JOHN L. GORNALL, JR.
ARNOLD E. RUBINOFF*

Practical Guidelines under the Economic Recovery Tax Act of 1981 Regarding the Taxation of U.S. Citizens and Resident Aliens Employed in a Foreign Country

Under the recently enacted Economic Recovery Tax Act of 1981 (the Act), (i) a U.S. citizen who is a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year,[1] or (ii) a U.S. citizen or resident who has been physically present in a foreign country or countries for 330 full days out of a period of twelve consecutive months,[2] may elect to exclude $75,000 of "foreign earned income" in the 1982 tax year.[3] This amount will be increased $5,000 per year over the next four years to $95,000 in the 1986 tax year.[4] In addition to the foreign earned income exclusion, the Act permits either an exclusion or deduction for a portion of housing costs incurred by or on behalf of an individual,[5] including those incurred on behalf of his spouse and dependents provided they reside with him, in each tax year.[6] It is important for an employer to understand the mechanics of the excess housing cost amount exclusion or deduction in order to utilize it as a planning device in classifying amounts paid to an employee as salary or housing allowance.

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*Messrs. Gornall and Rubinoff practice law in Atlanta.
[1]I.R.C. § 911(d)(1)(A) (1954).
[2]I.R.C. § 911(d)(1)(B) (1954) (West Supp. 1982).
[3]I.R.C. § 911(b)(2)(A) (1954).
[4]*Id.*
[5]I.R.C. § 911(a)(2) (1954).
[6]I.R.C. § 911(c)(2)(A) (1954).

The Foreign Earned Income Exclusion

"Foreign earned income" is the amount received by an individual from sources within a foreign country or countries which constitutes earned income attributable to labor or personal services performed outside the United States by such individual during a period described in subparagraph (i) or (ii) above.[7] Therefore, an individual's salary for services performed while in a foreign country will qualify as earned income from sources within a foreign country.[8]

In order to be considered a bona fide resident of a foreign country for purposes of the Act, a U.S. citizen must establish that he has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year.[9] This one-year period of foreign residence does not commence to run until the U.S. citizen has gone ashore in a foreign country.[10] The burden of proof is thus on the U.S. citizen claiming the foreign earned income exclusion to show that he is a bona fide resident of a foreign country or countries for the requisite period.[11] The question of whether a U.S. citizen has established a bona fide residence in a foreign country is a question of fact[12] which is determined based upon various factors such as time spent abroad, family life, social activities, foreign languages, local credit, purchasing a home or entering into a long-term lease of an apartment, etc.[13]

Since most employment assignments are such that an individual will not be stationed in a foreign country until after January 1 of a given year, thus eliminating the possibility of being in a foreign country for the entire taxable year, most individuals will attempt to qualify for the foreign earned income exclusion through the physical presence test described in subparagraph (ii) above.[14] It is thus imperative that an individual strictly adhere to

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[7]I.R.C. § 911(b)(1)(A) (1954).

[8]*Id.*

[9]I.R.C. § 911(d)(1)(A) (1954).

[10]*See J. Gerber Hootner*, 7 T.C. 1136 (1946), *aff'd sub. nom.*, Downs v. Commissioner, 166 F.2d 504 (9th Cir. 1948), *cert. denied*, 334 U.S. 832 (1948), 68 S. Ct. 1346, *reh. denied*, 335 U.S. 837 (1948), 69 S. Ct. 14.

[11]I.T. 3642, 1944 C.B. 262.

[12]*Donald H. Nelson*, 30 T.C. 1151 (1958).

[13]*See* I.R.C. Regs. § 1.871-2-1.871-4 (1954) (T.D. 6258 republished T.D. 6500) for definition of residence. Treas. Reg. § 1.911-2(a)(2) states that "[w]hether the individual citizen of the United States is a bona fide resident of a foreign country shall be determined by the application, to the extent feasible, of the principles of section 871 and the regulations thereunder, relating to what constitutes residence or nonresidence, as the case may be, in the United States in the case of an alien individual." *See William E. Adams* 46 T.C. 352 (1960) (residence determined on basis of acquisition of an abode, children enrolled in public school, U.S. address used on banking and legal documents, U.S. registration of car and involvement in local charities and business investments). *See also* Rev. Rul. 81-70, 1981-1 C.B. 389 (residence determined on basis of acquisition of an abode, children enrolled in public schools and involvement in local civic and professional associations).

