuals who claimed the earned income exclusion in 1975, the most recent year for which statistics are available. The highest concentration of individuals using the earned income exclusion in that year resided in Canada, the United Kingdom, West Germany, Iran, Australia, Japan, Saudi Arabia, Brazil, France, and Switzerland. The revenue loss attributable to the excluded income (if the law in effect prior to the Tax Reform Act of 1976 were applicable) has been estimated at $498 million for calendar year 1977 and $538 million for calendar year 1978.

The earned income exclusion (sec. 911) provided that deductions for expenses allocable to excluded income were not allowed. For example, a deduction for moving expenses otherwise allowable (sec. 217) was disallowed to the extent that the expenses were allocable to excluded earned income. The Internal Revenue Service took the position that, as a general rule, moving expenses were attributable to income earned subsequent to the move. Accordingly, taxpayers claiming the earned income exclusion generally could not claim part or all of their expenses of moving overseas.

Under certain circumstances, any employee (whether working in the United States or overseas) is entitled to exclude from gross income the value of meals and lodging furnished in kind by his employer (sec. 119). The value of employer-provided meals is excludable from the employee's gross income if they are provided on the business premises of the employer for the convenience of the employer. The value of employer-provided lodging is excludable if three tests are met: (1) the lodging is furnished on the business premises of the employer, (2)

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the lodging is furnished for the convenience of the employer, and (3) the employee is required to accept the lodging as a condition of his employment. The third requirement is not satisfied merely by an employment contract provision which requires the employee to accept the lodging; rather, it means that it is necessary for the employee to accept the lodging in order to perform the duties of his employment (for example, when the employer furnishes the lodging because the employee is required to be on duty at all times or because the employee could not perform the services required of him unless he is furnished the lodging). For employees working abroad, this exclusion for employer-provided housing under section 119 was available in addition to the earned income exclusion allowed under section 911. (The exclusion for employer-provided housing was not modified by the Tax Reform Act of 1976.)

There were, under prior law, no special deductions for the excess costs of living abroad. However, if a taxpayer working abroad is "temporarily" away from home in pursuit of a trade or business, the taxpayer may generally deduct traveling expenses (including amounts spent for meals and lodging) for himself, but generally not for family members who accompany him. The taxpayer's "home" for this purpose is generally his principal place of employment. While a determination of whether the taxpayer is "temporarily" away from home depends on all the facts and circumstances, the Internal Revenue Service often holds that the taxpayer is "temporarily" away from home if his employment is not anticipated to, and does not actually, last more than a year. Otherwise, the Service ordinarily views the taxpayer as not being temporarily away from home and not entitled to these deductions.[1]

By its terms, the foreign earned income exclusion was available only to U.S. citizens. However, resident aliens were also entitled to the exclusion if they otherwise met the requirements and were from a country which had a tax treaty with the United States requiring nondiscrimination.

The exclusion for income earned abroad does not apply to amounts paid by the U.S. Government to its employees working abroad. However, certain special governmental allowances paid under specific statutes such as housing, cost-of-living, education, and travel allowances provided these employees are excluded from gross income and thus exempted from U.S. taxation (sec. 912). Allowances received by members of the Armed Forces are exempted under provisions of law largely outside the Internal Revenue Code.

Under prior law, there were no special rules regarding the deductibility of foreign moving expenses (other than disallowance of the expenses to the extent that they were allocable to income excluded under sec. 911); the same rules, which included certain specific time and dollar limits, applied to both foreign and domestic moves. There were also no special rules relating to nonrecognition of gain by taxpayers who sold their homes when they moved abroad for extended periods. The proceeds of the sale generally had to be reinvested in a new home within 18 (or, in certain cases, 24) months to avoid recognition of the gain.

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[1] Rev. Rul. 60-189, 1960-1 C. B. 60.

Tax Reform Act of 1976

The Tax Reform Act of 1976 would generally have reduced the earned income exclusion for individuals working abroad to $15,000 per year. However, the Act would have retained a $20,000 exclusion for employees of domestic charitable organizations. In addition, the Act would have made three modifications in the computation of the exclusion.

First, the Act provided that any individual entitled to the earned income exclusion was not to be allowed a foreign tax credit with respect to foreign taxes allocable to the amounts that were excluded from gross income under the earned income exclusion.

Second, the Act provided that any additional income derived by individuals beyond the income eligible for the earned income exclusion was subject to U.S. tax at the higher rate brackets which would apply if the excluded earned income were not so excluded. Since the Act thus provided that the excluded income would in effect be taken against the lowest rate brackets of the taxpayer (i.e., "off the bottom"), the foreign taxes allocable to the excluded amount and disallowed would be those foreign taxes imposed on the first $15,000 (or other excluded amount) of income assuming a foreign effective tax rate as progressive as the U.S. tax rate.

Third, the Act made ineligible for the exclusion any income earned abroad which was received outside the country in which earned if one of the purposes of receiving the income outside of the country was to avoid tax in that country.

In addition to the changes made in the computation of the exclusion, the Act provided an election to an individual not to have the earned income exclusion apply so that the foreign tax credit would not be disallowed. To prevent shifting from an exclusion to a credit from year to year, the Act provided that once an election was made not to have the exclusion apply, it was binding for all subsequent years and could be revoked only with the consent of the Internal Revenue Service.

Finally, the 1976 Act provided that individuals taking the standard deduction were to be allowed the foreign tax credit.

The 1976 Act provided that the changes to the earned income exclusion were to become effective for taxable years beginning in 1976. However, the Tax Reduction and Simplification Act of 1977 delayed this effective date for one year, or until 1977.

The revenue loss attributable to the exclusion if the Tax Reform Act of 1976 were applicable has been estimated at $180 million for calendar year 1977 and $194 million for calendar year 1978.

