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Foreign Gross Income Exclusion Section 911

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REPORTS

FOREIGN GROSS INCOME EXCLUSION SECTION 911

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I. INTRODUCTION

The approach to taxation of United States citizens and residents living abroad is a classic example of "the more things change, the more they remain the same." It also reflects the short term inconsistency of Congress in an area where the opposite should be the watchword.

Initially adopted in 1926, the gross income exclusion¹ was described as ". . . one further step toward increasing our foreign trade."² United States citizens, living abroad but taxed on worldwide income, were perceived as being at a competitive disadvantage with their foreign counterparts who, though living abroad, were not so taxed.³

The exclusion was unlimited in amount⁴ when initially adopted. Since then, it has been significantly amended nine times;

1. See I.R.C. § 911 (1981).

2. H.R. REP. No. 1, 69th Cong., 1st Sess. 7 (1926). See also R. Blough, *Industry and Trade Administration*, U.S. Department of Commerce, U.S. Policy Toward the Taxation of Foreign Earnings of U.S. Citizens 1 (1978).

3. *Hearings on the Revenue Act of 1926 Before the House Committee on Ways and Means*, 69th Cong., 1st Sess. 182-83 (1925); S. REP. No. 781, 82d Cong., 1st Sess. 52-53 (1951). See also note, *Section 911 of the Internal Revenue Code and the Foreign-based Partner*, 74 YALE L.J. 956, 957 (1964).

4. Revenue Act of 1926, 44 Stat. 20, 24, 26, §209, §213(b)(14). The original exclusion extended to all ". . . amounts received from sources without the United States if such amounts constitute earned income. . . ." *Id.* The requirement that the excluded income be earned income, prevented exclusion of passive income such as dividends and interest. H.R. REP. No. 179, 68th Cong., 1st Sess. 5-6 (1925). This requirement continues even in the present exclusion. See I.R.C. §§911(b)(1),(d)(2) (1981). *But see* I.R.C. §911(b)(1)(A) (1981) (present exclusion requires earned income be from sources within foreign country, not merely from sources outside United States).

three of these amendments occurring since 1976.⁵ All but the most recent changes restricted availability and the class of persons able to claim its benefits.⁶ The most recent change occurring in 1981, broadens the exclusion substantially and thus, moves it back towards its original form in 1926.⁷

The new exclusion consists of two separate components. The first is a foreign earned income exclusion.⁸ The second is a housing cost amount exclusion.⁹ To claim either component, the taxpayer must be an individual¹⁰ whose tax home is in a foreign country¹¹

5. The legislative directory of the exclusion since adoption in 1926 has been analyzed in detail. See, e.g., Maiera, *The Foreign Earned Income Exclusion: Reinventing the Wheel*, 34 TAX LAW. 691 (1981); Note, *United States Expatriates—The Foreign Earned Income Act of 1978*, Pub. L. No. 95-615, 92 Stat. 3097 (1978), 19 HARV. INT'L. L.J. 633, 643-644 (1978); Revenue Act of 1926; 44 Stat. 9, §213(b)(14); Levine, *Section 911: The Foreign Earned Income Exclusion—Death Blow or Recovery?*, 56 TAXES 169 (1978); Slowinski & Williams, *The Formative Years of the Foreign Source Earned Income Exclusion: Section 911*, 51 TAXES 355 (1973).

The Foreign Earned Income Act of 1978 provided a series of deductions designed to take into account excess foreign living costs. See PUB.L. No. 95-615 §§202-203, 92 Stat 3097 (1978). The exclusion was retained only as to taxpayers residing in camps located in hardship areas. *Id.* This distinction was drawn because Congress believed these taxpayers incurred an "unusual sacrifice" in their standard of living. See S. REP. No. 746, 95th Cong., 2d Sess. 12, reprinted in 1978 U.S. CODE CONG. & AD. NEWS 7612, 7623. Though adopted as part of the Tax Treatment Extension Act of 1977, the legislative history consistently referred to these provisions as the Foreign Earned Income Act. See 124 CONG. REC. H. 513, 534 (daily ed. Sept. 28, 1978).

The deduction for excess foreign living costs and the exclusion for taxpayers residing in camps were criticized as complex, burdensome, and arbitrary. Maiera, *The Foreign Earned Income Exclusion: Reinventing the Wheel*, 34 TAX LAW. 691, 735 (1981). It was further said that these provisions achieved ". . . neither tax equity nor traditional foreign trade objectives". *Id.* at 735. See also Postelwaite & Stern, *Innocents Abroad? The 1978 Foreign Earned Income Act and the Case for its Repeal*, 65 VAL. L. REV. 1093 (1979). The result was an additional tax burden which led to an added cost for United States companies doing business abroad. To delimit this cost, foreign rather than United States executives were employed. This impacted adversely on exports since foreign executives typically ordered products from foreign suppliers with which they had greater familiarity. See U.S. DEP'T OF COMMERCE, REPORT OF THE PRESIDENT ON EXPORT PROMOTION FUNCTIONS AND POTENTIAL EXPORT DISINCENTIVES 8-1 (1980); U.S. GENERAL ACCOUNTING OFFICE, DOC. NO. 81-29, AMERICAN EMPLOYMENT ABROAD DISCOURAGED BY U.S. INCOME TAX LAWS 17 (1981).

6. See Note, *United States Expatriates—The Foreign Earned Income Act of 1978*, Pub. L. No. 95-615, 92 Stat. 3097 (1978), 19 HARV. INT'L L.J. 633, 643-644 (1978).

7. I.R.C. §911 (1981). See also Maiera, *The Foreign Earned Income Exclusion: Reinventing the Wheel*, 34 TAX LAW. 691 (1981). Similarity in language and approach continues to make much of the prior precedent relevant in analyzing the 1981 statute.

8. I.R.C. §911(a)(1) (1981).

9. I.R.C. §911(a)(2) (1981). Any portion of an individual's housing cost amount attributable to nonemployer provided amounts may be deducted, but that amount is not subject to the exclusion. I.R.C. §911(c)(3) (1981).

10. Section 911 expressly applies only to individuals. See I.R.C. §911(a). Regular corporations cannot qualify for its benefits. In contrast, since a partnership is treated as a conduit

and who satisfies *either* the bona fide resident or the physical presence test.¹²

II. TAX HOME IN A FOREIGN COUNTRY

The benefits of section 911 are unavailable unless the individual's tax home is located in a foreign country.¹³ The term "tax home" has the same meaning as that which it has for purposes of section 162(a)(2), which deals with travel expenses away from home.¹⁴

Unfortunately, the meaning of "tax home" for purposes of section 162(a)(2) is unclear.¹⁵ Both the Service and the Tax Court have taken the position that one's tax home is his regular or principal place of business.¹⁶ In contrast, most circuit courts of appeal construe the term to mean the abode or residence.¹⁷

Apparently, drawing on both positions, the proposed regulations state:

both for imposition and payment of tax, individual partners can qualify. See Treas. Reg. §1.702-1(a)(ii) (1981). See also Note, *Section 911 of the Internal Revenue Code and the Foreign-Based Partner*, 74 YALE L.J. 956 (1964). Because of the Subchapter S Revision Act of 1982, it appears the same result may apply for "S" corporations. Compare I.R.C. §1366 (1981) with Treas. Reg. §1.702. But see I.R.C. §1373 (there is not cross reference to subpart B of part III of subchapter N).

11. I.R.C. §911(d)(1) (1981).

12. I.R.C. §911(d)(1) (1981). As originally adopted in 1926, a taxpayer qualified for the exclusion if he was a "bona fide nonresident of the United States for more than six months during the taxable year". Revenue Act of 1926, 44 Stat 20, 24, 26, §209, §213(b)(14). This was construed to mean mere physical presence outside the United States for more than six months. See, e.g., *Commissioner v. Fiske's Estate*, 128 F.2d 487, 490 (7th Cir. 1942); *Price v. United States*, 87 F. Supp 901, 903 (N.D. Ill. 1949). Because Congress believed the test too permissive, the exclusion was amended in 1942 to require "bona fide residence in a foreign country or countries". S. REP. No. 1631, 77th Cong., 2d Sess. 116 (1942). In 1951, the physical presence test was added. S. REP. No. 78, 82d Cong., 1st Sess. 2024 (1951).

