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The Economic Recovery Tax Act of 1981 made major revisions in the taxation of foreign earned income. The former tax provisions of sections 911 and 913 failed in their purpose of equitably compensating individuals for the increased costs of working abroad, and have been replaced with a new section 911. The new law encourages Americans to go abroad by according them the most liberal tax benefits in over fifty years.

In his day, Horace Greely was a highly influential champion of many causes through his editorials in the *New York Tribune.* Thousands took his advice when he told the public to "Go West, young man, go West" in order to search for economic prosperity.[1] Were he alive today, upon being informed of the new tax benefits that the Economic Recovery Tax Act of 1981[2] has given to Americans working overseas, no doubt his advice to enterprising Americans would be "Go Abroad, young man, go Abroad."

United States citizens generally are taxed by the United States on their worldwide income.[3] The newly enacted Economic Recovery Tax Act of 1981 completely revised the income tax treatment that Americans working abroad had been accorded under the Foreign Earned Income Act of 1978.[4] Under the Foreign Earned Income Act, an expatriate could exclude $20,000 per year[5] for living in an enclave provided for him by his employer if it was located in an area marked by the existence of unhealthful or difficult physical conditions.[6] He could also take five specific and highly complicated deductions[7] for foreign cost-of-living differences, housing, schooling, and home leave expenses, and for living in a hardship

1. THE NEW COLUMBIA ENCYCLOPEDIA 1139 (1975).
2. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172 (1981) [hereinafter cited as ERTA].
3. S. REP. NO. 144, 97th Cong., 1st Sess. 34, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 191, 226.
4. Foreign Earned Income Act of 1978, Pub. L. No. 95-615, 92 Stat. 3097 (1978) [hereinafter cited as FEIA].
5. I.R.C. § 911(c) (West 1981) (amended by ERTA, § 111(a), 95 Stat. 190 (1981)).
6. *See infra* notes 71-74 and accompanying text.
7. I.R.C. § 913(b) (West 1981) (repealed by ERTA, § 112, 95 Stat. 194 (1981)).

area.[8] Today, the Economic Recovery Tax Act has replaced the above tax provisions with two exclusions; one being an annual rate exclusion of $75,000 (increasing $5,000 a year to $95,000 in 1986[9]), and the other being an exclusion for housing expenses in excess of $6,059.[10] This new tax treatment will apply to an estimated 135,961 income tax returns initially,[11] growing steadily as the incentives provided by the new tax treatment encourage Americans to go abroad.[12]

This comment will examine the tax treatment of the foreign earned income of an American citizen employed abroad. A history of the foreign earned income exclusion will be presented, starting with its origin in the Revenue Act of 1926, as well as an examination of the many policies sought to be achieved by such an exclusion. The historical analysis will conclude with an explanation of the current tax treatment provided by the Economic Recovery Tax Act of 1981. Finally, this comment will explore the reasons for enacting the new tax law, the defects that it will correct from the previous tax law, and the future effects it should have upon both the American economy and the number of Americans abroad.

I. The History of the Foreign Earned Income Exclusion[13]

A. *The Early History*

Earned income is income that is derived from labor, profes-

8. *See infra* notes 77-81 and accompanying text.
9. I.R.C. § 911(b)(2)(A) (West 1982). *See infra* text accompanying note 122.
10. I.R.C. § 911(c)(West 1982). *See infra* notes 128-132 and accompanying text.
11. "There is no precise count of Americans living overseas." *1981-82 Miscellaneous Tax Bills, IV: Hearings on S. 408, S. 436, S. 598, and S. 867 Before the Subcomm. on Taxation and Debt Management Generally of the Senate Comm. on Finance,* 97th Cong., 1st Sess. 423 (1981) (paper by Dr. Susan Nordhauser and Janet Richmond, University of Texas at San Antonio). Part of the reason for this is that the 1980 Census of Population did not include United States citizens residing abroad. *Taxation of Foreign Earned Income: Hearings on S. 2283, S. 2321, and S. 2418 Before the Subcomm. on Taxation and Debt Management Generally of the Senate Comm. on Finance,* 96th Cong., 2d Sess. 135 (1980) (report by Chase Econometric Associates, Inc.). However, in 1978 there were 169,951 income tax returns filed declaring foreign earned income. Internal Revenue Service, Statistics of Income 1972-1978, International Income and Taxes, Foreign Income and Taxes Reported on Individual Income Tax Returns 3 (1981). Since 1978, the Foreign Earned Income Act of 1978 has caused a decline of 20% in the number of Americans employed abroad. *See infra* notes 172, 173 and accompanying text. Therefore, the number of tax returns that can be estimated to be filed for 1982 is 135,961 (169,951 less 20%).
12. *See infra* text accompanying notes 175-200.
13. For a detailed treatment of the history of the foreign earned income exclusion, see Levine, *Section 911: The Foreign Earned Income Exclusion-Death Blow or Recovery?,* 56 Taxes 169 (1978); Slowinski and Williams, *The Formative*

sional service, or entrepreneurship, as opposed to income derived from invested capital, such as rents, dividends, and interest.[14] The first exclusion for foreign earned income was provided by section 213(b)(14) of the Revenue Act of 1926.[15] That Act exempted from taxation income such as "wages, salaries, professional fees, and other amounts received as compensation for personal services"[16] received from sources outside of the United States by an individual American citizen who was a bona fide nonresident of the United States for more than six months during the taxable year.[17] This qualification, that a person be a bona fide nonresident of the United States, became known as the bona fide foreign resident test.[18] The Revenue Act of 1928 adopted section 213(b)(14), making only technical changes, and redesignating it as section 116(a).[19]

In 1932, Congress amended section 116(a) so that it no longer exempted from income tax any amount paid by the United States government or any of its agencies.[20] The purpose of the exclusion was to help foreign trade by placing Americans who worked abroad in a position of tax equality with their host country competitors.[21] Without an exclusion these Americans would be taxed by both the foreign country and the United States.[22] However, the purpose was not being served by allowing military personnel, Ambassadors, ministers, and Foreign Service officers, whose incomes were not taxed by the foreign governments, to be included in the section 116(a) exclusion, as had previously been the practice.[23]

Years of the Foreign Source Earned Income Exclusion: Section 911, 51 TAXES 355 (1973).

14. BLACK'S LAW DICTIONARY 456 (rev. 5th ed. 1979). For a discussion of what constitutes foreign earned income under I.R.C. § 911, see Annot., 17 A.L.R. FED. 412 (1973).

15. Revenue Act of 1926, ch. 27, § 213(b)(14), 44 Stat. 9 (1926).

16. Revenue Act of 1926, ch. 27, § 209(a)(1), 44 Stat. 9 (1926).

17. Revenue Act of 1926, ch. 27, § 213(b)(14), 44 Stat. 9 (1926). A motive for enacting this section was to increase foreign trade in American made products. H.R. REP. No. 1, 69th Cong., 1st Sess. 7 (1925).

18. The bona fide foreign resident test has, in varying forms, survived to the present. *See infra* note 114 and accompanying text.

19. Revenue Act of 1928, ch. 852, §116(a), 45 Stat. 791 (1928).

20. Revenue Act of 1932, ch. 209, §116(a), 47 Stat. 169 (1932).

21. 75 CONG. REC. 10410 (1931-1932).

22. *Id.*

23. *Id.* The Senate proposed to eliminate section 116(a) because (1) those bona fide nonresidents who came under its exclusion were also granted a credit for any income taxes that they paid to foreign countries, and (2) a considerable proportion of the people receiving the benefits of section 116(a) were employees of

The exclusion was codified in the Internal Revenue Code of 1939,[24] retaining its designation as section 116(a).[25]

There were two amendments to section 116 made in 1942.[26] The first changed the bona fide foreign residence requirement from six months to an entire taxable year.[27] The second added subsection (a)(2) to extend the exclusion to United States citizens who had been bona fide residents of a foreign country or countries for two or more years before they changed their residence back to the United States, to cover any overseas time period that was not an entire taxable year.[28] The extension to the qualifying time was made in order to prevent the abuse of the exclusion by persons who left the United States for only six months for the sole purpose of evading income taxes.[29] The Revenue Act of 1943 added subsection (a)(3), which defined earned income,[30] to section

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the United States who, because of that status, were not required to pay income taxes to the foreign countries. S. REP. NO. 665, 72d Cong., 1st Sess. 31 (1932). The second reason appears to have been the Senate's primary motivation in calling for the repeal. *See supra* notes 21-23 and accompanying text. An agreement was worked out by a Conference Committee whereby amounts paid by the United States or any agency thereof were disallowed from the exclusion. H.R. REP. NO. 1492, 72d Cong., 1st Sess. 3 (1932).

24. Int. Rev. Code of 1939, ch. 1, §116(a), 53 Stat. 1 (1939).

25. Also codified was a definition of earned income. Originally, the Revenue Act of 1926, *see supra* note 15, defined earned income for § 213(b)(14) purposes with a cross reference to § 209. *See supra* note 16 and accompanying text. This practice was followed when § 213(b)(14) became § 116(a) in the Revenue Act of 1928, *see supra* note 19 and accompanying text, with § 209 becoming § 31. The Revenue Act of 1932 changed this practice by including a definition of earned income in § 116 itself, *see supra* note 20, but this new approach was abandoned two years later. Revenue Act of 1934, ch. 277, § 116(a), 48 Stat. 680 (1934). Section 116(a) then defined earned income by a cross reference to § 25(a), with § 25(a)(5)(A) defining earned income essentially the same as the Revenue Act of 1932 had. The Internal Revenue Code of 1939 codified this practice, but with § 25(a)(5)(A) becoming § 25(a)(4)(A).

26. Revenue Act of 1942, ch. 619, § 148, 56 Stat. 798 (1942).

27. The House of Representatives reversed its proexclusion stance of ten years before, *see supra* note 23, and voted to repeal section 116(a). H.R. 7378, 77th Cong., 2d Sess. § 134 (1942). This was done by the House in order to serve revenue needs and to end the existing unjust discrimination favoring individuals receiving their compensation from abroad. H.R. REP. NO. 2333, 77th Cong., 2d Sess. 50 (1942). The Senate recognized that there had been abuse of § 116(a) by citizens who left the United States for six months solely to evade income taxes, but felt that a total repeal of the section would work a hardship on many Americans who were bona fide residents of foreign countries. The Senate believed that the abuses could be cured by extending the bona fide foreign residence requirement from six months to the entire taxable year. S. REP. NO. 1631, 77th Cong., 2d Sess. 54 (1942). This new residency requirement was designated § 116(a)(1). Revenue Act of 1942, ch. 619, § 148, 56 Stat. 798 (1942) (current version at I.R.C. § 911(d)(1)(A) (West 1982)).