[14]I.R.C. § 911(d)(1)(B) (1954).

the number of days which he must be physically present in a foreign country or countries.[15]

The following analysis as to days which count toward being physically present in a foreign country or countries is based upon the assumption that the Act will adopt the Treasury Regulations and Revenue Rulings as they applied to the foreign earned income exclusion which existed prior to its repeal by the Foreign Earned Income Act of 1978.[16] (The language of the foreign earned income exclusion which existed prior to the Foreign Earned Income Act of 1978 is quite similar to the language contained in the Act except the pre-1978 exclusion required physical presence in a foreign country or countries for 510 full days in an eighteen month period.)[17]

The term "full day" as used in the physical presence test means a continuous period of twenty-four hours commencing at midnight and ending the following midnight.[18] For the purpose of computing the minimum of 330 full days of presence in a foreign country or countries, all separate periods of such presence during the period of twelve consecutive months are to be aggregated.[19] If in departing from the United States or one of its possessions by airplane, an individual travels over a foreign country before midnight of any day and thereafter does not pass over or travel through the United States or one of its possessions, such individual's first full day starts the day following the day of departure from the United States even though he does not arrive in the country of destination until after midnight of the second day.[20] The U.S. citizen is considered as being "physically present in a foreign country" when the aircraft in which he is traveling passes over the first foreign country.[21]

Example: An individual leaves Atlanta by airplane at 2:00 P.M. on September 14 en route to country *A*. His airplane passes over country *B* at 11:00 P.M. on the same day. He arrives in country *A* at 8:00 A.M. on September 16. His first full day is September 15.[22]

If an individual travels over a route (a portion of which is not within any country) en route from one place in a foreign country to another place in the same country, or to a place in another foreign country, and if such travel not within any country extends over a period of less than twenty-four hours and does not involve travel within the United States or any of its possessions, such individual shall not be deemed outside a foreign country

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[15] *Id.*

[16] *See, e.g.*, Treas. Reg. §§ 1.911-1, 1.911-2, T.D. 6249, 1957-2 C.B. 436-45; T.D. 6426, 1959-2 C.B. 90-91; *republished in* T.D. 6500 (not published in Cumulative Bulletin); T.D. 6665, 1963-2 C.B. 27, 30-41 (issued pursuant to the former I.R.C. § 911 (1954) *repealed in* 1978).

[17] *Compare* former I.R.C. § 911(a)(2) (1954), *repealed in* 1978, *with* I.R.C. § 911(d)(1)(B) (1954).

[18] Treas. Reg. § 1.911-1(b)(10), issued pursuant to former I.R.C. § 911 (1954), *repealed in* 1978.

[19] *Id.*

[20] Rev. Rul. 58-233, 1958-1 C.B. 271 (decided under the old 510 days rule contained in former I.R.C. § 911 (1954), *repealed in* 1978).

[21] *Id.*

[22] *Id.*

during the period of such travel.[23] However, while the air space over a foreign country is part of that country, international waters are not part of a foreign country.[24] Thus, days are lost when traveling by ship between two foreign countries or between two cities in the same foreign country if the travel extends over a period of more than twenty-four hours.[25]

> For example, a citizen of the United States, privately employed, departs by aircraft from Tokyo, Japan, at 11 P.M. on July 23 and arrives in Manila, Philippines, at 8 A.M. on the following morning. The citizen, for the purpose of section 911(a)(2) of the 1954 Code, will not be deemed outside a foreign country during the period of travel from Tokyo to Manila, inasmuch as such period of travel is less than 24 hours. On the other hand, if a privately employed citizen of the United States departs by vessel from Genoa, Italy, on August 20 and arrives in Naples, Italy, on August 22, the citizen, for the purpose of section 911(a)(2) of the 1954 Code, will be deemed outside a foreign country for a period of three days from August 20 to August 22.[26]