13. I.R.C. §911(d)(1) (1981). "The term "foreign country" . . . [means] . . . any territory under the sovereignty of a government other than territory of the United States. Treas. Reg. §1.911-2(h) (proposed July 20, 1983). For this purpose, the "United States" is defined as the states, the District of Columbia, possessions, territorial waters, air space over the United States, and the sea-bed over which the United States has exclusive rights under international law for the exploration and exploitation of natural resources. Treas. Reg. §1.911-2(g) (proposed July 20, 1983).

14. I.R.C. §922(d)(3) (1981).

15. See, e.g. *Estes, Foreign Adventures: The Foreign Earned Income Act of 1978*, 3 TAX OF INDIVIDUALS 263, 265-266 (1979) (emphasizing absence of clarity).

16. See, e.g., *Simpson v. Commissioner*, 19 T.C.M. (CCH) 1003 (1960); Rev. Rul. 75-432, 1975-2 C.B. 60.

17. See, e.g., *Wallace v. Commissioner* 144 F.2d 407, 410 (9th Cir. 1944); *Commissioner v. Janss* 260 F.2d 99 (8th Cir. 1958); *Steinhort v. Commissioner* 335 F.2d 496 (5th Cir. 1964).

. . . under section 911, an individual's tax home is considered to be located at his regular or principal (if more than one regular) place of business or, if the individual has no regular or principal place of business because of the nature of the business, then at his regular place of abode in a real and substantial sense.¹⁸

Section 911(d)(3) further provides that an individual is not treated as having a tax home in a foreign country for any period "for which his abode is within the United States."¹⁹

III. BONA FIDE RESIDENT TEST

An individual whose tax home is a foreign country and who satisfies the bona fide resident test can claim the benefits of section 911.²⁰ This test requires the taxpayer to be a United States citizen.²¹ It is not ordinarily applicable to United States resident aliens even if they do establish a separate bona fide residence abroad.²²

In order to completely satisfy the test, the taxpayer must also demonstrate that he has been a bona fide resident of a foreign country for an uninterrupted period which includes an entire taxable year.²³ Thus, a calendar year taxpayer who arrives in a foreign country on January 4, 1983, and departs on December 27, 1984, will not qualify for the exclusion despite living in the foreign country over 23 total months.²⁴

18. Treas. Reg. §1.911-2(b) (proposed July 20, 1983).

19. I.R.C. §911(d)(3) (1981). *See also* Treas. Reg. §1.911-2(b) (proposed July 20, 1983) ("[t]emporary presence of the individual in the United States does not necessarily mean the individual's abode is in the United States during that time").

The limitation on an individual's abode being in the United States for purposes of I.R.C. §911 raises troubling issues. An individual may have more than one residence. Thus, if the term "abode" is construed as being synonymous with "residence", I.R.C. §911 will be unavailable unless the United States residence is abandoned. It is doubtful that Congress foresaw this result.

20. I.R.C. §911(a),(d)(1)(A) (1981).

21. I.R.C. §911(d)(1)(A) (1981).

22. *Id.* *See also* W. NEWTON, INTERNATIONAL ESTATE PLANNING, §3.04 (1983). (an individual may have more than one residence). Individuals protected by a treaty nondiscrimination clause can continue to satisfy the bona fide residence test. *See* Rev. Rul. 72-330, 1972-2 C.B. 444-450, *and* Rev. Rul. 72-598, 1972-2 C.B. 451 (listing treaty countries whose citizens were entitled to claim the benefit of former I.R.C. §911).

23. I.R.C. §911(d)(1)(A) (1981). Bona fide residence in a foreign country is treated as being for an uninterrupted period, even if temporary visits are made to the United States or elsewhere during that same period. Treas. Reg. §1.911-2(b) (proposed July 20, 1983).

24. If the criteria triggering the bona fide residence test were ultimately satisfied, the benefits of section 911 would relate back to the beginning of the period of actual foreign

The criteria for determining residency abroad are those reflected in Treas. Reg. section 1.871-2(b).²⁵ They are largely subjective, resting on the facts and circumstances of each case.²⁶ In any event, the bona fide residency must occur within a foreign country, not merely outside the United States.²⁷

EXAMPLE: X, a United States citizen, is employed on a tugboat in the North Sea. Because the North Sea is not a foreign country, the bona fide residency test is not satisfied.²⁸

In contrast, a taxable year may embrace less than twelve months. This occurs if the taxpayer dies after establishing bona fide residence and a return is filed under section 443(a)(2) for a short taxable year.

EXAMPLE: Y, a United States citizen, establishes a bona fide residence in Argentina on January 1. Y dies on June 25 of that same year. The term "taxable year" for purposes of section 911 embraces the period between January 1 and June 25.²⁹

Individuals relying on the bona fide resident test are precluded from taking inconsistent positions with respect to foreign

residence. In any event, even under the facts presented, the physical presence test would be satisfied, I.R.C. §911(d)(1)(B) (1981).

25. See Treas. Reg. §1.911-2(c) (proposed July 20, 1983) (Principles of I.R.C. §871 (1981) and accompanying regulations apply to bona fide resident test). The proposed statutory definition of resident does not apply. See H. REP. No. 4170, 98th Cong., 1st Sess. (1983).

26. The ultimate fact is the taxpayer's intention to become a bona fide resident of the foreign country. Determination is based on examination of objective criteria. See, e.g., *Sochurck v. Commissioner* 300 F.2d 34, 38 (7th Cir. 1982) (guidelines for bona fide resident test); *Yost v. Commissioner*, 44 T.C.M. (CCH) 1071, 1074 (1982) (maintaining apartment and participation in local affairs established bona fide residence in Singapore); *Duley v. Commissioner*, 41 T.C.M. (CCH) 1521, 1530-33 (1981) (bona fide resident of Lebanon where taxpayer married Lebanese national and children raised with Lebanese customs); *Heinzelman v. Commissioner*, 41 T.C.M. (CCH) 1423, 1426 (1981) (taxpayer's credible testimony established bona fide residence; representations to foreign immigration officials not conclusive). See also *Craig v. Commissioner*, 73 T.C. 1034 (1980) (taxpayer abandoned Swiss residence on severing all community ties, packing up possessions, and leaving for United States without intention of returning).

27. I.R.C. §911(d)(1)(A) (1981). See also Treas. Reg. §1.911-2(h) (proposed July 20, 1983) ("foreign country" means territory under sovereignty of government other than United States).

28. See *Plaisance v. United States*, 433 F. Supp 936 (E.D. La. 1977) (North Sea not under sovereignty of any government). But see *Yost v. Commissioner*, 44 T.C.M. (CCH) 1071 (1982) (taxpayer bona fide resident of Singapore through two-thirds of time spent on drilling rig outside Singapore's territorial waters).

29. See *Roodner v. Commissioners*, 64 T.C. 680, 682 (1975).

residency. This means the test will not be satisfied if the taxpayer submits a statement to authorities of the foreign country stating that he is not a resident so as not to be subject to tax as a resident of that country.³⁰

In applying this limitation, the criteria for gauging residence under section 911 should be compared with those applied by the foreign country under its own internal law. The two may not be synonymous; therefore, filing a return as a nonresident, for purposes of taxation in the foreign jurisdiction, may be wholly consistent with a claim of bona fide residence under section 911.³¹

IV. PHYSICAL PRESENCE TEST

Individuals whose tax home is in a foreign country and who satisfy the physical presence test may also claim section 911.³² In contrast with the bona fide resident test, the physical presence test is entirely objective³³ and extends to both United States citizens and residents.³⁴ It requires that the taxpayer be physically present, in a foreign country, for at least 330 full days during any period of 12 consecutive months.³⁵

The 330 full days need not be consecutive.³⁶ They may be interrupted by periods during which the individual is not present in

30. I.R.C. §911(d)(5) (1981). If an individual has submitted a statement of nonresidence to the authorities of a foreign country, the accuracy of which has not been resolved, the individual will not be considered a bona fide resident of that foreign country.