28. Revenue Act of 1942, ch. 619, § 148, 56 Stat. 798 (1942).

29. *See supra* note 27.

30. The definition was essentially the same as that codified in § 25(a)(4)(A) of the Internal Revenue Code of 1939, which is what § 116 had been cross referencing to. *See supra* note 25.

116.[31]

The Revenue Act of 1951[32] amended section 116, extending the exemption 1) to the uninterrupted periods of bona fide foreign residence which are included in an entire taxable year; and 2) to those individual citizens who were physically present in a foreign country for at least 510 full days during any period of eighteen consecutive months.[33] This new extension to those who were present in foreign countries became known as the physical presence test.[34] Prior to the enactment of the Economic Recovery Tax Act of 1981, these provisions were considered to be the "peak" in providing the maximum amount of foreign earned income tax benefits to individuals.[35] However, the "peak" did not last long, since two years after passing the Revenue Act of 1951, Congress placed a limit of $20,000 per entire tax year[36] on the amount that could be excluded under the recently enacted physical presence exclusion of section 116(a)(2).[37]

31. Revenue Act of 1943, ch. 63, § 107, 58 Stat. 21 (1944).

32. Revenue Act of 1951, ch. 521, § 321(a), 65 Stat. 452 (1951).

33. These changes were brought to correct two defects that were seen in the current law. The first was that since the exclusion only applied to an entire taxable year, it did not cover the individual's first year abroad unless he became a bona fide foreign resident of a foreign country on January first. Thus a person could conceivably lose 364 days of income exclusion. To correct this problem the exclusion was extended to an uninterrupted period which included an entire taxable year. S. REP. NO. 781, 82d Cong., 1st Sess. 53, *reprinted in* 1951 U.S. CODE CONG. & AD. NEWS 1969, 2024. The second defect was that the bona fide foreign residence requirement was being construed too strictly. Persons like managers, technicians, and skilled workmen, who went abroad only for stated periods of time, and others who by the very nature of their work could not establish a residence, were not allowed exclusions, despite the fact that they lived abroad for considerable lengths of time. As a result the physical presence test was added to apply to those individuals who were present in a foreign country or countries for 17 (510 days + 30 day months) out of 18 consecutive months. *Id.*

34. For the current physical presence test, *see infra* note 115 and accompanying text.

35. Levine, *Section 911: The Foreign Earned Income Exclusion — Death Blow or Recovery?,* 56 Taxes 169, 172 (1978).

36. For time periods of less than an entire taxable year the limit was determined by the following ratio:

$$\frac{\text{Number of days in the part of the taxable year within the 18-month period}}{\text{Total number of days in such year}} \times \$20{,}000$$

Technical Changes Act of 1953, ch. 512, § 204, 67 Stat. 615 (1953). This ratio also applied to those situations in which none of the 17 months constituted an entire taxable year (*i.e.,* presence in foreign country from March 1, 19A to July 31, 19B.)

37. Technical Changes Act of 1953, ch. 512, § 204(a), 67 Stat. 615 (1953). While

The Internal Revenue Code of 1954[38] adopted in substance section 116(a).[39] However, section 116(a) was redesignated as section 911,[40] with the bona fide foreign residence provision becoming subsection (a)(1), the physical presence provision becoming subsection (a)(2), and the definition of gross income becoming subsection (b). The new section 911 was amended four years later, along with section 6012, by the Technical Amendments Act of 1958,[41] to require earned income from abroad to be reported to the Internal Revenue Service. Before this amendment the Service had no way to determine whether those taxpayers claiming the 911 exclusions were properly allowable.[42]

The $20,000 annual exclusion limit that applied to those claiming under the physical presence test[43] was limited to the first three years of those claiming under the bona fide foreign residence provision by the Revenue Act of 1962.[44] For any period of foreign residence after three consecutive years the exclusion increased to $35,000 per year.[45] In addition, the value of any fringe

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both Houses saw the purpose of § 116(a)(2) to be to encourage people with technical knowledge to go abroad and complete specific projects, and that it was being abused by individuals with large incomes who went abroad primarily to avoid paying any income taxes, only the House called for its repeal. H.R. REP. NO. 894, 83d Cong., 1st Sess. 4 (1953). The Senate was able to convince the House that the abuses could be corrected by placing a limit on the amount of the income that would be exempt. S. REP. NO. 685, 83d Cong., 1st Sess. 5, *reprinted in* 1953 U.S. CODE CONG. & AD. NEWS 2423, 2427.

38. Int. Rev. Code of 1954, ch. 736, 68A Stat. 3 (1954).

39. S. REP. NO. 1622, 83d Cong., 2d Sess. 420, *reprinted in* 1954 U.S. CODE CONG. & AD. NEWS 4621, 5063.

40. Int. Rev. Code of 1954, ch. 736, § 911, 68A Stat. 3 (1954) (now I.R.C. § 911).

41. Technical Amendments Act of 1958, Pub. L. No. 85-866, § 72, 72 Stat. 1606 (1958).

42. Congress found that the scope of the exclusions was misunderstood. Some persons assumed that the exclusions applied to any type of income that was being received (instead of compensation for personal services) or that they did not have to meet the bona fide residence or physical presence tests. To assist taxpayers in determining whether they qualify for the 911 exclusions they are required to treat any income that comes under § 911 as gross income only for § 6012 purposes (determining whether or not a tax return must be filed). H.R. REP. NO. 775, 85th Cong., 1st Sess. 40-41 (1957); S. REP. NO. 1983, 85th Cong., 2d Sess. 93-94, *reprinted in* 1958 U.S. CODE CONG. & AD. NEWS 4791, 4882.

43. *See supra* notes 36, 37 and accompanying text.

44. Revenue Act of 1962, Pub. L. No. 87-834, § 11, 76 Stat. 960 (1962).

45. It was recognized that those who are abroad for longer periods of time are more dependent upon the economy of their foreign residence than that of the United States. Anyone who had already been a bona fide foreign resident for three years or more at the time the Revenue Act of 1962 was enacted would immediately receive the higher ceiling. H.R. REP. NO. 1447, 87th Cong., 2d Sess. 54-55 (1962).

The amount excludable accrued on a daily basis throughout the entire taxable year, with the number of days used in the computation on a daily basis being the number of days in the taxable year for which the exclusion is claimed. Thus, unless a bona fide foreign residence was established on January first, the above ratio benefits that a bona fide foreign resident received as compensation were to be added to gross income for purposes of the exclusion limit.[46] Also, if a person reported to a foreign country that he was not a resident of that country, and as a result was treated by that country as a nonresident for tax purposes, he could not claim exemption under section 911(a)(1) as a bona fide foreign resident.[47] A final modification to the foreign resident exclusion was added two years later when the yearly limit for three or more years of continuous foreign residence was lowered from $35,000 to $25,000.[48]

Section 911 remained unchanged[49] for the next twelve years. In 1976, however, the Tax Reform Act of 1976[50] made five major changes to section 911. Although these changes never became effective,[51] the importance of the Tax Reform Act is that it marks the beginning of a five year period in which Congress made major changes in the foreign earned income exclusion[52] in an attempt to find the correct tax objective to be achieved.[53]

The first of the changes sought by the Tax Reform Act was a reduction of the limit on the amount excludable under either the bona fide foreign residence or physical presence tests from $20,000 to $15,000, along with the elimination of the increase in the limit for bona fide foreign residents who lived abroad for three or more

was used. S. REP. NO. 1881, 87th Cong., 2d Sess. 232-33, *reprinted in* 1962 U.S. CODE CONG. & AD. NEWS 3297, 3535.

46. "The type of fringe benefits referred to are non-cash compensation, such as provision for a home or a car." S. REP. NO. 1881, 87th Cong., 2d Sess. 75, *reprinted in* 1962 U.S. CODE CONG. & AD. NEWS 3297, 3378.

47. This was to prevent an individual from avoiding income tax in the United States and the foreign county by taking inconsistent positions with respect to residence in the two countries. S. REP. NO. 1881, 87th Cong., 2d Sess. 75, *reprinted in* 1962 U.S. CODE CONG. & AD. NEWS 3297, 3378.

48. Revenue Act of 1964, Pub. L. No. 88-272, § 237, 78 Stat. 19 (1964).

49. A minor change was made to § 911 by the Foreign Investors Tax Act of 1966, Pub. L. No. 89-809, § 105(e)(3), 80 Stat. 1539, 1567 (1966), to allow for a cross reference to § 981 for "elections as to treatment of income subject to foreign community property laws."

50. Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (1976).

51. *See infra* notes 61-65 and accompanying text.

52. *See infra* notes 54-111 and accompanying text. During its 50 year history prior to the Tax Reform Act of 1976, the earned income exclusion had not undergone as many major changes in as short of a time as it did in the five year period between the Tax Reform Act of 1976 and the Economic Recovery Tax Act of 1981. *Compare supra* notes 15-48 and accompanying text *with infra* notes 54-111 and accompanying text.

53. *See infra* notes 163-176 and accompanying text.

years.[54] However, for any individual who performed qualified charitable services, the limit remained $20,000.[55] The second change was that any taxes paid to a foreign country on the excluded income could not be used as a credit against United States income taxes.[56] The third change was that any earned income that was received outside of the foreign country in which it was earned was not excludable if one of the reasons for receiving it outside of the foreign country was to avoid that country's income tax.[57] The fourth change was in the method of computing the income tax.[58] Any income that was excluded was now treated as income subject to tax at the lowest tax brackets, so that any income not excluded was taxed at the progressively higher tax rates as though there was no income being excluded.[59] The last change

54. Tax Reform Act of 1976, Pub. L. No. 94-455, § 1011(a), 90 Stat. 1520 (1976). The House believed that a tax advantage for United States citizens living and working abroad for private companies over United States citizens living and working in the United States was no longer appropriate, and called for a three year phasing out of the section 911 exclusion. H.R. REP. NO. 658, 94th Cong., 2d Sess. 200-01, *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS 2897, 3095. The Senate disagreed with the House and believed that the elimination of the exclusion would jeopardize the competitive position of United States firms abroad. S. REP. NO. 938, 94th Cong., 2d Sess. 210, *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS 3439, 3640. The two compromised in Conference Committee and established the lower exclusion limits. H.R. REP. NO. 1515, 94th Cong., 2d Sess. 454, *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS 4118, 4161.

55. Tax Reform Act of 1976, Pub. L. No. 94-455, § 1011(a), 90 Stat. 1520 (1976). Qualified charitable services was work performed for an organization like those found under section 501(c), such as religious, scientific, literary, or educational organizations.