B. Reasons for Change

The Congress believed that, because of the extraordinary costs of overseas living in many situations, special consideration must be given to Americans working abroad in order to treat them equitably for tax purposes. The Congress believed that certain of an individual's excess costs of living abroad should be allowable as a deduction to put him in a position more comparable to Americans working in the United States. Accordingly, the Act establishes a new excess foreign living cost deduction consisting of four separate elements: the general cost of living, housing, education, and home leave costs. This deduction will create greater equity between people working abroad and at home.

Even if an employee does not bear the cost of these excess expenses himself because he is reimbursed or provided with housing or education for his children by his employer, he must include the reimbursement or the allowances at their local fair market value in his gross income.[1] Therefore, unless the employee is allowed a corresponding deduction, he must pay tax on these reimbursements and allowances even though they are intended only to put him in the same position that he would have been in had he been working in the United States.

The Congress believed that an incentive in addition to the deductions for excess foreign living costs would be desirable in order to compensate U.S. individuals working abroad in hardship areas for the adverse living conditions they must endure and to encourage them to accept employment in those areas. The Congress felt that such an incentive would reduce the possibility that employers of Americans working abroad would find it necessary to replace them with foreign workers because of tax considerations. The presence of Americans working abroad in these areas encourages the purchase of U.S. instead of foreign goods and services and, therefore, the incentives provided by the Act will produce benefits for the U.S. economy. In addition, the presence of Americans working abroad provides considerable noneconomic benefits, such as enhanced international goodwill and mutual understanding. The incentives take the form of an additional $5,000 deduction for workers in hardship areas or, for employees in camps in hardship areas, an alternative $20,000 exclusion.

Taxpayers moving abroad often experience considerable delays in obtaining new housing. The Congress believed that the time and dollar limitations on temporary living and house-hunting costs should be increased for foreign moves, and a deduction for storage costs should be permitted. Also, taxpayers who retired, and the survivors of taxpayers who died while abroad, generally could not deduct the costs of moving back to the United States. The Congress believed that this worked an undue hardship and that deductions for the expenses of

[1] *See, e.g., James H. McDonald,* 66 T.C. 223 (1976); *Philip H. Stephens,* T.C. Mem. 1976–13; *Harry Z. Bornstein, T.C. Mem.* 1978–278.

these moves should be allowed. Moreover, the Congress believed that a deduction for moving expenses should not be disallowed to the extent that they are allocable to income excluded under section 911.

Taxpayers moving abroad for extended periods often sell their home in the United States but are abroad too long to reinvest the proceeds in a new principal residence within the allowable period to avoid recognition of gain on the sale. The Congress believed that the allowable period should be extended to up to 4 years while the taxpayer is abroad. This would be similar to the rule now in effect for members of the Armed Forces.

The Congress believed it is necessary to obtain information on the operation of the provisions in the Act relating to the exclusion for income earned abroad (sec. 911) and the deduction for excess foreign living costs (sec. 913). In addition, the Congress believed that better information is needed on the operation of the exclusion of certain government allowances by civilian employees of the U.S. Government working abroad (sec. 912). Accordingly, the Act provides for reports to be made by the Treasury Department on these provisions.

C. Summary of Provisions

The Act generally replaces the section 911 earned income exclusion for years beginning after December 31, 1977, with a new system of itemized deductions for the excess costs of working overseas. The basic eligibility requirements for the deduction are generally the same as for the prior earned income exclusion. Because the new provisions of the Act are effective on January 1, 1978, and the Act did not become law until November 8, 1978, taxpayers may elect for 1978 to be taxed under these new provisions or under prior law (the exclusion as amended by the Tax Reform Act of 1976) so that the Act will not have any mandatory retroactive effect. In addition, for years which began in 1977, the Act provides that the law in effect prior to the 1976 Act applies.

The new excess living cost deduction (new sec. 913) consists of separate elements for the general cost of living, housing, education, and home leave costs. The cost-of-living element of the deduction is generally the amount by which the cost of living in the taxpayer's foreign tax home exceeds the cost of living in the highest cost metropolitan area in the continental United States (other than Alaska). The deduction is based on the spendable income of a person paid the salary of a Federal employee at grade level GS–14, step 1, regardless of the taxpayer's actual income. The housing element is the excess of the taxpayer's reasonable housing expenses over his base housing amount (generally one-sixth of his net income). The education deduction is generally the reasonable schooling expenses for the education of the taxpayer's dependents at the elementary and secondary levels. The deduction for annual home leave consists of the reasonable cost of coach fare transportation for the taxpayer, his spouse, and his dependents from his tax home outside the United States to his most recent place of residence within the United States.

In addition, taxpayers living and working in certain hardship areas are allowed a special $5,000 deduction in order to compensate them for the hardships involved and to encourage U.S. citizens to accept employment in these areas. For this purpose, hardship areas are generally those designated by the State Department as hardship posts where the hardship post allowance paid government employees is 15 percent or more of their base pay.

As an exception to these new rules, the Act permits employees who reside in camps in hardship areas to elect to claim a $20,000 earned income exclusion (under sec. 911) in lieu of the new excess living cost and hardship area deductions. No foreign tax credit would be allowed for foreign taxes attributable to the excluded amount. For taxpayers electing the exclusion, the camp would be treated as the employer's business premises so that the exclusion for employer-provided meals and lodging can also be claimed (provided the other requirements of sec. 119 are satisfied).

The Act liberalizes the deduction for moving expenses for foreign job-related moves, increasing the dollar limitations applicable to temporary living expenses. The Act also extends up to four years while the taxpayer is working abroad the 18- or 24-month period for reinvestment of proceeds realized on the sale of a principal residence.