Treas. Reg. §1.911-2(c) (proposed July 20, 1983).

31. See, e.g., Rev. Rul. 78-254, 1978-1 C.B. 243, 245. The ruling held a United States citizen living in Belgium was a bona fide resident for purposes of section 911 despite filing as a nonresident for Belgian income tax. The reasoning was that the standards of residence under Belgian law were more restrictive than those applied under section 911.

In addition, the fact that a United States citizen abroad is exempt from foreign taxation under treaty will not preclude the citizen from claiming bona fide residency under section 911. See, e.g., *Scott v. United States* 432 F.2d 1388, 1895 (Ct. Cl. 1970); *Riley v. Commissioner*, 74 T.C. 414, 422 (1980).

32. I.R.C. §§911(a), (d)(1)(B) (1981).

33. I.R.C. §911(d)(1)(B) (1981).

34. *Id.*

35. I.R.C. §911(d)(1)(B) (1981). Prior to amendment in 1981, the taxpayer had to be present in a foreign country for at least 510 full days out of any period of 18 consecutive months. The effect of the amendment was to liberalize the requirements for satisfying the physical presence test.

Rev. Rul. 58-233, 1958-1 C.B. 271, dealing with the old 510 day rule, concludes that an individual's initial presence in a foreign country begins when any aircraft in which he is traveling passes over the first foreign country. *C.f.* Rev. Rul. 55-171, 1955-1 C.B. 80 (international waters not considered part of a foreign country).

36. Treas. Reg. §1.911-2(d)(2) (proposed July 20, 1983).

any foreign country.³⁷ All separate periods of presence during the period of 12 consecutive months are aggregated in computing the 330 full days.³⁸

For this purpose, the term "full day" means the continuous twenty-four hour period beginning with midnight and ending the following midnight.³⁹ An individual who is present in a foreign country and then travels for less than a twenty-four hour period over areas not within any foreign country and not within the United States is not deemed outside a foreign country during the period of travel.⁴⁰

The 12 consecutive month period may begin with any day but must end on the day before the corresponding day in the twelfth succeeding month.⁴¹ "The 12-month period may begin before or after arrival in a foreign country and may end before or after departure."⁴²

EXAMPLE: T, a United States citizen, arrives in Brazil from Miami at 12:00 noon on April 24, 1982. T remains in Brazil until 2:00 p.m. on March 21, 1983, when T departs for the United States. Among other possible 12-month periods, T is present in a foreign country for 330 full days during each of the following 12-month periods: March 21, 1982 through March 20, 1983; and April 25, 1983 through April 24, 1983.⁴³

Because the physical presence test is entirely objective and purely mechanical in nature, most taxpayers are better protected under it than the subjective bona fide resident test. Furthermore, most taxpayers will satisfy the 330 full day criteria of the physical presence test before they will satisfy the bona fide resident test. There may be isolated occasions, however, when a taxpayer cannot satisfy the physical presence test but still can viably maintain satisfaction of the bona fide resident test. In any event, satisfaction of either test causes the benefits of the exclusion to relate back to the

37. *Id.*

38. *Id.* There is no requirement that the taxpayer be employed during the 330 day period. Theoretically, he could even be on vacation during the period though this could raise an issue with respect to the generation of earned income to be sheltered by the exclusion. See I.R.C. §§911(b)(1)(A), (d)(2) (1981).

39. Treas. Reg. §1.911-2(d)(2) (proposed July 20, 1983).

40. *Id.*

41. Treas. Reg. §1.911-2(d)(1) (proposed July 20, 1983).

42. *Id.*

43. Treas. Reg. §1.911-2(d)(3) Ex. (1) (proposed July 20, 1983).

beginning of the period of bona fide residence or physical presence.⁴⁴

V. WAIVER OF PERIOD OF STAY DUE TO FOREIGN CRISIS

The periods of stay for both the bona fide resident and the physical presence tests may be waived due to a foreign crisis.⁴⁵ This occurs where an individual, who is already a bona fide resident or physically present in a foreign country,⁴⁶ is required to leave because of war, world unrest, or similar adverse conditions before satisfying the requisite period of stay.⁴⁷

The conditions in the foreign country must be such as to preclude the taxpayer from the normal conduct of business.⁴⁸ It must also be established that the taxpayer could reasonably have been expected to satisfy the normal periods of stay but for the conditions.⁴⁹

Where the periods of stay are waived, the individual is entitled to the benefits of section 911 but only for the actual period of residence or presence.⁵⁰ This means only those days within the actual period are taken into account.⁵¹

EXAMPLE: M, a United States citizen, enters foreign country I on June 1, 1984. Due to conditions of war, M departs country I on December 15, 1984. M establishes he could reasonably have been expected to stay for 330 full days. Thus, he is entitled to the benefits of section 911 but only for the period between June 1, 1984, and December 15, 1984.

44. Treas. Reg. §1.911-2(d)(3) Ex (1), 1.911-3(d)(3) (proposed July 20, 1983); S. REP. No. 781 (Pt 2), 82d Cong., 1st Sess 38-39 (1951).

45. I.R.C. §911(d)(4) (1981).

46. I.R.C. §911 (d)(4)(A) (1981). It is further required that the individual's tax home be in a foreign country. Treas. Reg. §1.911-2(f) (proposed July 20, 1983).

47. I.R.C. §911(d)(4)(B)(i) (1981). In the case of the bona fide resident test, the requisite period is "an entire taxable year". I.R.C. §911(d)(1)(A) (1981). The requisite period is 330 full days for the physical presence test. *Id.* §911(d)(1)(B) (1981).

The Internal Revenue Service has published a list of countries where conditions of war, civil unrest, or similar adverse conditions are deemed to exist. *See* IR-38-34.

48. I.R.C. §911(d)(4)(B)(i) (1981).

49. I.R.C. §911(d)(4)(C) (1981). The individual must attach to his return for the taxable year a statement that he expected to meet the requirements of section 911 but for the conditions in the foreign country which precluded the normal conduct of business. Treas. Reg. §1.911-2(f) (proposed July 20, 1983). *See also* IR-81-34 (for waiver under prior exclusion, taxpayers filed Form 1040X along with Form 2555).

50. Treas. Reg. §1.911-2(f) (proposed July 20, 1983).

51. *Id.*

VI. FOREIGN EARNED INCOME

Both the foreign earned income and the housing cost amount exclusions are tied to income classified as "foreign earned income".⁵² This means the income must be (A) earned⁵³ and (B) from sources within a foreign country.⁵⁴

A. *Earned Income*

Earned income is wages, salaries, profession fees and other amounts received as compensation for personal services actually rendered.⁵⁵ It also includes the fair market value of all remuneration paid in any medium other than cash.⁵⁶ Excluded is any portion of an amount paid by a corporation which represents a distribution of earnings and profits rather than a reasonable allowance as compensation for personal services actually rendered the corporation.⁵⁷

In the case of an individual engaged in a trade or business in which both personal services and capital are material income-producing factors, a reasonable allowance as compensation for personal service actually rendered by the individual is considered earned income.⁵⁸ The amount cannot exceed thirty percent (30%) of the individual's share of net profits of the trade or business.⁵⁹

Earned income also includes all fees received by an individual engaged in a professional occupation such as a doctor or lawyer.⁶⁰ Professional fees constitute earned income even in the event the taxpayer's assistants perform part or all of the services.⁶¹ The patients or clients, however, must be those of the taxpayer and must look to the individual as the person responsible for the services rendered.⁶²