56. Tax Reform Act of 1976, Pub. L. No. 94-455, § 1011(b)(1), 90 Stat. 1520 (1976). One purpose of the exclusion was to prevent double taxation, but by allowing taxpayers to deduct any amount paid for foreign income taxes on the amount excluded against any United States taxes due on the nonexcluded income, they received a "double benefit" which had the effect of exempting up to $40,000 or more of earned income from United States taxes if they paid any significant income tax to a foreign country. H.R. REP. NO. 658, 94th Cong., 2d Sess. 200, *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS. 2897, 3094-95.

57. Tax Reform Act of 1976, Pub. L. No. 94-455, § 1011(b)(2), 90 Stat. 1520 (1976). The tax avoidance purpose does not have to be the sole or even a primary motive. Thus, when a foreign country does not tax income received in another country, and an individual has his earned income deposited in a bank in another country, there is a strong indication of a tax avoidance purpose. S. REP. NO. 938, 94th Cong., 2d Sess. 210-12, *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS 3439, 3640-42.

58. Tax Reform Law of 1976, Pub. L. No. 94-455, § 1011(b)(3), 90 Stat. 1520 (1976).

59. The effect of this new method of computing taxes can best be shown by an example. Suppose an individual has foreign earned income of $25,000. Using the 1976 tax tables for a single individual, the old tax would be:

gross income	$25,000
less § 911 exclusion	15,000
taxable income	10,000
Tax on $10,000 = $2,090	

was that an individual could elect not to have the 911 exclusion applied to his income. But once the election was made it was applicable to all subsequent taxable years, and could only be revoked with the consent of the Secretary of the Treasury.[60]

The Tax Reform Act of 1976 made its new provisions retroactively applicable to income earned on January 1, 1976.[61] To avoid substantial inequities that would result from retroactive application,[62] the Tax Reduction and Simplification Act of 1977 postponed the effective date until January 1, 1977.[63] The date was once again postponed to taxable years beginning on January 1, 1978 by the Tax Treatment Extension Act of 1977.[64] Ultimately, the Tax Reform Act of 1976 never went into effect, as it was superceded by the Foreign Earned Income Act of 1978.[65]

B. *The Foreign Earned Income Act of 1978*

Both the House and the Senate believed that because of the extraordinary cost of living overseas a new and more balanced approach to foreign earned income taxation had to be determined; that "special consideration must be given to Americans working abroad in order to treat them equitably for tax purposes."[66] How-

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However, under the new computation method the tax would be:

tax on entire $25,000	= 7,190	
less tax on § 911 exclusion of 15,000	= 3,520	(treated as 1st income earned)
Tax on income not excluded	$3,670	

An individual thus faced an increased tax burden of $1,580 (3,670 - 2,090). It was believed that this new method of computation was more consistant with the progressive tax system. S. REP. No. 938, 94th Cong., 2d Sess. 211, *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS 3439, 3641.

60. Tax Reform Act of 1976, Pub. L. No. 94-455, § 1011(b)(3), 90 Stat. 1520 (1976).

61. Tax Reform Act of 1976, Pub. L. No. 94-455, § 1011(d), 90 Stat. 1520 (1976).

62. Since the Act was not passed until October 4, 1976, many of the individuals who were effected by the changes were not informed of the increased taxes in time to save up enough money to pay for them. To require these people to pay would impose a hardship upon them. S. REP. No. 66, 95th Cong., 1st Sess. 16, 84, *reprinted in* 1977 U.S. CODE CONG. & AD. NEWS 185, 197, 261.

63. Tax Reduction and Simplification Act of 1977, Pub. L. No. 95-30, § 302, 91 Stat. 126 (1977).

64. Tax Treatment Extension Act of 1977, Pub. L. No. 95-615, § 4(a), 92 Stat. 3097 (1978).

65. FEIA, Pub. L. No. 95-615, § 209(a), 92 Stat. 3097 (1978), applied to taxable years beginning after December 31, 1977.

66. H.R. REP. No. 1463, 95th Cong., 2d Sess. 7 (1978); *see also* S. REP. No. 746, 95th Cong., 2d Sess. 6-7, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 7612, 7618.

ever, they disagreed as to how this new approach should be implemented. The House believed[67] that both an exclusion of earned income and deductions for excess living costs were necessary to encourage employees to go to, and to compensate them for, living in certain hardship areas.[68] The Senate believed that a flat income exclusion was arbitrary and unfair, in that the amount excluded was the same regardless of whether an individual's living expenses overseas were higher than, the same as, or lower than the comparable cost in the United States. The equitable way to tax overseas Americans was to take into account the increased expenses incurred while working abroad.[69] The compromise of these two views resulted in the Foreign Earned Income Act of 1978 (FEIA).[70]

The FEIA amended Section 911[71] to enable a person living abroad to exclude up to $20,000 of earned income per taxable year if that person met either the bona fide foreign resident or physical presence tests,[72] and who, because of his or her employment, resided in a "camp"[73] located in a "hardship area."[74] In addition,

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67. H.R. REP. NO. 1463, 95th Cong., 2d Sess. 7 (1978).

68. These hardship areas were countries other than Canada or Western Europe; specifically "any foreign country except Andorra, Austria, Belgium, Canada, Denmark, Finland, France, Germany (Federal Republic), Greece, Iceland, Ireland, Italy, Liechtenstein, Luxembourg, Monaco, The Netherlands, Norway, Portugal, San Marino, Spain, Sweden, Switzerland, and the United Kingdom." H.R. REP. NO. 1463, 95th Cong., 2d Sess. 9 (1978). The benefits of having Americans in hardship countries would be to encourage foreigners to buy American products and services, as well as enhanced international goodwill and mutual understanding. *Id.* at 7.

69. S. REP. NO. 746, 95th Cong., 2d Sess. 7, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 7612, 7618.

70. FEIA, Pub. L. No. 95-615, 92 Stat. 3097 (1978).

71. *Id.* at § 202.

72. *See supra* notes 16-18, 33, 34 and accompanying text.

73. A camp consists of:

> substandard lodging which is —
>
> (i) provided by or on behalf of the employer for the convenience of the employer because the place at which such 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 such individual renders services, and
>
> (iii) furnished in a common area (or enclave) which is not available to the public and which normally accomodates 10 or more employees.

Former I.R.C. § 911(c)(1)(B) (West 1979) (originally enacted as FEIA, Pub. L. No. 95-615, § 202 (b), 92 Stat. 3097, 3099 (1978), repealed by ERTA, Pub. L. No. 97-34, § 111(a), 95 Stat. 190 (1981)).

74. A hardship area "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. . . ." Former I.R.C. § 913(h)(2) (originally enacted as FEIA, Pub. L. No. 95-615, § 203(a), 92 Stat. 3097, 3104 (1978), repealed by ERTA, Pub. L. No. 97-34, § 112(a), 95 Stat. 194 (1981)).

Section 913 was enacted[75] to provide five categories of deductions in areas where individuals abroad face excess costs.[76] The five categories were: 1) a qualified cost-of-living differential,[77] 2) qualified housing expenses,[78] 3) qualified schooling expenses,[79] 4)

75. FEIA, Pub. L. No. 95-615, § 203, 92 Stat. 3097 (1978).

76. S. REP. NO. 746, 95th Cong., 2d Sess. 8, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 7612, 7619.

77. The qualified cost of living differential is the reasonable amount by which the general cost of living in the foreign country where the individual's "tax home", *see infra* note 113, is located exceeds the general cost of living in the metropolitan area in the United States (excluding Alaska and Hawaii) having the highest general cost of living. This amount is determined at least annually by the Secretary of the Treasury, who may take into account the Department of State's Local Index of Living Costs Abroad. The amount that is arrived at is to reflect the cost of living (except housing and schooling expenses) of a family receiving the compensation of a United States employee at an annual salary grade of GS-14, step 1, which is currently $37,871, *see infra* note 131, and is to vary according to the composition (spouse and/or dependents) residing with the taxpayer. The amount of the differential that is allowed is computed on a daily basis only for those days when the taxpayer's tax home is located in a foreign country, and is not allowed for any period in which the individual's meals and lodging are excluded from gross income under § 119 (provided for the convenience of the employer). I.R.C. § 913(d) (West 1979) (repealed by ERTA, Pub. L. No. 97-34, § 112(a), 95 Stat. 194 (1981)).

78. Qualified housing expenses is the excess of reasonable expenses (expenses that are not lavish or extravagant under the circumstances) incurred during the taxable year by the taxpayer for housing in a foreign country, less the "base housing amount." The "base housing amount" is 20% of the excess of a complicated formula. The formula is the taxpayer's earned income (reduced by any of the deductions other than those in § 913 which can be charged against it), less the sum of the reasonable housing expenses mentioned above, the qualified cost-of-living differential, *see supra* note 77, the qualified school expenses, *see infra* note 79, the qualified home leave travel expenses, *see infra* note 80, and the qualified hardship area deduction, *see infra* note 81. The "base housing amount" for the household that a taxpayer maintains at his tax home can be zero where the taxpayer maintains a second foreign household for his spouse and dependents, if the second household is maintained because of adverse living conditions at the tax home, and that tax home is located in a hardship area, *see supra* note 74. Housing expenses, as well as the "base housing amount", are only determined for those days when the taxpayer's tax home is located in a foreign country, except for time periods when the taxpayer excluded the value of housing provided for him by his employer under § 119. In addition, where an individual maintains two households and the above mentioned zero base housing amount conditions do not apply, only the housing expenses for the household which is closest to his tax home can be used for determining the qualified housing expenses. I.R.C. § 913(e) (West 1979) (amended as I.R.C. § 911(c)).

79. Qualified schooling expenses are the reasonable costs of tuition, fees, books, local transportation, and other expenses required by a school, which are paid for or incurred by an individual to educate his or her dependents in grades kindergarten through twelve in a "United States-type school" ("i.e., English speaking and offering education for which United States schools would ordinarily grant credit toward graduation." H.R. REP. No. 1463, 95th Cong., 2d. Sess. 13 (1978)). If there is no adequate "United States-type school" within a reasonable distance of

qualified home leave travel expenses,[80] and, 5) a qualified hardship area deduction.[81] These deductions were available to any individual who met either the bona fide residence or physical presence tests,[82] up to an amount not to exceed the foreign earned income received in the taxable year.[83]

Section 119,[84] which excluded from income the value of any meals and lodging furnished for the convenience of the employer, was expanded to cover meals and lodging furnished to spouses and dependents,[85] and to include a "camp"[86] in the definition of business premises.[87] Finally, deductible moving expenses under section 217 were increased threefold in connection with house hunting costs[88] and the time allowed for such hunting,[89] as well as to include the reasonable expenses of moving and storing household goods while abroad.[90]

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the individual's tax home, and a dependent is instead sent to a different school, the total amount that can be deducted is the amount that would have been incurred had the dependent gone to the "United States-type school." However, if no adequate "United States-type school" is within reasonable commuting distance ("a distance which is capable of being traveled safely and regularly by customarily available transportation, including privately owned vehicles, in 1 hour." T.D. 7736, 1981-4 I.R.B. 15, 23) of the tax home, then the cost of room and board, plus transportation to and from the school to the tax home, is allowed. Qualified schooling expenses are only allowed for those time periods when the individual's tax home is in a foreign country. I.R.C. § 913(f) (West 1979) (repealed by ERTA, Pub. L. No. 97-34, § 112(a), 95 Stat. 194 (1981)).