On an aggregate basis for all Americans working abroad, the new provisions of the Act represent a compromise between the provisions of the 1976 Act and the provisions of the law in effect prior to the 1976 Act. For calendar year 1978, it is estimated that the total revenue cost of the provisions of the Act will be $412 million, compared to an estimated cost of $194 million had the 1976 Act provisions applied for the year, and an estimated $538 million had the law in effect prior to the 1976 Act applied. Thus, the new additional benefits for people who earn income abroad over and above the benefits which would have been available under the 1976 Act provisions are estimated to result in a net revenue loss of $218 million for calendar year 1978.

On an individual basis, the Act may result in substantial changes in the liabilities of many Americans working abroad because the new deductions are based on the actual circumstances of each taxpayer rather than a flat amount for all taxpayers as under prior law. Thus, the provisions of the Act will be relatively more beneficial for taxpayers in high cost (or hardship) areas such as Northern Europe, Japan, and the Middle East. In addition, because the deductions (particularly the schooling and home leave elements) generally vary with family makeup, they will tend to benefit taxpayers with dependents. In many cases, the new provisions will be more beneficial for these taxpayers than either the 1976 Act provisions or the law in effect prior to the 1976 Act. By the same token, the new provisions will be relatively less beneficial for those taxpayers in relatively low cost areas such as Canada or Mexico and for single taxpayers or those whose families have remained in the United States. For some of these taxpayers, the new provisions may be less beneficial than the provisions of the 1976 Act.

D. Explanation of Provisions

1. Extension of pre-1976 Act law (Sec. 4)

The Act delays the effective date of the changes made by the Tax Reform Act of 1976 to the taxation of Americans working abroad so that the law in effect prior to adoption of the 1976 Act applies to taxable years which begin in 1977. The Act generally extends through 1977 the rule of prior law that an individual who elects the foreign tax credit must itemize deductions. However, the Act provides that individuals who are not eligible in 1977 for the earned income exclusion need not itemize deductions if they elect the foreign tax credit. For 1978 and later years, individuals may elect the foreign tax credit without having to itemize deductions regardless of whether or not they qualify for the special treatment under the Act for Americans working abroad.

The IRS announced (IR–2052, November 9, 1978) that it would not assert late filing penalties for the 1977 returns of taxpayers entitled to the foreign earned income exclusion if the taxpayers were covered by prior extensions for the year granted by the IRS and if the returns were filed by February 15, 1979.

2. Deduction for certain expenses of living abroad (Sec. 203)

In general

Under the Act, the flat exclusion of income earned abroad will in general be replaced for taxable years beginning after December 31, 1977, with a deduction for certain excess foreign living costs. For years after 1977, an annual $20,000 exclusion under section 911 may still be elected in lieu of the deduction by certain employees in camps in hardship areas. (For taxable years which begin in 1978, taxpayers may elect to be taxed under the provisions of this Act or under the exclusion as amended by the 1976 Act.)

Those persons eligible for the new deduction will generally be the same as were eligible for the earned income exclusion under prior law. As under prior law, U.S. citizens will be eligible if they are *bona fide* residents of a foreign country or countries for a period which includes an entire taxable year or if they are physically present in a foreign country or countries for 510 days out of a period of 18 months. Also, aliens who are residents of the United States will be eligible for the deduction if they meet the requirements of the 510-day presence test. (Under prior law, resident aliens qualified for the foreign earned income exclusion only if they were nationals of a foreign country having a tax treaty with the United States which contained nondiscrimination provisions.) However, resident aliens cannot qualify under the *bona fide* residence test.

In addition to meeting the basic eligibility requirements, an individual must have his "tax home" in a foreign country to obtain the benefits of the various elements of the deduction for excess foreign living costs. For this purpose, the term "tax home" generally means the individual's home for purposes of the deduction for traveling expenses while away from home (sec. 162(a)(2)), which is ordinarily his principal place of work. Thus, an individual who is temporarily away from his tax home in the United States does not qualify for the deduction for excess foreign living costs. An exception to the general rule is that a taxpayer is ineligible for the deduction for excess foreign living costs for any period for which his abode is in the United States. For example, a taxpayer who lives in Detroit, Michigan, but commutes daily to work in Windsor, Ontario, would ordinarily have his tax home in Windsor but nevertheless would be ineligible for the deduction for excess foreign living costs. Moreover, for purposes of this deduction, a household or residence is treated as at the tax home of an individual if the household or residence is within a reasonable commuting distance of his tax home. Thus, if the taxpayer works in a city but lives in a suburban area, his household or residence, rather than his actual principal place of work, is treated as his tax home.

The Act makes the deduction for additional foreign living costs a deduction from gross income in determining adjusted gross income. As a result, a taxpayer is able to claim the deduction for additional foreign living costs without being required to itemize deductions. Employers are permitted to adjust the wage withholding of their employees to take the deduction for excess foreign living costs into account.

Taxpayers who claim the deduction for excess foreign living costs may claim the foreign tax credit for income taxes paid to foreign countries, but the foreign tax credit limitation is to be computed by considering the deduction for excess foreign living costs, including any hardship deduction and any deduction for moving expenses allocable to foreign earned income, as entirely related to foreign source income. The deduction for excess foreign living costs would also generally be attributed to foreign earned income for other purposes under the Code. Thus, it would be considered a deduction attributable to gross income from a trade or business in determining net earnings from self-employment (sec. 1402(a)). This could reduce the taxpayer's self-employment tax liability. It could also reduce the maximum allowable contribution on behalf of a self-employed individual to a qualified pension or profit-sharing plan.

Specific deductions for excess foreign living costs

The elements of the deduction for excess foreign living costs are discussed in more detail below.

Cost of living

This element of the deduction consists of a reasonable amount determined under tables (or under any other method) prescribed by the Treasury Department establishing the amount (if any) by which the general cost of living in the foreign place in which the individual's tax home is located exceeds the general cost of living for the metropolitan area in the continental United States (excluding Alaska) having the highest general cost of living. The tables (or other method) are to be revised at least once for each calendar year to reflect any changes in the general living cost differential (including, for example, those attributable to currency exchange rate fluctuations and differences in inflation rates).