Certain amounts are not earned income. These are amounts:

52. I.R.C. §§911(a), (c)(3)(D) (1981); Treas. Reg. §1.911-4(d)(1) (proposed July 20, 1983).

53. I.R.C. §911(d)(2) (1981).

54. I.R.C. §911(b)(1)(A) (1981).

55. I.R.C. §911(d)(2)(A) (1981).

56. Treas. Reg. §1.911-3(b)(1) (proposed July 20, 1983).

57. I.R.C. §911(d)(2)(A) (1981).

58. I.R.C. §911(d)(2)(B) (1981).

59. *Id.*

60. Treas. Reg. §1.911-3(b)(3) (proposed July 20, 1983).

61. *Id.*

62. *Id.*

(1) received as a pension or annuity,⁶³(2) paid by the United States or an agency thereof to an employee of the United States or an agency thereof,⁶⁴(3) included in gross income by reason of section 402(b) (relating to taxability of beneficiary of nonexempt trust) or section 403(c) (relating to taxability of beneficiary under nonqualified annuity),⁶⁵ or (4) received after the close of the taxable year following the taxable year in which the services to which the amounts are attributable were performed.⁶⁶

EXAMPLE: X, a United States citizen, is a bona fide resident of Norway. In 1984, X performs services in Norway at a salary of \$100,000. The salary is received in two equal installments in 1985 and 1986. Only the amount received in 1985 is excludable. The balance, received in 1986, after the close of the taxable year following that in which the services were performed, is not excludable.⁶⁷

B. Source Within a Foreign Country

The income, to be excluded under section 911, must not only be earned income, but also must be derived from sources within a foreign country. This means the income must be attributable to services performed in a foreign country,⁶⁸ not merely to services performed outside the United States. Thus, income attributable to services performed in areas not under the sovereignty of any country fails to qualify. The place of receipt of the income is immaterial in determining where services are performed.⁶⁹

63. I.R.C. §911(b)(1)(B)(i) (1981). The proposed regulations also exclude social security benefits from earned income. Treas. Reg. §1.911-3(c)(2) (proposed July 20, 1983).

64. I.R.C. §911(b)(1)(B)(ii) (1981). This provision modified prior law and extends the benefits of I.R.C. §911 (1981) to independent contractors and other non-employees who receive United States governmental funds abroad. See also I.R.C. §912 (1981) (allowances for United States governmental employees abroad).

65. I.R.C. §911(b)(1)(B)(iii) (1981). See also Treas. Reg. §1.911-3(c)(4) (proposed July 20, 1983).

66. I.R.C. §911(b)(1)(B)(iv) (1981). The proposed regulations further provide that earned income does not include an amount: (1) excluded from gross income under I.R.C. §119, or (2) included in gross income by reason of proposed Treas. Reg. §1.911-6(b)(4). See Treas. Reg. §§1.911-3(c)(1), (5) (proposed July 20, 1983).

67. I.R.C. §911(b)(1)(B)(iv) (1981).

68. I.R.C. §911(b)(1)(A); Treas. Reg. §1.911-3(a) (proposed July 20, 1983). See also Treas. Reg. §1.911-2(g), (h) (proposed July 20, 1983) (defining "foreign country").

69. Treas. Reg. §1.911-3(a) (proposed July 20, 1983).

VII. FOREIGN EARNED INCOME EXCLUSION

The first component of the section 911 exclusion is the foreign earned income exclusion.⁷⁰ The amount of this exclusion is limited.⁷¹ The limitation is tied to the lesser of two separate computations.⁷² The first of these is the individual's foreign earned income for the taxable year in excess of amounts excluded by virtue of the housing cost amount.⁷³

The second is the "annual rate" for the taxable year multiplied by the following fraction:

$$\frac{\text{Number of Qualifying Days in Taxable Year}^{74}}{\text{Number of Days in Taxable Year}}$$

The "annual rate" for 1984 is \$80,000.⁷⁵ It remains at \$80,000 through 1987 and then increases at a rate of \$5,000 per year until it reaches \$95,000 in 1990 and thereafter.⁷⁶

For the purpose of making this computation, the number of qualifying days is the number of days in the taxable year during which the individual satisfied the tax home requirement and satisfied either the bona fide resident or physical presence test.⁷⁷

EXAMPLE: X, a United States citizen and a calendar year taxpayer, established a tax home and became a bona fide resident of foreign country A on November 1, 1984. X maintained the tax home and continued the bona fide residence until March 31, 1986. The number of qualifying days is 61 for 1984, 365 for 1985 and 90 for 1986.⁷⁸ If X earned \$100,000 in salary for services performed in country A during each of these periods, the amount of the exclusion is:⁷⁹

70. I.R.C. §911(a)(1) (1981). The second component is the housing cost amount exclusion. I.R.C. §911(a)(2) (1981).

71. I.R.C. §911(b)(2) (1981).

72. Treas. Reg. §1.911-3(d)(2)(i) (proposed July 20, 1983).

73. *Id.*

74. *Id.*

75. I.R.C. §911(b)(2)(A) (1981).

76. *Id.*; See also Treas. Reg. §1.911-5(a)(1) (proposed July 20, 1983) (married couples with two qualified individuals can separately claim I.R.C. §911).

77. Treas. Reg. §1.911-3(d)(3) (proposed July 20, 1983).

78. *Id.*

79. For purposes of this example, no housing cost amount exclusion is at issue.

$$1984: \frac{61}{366} \times \$80,000 = \$13,333$$

$$1985: \frac{365}{365} \times \$80,000 = \$80,000$$

$$1986: \frac{90}{365} \times \$80,000 = \$19,726$$

Foreign earned income is considered as earned in the taxable year in which the individual performed the services giving rise to the income.⁸⁰ In determining the amount of the exclusion, income earned in one year but received in another is attributable to the taxable year in which the services giving rise to the income were performed.⁸¹

A. Community Property Earned Income

A husband and wife, both of whom are qualified individuals, can each separately claim the benefits of section 911.⁸² Community property laws are, for this purpose, disregarded.⁸³ This means the income is attributable to the spouse who rendered the services, without regard to community property laws.

In the case of separate returns, each spouse may exclude the amount of that spouse's foreign earned income attributable to his or her services.⁸⁴ If a joint return is filed, the sum of the amounts for each spouse may be excluded.⁸⁵

80. Treas. Reg. §1.911-3(d)(1) (proposed July 20, 1983).

81. I.R.C. §911(b)(2)(B) (1981); Treas. Reg. §1.911-3(e)(1) (proposed July 20, 1983). Caution should be exercised to avoid receipt of the income after the close of the taxable year following that in which the services were performed. Otherwise, the exclusion will be lost. I.R.C. §911(b)(1)(B)(iv) (1981). See also Treas. Reg. §1.911-3(e)(2)(ii) (proposed July 20, 1983).

Bonuses or substantially nonvested property (as defined in §1.83-3(b)) attributable to services performed in more than one taxable year are treated as attributable to services performed in each taxable year during the period when the services giving rise to the bonus or substantially nonvested property were performed. Treas. Reg. §1.911-3(e)(2)(i) (proposed July 20, 1983).

82. Treas. Reg. §1.911-5(a)(1) (proposed July 20, 1983).

83. I.R.C. §911(b)(2)(C) (1981); Treas. Reg. §1.911-5(b) (proposed July 20, 1983).

84. Treas. Reg. §1.911-5(a)(2) (proposed July 20, 1983). Regulations under prior law provided that if separate returns were filed, ½ of the aggregate amount excluded on a joint return was the exclusion on a joint return. Treas. Reg. §1.911-4(a) (proposed July 20, 1983).