80. Qualified home leave travel expenses is the reasonable cost of transportation from the foreign tax home to the individual's principal (or most recent) domestic residence, and back, incurred by the taxpayer, his spouse, and any dependents. The travel must be to the United States, and where the individual does not travel to his principal domestic residence, the deduction is limited to the transportation costs between the foreign tax home and the nearest United States port of entry (Alaska or Hawaii need not be considered). This deduction is limited to the cost of one round trip per person for each continuous 12 month period that the tax home is located in a foreign country. I.R.C. § 913(g) (West 1979) (repealed by ERTA, Pub. L. No. 97-34, § 112(a), 95 Stat. 194 (1981)).

81. The qualified hardship area deduction is an amount computed on a daily basis at an annual rate of $5,000 for each day that an individual's tax home is located in a hardship area. A hardship area is a foreign place so designated by the Secretary of State where extraordinarily difficult living conditions (i.e., unhealthful conditions) or excessive physical hardships exist, and for which a post differential of 15% or more is provided by 5 U.S.C. § 5925 (or would be if United States Government personnel were present). I.R.C. § 913(h) (West 1979) (repealed by ERTA, Pub. L. No. 97-34, § 112(a), 95 Stat. 194 (1981)).

82. FEIA, Pub. L. No. 95-615, § 203(a), 92 Stat. 3097 (1978) (which became I.R.C. § 913(a), repealed by ERTA, Pub. L. No. 97-34, § 112(a), 95 Stat. 194 (1981)).

83. FEIA, Pub. L. No. 95-615, § 203(a), 92 Stat. 3097 (1978) (which became I.R.C. § 913(c), repealed by ERTA, Pub. L. No. 97-34, § 112(a), 95 Stat. 194 (1981)).

84. I.R.C. § 119 (West 1979).

85. FEIA, Pub. L. No. 95-615, § 205, 92 Stat. 3097 (1978).

86. *See supra* note 73.

87. FEIA, Pub. L. No. 95-615, § 202(c), 92 Stat. 3097 (1978).

88. From $1,500 to $4,500.

89. From 30 consecutive days to 90 consecutive days.

90. FEIA, Pub. L. No. 95-615, § 204(a), 92 Stat. 3097 (1978).

The impact of the FEIA's tax provisions proved detrimental to the United States economy.[91] The deductions provided under section 913 failed to adequately protect taxpayers from the increased costs faced in going overseas,[92] and the preparation of income tax returns was overly complex and costly.[93] As a result, the number of Americans working abroad declined, both in total numbers[94] and in proportion to third country nationals employed by United States multinational firms.[95] The FEIA also reduced the ability of United States businesses to effectively compete against companies from other countries.[96]

C. *The Economic Recovery Tax Act of 1981*

From the very enactment of the FEIA there were Congressmen advocating that a new method of taxing foreign earned income was needed.[97] The growth of the discontent with the FEIA treatment was evidenced by the increase in bills proposing changes in it from five in 1979,[98] to twelve in 1980.[99] With the continuing trade deficits it was important to allow Americans to work overseas in order to help keep American businesses competitive.[100] However, the complexity and burdens of the tax law made it difficult for United States businesses to employ Americans abroad.[101] Believing that "a broad range of activities by Americans abroad

91. *See infra* notes 168-174 and accompanying text.
92. *See infra* notes 212, 213 and accompanying text.
93. *See infra* notes 231, 245 and accompanying text.
94. *See infra* note 173 and accompanying text.
95. *See infra* notes 219, 220 and accompanying text.
96. *See infra* notes 217, 218 and accompanying text.
97. Senator Chafee, in urging the adoption of the foreign earned income provisions of the Economic Recovery Tax Act of 1981, stated: "Among the many other important provisions of this legislation, there is one other I would like to point out. It is one which I take some satisfaction in having drafted, one which I have been working on constantly for the last 2 years. . . ." 127 Cong. Rec. S8,735 (daily ed. July 29, 1981) (remarks of Sen. Chafee).
98. S. 873, 96th Cong., 1st Sess. (1979); S. 3561, 96th Cong., 1st Sess. (1979); H.R. 5211, 96th Cong., 1st Sess. (1979); H.R. 5473, 96th Cong., 1st Sess. (1979); H.R. 5973, 96th Cong., 1st Sess. (1979).
99. S. 2283, 96th Cong., 2d Sess. (1980); S. 2321, 96th Cong., 2d Sess. (1980); S. 2418, 96th Cong., 2d Sess. (1980); S. 2773, 96th Cong., 2d Sess. (1980); S. 2779, 96th Cong., 2d Sess. (1980); S. 2814, 96th Cong., 2d Sess. (1980); S. 2940, 96th Cong., 2d Sess. (1980); S. 3251, 96th Cong., 2d Sess. (1980); H.R. 6659, 96th Cong., 2d Sess. (1980); H.R. 7479, 96th Cong., 2d Sess. (1980); H.R. 7811, 96th Cong., 2d Sess. (1980); H.R. 7872, 96th Cong., 2d Sess. (1980).
100. S. REP. NO. 144, 97th Cong., 1st Sess. 36, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 191, 228.
101. *Id.*

benefit the United States economy and should be encouraged,"[102] the Economic Recovery Tax Act of 1981 (ERTA) made sweeping revisions in foreign earned income taxation.

As an incentive to encourage Americans to work overseas,[103] the deductions for excess foreign living costs (except for housing) were eliminated by the repeal of section 913,[104] and replaced with a flat specified exclusion in an amended section 911.[105] An American citizen who meets either the old bona fide foreign residence test, or a new physical presence test[106] of 330 full days in any consecutive twelve month period, is allowed to exclude $75,000 in tax year 1982,[107] increasing by $5,000 a year to $95,000 in 1986.[108] An additional exclusion is allowed for reasonable expenses incurred for housing.[109] The requirement that section 911 apply only to individuals residing in a camp located in a hardship area consisting of substandard housing was eliminated,[110] with a resulting easing of the requirements for employees to claim the benefits of a section 119 deduction (meals or lodging furnished for the convenience of the employer).[111]

The remainder of this comment will explain the newly enacted foreign earned income law in detail. Differences between the old and new law will be pointed out, along with the strengths and weaknesses of both. It should be noted that because section 911 and 913 were essentially the same at the end of 1981 when they were amended by the ERTA as they were when amended by the FEIA in 1978, the law that was in effect will be referred to as that created by the FEIA.

II. The Current Tax Treatment of Foreign Earned Income

Starting on January 1, 1982, a qualified individual can make an election to exclude from his/her gross income certain amounts of foreign earned income and housing costs.[112] A qualified individ-

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102. *Id.*
103. *Id.*
104. ERTA, Pub. L. No. 97-34, §112(a), 95 Stat. 194 (1981).
105. ERTA, Pub. L. No. 97-34, §111(a), 95 Stat. 190 (1981).
106. ERTA, Pub. L. No. 97-34, § 111(a), 95 Stat. 190 (1981) (codified as I.R.C. § 911(d)(1)(B)(West 1982)).
107. ERTA, Pub. L. No. 97-34, § 111(a), 95 Stat. 190 (1981) (codified as I.R.C. § 911(b)(2)(A)(West 1982)).
108. *Id.*
109. ERTA, Pub. L. No. 97-34, § 111(a), 95 Stat. 190 (1981) (codified as I.R.C. § 911(c)(West 1982)).
110. ERTA, Pub. L. No. 97-34, § 111(a), 95 Stat. 190 (1981).
111. H.R. Rep. No. 215, 97th Cong., 1st Sess. 204-05, *reprinted in* 1981 U.S. Code Cong. & Ad. News 285, 295.
112. I.R.C. § 911 (West 1982).

ual is a person whose tax home[113] is in a foreign country and who is either: 1) a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire tax year (bona fide foreign resident test),[114] or 2) is present in a foreign country or countries during at least 330 full days in any period of twelve consecutive months (physical presence test).[115] A person will not be allowed to qualify as a bona fide foreign resident where he/she has taken inconsistent positions with respect to residency in order to avoid taxation.[116] However, the above qualifying tests can be waived under special circumstances. For example, if a person is forced to leave[117] a foreign country because of war, civil unrest, or similar adverse conditions,[118] before he can

113. The term tax home means that home which a person has for purposes of § 162(a)(2) deductions for traveling expenses paid or incurred while away from home in the pursuit of a trade or business. I.R.C. § 911(d)(3)(West 1982).

114. I.R.C. § 911(d)(1)(A)(West 1982).

115. I.R.C. § 911(d)(1)(B)(West 1982).

116. This applies to a person who has made a statement to the foreign country's authorities that he is not a resident of their country, and as a result was not taxed by that country. He cannot now make statements to United States authorities that he is a foreign resident in order to avoid taxation by this country. I.R.C. § 911(d)(5)(West 1982). *See also supra* note 47 and accompanying text.