The cost-of-living differential is to be determined by reference to the reasonable daily living expenses of a person paid the salary of a Federal employee in step 1 of grade GS–14 ($32,442 for fiscal year 1979), regardless of the taxpayer's actual income. Reasonable daily living expenses exclude housing and schooling expenses, for which special deductions are provided. The cost of items such as annual home leave, savings, income taxes, life insurance, charitable contributions, and retirement deductions will also be excluded because they are not daily living expenses and are generally not affected by differences between the cost of living in the foreign country and that in the United States. The differential will be based on retail prices and thus any value added taxes and sales taxes will be taken into account. The differential prescribed for any foreign place may vary depending on the composition of the family (spouse and dependents) residing with the individual.

The Treasury, in determining the qualified cost-of-living differential for any foreign place, may follow, to the extent and with such adjustments and modifications it considers appropriate, the methodology or the indexes used in determining the cost-of-living allowances provided U.S. Government employees working overseas. The Treasury may also use any other method which meets the specified criteria, and it may also use indexes it prepares itself or which are prepared for it by outside consultants.

The differential is to be computed on a daily basis for the period during which the individual's tax home is in a foreign country. In addition, an individual generally will not be entitled to any qualified cost-of-living differential for any period for which the individual's meals and lodging are excluded from gross income under section 119. Thus, if a taxpayer's tax home is in a particular foreign country for 90 days during the taxable year, and during 30 of those days he receives meals and lodging, the value of which he excludes under section 119, his cost-of-living element for that country will be based on a period of 60 days.

A foreign "place" may be limited to a part of a foreign country or may include more than one foreign country, and the determination of the size of each foreign "place" may depend on, among other things, disparities in relevant costs between places and the number of persons in each place claiming the deduction for excess foreign living costs.

Housing

This element of the deduction is an amount equal to the excess of the individual's housing expenses over the individual's base housing amount. The base housing amount is intended to reflect the cost of housing which the taxpayer would typically incur if he were residing in the United States. This cost is assumed to be one-sixth of the taxpayer's earned income (net of excess foreign living costs and other allocable deductions).

For purposes of computing excess housing expenses, the term "housing expenses" means the reasonable expenses, such as rent, paid or incurred during the taxable year by or on behalf of the individual for housing for the individual (and, if they reside with him, for his spouse and dependents) in a foreign country. Housing expenses include expenses attributable to the housing (such as utilities and insurance), but do not include interest and taxes of the kind deductible under section 163 or 164 or any amount allowable as an equivalent deduction to tenant-stockholders of cooperative housing corporations under section 216(a); interest and taxes are separately deductible as provided in those sections. Housing expenses will not be treated as reasonable to the extent that the expenses are lavish or extravagant under the circumstances. The costs of a house purchase, or improvements, are capital expenditures, not housing expenses, and are not deductible under this provision. Moreover, no deduction is allowable based on "expenses" of mortgage amortization or imputed depreciation on the house. The value of housing which is excluded by the taxpayer under section 119 is not a housing cost.

The individual's "base housing amount," as described above, is generally one-sixth of the excess of his earned income from U.S. as well as foreign sources over the sum of his deductible excess foreign living costs and other allocable deductions (that is, one-sixth of his net earned income). The mathematical equivalent of one-sixth of the taxpayer's net earned income (his earned income minus the sum of his (i) deductible *excess* foreign cost-of-living, education, home leave, hardship area, and housing cost elements and (ii) any other allocable deductions) is one-fifth of the taxpayer's earned income minus the sum of (i) the deductible excess foreign cost-of-living, education, and home leave, and hardship area elements, (ii) the *full* cost of the taxpayer's housing, and (iii) any other allocable deductions. Since net earned income is itself a function of the deduction for excess housing costs, in order to avoid circularity the Act adopts the latter method to compute excess housing costs.[1]

The computation of the housing deduction may be illustrated by the following example of an individual with earned income for the year of $45,000 whose deductible education, home leave, and cost-of-living expenses are $10,000 and whose total housing costs are $15,000. The taxpayer's base housing amount would be $4,000—one-fifth of the $20,000 excess of the taxpayer's $45,000 earned income over (i) his $10,000 of deductible foreign living costs other than the housing element and (ii) the $15,000 spent on housing. Thus, the excess housing cost element of the deduction would be $11,000 (the excess of the $15,000 housing costs over the $4,000 base housing amount), leaving the taxpayer with net earned income of $24,000 ($45,000 less deductible excess living costs of $21,000). The taxable $4,000 base housing amount is one-sixth of net earned income.

An exception to the foregoing method of calculating the base housing amount is provided if the taxpayer's tax home is in a hardship area and if, because of living conditions which are dangerous, unhealthful, or otherwise adverse, the individual maintains a household for his spouse and dependents at a place outside the United States other than his tax home which is in addition to the household he main-

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[1] Since the full cost of the taxpayer's housing is by definition equal to the sum of his base housing amount and his excess housing costs, the excess of earned income over (i) deductible foreign living costs (other than the housing element), (ii) the full cost of housing, and (iii) other allocable deductions can be restated as the excess of net earned income over the base housing amount. The mathematical equivalence of the two methods can be demonstrated by the following formula in which the unknown "x" is net earned income and x/6 is thus the base housing amount: $(x-(x/6))/5=x/6$.

tains within a reasonable commuting distance of his tax home. In that case, the base housing amount for the household maintained at his tax home will be zero. This provision is available where the employee maintains a separate household for his family because of adverse living conditions at his place of employment. It is intended by the Congress that this requirement be liberally construed.