85. Treas. Reg. §1.911-5(a)(2) (proposed July 20, 1983).

EXAMPLE: X, a United States citizen, has his tax home in and is a bona fide resident of Country A for the entire 1984 taxable year. X receives \$100,000 community property earned income from Country A. Y, X's spouse, also qualifies for the exclusion and receives \$15,000 on community property earned income. If X and Y file separate returns, X can include \$80,000 and Y, \$15,000. If a joint return is filed, a total of \$100,000 can be excluded.⁸⁶

B. *Moving Expense Reimbursements: Effect on Foreign Earned Income Exclusion*

Moving expense reimbursements are included in an individual's gross income as compensation for services.⁸⁷ Thus, such reimbursements may be characterized as foreign earned income for purposes of the section 911(a)(1) exclusion.⁸⁸ For this characterization to occur, the reimbursement must be attributable to services performed by an individual in a foreign country.⁸⁹

In the absence of agreement, the reimbursement is deemed attributable to future services to be performed at the new place of work.⁹⁰ Accordingly, a reimbursement received in connection with a move to a foreign country is attributable to services performed in that country.⁹¹ A reimbursement for a move from a foreign country

86. *Id.*

87. I.R.C. §82 (1981). A corresponding deduction for moving expenses is provided by I.R.C. § 217 (1981).

88. Treas. Reg. §1.911-3(e)(3)(i) (proposed July 20, 1983). To the extent the reimbursement is properly allocated to or chargeable against amounts of foreign earned income under I.R.C. §911(a), no deduction is allowed under I.R.C. §217. I.R.C. §911(d)(6) (1981); Treas. Reg. §1.911-6(b)(1) (proposed July 20, 1983).

89. Treas. Reg. §§ 1.911-3(a), (e)(3)(i) (proposed July 20, 1983). This means the reimbursement is treated as foreign source income. I.R.C. §862(a)(3) (1981). To the extent the reimbursement is not allocable to or chargeable against earned income under I.R.C. §911 (a) (1981), treatment as foreign source income is particularly important for enhancing the overall limitation of the foreign tax credit. I.R.C. §904 (1981).

90. Treas. Reg. §1.911-3(e)(3)(i) (proposed July 20, 1983).

91. *Id.* If the reimbursement is deemed to be from foreign sources, it is considered attributable to services performed in the year of the move. Treas. Reg. §1.911-3(e)(3)(ii) (proposed July 20, 1983). The individual, however, does not qualify for the exclusion for the entire taxable year; he must treat a portion of the reimbursement as attributable to services performed in the succeeding taxable year, if the move is from the United States to a foreign country, or to the prior taxable year, if the move is from a foreign country to the United States. *Id.* The portion of the reimbursements treated is determined by multiplying the total reimbursement by the following fraction:

$$\frac{\text{Number of qualifying days in year of move}}{\text{Total number of days in the taxable year in the year of move}}$$

to the United States, however, is ordinarily attributable to services performed in the United States.⁹²

An agreement between the employer and employee may change these basic rules. For this to occur, the agreement should be in writing,⁹³ entered into before the move to the foreign country and an inducement for the move.⁹⁴ The agreement should spell out that the employee will be reimbursed for moving expenses incurred in returning to the United States regardless of whether he continues to work for the employer after returning.⁹⁵

C. Disallowance of Deductions, Exclusions, and Credits

Deductions, exclusions, and credits are disallowed to the extent properly allocable to or chargeable against amounts excluded under section 911(a).⁹⁶ For this purpose, deductions, exclusions, and credits definitely related⁹⁷ to earned income are allocated and apportioned to foreign earned income and United States source earned income.⁹⁸ Deductions that are allocated and apportioned to foreign earned income must then be allocated and apportioned to foreign earned income excluded under section 911(a).⁹⁹

EXAMPLE: X, a United States citizen, satisfies the bona fide resident test in Country A for the taxable year 1984. During this same period X earns \$100,000 of foreign earned income, incurs \$5,000 in otherwise deductible expenses definitely related to that income, and excludes the maximum amount of \$80,000.

and subtracting the product from the total reimbursement. *Id.*

92. Treas. Reg. §1.911-3(e)(3)(i) (proposed July 20, 1983).

93. *Id.* The proposed regulations state that in no case will an oral agreement be considered evidence to the contrary. *Id.* See Also *Moving Expenses Repayment Can Be Foreign Source Income*, 55 J. TAX'N 118 (1981) (suggesting *written* agreements regarding reimbursements). *But see* *Redding v. Commissioner*, 43 T.C.M. (CCH) 719 (1982) (in the absence of a formal employment contract, assignment memorandum and letter was sufficient for foreign source characterization).

94. Treas. Reg. §1.911-3(e)(3)(i) (proposed July 20, 1983). *Cf.* *Dammers v. Commissioner*, 76 T.C. 835, 837 (1981) and *Redding v. Commissioner*, 43 T.C.M. (CCH) 719 (1982) (moving expenses paid by employers to move petitioners back to United States after completion of their assignments abroad were foreign source income for overall limitation of foreign tax credit).

95. Treas. Reg. §1.911-3(e)(3)(i) (proposed July 20, 1983).

96. I.R.C. §911(d)(6) (1981); Treas. Reg. §1.911-6(a) (proposed July 20, 1983).

97. See Treas. Reg. §1.861-8 (1981) (defining *definitely related*).

98. Treas. Reg. §1.911-6(a) (proposed July 20, 1983). The allocation and apportionment is in accordance with the rules contained in Treas. Reg. §1.861-8 (1981). *Id.*

99. Treas. Reg. §1.911-6(a) (proposed July 20, 1983).

The nondeductible amount is computed as follows:

$$\frac{\$ 80,000}{100,000} \times \$5,000 = \$4,000^{100}$$

Both moving expenses and foreign taxes are examples of expenses disallowed to the extent properly allocable to or chargeable against amounts excluded under section 911(a).¹⁰¹ To illustrate, in the case of foreign taxes, the disallowed amount is determined by multiplying the foreign taxes by a fraction.¹⁰² The numerator is amounts excluded under section 911(a) less expenses properly allocable to those amounts.¹⁰³ The denominator is foreign earned income less deductible expenses properly allocated or apportioned thereto.¹⁰⁴

Deductions, exclusions, or credits not definitely related to any class of gross income are not affected by this limitation and thus, are not disallowed.¹⁰⁵ These include personal and family medical expenses, qualified retirement contributions,¹⁰⁶ real estate taxes and mortgage interest on a personal residence, charitable contributions, alimony payments, and deductions for personal exemptions.¹⁰⁷

¹⁰⁰ See, e.g., Treas. Reg. §1.911-6(d) Ex. 1 (proposed July 20, 1983).

101. Treas. Reg. §1.911-6(b), (d) Ex. 2 (proposed July 20, 1983) (moving expenses). Treas. Reg. §911-6(c), (d) Ex. 3 (proposed July 20, 1983) (foreign taxes). The disallowance extends both to the deduction and credit for foreign taxes. Treas. Reg. §1.911-6(c) (proposed July 20, 1983); Cf. Rev. Rul. 79-85, 1979-1 C.B. 246 (treaty foreign tax credit unavailable to extent foreign taxes allocable to income excluded under I.R.C. §911).

102. Treas. Reg. §1.911-6(c) (proposed July 20, 1983).

103. *Id.*

104. *Id.* In determining the extent to which foreign taxes are disallowed, the housing cost amount deduction is treated as definitely related to foreign earned income that is not excluded. *Id.* If the foreign tax is imposed on earned income and some other income (such as interest) and the taxes on the latter cannot be segregated, the denominator equals the total of all amounts subject to tax less deductible expenses allocable to all such amounts. *Id.* See also Treas. Reg. §1.911-6 (d) Ex. 3 (proposed July 20, 1983).

An unanswered issue is whether the fraction—the numerator and denominator—is to be based on figures for the taxable year in which the excluded income was received. See *Shop Talk*, 59 J TAX 366 (1983). It is suggested that year of receipt figures are perhaps the appropriate result. *Id.*

105. Treas. Reg. §1.911-6(a) (proposed July 20, 1983).

106. *But see* I.R.C. §219(b)(1) (1981). See also Treas. Reg. §1.911-6(a) (proposed July 20, 1983).