117. The individual must have left the foreign country after August 31, 1978. I.R.C. § 911(d)(4)(B)(1982).

118. A waiver of the qualifying tests was granted for the following countries:

	Time Periods	
Country	On or After	On or Before
Afghanistan	April 23, 1979	(still in effect)
Algeria	September 4, 1979	March 10, 1980
Bahrain	August 31, 1979	June 30, 1980
Bangladesh	August 31, 1979	March 10, 1980
Bolivia	May 3, 1980	(still in effect)
Chad	November 19, 1978	(still in effect)
El Salvador	September 24, 1979	(still in effect)
Iran	September 1, 1978	(still in effect)
Iraq	August 31, 1979	(still in effect)
Kuwait	August 31, 1979	June 30, 1980
Lebanon	August 31, 1979	(still in effect)
Liberia	January 27, 1980	July 29, 1980
Libya	August 31, 1979	(still in effect)
Nicaragua	March 14, 1979	August 27, 1979
Oman	August 31, 1979	March 10, 1980
Pakistan	August 23, 1979	June 30, 1980
Qatar	August 31, 1979	March 31, 1980
Syria	August 31, 1979	May 15, 1980
United Arab Emirates	August 31, 1979	March 31, 1980
Yeman Arab Republic	August 31, 1979	March 10, 1980

Rev. Proc. 81-23, 1981-1 C.B. 693; [1981] Fed. Taxes (P-H) ¶ 55,152. "Taxpayers who believe that additional countries or time periods should be added to this list may petition the Assistant Secretary (Tax Policy), Department of the Treasury, 1500 meet either of the above qualifying tests, he will be treated as having met the requirements if he can establish that but for the adverse conditions he could reasonably have been expected to have met one of the qualifying tests.[119] In such cases, the amount of the exclusion that will be allowed from gross income shall be determined only for those days in which the individual was actually present in the foreign country.[120]

Once one of the qualifying tests have been met, an individual can elect to exclude both an annual amount of foreign earned income and a housing cost amount.[121] The annual amount that is exempt is computed on a daily basis for each day that the individual satisfies the qualifying tests (bona fide foreign resident or physical presence), up to an annual rate of:[122]

Taxable Year	Annual Rate
1982	75,000
1983	80,000
1984	85,000
1985	90,000
1986 and thereafter	95,000

In determining which of the above taxable years certain income belongs (and thus which annual rate applies), it is included in the taxable year in which the services that generated that income were performed, not in the year in which it is received.[123] In addition, the annual exemption does not include amounts received as a pension or an annuity,[124] payments by the United States or one of its agencies to employees of the United States or one of its agencies,[125] amounts included in gross income by reason of I.R.C. section 402(b) (relating to the taxability of a beneficiary of nonexempt trusts) or I.R.C. section 403(c) (relating to the taxability of the beneficiary under a nonqualified annuity),[126] or income

Pennsylvania Avenue, N.W., Washington, D.C. 20220." Rev. Proc. 81-23, 1981-1 C.B. 693.

119. I.R.C. § 911(d)(4)(West 1982) (formerly I.R.C. § 913(j)(4)).

120. I.R.C. § 911(d)(4)(West 1982).

121. I.R.C. § 911(a)(West 1982).

122. I.R.C. § 911(b)(2)(A)(West 1982). For example, suppose John Taxpayer moves overseas on January 1, 1983, and remains overseas until January 31, 1984. It is possible for him to have qualified for the annual exemption either by the bona fide foreign residence or physical presence test. He can exempt $80,000 in 1983 (assuming that he makes that much), and $7,199((31 days + 366 days) x $85,000 annual rate) in 1984.

123. I.R.C. § 911(b)(2)(B)(West 1982).

124. I.R.C. § 911(b)(1)(B)(i)(West 1982) (formerly I.R.C. § 911(c)(5)(A)).

125. I.R.C. § 911(b)(1)(B)(ii)(West 1982). However, some independent contractors and teachers at certain schools for American dependents are not employees of the United States or any of its agencies and are allowed the exclusion. H.R. Rep. No. 215, 97th Cong., 1st Sess. 204, *reprinted in* 1981 U.S. Code Cong. & Ad. News 285, 295.

126. I.R.C. § 911(b)(1)(B)(iii)(West 1982) (formerly I.R.C. § 911(c)(5)(B)).

recieved after the close of the taxable year which followed the taxable year in which the services that generated the income were performed.[127]

The "housing cost amount" exclusion[128] is arrived at by subtracting the base housing amount from the reasonable housing expenses[129] that were paid for or incurred during the taxable year.[130] The base housing amount is the product of sixteen percent of the annual salary paid by the United States government to an employee at step 1 of grade GS-14,[131] multiplied by the number of days in the taxable year which the individual met either the bona fide foreign residence or physical presence test; it is currently $6,059.[132] Reasonable housing expenses include items such as utilities and insurance,[133] but not interest or taxes which can be deducted under separate sections of the tax code.[134] In addition, reasonable housing expenses that are incurred by setting up a separate abode outside of the United States for the taxpayer's spouse and dependents can also be considered in arriving at the "housing cost amount," provided the reason that the spouse and dependents do not reside with the taxpayer is that living conditions at his/her location are "dangerous, unhealthful, or otherwise adverse."[135]

Where the housing costs are paid for by the taxpayer's employer, the "housing cost amount" is excluded from the employee-taxpayer's gross income.[136] Any "housing cost amount" incurred by the taxpayer is allowed as a deduction against gross income,[137] subject to limitations. The deduction cannot exceed the excess of the taxpayer's foreign earned income for the taxable year, less

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127. I.R.C. § 911(b)(1)(B)(iv)(West 1982).

128. I.R.C. § 911(a)(2)(West 1982).

129. "Housing expenses shall not be treated as reasonable to the extent such expenses are lavish or extravagant under the circumstances." I.R.C. § 911(c)(2)(A)(West 1982).

130. I.R.C. § 911(c)(1)(West 1982).

131. The present salary paid under the general schedule, or "GS", at grade GS-14, step 1, is $37,871, which makes the base housing amount $6,059 (16% of 37,871). 5 U.S.C. § 5332 (1980).

132. *Id.*

133. I.R.C. § 911(c)(2)(A)(i)(West 1982).

134. I.R.C. § 911(c)(2)(A)(ii)(West 1982). *See* I.R.C. §§ 163 (West 1982), 164 (West 1982), 216(a)(West 1982).

135. I.R.C. § 911(c)(2)(B)(ii)(West 1982).

136. H.R. REP. No. 215, 97th Cong., 1st Sess. 204, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 285, 294.

137. I.R.C. § 911(c)(3)(A)(West 1982).

the amount of that income which is excluded from gross income by the annual rate.[138] If the "housing cost amount" is larger than the amount allowed as a deduction, the remainder can be carried over to the succeeding tax year.[139] However, in that succeeding tax year the remainder is subject to the same limitation that created it, and any of the remainder that is again not allowed is lost as a deduction.[140]

As mentioned earlier, the above annual amount and "housing cost amount" exclusions are available upon the election of the taxpayer; they are not mandatory. Once an election is made it applies both to the current taxable year as well as to all future years.[141] An election cannot be revoked for the year in which it is first taken, but it can be revoked at any time thereafter.[142] If the revocation is with the consent of the Secretary of the Treasury, the taxpayer is free to once again make an election the following year. In determining whether or not to consent to a revocation, the Secretary can take into account United States residency for a period of several years.[143] If consent is not given, then the taxpayer cannot make another election until the sixth taxable year following the taxable year in which the revocation was made.[144]

An additional exclusion from gross income is available for some meals and lodging. Subsection (c) was added to section 119 to take into account overseas Americans.[145] Currently, a taxpayer abroad can exclude the value of meals and/or mandatory[146] lodging furnished to him, his spouse, and his dependents, where the meals and lodging are furnished by or on behalf of the employer for the employer's convenience, and upon the employer's business premises.[147] If lodging is located in a camp, the camp is considered to be a part of the employer's business premises.[148] A camp[149] consists of lodging which is:

(A) provided by or on behalf of the employer for the convenience of the employer because the place at which such individual renders services is

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138. I.R.C. § 911(c)(3)(B)(West 1982).
139. I.R.C. § 911(c)(3)(C)(West 1982).
140. *Id.*
141. I.R.C. § 911(e)(1)(West 1982).
142. I.R.C. § 911(e)(2)(West 1982).
143. H.R. REP. NO. 215, 97th Cong., 1st Sess. 203, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 285, 293-94.
144. I.R.C. § 911(e)(2)(West 1982).
145. ERTA, Pub. L. No. 97-34, § 113, 95 Stat. 195 (1981)(codified as I.R.C. § 119(c)(West 1982)).
146. "[I]n the case of lodging, the employee is required to accept such lodging . . . as a condition of his employment." I.R.C. § 119(a)(2)(West 1982).
147. I.R.C. § 119(a)(West 1982).
148. I.R.C. § 119(c)(1)(West 1982).
149. This definition of camp is essentially the same as the old one, except that it is no longer required to be "substandard lodging." *See supra* note 73.

in a remote area where satisfactory housing is not available on the open market,
(B) located, as near as practicable, in the vicinity of the place at which such individual renders services, and
(C) furnished in a common area (or enclave) which is not available to the public and which normally accommodates 10 or more employees.[150]

The ERTA made no changes in the treatment of moving expenses under section 217.[151] A taxpayer can deduct some of the reasonable moving expenses incurred in a foreign move to a new principal place of work outside the United States.[152] Reasonable moving expenses include the cost of traveling (including meals and lodging) to and from the area of the new foreign place of work for the principal purpose of searching for a new residence.[153] Also included are the expenses of traveling (including meals and lodging) from the former residence to the new foreign residence,[154] as well as the expense of meals and lodging incurred while residing in temporary living quarters at the foreign place of work during "any period of 90 consecutive days after obtaining employment."[155] In addition, the cost of moving household goods and personal effects either to the new foreign residence,[156] or to and from storage (plus the costs of storing those goods for the entire time, or a portion of the time that the taxpayer continues to work at the new foreign location)[157] are considered moving expenses.[158] The amount that can be deducted for moving expenses is not unlimited, although foreign moves are accorded higher limits than domestic moves. The combined total amount that can be deducted for traveling to the foreign area to search for a new residence and for meals and lodging while in the temporary quarters is $4,500.[159]

150. I.R.C. § 119(c)(2)(West 1982).
151. I.R.C. § 217 (West 1982).
152. I.R.C. § 217(a)(West 1982) and 217(h)(3)(West 1982).
153. I.R.C. § 217(b)(1)(C)(West 1982).
154. I.R.C. § 217(b)(1)(B)(West 1982).
155. I.R.C. §§ 217(b)(1)(D)(West 1982) and 217(h)(1)(A) (West 1982).
156. I.R.C. § 217(b)(1)(A)(West 1982).
157. I.R.C. § 217(h)(2)(West 1982).
158. Reasonable moving expenses also include items "constituting qualified residence sale, purchase, or lease expenses," such as realtor costs and settlements of unexpired leases. I.R.C. §§ 217(b)(1)(E)(West 1982) and 217(b)(2)(West 1982).
159. I.R.C. § 217(h)(1)(B)(West 1982). In addition, the amount of time that is allowed for deducting meals and lodging while residing in temporary quarters is 90 consecutive days for foreign moves as compared to only 30 consecutive days for domestic moves. I.R.C. §§ 217(b)(1)(D)(West 1982) and 217(h)(1)(A)(West 1982).