Generally, the housing expenses taken into account under this provision will be those which are attributable to housing during periods for which the individual's tax home is in a foreign country, but do not include expenses for any portion of that period, on a daily basis, during which the value of the individual's housing is excluded under section 119. Moreover, in general, only housing expenses with respect to the abode which bears the closest relationship to the individual's tax home will be taken into account under this provision. For example, if an individual works in the Middle East and maintains an abode there, but also maintains a house in Europe, only the expenses of the abode in the Middle East are to be taken into account.

Because the taxpayer's hardship area deduction (if applicable) is subtracted from his earned income in determining the base housing amount, it may increase the amount deductible as excess housing expenses by as much as $1,000. This does not reduce the taxpayer's allowable hardship area deduction. Moving expense deductions would similarly reduce the base housing amount.

Schooling expenses

This element of the deduction consists of the reasonable schooling expenses paid or incurred by or on behalf of the individual during the taxable year for the education of each dependent of the individual at the elementary or secondary level (the equivalent of education in a United States-type school from kindergarten through the 12th grade).

The term "schooling expenses" means the cost of tuition, fees, books, and local transportation and of other expenses required by the school. If there is an adequate United States-type school (i.e., English-speaking and offering education for which U.S. schools would ordinarily grant credit toward graduation) available within a reasonable commuting distance of the individual's tax home and the dependent attends a school other than that school, then the amount taken into account as reasonable schooling expenses is not to exceed the aggregate amount which would be charged for the period by that school. (The dependent may attend school elsewhere, including the United States, but the deduction is limited to that amount.) If there is more than one adequate United States-type school within a reasonable commuting distance of the individual's tax home, this limitation is to be imposed with reference to the least expensive of those schools, unless the taxpayer cannot through diligent efforts obtain the admission of the dependent to the school or unless the dependent has physical or mental handicaps requiring special programs or facilities not available at the school. In such a case, the limitation is to be imposed with reference to the least expensive school within a reasonable commuting distance to which admission may be obtained or at which the special programs or facilities are available.

If an adequate United States-type school is not available within a reasonable commuting distance of the individual's tax home, the expenses of room and board of the dependent and the expenses of the transportation of the dependent between the tax home and the location of the school will be treated as schooling expenses.

An amount is to be taken into account as a schooling expense only if it is attributable to education for a period during which the individual's tax home is in a foreign country. Moreover, the deduction is available only with respect to schooling expenses of dependents for periods during which they reside with the taxpayer at that tax home. Of course, a dependent does not fail to "reside" with the taxpayer for this purpose solely because he attends a boarding school away from the taxpayer's tax home.

Home leave transportation

This element of the deduction consists of the reasonable amounts paid or incurred by or on behalf of the taxpayer for the transportation of himself and his spouse and dependents from the location of his tax home outside the United States to the taxpayer's present (or, if none, most recent) principal residence in the United States and return. If the taxpayer never had a residence in the United States, the deduction applies to transportation to the nearest port of entry in the continental United States (excluding Alaska) and return.

Amounts may be taken into account under this provision only with respect to one round trip per person for each continuous 12-month period for which the taxpayer's tax home is in a foreign country. The deduction will be allowed for home leave taken before the 12-month period is completed, but only if the taxpayer's tax home is in a foreign country for the full 12-month period. The deduction applies only to round trips originating from the taxpayer's tax home abroad; accordingly, the taxpayer may not deduct the cost of bringing his family from the United States (or any other location) to his foreign tax home and returning them to the United States (or other point of origin).

The amount taken into account in determining excess foreign living costs for any transportation by air is not to exceed the lowest coach or economy rate at the time of day of the transportation charged by a commercial airline for the transportation during the calendar month in which the transportation is furnished. If there is no coach or economy rate or if the individual is required to use first-class transportation because of a physical impairment, the amount taken into account is to be limited to the lowest first-class fare available at that time of day. The costs of stopovers en route are not deductible as transportation costs.

Hardship post deduction

This element of the deduction consists of an amount computed on a daily basis at an annual rate of $5,000 for days during which the individual's tax home is in a hardship area. The term "hardship area," for purposes of this provision and other provisions in the Act in which the term is used, means any foreign place designated by the Secretary of State as a hardship post where extraordinarily difficult living conditions, notably unhealthful conditions, or excessive physical hardships exist and for which a post differential of 15 percent or more is provided under section 5925 of title 5, United States Code, or would be so provided if officers and employees of the Government of the United States were present at that place.

The Department of State has defined each of the factors relevant to a hardship post designation in specific terms. For example, the factor "extraordinarily difficult living conditions" currently includes consideration of inadequate housing accommodations, lack of cultural and recreational facilities, geographical isolation, inadequate transportation facilities, and lack of food and consumer services. The factor "excessive physical hardship" involves consideration of the effects of climate and altitude and the presence of dangerous conditions affecting life, mental health, or physical well-being including, for example, terrorism. The factor "notably unhealthful conditions" involves consideration of the incidence of disease and epidemics, lack of public sanitation and health-control measures, and inadequacy of medical and hospital facilities. Generally, hardship areas are located in less developed countries. The Secretary of State is authorized, but not required, to designate as hardship areas additional areas where no government employees are present. Requests for designations should be addressed to the Director of Allowances, Department of State, Washington, D.C. 20520.

Special rules for qualified second households

Special rules apply to the foregoing elements of the deduction for excess foreign living costs if a household is maintained in a foreign country by an individual for his spouse and dependents at a place other than his tax home because of living conditions at his tax home which are dangerous, unhealthful, or otherwise adverse. The second household in this case is a "qualified second household." An individual may have only one qualified second household at any time. If an individual maintains a qualified second household, the general rules are modified as described below.