107. Treas. Reg. §1.911-6(a) (proposed July 20, 1983).

VIII. HOUSING COST AMOUNT EXCLUSION

The second component of the section 911 exclusion is the housing cost amount exclusion.¹⁰⁸ The amount of the exclusion is subject to two separate limitations.¹⁰⁹ The first limitation is the individual's housing cost amount attributable to employee provided amounts.¹¹⁰ The second is the individual's foreign earned income for the taxable year.¹¹¹

For the purpose of determining the first limitation, the housing cost amount is defined as: reasonable housing expenses,¹¹² paid or incurred¹¹³ during the taxable year by or on behalf of the individual, attributable to housing in a foreign country,¹¹⁴ less the base housing amount.¹¹⁵ "Employer provided amounts" are amounts paid or incurred on behalf of the individual by his employer which is foreign earned income included in the individual's gross income for the taxable year.¹¹⁶ In the absence of income from self-employment, the entire housing cost amount is attributable to employer

108. I.R.C. §911(a)(2) (1981). The first component is the foreign earned income exclusion. I.R.C. §911(a)(1).

109. I.R.C. §911(c) (1981); Treas. Reg. §1.911-4(d)(1) (proposed July 20, 1983).

110. I.R.C. §911(c) (1981). Treas. Reg. §1.911-4(d)(1) (proposed July 20, 1983).

111. I.R.C. §911(c) (1981); Treas. Reg. §1.911-4(d)(1) (proposed July 20, 1983).

112. Housing expenses include rent, the fair market value of housing provided in kind by the employer, utilities (other than telephone charges), real and personal property insurance, occupancy taxes other than those which constitute "excluded expenses", nonrefundable fees paid to secure a leasehold, rental of furniture and accessories, and household repairs. Treas. Reg. §1.911-4(b)(1) (proposed July 20, 1983). See also Treas. Reg. §1.911-4(b)(2) (proposed July 20, 1983) (defining "excluded expenses") An amount paid for housing is not treated as reasonable to the extent the expense is lavish or extravagant under the circumstances. I.R.C. §911(c)(2)(A) (1981); Treas. Reg. §1.911-4(b)(4) (proposed July 20, 1983).

113. See I.R.C. §7701(a)(25) (1981) (defining "paid or accrued").

114. The housing must be for the individual and any spouse or dependents who reside with the individual. Treas. Reg. §1.911-4(a) (proposed July 20, 1983).

115. The base housing amount is equal to 16 percent times the annual salary of a United States employee who is paid at an annual salary rate for step 1 of grade GS-14 multiplied by the fraction:

$$\frac{\text{Number of Qualifying Days}}{\text{Number of Days in Taxable Year}}$$

The number of qualifying days is determined in accordance with Treas. Reg. §1.911-3(d)(3) (proposed July 20, 1983); Treas. Reg. §1.911-4(c)(1) (proposed July 20, 1983). The annual salary rate for step 1 of grade GS-14 is determined on January first of the calendar year in which the individual's taxable year begins. Treas. Reg. §1.911-4(c)(2) (proposed July 20, 1983).

116. I.R.C. §911(c)(3)(D) (1981); Treas. Reg. §1.911-4(d)(2) (proposed July 20, 1983). Section 911 is not applied for this purpose.

provided amounts.¹¹⁷

The lesser of the two limitations determines the housing cost amount exclusion.

EXAMPLE I: B, a United States citizen, is a calendar year taxpayer who was a bona fide resident of and whose tax home was located in foreign country G for the entire taxable year 1982. B receives an \$80,000 salary from B's employer for services performed in G. B incurs no business expenses. B receives housing provided by B's employer with a fair rental value of \$15,000. The value of the housing furnished by B's employer is not excludable from gross income under section 119. B pays \$10,000 for housing expenses. B's gross income and foreign earned income for 1982 is \$95,000. B elects the foreign earned income exclusion of section 911(a)(1) and the housing cost amount exclusion of section 911(a)(2). B must first compute his housing cost amount exclusion. B's housing cost amount is \$18,650 determined by reducing B's housing expenses, \$25,000 (\$15,000 fair rental value of housing and \$10,000, other expenses), by the base housing amount of \$6,350 ($39,689 \times .16$) $\times 365/365$). Because B has no income from self-employment, the entire amount is attributable to employer provided amounts and, therefore, is excludable. B's section 911(a)(1) limitation is \$75,000. That is the lesser of $\$75,000 \times 365/365$ or $\$95,000 - 18,650$. B's total exclusion for 1982 under section 911(a)(1) and (2) is 93,650.¹¹⁸

EXAMPLE II: The facts are the same as in Example I except that B's salary for 1982 is \$70,000. B's foreign earned income for 1982 is \$85,000. B's housing cost amount is \$18,650 all of which is attributable to employer provided amounts. B's housing cost amount is excludable to the extent of the lesser of B's housing cost amount attributable to employer provided amounts, \$18,650, or the foreign earned income for the taxable year, \$85,000. Thus, B excludes \$18,650 under section 911(a)(2). B's section 911(a)(1) limitation for 1982 is \$66,350 (the lesser of $\$75,000 \times 365/365$ or $\$85,000 - 18,650$). B's total exclusion for 1982 under section 911(a)(1) and (2) is \$85,000.¹¹⁹

117. Treas. Reg. §§1.911-4(d)(2), (3) (proposed July 20, 1983).

118. Treas. Reg. §1.911-4(f) Ex.1 (proposed July 20, 1983). For these examples, the annual rate for a step 2 of GS-14 is \$39,689. Treas. Reg. §1.911-4(f) (proposed July 20, 1983). See also Gornall and Rubinoff, *Practical Guidelines Under the Economic Recovery Tax Act of 1981 Regarding the Taxation of U.S. Citizens and Resident Aliens Employed in a Foreign Country*, 17 INT'L. LAW. 345, 353 n61 (1983).

119. Treas. Reg. §1.911-4(f) Ex.2 (proposed July 20, 1983).

A. Housing Cost Amount Deduction

Any portion of an individual's housing cost amount attributable to nonemployer provided amounts is not subject to exclusion.¹²⁰ Instead, the individual may deduct that amount from gross income for the taxable year.¹²¹ The deduction, however, is limited to the individual's foreign earned income for the taxable year in excess of foreign earned income excluded and the housing cost amount excluded for that year.¹²²

EXAMPLE I: C is a United States citizen, self-employed, and a calendar year and cash basis taxpayer. C arrived in foreign country H on October 3, 1982, and departed from H on March 8, 1984. C's tax home was located in H throughout that period. C was physically present for 330 full days during the twelve consecutive month period August 30, 1982, through August 29, 1983. The number of C's qualifying days in 1982 is 124. During 1982, C had \$35,000 of foreign earned income, none of which was attributable to employer provided amounts, and \$8,000 of reasonable housing expenses. C's housing amount is \$5,843 ($\$8,000 - ((39689 \times .16) \times 124/365)$). C elects to exclude her foreign earned income under section 911-3(d)(1). C's section 911(a)(1) limitation of 1982 is \$25,479 (the lesser of C's foreign earned income for the taxable year (\$35,000) or the annual-rate for the taxable year multiplied by the number of C's qualifying days over the number of days in the taxable year ($\$75,000 \times 124/365 = \$25,479$)). C may not claim the housing cost amount exclusion under section 911(a)(2) because no portion of the housing cost amount is attributable to employer provided amounts. C may deduct the lesser of her housing cost amount (\$5,843), or her foreign earned income in excess of amounts excluded under section 911(a) ($\$35,000 - 24,479 = \$9,521$). Thus, C's housing cost amount deduction is \$5,843.¹²³

If a portion of the individual's housing cost amount deduction is disallowed for a taxable year, that portion is carried over and treated as a deduction, but only in the succeeding taxable year.¹²⁴ The portion which may be deducted in the succeeding taxable year

120. Treas. Reg. §1.911-4(e)(1) (proposed July 20, 1983). Earnings from self-employment are non-employer provided amounts. Treas. Reg. §1.911-4(d)(2) (proposed July 20, 1983).