Except for the modified version[160] of the qualified housing expenses deduction which was adopted into Section 911, the qualified cost-of-living differential, the qualified schooling expenses, the qualified home leave travel expenses, and the qualified hardship area deductions were eliminated with the repeal of section 913.[161] In addition, no deduction or exclusion from gross income is available where the claimed amount was properly allocable or chargeable against amounts excluded from gross income by the annual amount or housing cost amount.[162]

III. THE IMPACT OF THE NEW TAX PROVISIONS

A. *Equity vs. Incentive*

Congress must choose between two basic objectives when formulating tax laws for Americans working abroad, since the same set of laws cannot be used to meet both objectives.[163] One objective is equity, placing Americans working abroad in the same tax position as other employees working in the United States and earning the same salary; the other objective is incentive, placing Americans abroad in the same position as other employees (either host country workers or third country workers) working in the same country and earning the same salary.[164]

In enacting the Foreign Earned Income Act of 1978, Congress chose the equity objective. Congress stated that:

> [B]ecause 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. . . . [C]ertain of an employee'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.[165]

It was believed that the combination of section 911 and the newly created section 913, with its five specific deductions, would

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160. I.R.C. §§ 911(a)(2) (West 1982) and 911(c)(West 1982); *see supra* notes 128-144 and accompanying text.

161. "Section 913 (relating to deductions for certain expenses of living abroad) is hereby repealed." ERTA, Pub. L. No. 97-34, § 112(a), 95 Stat. 194 (1981). These deductions failed to adequately protect Americans from the increased costs incurred in living overseas. *See infra* notes 212, 213 and accompanying text.

162. I.R.C. § 911(d)(6)(West 1982). Included in this "denial of double benefits" is the taking as a credit or deduction an amount paid or accrued as taxes to a foreign country. *Id.*

163. *1981-82 Miscellaneous Tax Bills, IV: Hearings on S. 408, S. 436, S. 598, and S. 867 Before the Subcomm. on Taxation and Debt Management Generally of the Senate Comm. on Finance,* 97th Cong., 1st Sess. 426 (1981) (paper by Dr. Susan Nordhauser and Janet Richmond, University of Texas at San Antonio) [hereinafter cited as *Hearings*].

164. *Id.*

165. H.R. REP. No. 1463, 95th Cong., 2d Sess. 7 (1978) (emphasis added).

accomplish the desired equity.[166] In addition, it was believed that these provisions would encourage Americans to accept employment abroad, which in turn would benefit the United States economy by having these individuals promote the export of American goods and services.[167]

In reality, however, the FEIA did not live up to its expectations and instead has had an extremely detrimental effect on both the United States economy and the number of American expatriates employed abroad. In 1978, the Treasury Department's Office of Tax Analysis projected that a decline of ten percent in the number of United States workers employed abroad would result in a five percent decline in real exports.[168] Chase Econometric Associates, Inc. used this five percent real export reduction projection in a simulation by its United States Econometric Model to determine what the impact would be upon 1980 tax revenues.[169] Chase found that the Federal Government would lose more than $6.1 billion, and the State and local governments $800 million in tax revenues from corporate and personal taxes.[170] In addition, the Federal Government would lose another $300 million in Social Security receipts, with the State and local governments incurring an additional $200 million in unemployment benefits annually caused by some 80,000 persons out of work.[171] The significance of this simulation is underscored by a 1981 General Accounting Office report[172] which stated that the FEIA has caused a twenty percent reduction (compared with only ten percent used in the Treasury Depatment's projection) in the United States expatriate work force.[173] As a result, there was "a reduction in overall tax receipts far greater than the increased taxes paid by overseas

166. *Id.*

167. *Id.*

168. *Taxation of Foreign Earned Income: Hearings on S. 2283, S. 2321, and S. 2418 Before the Subcomm. on Taxation and Debt Management Generally of the Senate Comm. on Finance,* 96th Cong., 2d Sess. 140 (1980) (report by Chase Econometric Associates, Inc.) [hereinafter cited as *Taxation of Foreign Earned Income*].

169. CHASE ECONOMETRIC ASSOCIATES, INC., ECONOMIC IMPACT OF CHANGING TAXATION OF U.S. WORKERS OVERSEAS (June 1980).

170. *Taxation of Foreign Earned Income, supra* note 168, at 146-47.

171. *Id. See also Hearings, supra* note 163, at 67 (testimony of William E. Brock, U.S. Trade Representative).

172. GENERAL ACCOUNTING OFFICE, AMERICAN EMPLOYMENT ABROAD DISCOURAGED BY U.S. INCOME TAX LAWS (Feb. 27, 1981).

173. *Easing tax burdens overseas,* BUS. WK., Apr. 6, 1981, at 70.

workers" under the FEIA.[174]

Congress recognized the failure of the equity approach, and in passing the ERTA, changed taxation objectives[175] from equity to *incentive.*[176] Americans are now encouraged to go abroad and promote the export of United States manufactured goods and services.[177] To accomplish this objective the tax benefits of going abroad have been increased,[178] along with a softening of the qualification requirements so that more persons can obtain the increased benefits.[179] The change to an incentive objective is the key to explaining the liberalization in the tax treatment that has been accorded Americans overseas.

One incentive is the replacement of the limited excess foreign living cost deduction[180] with a flat annual rate exclusion of $75,000, going to $95,000.[181] This exclusion applies to any foreign earned income that an individual receives,[182] and not just to that foreign earned income which applied to one of the specific deductions.[183] In addition, a person can exclude an unlimited amount spent on housing (less the base housing amount of $6,059) so long as it is reasonable.[184] The effect of these two exemptions is illustrated in Appendix One. This Appendix compares the tax treatment under the FEIA and the ERTA of a married American with two children, earning a base salary of $40,000, receiving certain overseas allowances, and employed as either an engineer in Saudi Arabia, a marketing representative in Japan, or a manager in Hong Kong.[185] The amount of the differing figures for each country reflects the various costs that are particular to each country.[186] The gross foreign earned income that is received is $106,368 in Saudi Arabia, $96,010 in Japan, and $83,796 in Hong Kong. Under the FEIA,

174. *Hearings, supra* note 163, at 47 (statement of Hon. Malcolm Baldrige, Secretary of Commerce).

175. *See supra* text accompanying notes 163 and 164.

176. S. Rep. No. 144, 97th Cong., 1st Sess. 36, *reprinted in* 1981 U.S. Code Cong. & Ad. News 191, 228.

177. *Id.*

178. *See infra* notes 181-189 and accompanying text.

179. *See infra* notes 190-200 and accompanying text.

180. *See supra* notes 77-81 and accompanying text.

181. S. Rep. No. 144, 97th Cong., 1st Sess. 37, *reprinted in* 1981 U.S. Code Cong. & Ad. News 105, 143.

182. I.R.C. §§ 911(a)(1)(West 1982) and 911(b)(1)(A)(West 1982).

183. I.R.C. § 913(a)(West 1981) (repealed by ERTA, Pub. L. No. 97-34, § 112(a), 95 Stat. 194 (1981)).

184. *See supra* notes 128-135 and accompanying text.

185. This appendix is based upon the report by Chase Econometric Associates, *supra* notes 169 and 170, at 152-57.

186. Chase extrapolated these amounts from General Accounting Office, Impact on Trade of Changes in Taxation of U.S. Citizens Employed Overseas (1978). *Id.* at 152.

these gross amounts could be reduced by the section 913 deductions down to taxable income amounts of $57,844 in Saudi Arabia, $59,333 in Japan, and $61,428 in Hong Kong.[187] However, under the ERTA, the combination of the annual rate and the housing cost amount totally eliminate all of the Hong Kong workers income from income tax, while excluding all but $7,007 and $3,441 of income from a worker in Saudi Arabia and Japan. But, in the event that a worker is unable to exclude all of his foreign earned income,[188] the amount that is excluded is taken off the top of gross income, so that the remaining income is taxed at a lower marginal rate.[189]

A second incentive to encourage Americans to work abroad is the relaxation of the physical presence qualifying test to 330 days out of any twelve consecutive month period.[190] Under the bona fide foreign resident test[191] a person must be a foreign resident for a period of time which includes an entire taxable year.[192] Thus, it is possible for a person to qualify for the exclusion after only one year, if that person has the good fortune of moving abroad just before January 1, and leaving just after December 31. At the other extreme, a person can move abroad on January second and remain until December thirtieth of the following year, and not qualify. The former physical presence test avoided some of this inequity by setting its qualifying time in the middle of the

187. It should be pointed out that under the foreign tax credit of I.R.C. § 901, income tax that is paid to a foreign country on non-excluded income can be used to offset United States income tax. Thus in a foreign country which has an income tax that is comparable to or higher than the United States tax rate, a person may use the amount of foreign paid income tax to offset any United States income tax liability. However, some countries, such as Saudi Arabia, have no personal income tax, so the foreign tax credit is unavailable.

188. A worker in Saudi Arabia and Japan may still be able to exclude all of his income from tax by using the foreign tax credit, *supra* note 155, § 119 exclusion for meals and lodging provided for the convenience of the employer, *supra* notes 115-20 and accompanying text, and moving expenses, *supra* notes 121-28 and accompanying text.

189. This approach is different from that enacted under the Tax Reform Act of 1976, Pub. L. No. 94-455, § 1011(b)(3), 90 Stat. 1520 (1976), which would have taken the excluded income off the bottom, leaving the remaining income to be taxed at the higher marginal rates. *Supra* notes 58 and 59.

190. I.R.C. § 911(d)(1)(B)(West 1982). For the physical presence test that was replaced by the ERTA, *see supra* notes 33, 34 and accompanying text.

191. *See supra* notes 113, 114 and accompanying text. The bona fide foreign residence test was not changed by the ERTA.

192. I.R.C. § 911(d)(1)(A)(West 1982).

discrepancy.[193] While the majority of taxpayers were able to use the bona fide foreign residence test, over twenty-six percent of the United States expatriates worked for at least seventeen months and yet could only qualify under the physical presence test.[194] The ERTA's new physical presence test has totally eliminated the above inequities between the two tests, because anyone who now qualifies under the bona fide foreign resident test (regardless of the length of time) will have already qualified under the physical presence test. As a result, the total number of people who become eligible to obtain the benefits of section 911 should increase, along with the proportion of those filing under the physical presence test.

There are two final incentives created by the ERTA to encourage more Americans to go abroad. Both of these incentives increase the number of persons who qualify for the exclusions. One incentive is a less restrictive definition of what constitutes a camp. Under the FEIA, a camp had to consist of substandard lodging which was located in a specially designated hardship area, notably where unhealthful conditions or excessive physical hardships existed.[195] The ERTA eliminated both the substandard lodging and hardship area requirements.[196] Today, a camp consists of lodging which is provided to an employee by his employer, located in an enclave which is as near as practicable to the employee's work site.[197] The other incentive allows persons who are paid by the United States Government, but who are not employed by it or any of its agencies, to take the exclusion.[198] Examples of persons in this group are certain overseas independent contractors and teachers at some schools for American dependents[199] who merely receive their paychecks from the United States Government, and are not technically United States Government employees. Under the FEIA, amounts paid by the United States government or any of its agencies could not be ex-

193. A person only had to be overseas for 17 out of 18 consecutive months. *See supra* note 33 and accompanying text.

194. INTERNAL REVENUE SERVICE, STATISTICS OF INCOME 1972-1978, INTERNATIONAL INCOME AND TAXES, FOREIGN INCOME AND TAXES REPORTED ON INDIVIDUAL INCOME TAX RETURNS 24 (1981).