The cost-of-living deduction is based on the foreign place where the qualified second household is located, not on the place of the taxpayer's tax home. The deduction is not disallowed for days during which the taxpayer excludes the value of meals and lodging provided by his employer under section 119. This rule may be illustrated by an example of an employee working on a foreign off-shore oil rig. He alternately spends two weeks on the rig and one week off, and he maintains his family's residence on shore. Ordinarily, the drilling rig would be the employee's tax home and the home on shore would be a qualified second household. The cost-of-living allowance would be based on the foreign place in which the qualified second household is located, not the place where the rig is located. To the extent that the deduction depends on family size, the taxpayer is included as a family member, but not for days during which he excludes the value of meals and lodging under section 119. The taxpayer receives no separate cost-of-living deduction for his tax home.

The housing deduction is available both with respect to the taxpayer's housing at his tax home and also for his family's housing at the qualified second household. The deduction for the taxpayer's housing differs depending upon whether or not it is in a hardship area. If it is in a hardship area, a deduction is allowed for the full amount of the taxpayer's housing costs at his tax home (the base housing amount for his housing is zero). If, however, his housing is not in a hardship area, calculation of his base housing amount is made under the general rules, and without regard to any housing expenses incurred at his qualified second household. In any event, whether or not the taxpayer's tax home is in a hardship area, he may also deduct the excess of the expenses of maintaining the qualified second household over the base housing amount for the qualified second household. This base housing amount is computed under the rules previously described, except that earned income is to be reduced by the full housing costs at both the qualified second household and the taxpayer's tax home.

The deduction for excess housing costs at the qualified second household is not disallowed for days during which the taxpayer excludes the value of meals and lodging at his tax home under section 119. Also, the rule which permits the taxpayer to deduct costs only with respect to the household having the closest relationship to his tax home is modified to permit the deduction of excess housing costs at the qualified second household as well.

Dependents living at the qualified second household are treated as residing at the tax home so as to permit their reasonable schooling expenses to be deducted. The determination of whether the costs of non-local travel, room and board are deductible, and of the reasonableness of the expenses, both depend on the availability of adequate United States-type schools within reasonable commuting distance of the qualified second household, rather than within reasonable commuting distance of the tax home.

Home leave transportation for the spouse and dependents of the taxpayer is available for round trips from the qualified second household, rather than from the tax home.

Other rules

The deduction for excess foreign living costs allowed to any individual for a taxable year may not exceed (a) the individual's earned income (generally computed in the same manner as under section 911 of the Code, but not including amounts paid by the United States or any agency thereof) from sources outside the United States for the portion of the taxable year in which his tax home is in a foreign country reduced by (b) the sum of (i) any foreign earned income which represents the value of meals and lodging excluded from his gross income under section 119, and (ii) the allocable deductions other than the deduction for excess foreign living costs. For this purpose, "allocable deductions" are generally to be determined in the same manner as are the deductions allocable to or chargeable against income excluded under section 911.

The purpose of the earned income limitation is to insure that the deduction for excess foreign living costs, like the exclusion under section 911, offsets only the taxpayer's foreign earned income and not his other income. The adjustment for amounts excluded under section 119 is necessary because these amounts would be included in the definition of earned income even though they are excluded from gross income.

To prevent duplication of benefits, an individual will not be allowed any amount (i) as a deduction (other than the deduction for personal exemptions under section 151), (ii) as an exclusion, or (iii) as a credit for household and dependent care services under section 44A, to the extent that the amount is taken into account in determining the deduction for excess foreign living costs.

The Treasury Department is authorized to prescribe such regulations as may be necessary or appropriate to carry out the purposes of section 913, including rules for cases where a husband and wife each have earned income from foreign sources and for married individuals filing separate returns. It is anticipated that the regulations will, among other things, provide for the coordination of sections 911, 912, and 913, and will deal with questions arising from changes in the status of taxpayers during a taxable year.

3. Income earned by individuals in certain camps (sec. 202)

The Act provides an election for employees in camps in hardship areas who are otherwise eligible for the deduction for excess foreign living costs to claim an exclusion (under sec. 119) for the value of their meals and lodging and an annual exclusion (under sec. 911) of up to $20,000 annually. An individual who elects the exclusion is ineligible for the excess foreign living cost deduction for that taxable year.

To be eligible for the election, the individual must reside in the camp because of his employment. Lodging is not a "camp" unless it is substandard lodging which is (i) provided by or on behalf of the employer for the convenience of the employer because the place at which the individual renders services is in a remote area where satisfactory housing is not available on the open market; (ii) located, as near as practicable, in the vicinity of the place at which the individual renders services; and (iii) furnished in a common area (or enclave) which is not available to the public and which normally accommodates 10 or more employees. The term "hardship area" has the same meaning for purposes of this provision as for the deduction for excess foreign living costs (sec. 913).

If the individual qualifies for the exclusion on the basis of *bona fide* residence in a foreign country or countries for a period which includes an entire taxable year, the exclusion generally applies to amounts received from sources within a foreign country or countries which constitute earned income attributable to services performed during the period of *bona fide* residence. If the individual qualifies on the basis of presence in a foreign country or countries for 510 days in any period of 18 consecutive months, the exclusion generally applies to amounts received from sources within a foreign country or countries which constitute earned income attributable to services performed during the 18-month period.

Unlike prior law, the provision only allows the exclusion of income from sources within foreign countries. Thus, in no event may earned income be excluded if it is from sources within possessions or territories of the United States or other areas of the world not under the sovereignty of a foreign government. (Treas. Reg. § 1.911-2(f).)

The total amount excluded under this provision for any taxable year may not exceed $20,000, prorated for the days of the year during which the employee resides in a camp. As under present law, any deductions properly allocable to or chargeable against excluded foreign earned income are disallowed. However, the Act provides that the deduction for moving expenses (sec. 217) is not to be disallowed on the basis of allocability to excluded foreign earned income. Prior law provided that personal exemptions were not to be disallowed on the basis of allocability to excluded foreign earned income. The Act eliminates this provision as superfluous because personal exemptions would not be allocated to foreign earned income under the general rules of allocating deductions.