It is important to note that earned income from sources without the United States attributable to any period of twelve consecutive months qualifies for exclusion provided the individual spends 330 full days of that period in a foreign country or countries.[27]

> *Example*: If an individual spends 330 full days of the twelve month period commencing April 1, 1982 and ending March 31, 1983 in a foreign country or countries, then he may exclude in the 1982 tax year the foreign earned income (subject to the applicable dollar limitation) which he received from April 1, 1982 through December 31, 1982. Additionally, such individual may exclude in the 1983 tax year the foreign earned income (subject to the applicable dollar limitation) which he received from January 1, 1983 through March 31, 1983.[28]

Furthermore, the twelve consecutive month period may be part of a longer period of presence in a foreign country.[29] Accordingly, an individual can select the date on which he begins and ends his twelve month period, subject only to the requirement that he have spent 330 full days in one or more foreign countries within that period.[30] The law does not require that the first day or the last day in a foreign country be the first or the last day of the twelve month period.[31] Nor does the law require that the

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[23]Treas. Reg. § 1.911-1(b)(1), issued pursuant to former I.R.C. § 911 (1954), *repealed in* 1978.

[24]Rev. Rul. 55-171, 1955-1 C.B. 80, 85; Rev. Rul. 58-4, 1958-1 C.B. 268, 270 (decided under the old 510 days rule contained in former I.R.C. § 911 (1954), *repealed in* 1978).

[25]Rev. Rul. 55-171, *supra* note 24, at 85.

[26]*Id.*

[27]I.R.C. § 911(b)(1)(A) (1954); Treas. Reg. § 1.911-1(b)(8); issued pursuant to former I.R.C. § 911 (1954), *repealed in* 1978.

[28]*See e.g.* Treas. Reg. § 1.911-2(b)(2)(i), issued pursuant to former I.R.C. § 911 (1954), *repealed in* 1978.

[29]Treas. Reg. § 1.911-1(b)(9), issued pursuant to former I.R.C. § 911 (1954), *repealed in* 1978; Rev. Rul. 55-171, 1955-1 C.B. 80, 85.

[30]*Id.*

[31]*Id.*

twelve month period commence with the beginning of any specific month or any specific day of any month.[32]

Example: An individual who arrives in a foreign country on January 1, 1982 and finally departs therefrom on June 30, 1983, may not be present in such foreign country for 330 full days during the twelve month period commencing with January 1, 1982 and ending with December 31, 1982, because of his visits to the United States during such period. However, he may satisfy the 330 full day requirement during the twelve month period commencing with April 15, 1982, and ending with April 14, 1983. In such event, the foreign earned income exclusion will apply to income attributable to the period from April 15, 1982 through April 14, 1983, but not to income attributable to the remainder of the time the individual was in the foreign country.[33]

It is additionally possible for two separate twelve month periods to overlap and for an individual to qualify for tax exemption with respect to both twelve month periods.[34]

Example: An individual is present in a foreign country for a period of eighteen consecutive months from January 1, 1982, through June 30, 1983. He satisfies the 330 full day requirement with respect to the period commencing January 1, 1982 and ending with December 31, 1982 and elects to exclude his foreign earned income (subject to the applicable dollar limitation) attributable to such twelve month period. If he is able to satisfy the 330 full day requirement with respect to the period commencing July 1, 1982 and ending June 30, 1983, he may additionally exclude his foreign earned income (subject to the applicable dollar limitation) attributable to the period of January 1, 1983 through June 30, 1983, even though the months of July 1982 through December 1982 had been used to satisfy the 330 full day requirement with respect to the twelve month period commencing January 1, 1982 and ending with December 31, 1982.[35]

However, the mere fact that the 330 full day requirement has been satisfied with respect to a twelve month period, does not mean that income earned thereafter will be excluded under the earned income exclusion allowed by the physical presence test unless such income is attributable to another twelve month period during which there is compliance with the 330 full day requirement.[36] Thus, the 330 full day requirement cannot be prorated over less than a twelve month period in order to determine whether the earned income exclusion allowed by the physical presence test applies to income

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[32]*Id.*

[33]Treas. Reg. § 1.911-1(b)(9), issued pursuant to former I.R.C. § 911 (1954), *repealed in* 1978.