121. I.R.C. §911(c)(3) (1981); Treas. Reg. §1.911-4(e)(1) (proposed July 20, 1983).

122. I.R.C. §911(c)(3)(B) (1981); Treas. Reg. §1.911-4(e)(1) (proposed July 20, 1983).

123. Treas. Reg. §1.911-4(f) Ex (4) (proposed July 20, 1983).

124. I.R.C. §911(c)(3)(C) (1981); Treas. Reg. §1.911-4(e)(2) (proposed July 20, 1983).

is limited to the excess of:

- (1) foreign earned income for that year less the housing cost amount exclusion, over
- (2) that portion of the housing cost amount deducted in the succeeding taxable year.¹²⁶

EXAMPLE II: The facts are the same as in Example I except that C had \$30,000 of foreign earned income for 1982, none of which was attributable to employer provided amounts. C elects to exclude \$25,479 under section 1.911-3(d)(1). C may only deduct \$4,521 of her housing cost amount under section 1.911-4(e)(1) because her foreign earned income is in excess of amounts excluded under section 911(a) is \$4,521 (\$30,000 - 25,470). The \$1,322 of unused housing cost amount deduction may be carried over to the subsequent taxable year.¹²⁶

EXAMPLE III: The facts are the same as in Example I except that C had \$15,000 of foreign earned income for 1982, none of which was attributable to employer provided amounts. C elects to exclude the entire \$15,000 under section 1.911-3(d)(1). C is not entitled to a housing cost amount deduction for 1982 since she has no foreign earned income in excess of amounts excluded under section 911(a). C may carryover her entire housing cost amount deduction to 1983.¹²⁷

EXAMPLE IV: The facts are the same as in Example III. In addition, during taxable year 1983, C had \$115,000 of foreign earned income, none of which was attributable to foreign earned income under section 1.911-3(d)(1). C's limitation is the lesser of \$115,000 or \$80,000 ($\$80,000 \times 365/365$). C's housing cost amount for 1983 is \$33,650 ($40,000 - 39,689 \times .16$) $\times 365/365$). Since no portion of that amount is attributable to employer provided amounts C may not claim a housing cost amount exclusion. C may deduct the lesser of her housing cost amount (\$33,650), or her foreign earned income in excess of amounts excluded under section 911(a) ($\$115,000 - \$80,000 = 35,000$). Thus, C may deduct her \$33,650 housing cost amount in 1983. In addition, C may deduct \$1,350 of the housing cost amount deduction carried over from taxable year 1982 ($\$115,000 - 80,000 - 33,640 = \$1,350$). The remaining \$4,498 ($\$5,350 - 1,350$) of the housing cost amount deduction carried over from taxable year 1982 may not be deducted in 1983 or carried over to 1984.¹²⁸

125. *Id.*

126. Treas. Reg. §1.911-4(f) Ex (5) (proposed July 20, 1983).

127. Treas. Reg. §1.911-4(f) Ex (6) (proposed July 20, 1983).

128. Treas. Reg. §1.911-4(f) Ex (7) (proposed July 20, 1983).

A portion of the individual's housing cost amount may be attributable to both employer provided and nonemployer provided amounts.¹²⁹ In this event, separate computations for the housing cost amount exclusion and deduction may be required.

EXAMPLE V: D is a United States citizen and a calendar year and cash basis taxpayer. D is a bona fide resident and maintains his tax home in foreign country J for all of taxable year 1984. In 1984, D earns \$80,000 of foreign earned income, \$60,000 of which is an employer provided amount and \$20,000 of which is a nonemployer provided amount. D's total housing cost amount for 1984 is \$25,000. D elected to exclude the portion of his housing cost amount that is attributable to employer provided amounts. D's excludable housing cost amount is \$18,750; that is the total housing cost amount (\$25,000) multiplied by employer provided amounts for the taxable year (\$60,000) over foreign earned income for the taxable year (\$80,000). D also elected to exclude his foreign earned income under section 1.911-3(d)(1). D's section 911(a)(1) limitation for 1984 is \$61,250 (the lesser of \$80,000 - 18,650 or \$80,000 x 365/365). D cannot claim a housing cost amount deduction in 1984 because D has no foreign earned income in excess of his foreign earned income and housing cost amount excluded from gross income for the taxable year under sections 1.911-3 and 1.911-4. D may carry-over his housing cost amount deduction of \$6,250, the total housing cost amount less the portion attributable to employer provided amounts (\$25,000 - 18,750) to taxable year 1985.¹³⁰

B. Exclusion for Meals and Lodging for Employer's Convenience

A separate exclusion exists under section 119 for meals and lodging furnishing an employee for the convenience of the employer.¹³¹ This exclusion may apply to housing expenses otherwise covered by the exclusion or deduction for housing cost amounts. To the extent it does, section 119 takes precedence and the section 911 housing cost amount exclusion or deduction ordinarily may not be claimed.¹³²

129. Treas. Reg. §1.911-4(d)(2) (proposed July 20, 1983).

130. Treas. Reg. §1.911-4(f) Ex (8) (proposed July 20, 1983).

131. I.R.C. §119 (1981).

132. Treas. Reg. §1.911-4(b)(2)(vii) (proposed July 20, 1983). An exception arises if the individual maintains "a second foreign household". Treas. Reg. §1.911-4(b)(3) (proposed

The section 119 exclusion requires that both the meals and lodging be for the convenience, and on the business premises, of the employer.¹³³ Furthermore, in the case of lodging only, the employee must be required to accept the lodging as a condition of employment.¹³⁴

The term *business premises* of the employer is automatically deemed to include camps located in a foreign country where the employee is furnished lodging.¹³⁵ For this purpose, a camp constitutes lodging which is:

(1) provided by or on behalf of the employer for the employer's convenience because the place where the individual renders services is in a remote area where satisfactory housing is not available on the open market.¹³⁶

(2) located, as near as practicable, in the vicinity where the individual renders the services,¹³⁷ and

(3) furnished in a common area (or enclave) not available to the public, and which normally accommodates ten or more employees.¹³⁸

IX. ELECTION OF EXCLUSIONS

The exclusions for foreign earned income or housing cost amount are not automatic. Instead, each exclusion must be separately elected¹³⁹ and must be timely filed either with the income tax return or with an amended return for the first taxable year for which the election is effective.¹⁴⁰ The election is to be made on Form 2555 or on a comparable form.¹⁴¹

July 20, 1983). See also I.R.C. §911(c)(2)(B) (1981); Treas. Reg. §1.911-4(a)(5) (proposed July 20, 1983) (defining "second foreign household").

133. I.R.C. §119(a) (1981).

134. I.R.C. §119(a)(2) (1981).

135. I.R.C. §119(c) (1981).

136. I.R.C. §119(c)(2)(A) (1981).

137. I.R.C. §119(c)(2)(B) (1981).

138. I.R.C. §119(c)(2)(C) (1981).

139. I.R.C. §911(a) (1981); Treas. Reg. §1.911-7(a) (proposed July 20, 1983). In contrast with the section 911 exclusions, no election is necessary to claim the exclusion for meals and lodging for the employer's convenience under section 119. See I.R.C. §119(a) (1981).