A deduction or credit for foreign income taxes properly allocable to or chargeable against excluded income is disallowed. It is anticipated that the method of allocation will be prescribed by regulations. (The method set forth in sec. 701(u)(10) of the Revenue Act of 1978—one of the technical corrections to the 1976 Act—is only applicable to taxpayers who, for 1978, elect to be taxed under the 1976 Act.)

If an individual elects the exclusion, then the camp in which the individual resides is considered to be part of the business premises of the employer for purposes of the exclusion of the value of meals and lodging on the business premises of the employer (sec. 119). However, the other requirements of section 119 must be met for any meals or lodging to be excluded.

4. Moving expense deduction for foreign moves (sec. 204)

Under prior law, a taxpayer who moved in connection with employment at a new location was, if certain conditions were met, allowed a deduction for certain costs of the move (sec. 217). The reasonable expenses of moving household goods and personal effects, and of traveling, from the old residence to the new were deductible in full. Also, part of the expenses deductible were the costs of (a) traveling (including meals and lodging) after obtaining employment from the former residence to the general location of the new principal place of work and return for the principal purpose of searching for a new residence, and (b) meals and lodging while occupying temporary quarters in the general location of the new principal place of work during any period of 30 consecutive days after obtaining employment. The aggregate amount deducted for these costs could not, under prior law, exceed $1,500. The taxpayer could also deduct certain other expenses connected with the sale, purchase, or lease of a residence, but the aggregate amount deductible could not exceed $3,000, reduced by the amounts deducted for the costs of searching for a new residence and temporary living expenses.

In the case of foreign moves, the Act modifies these rules in several respects. First, it changes the 30-day limitation on the deduction of the cost of temporary quarters to 90 days and increases the dollar limitation on deductibility of those costs and costs of searching for a new residence from $1,500 to $4,500. Second, the $3,000 limitation (described above) on the deduction of expenses connected with the sale, purchase, and lease of a residence is raised to $6,000. (The limits are $2,250 rather than $4,500, and $3,000 rather than $6,000, in the case of a husband and wife filing separate returns.) Third, deductible moving expenses are changed to include the reasonable expenses (without any dollar limitation) of moving household goods and personal effects to and from storage and of storing the goods and effects for part or all of the period during which the taxpayer's new place of work abroad continues to be his principal place of work. The other limitations of section 217 continue to apply to foreign as well as domestic moves.

The term "foreign move" means a move in connection with the commencement of work by the taxpayer at a new principal place of work located outside the United States. Thus, a move from the United States to a foreign country, or from one foreign country to another, would be a foreign move. A move from a foreign country to the United States would not be a foreign move.

The Act also provides a deduction for the costs of moving from a residence outside the United States to a new residence in the United States in connection with the *bona fide* retirement of the individual whose principal place of work was outside the United States. The deduction is allowed without regard to the requirement of section 217 that the individual perform services in the United States as a full-time employee or self-employed person for a specified period of time. The other limitations of section 217 continue to apply.

Moving expenses which are paid or incurred by the spouse or any dependent of any decedent who (as of the time of his death) had a principal place of work outside the United States are also deductible without regard to the requirement that the taxpayer perform services at the new location, but are subject to the other limitations of section 217. The expenses allowed are those which are incurred for a move which begins within 6 months after the death of the decedent and which is to a residence in the United States from a former residence outside the United States which (as of the time of the decedent's death) was the residence of the decedent and the individual paying or incurring the expense.

The provisions are effective for expenses paid or incurred in taxable years beginning after 1977 (except for taxpayers who elect to be taxed under the 1976 Act) even if the foreign move commenced in an earlier year. Thus, a taxpayer who moved abroad in 1977 could deduct storage expenses paid or incurred in 1978.

5. Suspension of period for nonrecognition of gain on sale of a principal residence (sec. 206)

In general, if property used by the taxpayer as his principal residence is sold by him and, within a period beginning 18 months before the date of the sale and ending 18 months after that date, property is purchased and used by the taxpayer as his new principal residence, gain (if any) from the sale is recognized only to the extent that the taxpayer's adjusted sales price of the old residence exceeds the taxpayer's cost of purchasing the new residence (sec. 1034). In some cases where a new residence is constructed, the 18-month period is extended to 24 months.

Under the Act, the running of the 18- or 24-month time periods is generally to be suspended during any time that the taxpayer (or his spouse if the old residence and the new residence are each used by the taxpayer and his spouse as their principal residence) has a tax home (as defined in section 913) outside the United States after the date of the sale of the old residence; except that any period of time as so suspended is not to extend beyond the date 4 years after the date of the sale of the old residence. This is similar to the rule now in effect for members of the U.S. Armed Forces on extended active duty.

For example, if the taxpayer has a tax home abroad from January 1, 1979, to June 30, 1980, and if he sells his old residence on January 10, 1979, the latest date on which the taxpayer may use a new residence constructed by him and have any part of the gain on the sale of his old residence not recognized under this provision is June 30, 1982 (the date 24 months following the taxpayer's termination of his tax home abroad). However, if this taxpayer had a tax home abroad from January 1, 1979, to December 31, 1982, the latest date on which he might use a new residence constructed by him and have any part of the gain on the sale of his old residence not recognized under this provision would be January 10, 1983 (the date four years following the date of the sale of the old residence).

The provisions are effective for taxable years beginning in 1978 (except for taxpayers who elect to be taxed under the 1976 Act) even if the old residence was sold in an earlier year. Thus, if a taxpayer sold his old residence on September 30, 1976, and had a tax home abroad from January 31, 1978, to August 31, 1980, the latest date on which the taxpayer may purchase and use a new residence constructed by him and have any part of the gain on the sale not recognized under this provision is September 30, 1980.