[34]Rev. Rul. 55-171, *supra* note 24, at 85.

[35]Treas. Reg. § 1.911-1(b)(11) example (2), issued pursuant to former I.R.C. § 911 (1954), *repealed in* 1978.

[36]Treas. Reg. § 1.911-1(b)(9), issued pursuant to former I.R.C. § 911 (1954), *repealed in* 1978.

attributable to such less than twelve month period.[37]

Example: An individual is present in a foreign country for a period of eighteen consecutive months from January 1, 1982 through June 30, 1983. He satisfies the 330 full day requirement with respect to the period commencing January 1, 1982 and ending with December 31, 1982. If he is unable to satisfy the 330 full day requirement with respect to the period commencing July 1, 1982 and ending June 30, 1983, the 330 full day requirement cannot be prorated over the six month period commencing with January 1, 1983 and ending with June 30, 1983, in order to determine whether the foreign earned income exclusion applies to income attributable to such six month period. Therefore, assuming the individual is present in the foreign country 165 full days (½ of 330 full days) during the six month period (½ of twelve consecutive months), the foreign earned income exclusion will not be applicable to income attributable to any part of such six month period if no part thereof is included in any twelve month period during which the 330 full day requirement is satisfied.[38]

If the 330 full day requirement is satisfied with respect to a twelve consecutive month period which encompasses two taxable years, the amount which may be excluded under the foreign earned income exclusion for each such taxable year shall not exceed an amount which bears the same ratio to the maximum amount excludable for an entire taxable year (i.e., $75,000 in the 1982 tax year) as the number of days in the part of the taxable year within the twelve month period bears to the total number of days in such year.[39]

Example: An individual who files his return for the calendar year using a cash receipts and disbursements method is present in a foreign country from April 1, 1982 through March 31, 1983, and satisfies the 330 full day requirement with respect to such twelve consecutive month period. He received $100,000 of foreign earned income from April 1, 1982 through December 31, 1982, and $35,000 of foreign earned income from January 1, 1983 through March 31, 1983.

The amount excludable by the individual in the 1982 tax year is computed as follows:

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[37] *Id.*

[38] *Id.*

[39] Treas. Reg. § 1.911-2(b)(2), issued pursuant to former I.R.C. § 911 (1954), *repealed in* 1978.

Number of days in that part of the taxable year falling within the twelve month period / Number of days in the taxable year	×	$75,000.00 (Maximum amount excludable for the entire 1982 tax year under the foreign earned income exclusion)
	or	
275/365 (Number of days falling within April 1, 1982 through December 31, 1982)	×	$75,000.00 = $56,506.85

Thus, of the $100,000 of foreign earned income received by the individual in the 1982 tax year, he may elect to exclude $56,506.85 under the foreign earned income exclusion.[40]

The amount of excludable by the individual in the 1983 tax year is computed as follows:

90/365 (Number of days falling within January 1, 1983 through March 31, 1983)	×	$80,000 (Maximum amount excludable for the entire 1983 tax year under the foreign earned income exclusion) = $19,726.03

Thus, of the $35,000 of foreign earned income received by the individual in the 1983 tax year, he may elect to exclude $19,726.03 under the foreign earned income exclusion.[41]

Additionally, under the Act, to receive the foreign earned income exclusion one must affirmatively elect to do so.[42] Once made, the election remains in effect for that year and all subsequent years.[43] One may revoke the election; however, if the election is revoked without the consent of the Internal Revenue Service, one may not again elect to exclude income earned abroad until the sixth taxable year following the year for which revocation was made.[44] It should be further noted that once an individual returns to the United States after such an election has been made, the election remains in force.[45] This means that if such individual again establishes residence abroad, he can exclude income earned abroad pursuant to the earlier election.[46]

It is important to understand the ramifications of electing to receive the tax benefits of the foreign earned income exclusion since, in general, tax

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[40]Treas. Reg. § 1.911-1(b)(2)(ii), issued pursuant to former I.R.C. § 911 (1954), *repealed in* 1978.