195. *See supra* notes 73 and 74.

196. H.R. REP. NO. 215, 97th Cong., 1st Sess. 205, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 285, 295.

197. I.R.C. § 119(c)(West 1982).

198. I.R.C. § 119(b)(1)(B)(ii)(West 1982); S. REP. NO. 144, 97th Cong., 1st Sess. 37, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 105, 144.

199. H.R. REP. NO. 215, 97th Cong., 1st Sess. 204, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 285, 295.

cluded, regardless of who received the payment.[200]

B. Promotion of Foreign Exports[201]

International trade and exports are very important to the United States economy. Today, one out of every nine Americans can attribute his job to exports by American companies.[202] Furthermore, it has been estimated that a $1 billion increase in exports would create 40,000 new jobs in this country.[203] Yet, despite these facts America's trade deficit for 1981 increased about nine percent to $39.7 billion.[204] In addition, because of the FEIA, the number of Americans overseas has declined by twenty percent, with a resulting decline in United States exports, jobs, and tax revenues.[205]

When a company sends an employee abroad it pays that individual additional compensation such as foreign service premiums, relocation allowances, housing allowances and education allowances.[206] In addition, they also pay for the increased taxes that the employee may face from the additional compensation.[207] The purpose of these payments is to make the employee "whole" as though he had not incurred any additional expenses by moving overseas.[208] Before 1976, employees often wrote off many of these allowances by using a very broad reading of section 119.[209] But in 1976, the Tax Court rendered two decisions[210] which narrowly interpreted section 119. Only meals and lodging given for the employer's convenience, on the employer's premises, and required to be accepted as a condition of employment, could be excluded.

200. I.R.C. § 911(a)(West 1981)(amended by ERTA, Pub. L. No. 97-34, § 111, 95 Stat. 190 (1981)).

201. There are other ways besides taxation in which the United States Government can hinder foreign exports. *See* Q. FLEMING, A GUIDE TO DOING BUSINESS ON THE ARABIAN PENINSULA 96-113 (1981).

202. *Hearings, supra* note 163, at 46 (statement of Senator John H. Chafee).

203. *Id.*

204. Los Angeles Times, Jan 29, 1982, § IV, at 1, col. 4.

205. *See supra* note 173 and accompanying text.

206. Foote, *Compensation Plans for U.S. Expatriates,* 30 TAX EXECUTIVE 245, 247 (1978).

207. *Id.*

208. S. REP. No. 144, 97th Cong., 1st Sess. 36, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 105, 142.

209. *Taxation of Foreign Earned Income, supra* note 168, at 118 (report by Chase Econometric Associates, Inc.).

210. McDonald v. Commissioner, 66 T.C. 223 (1976); Phillip H. Stephens, 45 T.C.M. (P-H) 37 (1976).

This interpretation of section 119 greatly increased the tax liability on overseas workers, and ultimately to the companies who reimbursed their employees.[211]

When Congress enacted the FEIA, it believed that the new specific deductions would adequately protect employees (and thus their companies) from the increased costs encountered in living overseas.[212] In reality, the section 913 deductions proved inadequate to cover the actual increased costs.[213] The difference between the amount that was received by employees as overseas compensation, and the amount which could be deducted, constituted gross income which increased their income taxes and led to a phenomenon known as "tax spiraling."[214] While an employee incurred tax liability in one year, he did not know the exact extent of those taxes until the next year when he filed his return. It was at that time that the company knew how much to reimburse the employee for his increased taxes. The reimbursement payment was not deductable under any of the specific deductions, so it became gross income and increased the employee's tax burden for that second year.[215] Since his gross income for the second year was higher, the third year he would receive a larger reimbursment payment from his company to pay for the increased taxes. The effect of this cycle was that tax liability increased (spiraled) each year, even though salary, overseas allowances, and tax rates remained the same. One estimate of overseas tax spiraling showed that the tax liability of an overseas American earning a base salary of $40,000, and receiving $20,000 in allowances, increased from $11,500 in year one to $21,000 in year four, even though the salary and allowances remained the same.[216]

Increased tax burdens, like any other cost, result in higher prices, lower profits, or both. The FEIA increased the tax costs of sending a worker overseas, which resulted in an increase in the price of American goods and services of between two and ten per-

211. *Taxation of Foreign Earned Income, supra* note 168, at 118 (report by Chase Econometric Associates, Inc.).

212. H.R. REP. No. 1463, 95th Cong., 2d Sess. 7 (1978).

213. *Hearings, supra* note 163, at 80 (statement of Frank C. Conahan, Director, International Division, U.S. General Accounting Office); *See also* GENERAL ACCOUNTING OFFICE, AMERICAN EMPLOYMENT ABROAD DISCOURAGED BY U.S. INCOME TAX LAWS 13-14 (Feb. 27, 1981).

214. *See generally Hearings, supra* note 163, at 271 (statement of Richard M. Hammer, Price Waterhouse & Co.); GENERAL ACCOUNTING OFFICE, AMERICAN EMPLOYMENT ABROAD DISCOURAGED BY U.S. INCOME TAX LAWS 12-13 (Feb. 27, 1981).

215. *See Hearings, supra* note 163, at 80 (statement of Frank C. Conahan, Director, International Division, U.S. General Accounting Office).

216. *Hearings, supra* note 163, at 271 (statement of Richard M. Hammer, Price Waterhouse & Co.).

cent, depending upon the particular good or service.[217] These higher prices caused American firms to lose business by making non-competitive bids,[218] and replace their American employees with less costly foreign employees.[219] The percentage of American citizens employed by United States multinational corporations has decreased from 84 percent and 73 percent in 1972 and 1976, to 37.2 percent in 1980.[220] This decrease in the percentage of Americans employed by United States multinationals adversely effects the United States economy in two ways. First, foreign nationals tend to acquire any items needed by the multinational corporation from their home countries, instead of from the United States, since they are more familiar with those products.[221] Second, those foreign nationals that are hired by the United States firms learn American technology and "know how", and take that knowledge with them when they obtain new jobs, thereby intensifying the foreign competition with American firms.[222]

The new tax treatment by the ERTA should reverse the above-mentioned problems that have been brought about by the FEIA. The annual rate exclusion of $75,000 (for 1982) will cover over ninety percent of the Americans working abroad.[223] This figure moves even higher when the housing cost amount exclusion is added.[224] The savings in income tax that will be realized by taxpayers, both individuals and those companies which reimburse their employees for taxes, is estimated to be between $2,720 billion[225] and $2,820 billion[226] between 1982 and 1986. These tax savings will enable United States companies to lower the prices of their goods

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217. *Taxation of Foreign Earned Income, supra* note 168, at 115 (report by Chase Econometric Associates, Inc.).

218. S. REP. NO. 144, 97th Cong., 1st Sess. 36, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 105, 142.

219. *Hearings, supra* note 163, at 81 (statement of Frank C. Conahan, Director, International Division, United States General Accounting Office).

220. *Hearings, supra* note 163, at 137 (statement of Stephen Van Dyke Baer, Director of International Compensation Research and Development, Organization Resources Counselors, Inc.).

221. S. REP. NO. 144, 97th Cong., 1st Sess. 36, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 105, 142.

222. *Hearings, supra* note 163, at 51 (statement of Hon. Malcolm Baldrige, Secretary of Commerce).

223. *A cut in the cost of expatriate workers,* BUS. WK., Aug. 31, 1981, at 87.

224. *Id.*

225. STAFF OF JOINT COMM. ON TAXATION, 97TH CONG., 1ST SESS., SUMMARY OF H.R. 4242, 58 (Comm. Print 1981).

226. S. REP. NO. 144, 97th Cong., 2d Sess. 19, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 105, 142.

and services in order to effectively compete with their foreign rivals. The tax savings will also reduce the cost of sending many Americans abroad by twenty-five percent.[227] The effect of the tax cost to companies in sending an employee overseas, and the new tax savings brought about by the ERTA, are illustrated in Appendix Two. This Appendix is based upon the figures that were presented in Appendix One,[228] and shows the amount of foreign earned income that is subject to United States income tax by an American worker located in Saudi Arabia, Japan, or Hong Kong, after he has taken either the old FEIA deductions, or the current ERTA exclusions. Had the employee remained in the United States, he would have incurred $9,195 in taxes upon the base salary. Because most companies make their employees "whole" by reimbursing them for any additional taxes that they face from going overseas,[229] any tax amount over $9,195 represents an added cost to a company in sending an employee abroad. This is in addition to the overseas allowances that are also paid to the employee. In Appendix Two, the tax cost faced by a company under the FEIA in sending an employee to Saudi Arabia was $7,561, to Japan $8,217, and to Hong Kong $9,210. However, because the ERTA provides a much greater income exclusion, the company today does not face a tax cost in sending an employee abroad. In fact, because the employee's taxable foreign earned income under the ERTA is less than what his taxable base salary would be if he remained in the United States, he receives a savings in the amount that he has to pay in income taxes. In Appendix Two the savings are $8,732 in Saudi Arabia, $9,190 in Japan, and $9,195 in Hong Kong.[230]

C. *Elimination of Complexity*

A final reason that Congress had for abolishing the FEIA is that its provisions proved to be too complex.[231] An inevitable result of having an equitable objective for tax policy is that the resulting tax laws become very complex in an attempt to tax everyone equally.[232] In the case of the FEIA, it was so complex that the ac-

227. *A cut in the cost of expatriate workers,* BUS WK., Aug. 31, 1981, at 87.

228. *See supra* notes 185-86.

229. *See supra* notes 207, 208 and accompanying text.

230. Companies may take notice of this tax savings to the employee, and accordingly lower the amounts offered to them in the various overseas allowances. Such a reduction could be used by the company to lower the price of its goods and services, thereby making it more competitive in international markets.

231. S. REP. NO. 144, 97th Cong., 2d Sess. 36, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 105, 142.

232. *Tax Simplification: Hearings on S. 1062 and S. 1063 Before the Subcomm. on Taxation and Debt Management Generally of the Senate Comm. on Finance,*

tual amount of the deduction that a person could take varied significantly from case to case, making it very difficult for an individual (or his company if it was going to reimburse him for the additional tax cost) to estimate exactly what his tax liability would be in moving overseas.[233] This complexity also caused problems in each of the specific deductions.