6. Reports on exclusions and special deductions of private and civilian government employees working abroad (sec. 208)

Under the Act, as soon as practicable after the close of the calendar year 1979 and after the close of each second calendar year thereafter, the Treasury Department is to transmit a report to the House Ways and Means Committee and to the Senate Finance Committee setting forth with respect to the preceding two calendar years: (1) the number, country of residence, and other pertinent characteristics of persons claiming the benefits of sections 911, 912, and 913; (2) the revenue cost and economic effects of those provisions; and (3) a detailed description of the manner in which those provisions have been administered during the preceding two calendar years.

Each agency of the Federal Government which pays allowances excludable from gross income under section 912 is to furnish to the Treasury Department any information the Treasury determines to be necessary to carry out its responsibility to file these reports. Also, the Treasury may by regulations require any individual who receives allowances which are excluded from gross income under section 912 for any taxable year to include on his income tax return any information with respect to the amount and type of the allowances which the Treasury determines to be appropriate.

7. Meals and lodging furnished to employees (sec. 205)

One of the requirements for exclusion of the value of meals and lodging provided by the taxpayer's employer is that the meals or lodging be furnished to the taxpayer by his employer for the convenience of the employer. The Act modifies the wording of this requirement to provide that the exclusion applies with respect to meals or lodging furnished by or on behalf of his employer to the taxpayer, his spouse, or any of his dependents for the convenience of the employer. For example, meals provided at a construction job site by the client or the prime contractor to an employee of a subcontractor on the job project for the convenience of that subcontractor would meet this requirement. (Since the construction job site is the place of employment of the employee, it would qualify as the business premises of the employer for purposes of the exclusion. Treas. Reg. § 1.119–1(c).) Similarly, lodging provided at the job site by the client or by the prime contractor to that employee and his family would qualify if it was provided for the convenience of the subcontractor and the employee was required to accept it as a condition of his employment. However, the other requirements of section 119 must also be met for meals or lodging to be excluded by the employee. Thus, the meals and lodging must be provided on the business premises of the employer and must be provided in kind in conformity with the Supreme Court's decision in *Commissioner* v. *Kowalski*, 434 U.S. 77 (1977).

E. Effective Date

The Act provides that the law prior to the 1976 Act is extended through taxable years beginning in 1977. The other changes in the tax treatment of Americans working abroad would generally be effective for taxable years beginning after December 31, 1977, except that the provision allowing adjustment of wage withholding to take account of the deduction for excess foreign living costs is effective only with respect to compensation paid after the date of enactment (November 8, 1978). For taxable years which begin in 1978, taxpayers may elect to be taxed under the law in effect prior to date of enactment (that is, the law as amended by the 1976 Act).

F. Revenue Effect

The provisions of the Foreign Earned Income Act of 1978, relating to Americans working abroad, are estimated to have the following revenue effect for fiscal years 1979–83:

(Millions of dollars)

1979	1980	1981	1982	1983
−255 [1]	−254	−275	−297	−310

[1] The fiscal year 1979 revenue effect reflects no loss of revenue from the one-year delay of the 1976 Act on 1977 tax liability because that loss is properly allocable to fiscal year 1978 receipts.

II. SALARY REDUCTION PLANS, CASH OR DEFERRED PROFIT-SHARING PLANS, AND CAFETERIA PLANS (SECS. 5 AND 210)

Present Law

On December 6, 1972, the Internal Revenue Service issued proposed regulations which would have changed the tax treatment of employees under salary reduction plans, and which called into question the tax treatment of employees under cash or deferred profit-sharing plans and so-called "cafeteria" plans. The Employee Retirement Income Security Act of 1974 froze the tax treatment of these plans for two years, and the Tax Reform Act of 1976 extended the freeze until December 31, 1977.

Reasons for Change

The Congress prescribed rules in the Revenue Act of 1978 for profit sharing and cafeteria plans but did not believe they should be given retroactive effect. The Congress also believed that additional time is required to design appropriate rules for the tax treatment of employees under salary reduction plans.

Explanation of Provision

Under the bill, the freeze on existing tax treatment of salary reduction plans, cash or deferred profit-sharing plans, and "cafeteria" plans is extended until January 1, 1980, except that the freeze is not to apply with respect to any type of plan for any period for which rules for that type of plan are provided by the Revenue Act of 1978. Thus, the freeze will remain in effect with respect to salary reduction plans and cash or deferred profit-sharing plans until January 1, 1980. The freeze will remain in effect with respect to cafeteria plans only until taxable years beginning after December 31, 1978, when rules provided by the Revenue Act of 1978 come into effect.

Effective Date

This provision was effective upon enactment (November 8, 1978).

Revenue Effect

This provision has no effect on revenues.

III. OTHER PROVISIONS

The Foreign Earned Income Act of 1978, as originally passed by the House and the Senate, contained a number of other provisions. These were deleted (as a practical matter) in conference because, in the course of Congressional consideration of the bill, the same or similar provisions were incorporated in other legislation. (Technically, these provisions were enacted as part of this Act but section 210 of the Act provided that they were to cease to be effective the day after enactment. This procedure has no effect on the validity of those same or similar provisions which were enacted in other laws.)

These other provisions concerned commuting expenses (similar provision enacted in P.L. 95–427); fringe benefits (similar provision enacted in P.L. 95–427); Armed Forces health professions scholarships (same provision enacted in P.L. 95–171); 5-year amortization of low-income rental housing (same provision enacted in P.L. 95–171); limitations on net operating loss carryovers (similar provision enacted in P.L. 95–600); State legislators' travel expenses (same provision enacted in P.L. 95–258); and National Research Service Awards (similar provision enacted in P.L. 95–600).

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