[41]*Id.*

[42]I.R.C. § 911(a) (1954).

[43]I.R.C. § 911(e)(1) (1954).

[44]I.R.C. § 911(e)(2) (1954).

[45]H.R. REP. NO. 215, 97th Cong., 1st Sess. 203, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 293.

[46]*Id.*

savings under the foreign earned income exclusion will be greatest for highly compensated taxpayers located in low-tax rate countries.[47] There will be little or no tax saving for taxpayers subject to local tax in high-tax rate countries since the U.S. credit for foreign taxes would normally eliminate any U.S. tax liability.[48] Accordingly, if an individual is subsequently assigned to another foreign country, his prior decision to elect to exclude foreign earned income may not afford him the most favorable tax treatment.[49]

The Excess Housing Cost Amount Exclusion or Deduction

Under general U.S. income tax concepts a housing allowance provided by an employer is taxable income to the employee.[50] In order to further assist individuals employed in foreign countries, in addition to the foreign earned income exclusion, the Act, while repealing the variety of deductions for living abroad which were enacted by the Foreign Earned Income Act of 1978, permits either an exclusion or deduction for excess housing costs.[51] Like the foreign earned income exclusion, a taxpayer must affirmatively elect to receive the tax benefits of the excess housing cost amount exclusion or deduction.[52] The foreign earned income exclusion and the excess housing cost amount exclusion or deduction may be elected separately or together.[53] The rules set out in this letter with regard to revocation by a taxpayer of the foreign earned income exclusion apply equally to revocation of the excess housing cost amount exclusion or deduction.[54]

The excess housing cost amount exclusion or deduction permits an individual to elect to exclude from his taxable income a portion of a housing allowance provided by his employer[55] or, if no housing allowance is provided by his employer, to elect to deduct a portion of the amount which he pays for housing.[56] In the case of a housing allowance provided by an employer, the portion of income which an employee is permitted to exclude

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[47]A U.S. citizen or resident employed in a foreign country which imposes a high income tax will not benefit greatly from the foreign earned income exclusion because of the income taxes which he pays to the foreign country. Subject to certain limitations, such individual will receive a tax credit pursuant to I.R.C. § 901 (1954) *et seq*. to the extent of the income taxes paid to the foreign country.

[48]I.R.C. § 901 (1954) *et seq*.

[49]*Id*.

[50]*See* I.R.C. § 61 (1954); Treas. Reg. §§ 1.61-1(a), 1.61-2(d)(3).

[51]I.R.C. § 911(a)(2) (1954); § 911(c).

[52]I.R.C. § 911(a)(2) (1954). Although the excess housing cost amount deduction is not income exempt from taxation like the excess housing cost amount exclusion but rather a deduction allowable in computing adjusted gross income, it appears that an election must be made to receive the benefits of the excess housing cost amount deduction. *See* Economic Recovery Tax Act of 1981 General Explanation Prepared by the Joint Committee on Taxation at p.45.

[53]I.R.C. § 911(a) (1954).

[54]I.R.C. § 911(e)(2) (1954).

[55]I.R.C. § 911(c)(2) (1954); § 911(c)(3)(D).

[56]I.R.C. § 911(c)(3) (1954).

by virtue of the excess housing cost amount exclusion is subject to a single limitation.[57] In comparison, in the case of housing costs not attributable to employer provided amounts, there are two limitations which control the amount of housing costs which may be deducted by virtue of the excess housing cost amount deduction.[58]

The first limitation, which applies equally to a housing allowance provided by an employer and to housing costs not attributable to employer provided amounts, is that the excess housing cost amount exclusion or deduction is limited to an amount equal to the excess reasonable housing expenses of an individual, including those incurred on behalf of his spouse and dependents provided they reside with him, over a base housing amount.[59] The second limitation, which applies only to housing costs not attributable to employer provided amounts, is that "Excess Housing Cost Amounts," as hereinbelow defined, are allowed as a deduction in computing adjusted gross income of an individual to the extent the foreign earned income of the individual is not otherwise excluded from gross income under the foreign earned income exclusion.[60]