The qualified cost-of-living differential was a flat sum that was determined annually to reflect the difference in living costs between a particular foreign country and the most expensive continental United States city for a family earning a yearly salary of a "GS-14, step 1" employee ($37,871[234]).[235] Because it was a flat sum, a family that earned $35,000 annually received the same deduction as a family earning $350,000 annally, even though the latter family could reasonably be expected to encounter greater foreign living costs. At the same time a family with a yearly income under the GS-14 level received a windfall from the flat amount deduction because it compensated them for a standard of living that they had not enjoyed. Also, because the tables which contained the cost of living deduction amounts were published yearly, they did not accurately reflect the true living costs for countries with high inflation rates.[236] For example, the cost-of-living tables for a family of four residing in the United Kingdom jumped from $300 in 1978, to $4,500 in 1979, and finally to $7,900 in

96th Cong., 1st Sess. 29 (1979) (statement of Hugh Calkins, Tax Section, American Bar Association).

233. S. REP. NO. 144, 97th Cong., 2d Sess. 36, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 105, 142.

234. *See supra* note 131.

235. *See supra* note 77.

236. The inflation rate that some countries have experienced in recent years has been significant:

1980.[237] In addition, the cost-of-living tables were not published until late into the year, so the taxpayer had to estimate what the amount would be, thereby facing possible penalties for insufficient income tax witholding based upon an inaccurate estimate.[238]

The qualified schooling expenses deduction allowed a deduction for the reasonable costs of educating a dependent in the least expensive "United States-type school."[239] A problem was encountered in a city where there was more than one United States-type school. Even though a dependent attended a more expensive United States-type school for good cause (child's friends also attended the school, proximity of school to residence) the taxpayer could only deduct the amount that would have been incurred at the cheaper school. This was also true where a particular school originally was the least expensive, but subsequently raised its prices.[240]

The qualified housing expenses deduction was based upon a very complicated formula, which first required a taxpayer to find

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Country	Average Rate of Inflation (percent)	For the Year(s)
Angola	145	1971-74
Argentina	140-170	1978-79
Brazil	40-120	1978-81
Burma	25	1977
Chile	129	1976-79
Columbia	25.8	1980
El Salvador	30	1980
Ghana	54.4	1979
Iceland	50	1977-81
Israel	40	1976-79
Jamaica	45	1978
Mexico	28	1980
North Yemen	30	1979-80
Peru	62	1976-79
Philippines	24	1979
Portugal	24	1979
Rwanda	20-30	1975-80
Spain	26.4	1977
Turkey	20-25	1975-79
Uganda	50	1973-77
Uruguay	60	1979
Zaire	40	1974

COUNTRIES OF THE WORLD AND THEIR LEADERS YEARBOOK 1982, 213, 220, 224, 304, 313, 352, 379, 454, 516, 578, 613, 636, 767, 891, 899, 914, 933, 1001, 1097, 1103, 1139, 1166, 1189 (1982).

237. GENERAL ACCOUNTING OFFICE, AMERICAN EMPLOYMENT ABROAD DISCOURAGED BY U.S. INCOME TAX LAWS 11 (Feb. 27, 1981).

238. Iredale, *The Foreign Earned Income Act of 1978,* 31 U.S.C. TAX INST. 697, 716 (1979).

239. *See supra* note 79.

240. *See* Comment, *The Taxation of Americans Living Abroad: The Foreign Earned Income Act of 1978 and §§ 911 and 913 of the Internal Revenue Code,* 19 COLUM. J. TRANSNAT'L L. 79, 107 (1981).

the amount of each of the other section 913 deductions before it could be determined.[241] The qualified home leave travel expenses deduction allowed a taxpayer and his dependents residing abroad to deduct the reasonable costs of returning to the United States once every twelve months.[242] Reasonable costs, in the case of air travel, meant the lowest coach or economy fares available, leaving the taxpayer with the burden (in these days of highly competitive fares in the airline industry) of discovering and documenting what the lowest available fare was.[243] Finally, the qualified hardship area deduction was allowed only in areas designated by the Secretary of State where extraordinarily difficult living conditions (unhealthful conditions) or excessive physical hardships existed.[244] Unlike the Secretary of the Treasury or the Internal Revenue Service Commissioner, who would be inclined to consider only the economic effects of making a hardship area determination, the Secretary of State would no doubt consider the political ramifications of declaring a foreign country to be "unhealthful."

A further problem caused by the FEIA's complexity was that individuals and businesses had to hire expensive professionals to prepare their tax returns.[245] The cost to a company to prepare a return for an employee averaged $700 if done in-house, and over $1,100 if the company had to seek outside help.[246] Accounting firms like Arthur Young & Company and Price Waterhouse & Co. each prepare over 10,000 income tax returns a year for overseas Americans.[247] For a taxpayer who did not seek professional help, the risk of making an incorrect tax return was great.[248]

The ERTA has eliminated the complexity of the FEIA by repealing the specific deductions of section 913 and replacing them with two simple exclusions.[249] The annual rate is a flat exclusion

241. *See supra* note 78.

242. *See supra* note 80.

243. Comment, *The Foreign Earned Income Act of 1978: Nonbenefits for Nonresidents*, 13 CORNELL INT'L L.J. 105, 112 (1980).

244. *See supra* note 81.

245. S. REP. No. 144, 97th Cong., 1st Sess. 36, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 105, 142.

246. GENERAL ACCOUNTING OFFICE, AMERICAN EMPLOYMENT ABROAD DISCOURAGED BY U.S. INCOME TAX LAWS 15 (FEB. 27, 1981).

247. *Hearings, supra* note 163, at 246, 256-57 (statements of Robert H. Castles, Director of Expatriate Services, Arthur Young & Company, and Richard M. Hammer, Price Waterhouse & Co.).

248. *Hearings, supra* note 163, at 86 (statement of Frank C. Conahan, Director, International Division, U.S. General Accounting Office).

249. *See supra* notes 104-109 and accompanying text.

which applies to all of an individual's earned income, and not just to certain amounts in specific categories. In addition, the exact amount available under the annual rate is already known through 1986.[250] The housing cost amount is equally simple, excluding all of the reasonable housing expenses over $6,059.[251] The simplicity and certainty of these two exclusions will allow both business and individuals to make a careful examination of the costs and benefits involved in going abroad. It should also allow them to save much of the costs of having to use professional help in filing income tax returns.

IV. CONCLUSION

The tax treatment of foreign earned income has changed many times during the past half century while Congress pursued many different goals and policies. In attempting to tax overseas Americans the same as those similarly situated in the United States, the FEIA created major problems. The five specific deductions of section 913 fell far short of their intended result of protecting an individual from the excess costs encountered in living overseas. This lack of protection increased the expenses of sending Americans abroad, resulting in a loss of exports as the price of American goods and services rose to uncompetitive levels. The number of Americans abroad decreased by twenty percent, and those who remained overseas were forced to seek costly professional help in preparing their tax returns.

With the current objective of expatriate tax treatment now being to act as an incentive to encourage Americans to go abroad, the ERTA's provisions seem well suited to accomplish the goal. The limited and ineffective deductions of section 913 have been replaced with new major exclusions covering $75,000 (increasing yearly) plus excess housing costs, which will protect more than ninety percent of those abroad. In addition to the increase in the amount that can be excluded, the number of persons that can take advantage of the new exclusions has also increased. Appendix Two demonstrates how the exculsions will greatly increase the benefits to an individual and/or reduce the cost to a company in going abroad. The resulting decrease in prices will allow United States goods and services to effectively compete in the international market, stimulating exports and creating new domestic jobs. The simplicity of the new law also allows individuals and companies to calculate ahead of time, and with certainty, the possible gains to be obtained in going overseas. With the enactment

250. *See supra* note 122 and accompanying text.
251. *See supra* notes 128-132 and accompanying text.

of the Economic Recovery Tax Act of 1981, the time has truly come to "Go Abroad, young man, go Abroad."

SHELDON J. FLEMING

APPENDIX ONE

	Engineer in Saudi Arabia		Marketing Representative in Japan		Manager in Hong Kong	
	FEIA	ERTA	FEIA	ERTA	FEIA	ERTA
Base Salary	40,000	40,000	40,000	40,000	40,000	40,000
Allowances given to entice employee to accept overseas employment:						
Housing	30,420	30,420	23,628	23,628	20,268	20,268
Overseas Premium	6,000	6,000	6,000	6,000	6,000	6,000
Education	10,740	10,740	6,290	6,290	4,968	4,968
Home Leave	5,304	5,304	5,448	5,448	6,680	6,680
Cost of Living	5,904	5,904	14,644	14,644	5,880	5,880
Hardship	8,000	8,000	0	0	0	0
Foreign Earned Income	106,368	106,368	96,010	96,010	83,796	83,796
Less:						
911 Exclusions:						
Annual Rate (for 1982)	—	75,000	—	75,000	—	75,000
Housing Cost Amount	—	24,361	—	17,569	—	8,796
913 Deductions:						
Qualified cost-of-living differential	6,700	—	11,200	—	800	—
Qualified housing expenses	20,780	—	13,739	—	9,920	—
Qualified schooling expenses	10,740	—	6,290	—	4,968	—
Qualified home leave travel expenses	5,304	—	5,448	—	6,680	—
Qualified hardship area deduction	5,000	—	0	—	0	—
Taxable Foreign Earned Income	57,844	7,007	59,333	3,441	61,428	0

APPENDIX TWO[1]

	Engineer in Saudi Arabia		Marketing Representative in Japan		Manager in Hong Kong	
	FEIA	ERTA	FEIA	ERTA	FEIA	ERTA
Base Salary	40,000	40,000	40,000	40,000	40,000	40,000
Total Overseas Allowances	66,368	66,368	56,010	56,010	43,796	43,796
Foreign Earned Income	106,368	106,368	96,010	96,010	83,796	83,796
Less:						
Total 911 Exclusions	—	99,361	—	92,569	—	83,796
Total 913 Deductions	48,524	—	36,677	—	22,368	—
Taxable Foreign Earned Income[2]	57,844	7,007	59,333	3,441	61,428	0
Tax on Taxable Foreign Earned Income[3]	16,756	463	17,412	5	18,405	0
Less Tax on Base Salary	9,195	9,195	9,195	9,195	9,195	9,195
Tax Cost of Sending an Employee Overseas[4]	7,561	—	8,217	—	9,210	—
Tax Savings of Going Overseas	—	8,732	—	9,190	—	9,195

1. This exhibit is based upon the data presented in Appendix One.
2. This figure does not consider other exclusions or deductions which may be available, such as the foreign tax credit, meals or lodging provided for the convenience of the employer, or moving expenses.
3. Taxes are computed according to the schedule found in I.R.C. § 1(a) for tax year 1982.
4. Assumes that employee is reimbursed by his company for the additional tax liability incurred by going abroad.