140. Treas. Reg. §1.911-7(a) (proposed July 20, 1983).

141. *Id.* The following information must be included with each election:

(1) the individual's name, address, and social security number;

(2) the name of the individual's employer;

(3) whether the individual claimed exclusions under section 911 for years before 1981

The elections, once made, continue in effect for that year and all future years unless revoked.¹⁴² An individual does not have to make an election to claim the housing cost amount deduction.¹⁴³

X. PRACTICAL CONSIDERATIONS IN DETERMINING WHETHER TO ELECT EXCLUSIONS

Election of the exclusions is not appropriate in every circumstance. The extent to which it is appropriate to claim the exclusions is tied in part to disallowance of the deduction or credit for foreign taxes properly allocable to or chargeable against amounts excluded under section 911(a).¹⁴⁴ Election is appropriate if the effective rate of foreign taxation is less than that imposed by the United States. Where this occurs, the increment of tax savings is the difference between the United States and foreign taxes.

This is not the case if the effective rate of foreign taxation exceeds that imposed by the United States. In this event, the elections typically should be avoided.¹⁴⁵ Due to the overall limitation on the amount of the foreign tax credit,¹⁴⁶ the additional increment

and within the preceding five taxable years;

(4) whether the individual has revoked a previously made election and the taxable year for which such revocation was effective;

(5) The exclusion or exclusions the individual is electing;

(6) the foreign country or countries in which the individual's tax home is located and the date when such tax home was established;

(7) the status (either bona fide residence or physical presence) under which the individual claims the exclusion;

(8) the individual's qualifying period of residence or presence;

(9) the individual's foreign earned income for the taxable year including the fair market value of all noncash remuneration; and,

(10) If the individual elects to exclude the housing cost amount, the individual's housing expenses.

Id.

142. I.R.C. §911(e)(1) (1981); Treas. Reg. §1.911-7(a) (proposed July 20, 1983).

143. Treas. Reg. §1.911-7(a) (proposed July 20, 1983). Nevertheless, the individual must provide the Commissioner with sufficient information to determine the correct amount of tax. This information includes the individual's name, address, and social security number; the number of the individual's employer; the foreign country in which the individual's tax home was established; the status under which the individual claims the deduction; the individual's qualifying period of residence or presence; the individual's foreign earned income for the taxable year; and the individual's housing expenses. *Id.*

144. I.R.C. §911(d)(6) (1981); Treas. Reg. §1.911-6 (proposed July 20, 1983).

145. See, e.g., Gornall and Rubinoff, *Practical Guidelines Under the Economic Recovery Tax Act of 1981 Regarding the Taxation of U.S. Citizens and Residents Aliens Employed in a Foreign Country*, 17 INT'L LAW. 345, 352 (1983) (election "to exclude . . . may not afford . . . most favorable tax treatment").

146. I.R.C. §904 (1981)

of foreign taxes are not immediately allowable as a credit in the year in which incurred. Instead, the excess foreign taxes may be applied against other taxable years through the carryback and carryover provisions.¹⁴⁷ Building up the carryback and carryover is important since these benefits may be claimed even when the criteria for utilizing section 911 are unsatisfied.

Apart from the deduction or credit for foreign taxes, election of the exclusions is also inappropriate where the individual has incurred losses in connection with foreign operations. Otherwise, a portion of the losses, to the extent attributable to foreign earned income, would be disallowed.¹⁴⁸

XI. REVOCATION OF ELECTION

An individual may revoke either of the elections for the exclusions under section 911(a) for any taxable year after the first taxable year for which the election was effective.¹⁴⁹ A revocation must be separately made for each election.¹⁵⁰

Revocation is effected by filing a statement specifically providing that the individual is revoking one or more of the previously made elections.¹⁵¹ This is done either with the income tax return or with an amended return for the first taxable year for which the revocation is to be effective.¹⁵² Once revoked, the individual may not, without the commissioner's consent, again make the same election until the sixth taxable year following that for which the revocation was effective.¹⁵³

In determining whether to grant consent to re-elect section 911 before the sixth taxable year the commissioner shall consider: (1) the period of United States residence, (2) whether the individual moved from one foreign country to another with different tax

147. I.R.C. §904(c) (1983).

148. *Cf. Brewster v. Commissioner*, 55 T.C. 251 (1970) *aff'd* 473 F.2d 160 (D.C. Cir. 1972) and *Brewster v. Commissioner*, 67 T.C. 353 (1976) *aff'd* 79-1 U.S.T.C. ch. 9398 (CCH) (D.C. Cir. 1979) (disallowing portion of losses under prior *mandatory* earned income exclusion).

149. I.R.C. §911(e)(2) (1981); Treas. Reg. §1.911-7(1) (proposed July 20, 1983). An individual by filing an amended return may not revoke an election for the taxable year in which it was effective. Treas. Reg. §1.911-7(b)(1) (proposed July 20, 1983).

150. Treas. Reg. §1.911-7(b)(1) (proposed July 20, 1983).

151. *Id.*

152. *Id.*

153. I.R.C. §911(e)(2) (1981); Treas. Reg. §1.911-7(b)(1) (proposed July 20, 1983).

rates, and (3) any other facts and circumstances which may be relevant to the determination.¹⁵⁴

XII. RETURN FILING REQUIREMENTS WHERE THE CRITERIA FOR ELECTING EXCLUSIONS IS NOT YET SATISFIED

An individual ultimately may expect to satisfy the tax home and either the bona fide resident or physical presence tests to qualify for the exclusions or the deduction. If the income tax return must be filed before it can be determined whether either test will be satisfied, a number of alternatives are available.

First of all, the individual may file an income tax return and pay the tax by the due date. Since neither the bona fide resident nor the physical presence test has been satisfied, the return must be filed without regard to either the exclusions or the deduction.¹⁵⁵ Filing the return and paying the tax, however, does have the effect of precluding the running of interest¹⁵⁶ and the failure-to-pay penalty.¹⁵⁷ Once the requirements for claiming either the exclusions or the deduction have been satisfied, an amended return may be filed on Form 1040X for the overpayment.¹⁵⁸

The individual, as an alternative, may apply for a filing extension beyond the two-month automatic extension.¹⁵⁹ The application should set forth facts justifying the extension and must state the earliest date by which the individual expects to qualify for the exclusions or the deduction.¹⁶⁰ The request for extension should be filed early enough so that the tax return may be timely filed in the event the request is denied. Otherwise, the failure-to-file penalty may be imposed.¹⁶¹

154. Treas. Reg. §1.911-7(b)(2) (proposed July 20, 1983).

155. Treas. Reg. §1.911-7(c)(1) (proposed July 20, 1983). Once the bona fide resident or physical presence test is satisfied, the benefits of I.R.C. §911 relate back to the commencement of the period of bona fide residence or physical presence. See Treas. Reg., S. REP. No. 781, *supra* note 44.

156. I.R.C. §6601 (1981).

157. I.R.C. §6652(a) (1981).

158. I.R.C. §6402(a) (1981); Treas. Reg. §301.6402-3(a)(2). The amended return must be filed within the applicable period under the statute of limitations. I.R.C. §§6402(a), 6511(a) (1981).

159. Treas. Reg. §1.911-7(c)(2) (proposed July 20, 1983). The application should be on Form 2350 and must be filed with the Director, Internal Revenue Service Center, Philadelphia, Pennsylvania 19255. *Id.*

160. Treas. Reg. §1.911-7(c)(2) (proposed July 20, 1983).

161. I.R.C. §6651(a)(1) (1981). Furthermore, even if the extension is granted, interest will continue to run on any tax ultimately due, and the failure-to-pay penalty also will be

imposed. I.R.C. §6651(a)(2) (1981).

To avoid the running of interest and imposition of the failure-to-pay penalty, the individual can file a declaration of estimated tax. The declaration is made on Form 1040-ES. Treas. Reg. §1.6015 (d)-1(a)(1) (1976). In filing the declaration, the taxpayer is not required to take into account income which the individual reasonably believes will be excluded from gross income under I.R.C. §911 (1981). Treas. Reg. §1.911-7(d) (proposed July 20, 1983). The individual, however, must take into account denial of the foreign tax credit for foreign taxes allocable to the excluded income. *Id.* The individual must accompany the declaration with payment of the estimated tax.