Under the Act, the base housing amount is equal to 16 percent of the salary of an employee of the United States whose salary grade is step one of grade GS-14.[61] Consequently, the base housing amount at present would be 16 percent of $39,689 or $6,350.24.[62] Any reasonable housing expenses in excess of this amount (the "Excess Housing Cost Amount") may therefore either give rise to an exclusion or a deduction depending upon who paid the housing costs.[63]

Housing expenses include such expenses as rent, utilities, and insurance, but do not include interest and taxes.[64] However, interest and taxes may be eligible for deduction separately.[65] Housing expenses will not be treated as reasonable to the extent that such expenses are lavish or extravagant under the circumstances.[66]

It is apparent that in the case of an individual whose foreign earned income will not exceed $75,000 in the 1982 tax year, housing costs not attributable to employer provided amounts will not benefit from the housing cost amount deduction, assuming such individual elects and then excludes the full amount of the foreign earned income under the foreign

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[57] I.R.C. § 911(c)(1) (1954).
[58] I.R.C. § 911(c)(1) (1954); § 911(c)(3)(B).
[59] I.R.C. § 911(c)(1), (2) (1954); § 911(c)(2).
[60] I.R.C. § 911(c)(3)(B) (1954).
[61] I.R.C. § 911(c)(1)(B)(i) (1954).
[62] Exec. Order No. 12, 248, 3 C.F.R. 289-91, (1982), *superseded by*, Exec. Order No. 12, 330, *reprinted in* 5 U.S.C. § 5332 (West Supp. 1982) (the current rate for Step 1 of grade GS-14 is $39,689); H.R. REP. NO. 215, *supra* note 44, at 204, U.S. CODE CONG. & AD. NEWS, at 294; S. REP. NO. 144, *supra* note 46, at 37 CONG. & AD. NEWS, at 143.
[63] *Compare* I.R.C. § 911(c)(1) (1954) *with* I.R.C. § 911(c)(3)(A) (1954).
[64] I.R.C. § 911(c)(2)(A)(i) (1954); I.R.C. § 911(c)(2)(A)(ii) (1954).
[65] I.R.C. § 163 (1954) and § 164.
[66] I.R.C. § 911(c)(2)(A) (1954).

earned income exclusion.[67] This result occurs because housing costs not attributable to employer provided amounts are allowed as a deduction in computing adjusted gross income of an individual only to the extent the foreign earned income of the individual is not otherwise excluded from gross income under the foreign earned income exclusion.[68]

In comparison, a housing allowance provided by an employer will benefit from the housing cost amount exclusion, to the extent such housing allowance exceeds the base housing amount (presently $6,350.24), even if the employee's foreign earned income will not exceed $75,000 in the 1982 tax year.[69] While the employee with less than $75,000 of foreign earned income in the 1982 tax year may theoretically benefit from the housing cost amount exclusion, the employee will not benefit from the housing cost amount exclusion unless his employer provides him with a housing allowance in excess of $6,350.24 and then only to the extent the housing allowance exceeds $6,350.24.[70]

As mentioned above, to the extent the Excess Housing Cost Amount of an individual for any taxable year is not attributable to employer provided amounts, such amount will be treated as an allowable deduction to the extent that the foreign earned income of the individual for the taxable year exceeds the amount of foreign earned income excluded from such individual's gross income for the taxable year by virtue of the foreign earned income exclusion.[71]

Example: If an individual, whose housing costs are not attributable to employer provided amounts, has foreign earned income in the 1982 tax year of $100,000 and qualifying housing expenses in excess of the base housing amount of $20,000, the individual may elect and then exclude $75,000 under the foreign earned income exclusion plus deduct $20,000 for the excess housing cost amount deduction.[72]

Example: The facts are the same as in the previous example, except that the individual has foreign earned income in the 1982 tax year of $90,000. In this situation if the individual elects and then excludes $75,000 under the foreign earned income exclusion, he may only deduct $15,000 ($90,000 less $75,000) for the excess housing cost amount deduction since the foreign earned income of the individual in the 1982 tax year exceeded the amount of foreign earned income excluded from such individual's gross income in the 1982 tax year by only $15,000.[73]

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[67] I.R.C. § 911(c)(3)(A) (1954) and § 911(c)(3)(B).

[68] *Id.*

[69] *Compare* I.R.C. § 911(a)(2) (1954) and § 911(c)(1) *with* I.R.C. § 911(c)(3)(A) (1954) and § 911(c)(3)(B).

[70] *Id.*

[71] I.R.C. § 911(c)(3)(B) (1954).

[72] I.R.C. § 911(c)(3)(A) (1954) and § 911(c)(3)(B); *see* § 911(b)(2).

[73] *Id.*

The Act does, however, provide for a special carryover rule with respect to the portion of the Excess Housing Cost Amount which is not deductible by reason of the income limitation.[74] The special carryover rule allows an individual to deduct all or a portion of the unused Excess Housing Cost Amount in the next taxable year.[75] The unused Excess Housing Cost Amount may be carried forward only to the next taxable year, subject, however, to the income limitations in that year.[76] To calculate whether or not an individual's carry forward Excess Housing Cost Amount may be used, the Excess Housing Cost Amount for that current year must be deductible in full.[77]

Example: An individual, whose housing costs are not attributable to employer provided amounts, has foreign earned income in the 1982 tax year of $75,000 and qualifying housing expenses in excess of the base housing amount of $20,000. The individual elects and then excludes the $75,000 under the foreign earned income exclusion, however, since there is no foreign earned income in excess of the amount of foreign earned income excluded under the foreign earned income exclusion, the individual will have $20,000 of Excess Housing Cost Amount which is not deductible by reason of the income limitation. The individual may deduct all or a portion of the $20,000 in the 1983 tax year subject, however, to (i) the income limitation in the 1983 tax year, and (ii) the rule that the Excess Housing Cost Amount for the 1983 tax year must be deductible in full.[78]

Example: The facts are the same as in the previous Example. The individual additionally has foreign earned income in the 1983 tax year of $100,000 and qualifying housing expenses in excess of the base housing amount of $5,000. The individual elects and then excludes $80,000 under the foreign earned income exclusion for the 1983 tax year. In order to carryover and deduct the unused Excess Housing Cost Amount from the 1982 tax year $20,000) the individual must first deduct in full the Excess Housing Cost Amount for the 1983 tax year ($5,000). Since the individual had $100,000 of foreign earned income and elected to exclude $80,000 under the foreign earned income exclusion, $20,000 of foreign earned income is available against which the Excess Housing Cost Amount can be deducted. Thus, first, the Excess Housing Cost Amount for the 1983 tax year ($5,000) must be deducted from the $20,000 if the individual wants to carryover the unused Excess Housing Cost Amount from the 1982 tax year. This leaves $15,000 ($20,000 less $5,000) from which the unused Excess Housing Cost Amount from the 1982 tax year ($20,000) can be deducted and, therefore, only $15,000 of the $20,000 unused

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[74] I.R.C. § 911(c)(3)(C) (1954).
[75] *Id.*
[76] I.R.C. § 911(c)(3)(C)(ii) (1954).
[77] *Id.*
[78] *Id.*

Excess Housing Cost Amount from the 1982 tax year can carryover and be deducted in the 1983 tax year. The $5,000 of the unused Excess Housing Cost Amount from the 1982 tax year which could not carryover and be deducted in the 1983 tax year is lost forever and cannot be deducted in the 1984 tax year.[79]

The rules set forth in this article apply to taxable years beginning after December 31, 1981.[80] They should be reviewed, not only by individuals planning to be employed in a foreign country, but additionally by employers anticipating sending an employee to a foreign country, since an employer may want to consider the tax dollar savings to be realized by an employee by virtue of the foreign earned income exclusion in determining the cost of living index differential the employer plans to pay the employee while he is stationed in the foreign country.

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[79] I.R.C. § 911(c)(3)(C)(i) (1954) and § 911(c)(3)(C)(ii).
[80] I.R.C. § 911 (1954) (note).