Calendar No. 681

95TH CONGRESS 2d Session } SENATE { REPORT No. 95-746

TAX TREATMENT EXTENSION ACT OF 1978

REPORT

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ON

H.R. 9251

APRIL 19 (legislative day, FEBRUARY 6), 1978.—Ordered to be printed

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Mr. LONG, from the Committee on Finance,
submitted the following

REPORT

[To accompany H.R. 9251]

The Committee on Finance, to which was referred the bill (H.R. 9251) relating to extensions of time for the tax treatment of certain items, having considered the same, reports favorably thereon with amendments and recommends that the bill as amended do pass.

The amendments are shown in the text of the bill in italic.

I. SUMMARY

The bill, as amended, extends the effective date of several provisions dealt with in the Tax Reform Act of 1976 and generally prohibits the Treasury Department (Internal Revenue Service) from issuing certain rulings or regulations effective prior to specific dates in 1978.

The effective dates of the following provisions are extended by the bill:

(1) the pre-1976 Act exclusion for section 911 (income earned abroad exclusion) is extended for two years, or until January 1, 1979;

(2) the current treatment of salary reduction, etc., pension plans is extended for two years, or until January 1, 1980;

(3) the effective dates of the net operating loss "trafficking" rules adopted in the 1976 Act are extended for two years; and

(4) the effective date for the tax treatment of State legislators' travel expenses away from home is extended for one additional year, that is, for years beginning before January 1, 1978.

In addition, the bill contains prohibitions on the issuance of certain Treasury Department (Internal Revenue Service) rulings or final regulations with respect to certain commuting expenses (until after April 30, 1978) and final regulations with respect to employee fringe benefits (until after June 30, 1978). These deferrals are to give Con-

gress time to review and consider, if necessary, any proposed changes in Treasury regulations or rulings in these two areas.

Beginning with 1979, the bill provides new rules for the treatment of certain excess living costs for U.S. citizens earning income abroad. Also, the bill provides an exclusion (as a scholarship or fellowship) for certain Public Health Services Act awards received in the 1974–1979 period.

Further, the bill, as amended by the committee, deletes two provisions of the House-passed bill that have since been enacted into law in separate legislation: (1) the two-year extension of the Armed Forces Health Professions Scholarship exclusion (H.R. 3387, P.L. 95–171); and (2) the one-year extension of the 5-year amortization (sec. 167(k)) for low-income housing (also H.R. 3387, P.L. 95–171).

II. EXPLANATION OF PROVISIONS

A. Commuting Expenses (sec. 2 of the bill, Rev. Rul. 76–453, and secs. 62, 162, and 262 of the Code)

Present law

In general, a taxpayer is allowed a deduction for ordinary and necessary expenses paid or incurred in carrying on a trade or business. This includes transportation expenses incurred in the pursuit of a trade or business. However, no deduction is allowed for personal, living or family expenses, including the cost of commuting to and from work. Problems have arisen in delineating between transportation expenses which are considered to be nondeductible personal commuting expenses and other transportation expenses which are deductible business expenses. Generally, transportation expenses are not deductible if the taxpayer is going to his principal place of work from his residence or is returning to his home from his principal place of work. On the other hand, transportation expenses to temporary worksites other than the taxpayer's principal place of work often are deductible as a business expense.

On November 22, 1976, the IRS published Revenue Ruling 76–453 (1976–2 C.B. 86) which states that a taxpayer's transportation expenses incurred in traveling between the taxpayer's residence and place of work, even though temporary, will be nondeductible commuting expenses, regardless of the nature of the work performed, the distance traveled, the mode of transport or the degree of necessity. In addition, the ruling states that reimbursement for such expenses will be considered "wages" for purposes of FICA, FUTA and income tax withholding. The ruling was originally effective for transportation costs paid or incurred after December 31, 1976. The Service three times postponed the effective date of this ruling, and on September 23, 1977, announced that the ruling was suspended indefinitely and that proposed regulations inviting public comment would be issued shortly. Proposed regulations have not as yet been issued.

Reasons for change

The committee believes that the Congress should have an opportunity to study this area prior to the adoption of any rules or regulations by the IRS changing the treatment of transportation expenses between a taxpayer's residence and place of work.

Explanation of provision

This provision requires that the application of the income tax, FICA, FUTA and withholding provisions relating to the treatment of transportation expenses paid or incurred after 1976 and before May 1, 1978, in traveling between a taxpayer's residence and place of work shall be made fully in accordance with the rules in effect prior to the issuance of Revenue Ruling 76-453 on November 22, 1976. Under the bill, the IRS is not to issue any ruling or final regulation prior to May 1, 1978, changing the tax treatment of these transportation expenses paid or incurred prior to such date.

It is the intention of the committee that the provision will allow Congress time to further study this matter prior to the effective date of any changes made by new regulations or rulings issued by the IRS.

This provision is the same as in the House bill.

Effective date

The provision is effective with respect to transportation expenses paid or incurred after December 31, 1976, and before May 1, 1978.

Revenue effect

This provision will have no effect on budget receipts.

B. Employee Fringe Benefits (sec. 3 of the bill and sec. 61 of the Code)

Present law

Section 61 of the Internal Revenue Code defines gross income as including "all income from whatever source derived" and specifies that it includes "compensation for services". The regulations (§ 1.61-2 (b)(1)) provide that income includes compensation for services paid for other than in money. Further, the Supreme Court has stated that section 61 "is broad enough to include in taxable income any economic or financial benefit conferred on the employee as compensation whatever the form or mode by which it is affected."[1] Generally, however, taxability has been predicated on somewhat more than a finding that an employee has enjoyed an economic benefit.

Some fringe benefits, such as the provision of health insurance by an employer for its employees, are expressly excluded from gross income by the Internal Revenue Code; others are excluded by legislation outside the Code; and yet other exclusions are based on judicial authority or on administrative practice. While many fringe benefits are excluded on a *de minimis* principle, i.e., accounting for the benefit would be unreasonable or administratively impractical, other items, such as some benefits paid in kind, are excluded due to a combination of valuation difficulties and widely held perceptions that the items do not constitute income.

In 1975, the Treasury Department issued a discussion draft of proposed regulations[2] which contained a number of rules for determining whether various fringe benefits constitute taxable compensation. Under the principles contained in the discussion draft, some employee fringe benefits which, as a matter of administrative practice, have not been considered to be taxable compensation would have been

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[1] *Comm'r* v. *Smith*. 324 U.S. 177, 181 (1945).
[2] 40 Fed. Reg. 41118 (Sept. 5, 1975).

treated as subject to tax. Other valuable benefits which might be viewed as taxable compensation would not have been taxed under the discussion draft's proposed rules. The discussion draft was withdrawn by the Treasury Department on December 28, 1976.[3] Thus, the question of whether, and what, fringe benefits result in taxable income to employees generally continues to depend on the facts and circumstances in each individual case.

Reasons for change

Although the use of fringe benefits has increased in recent years, few comprehensive or generally applicable income tax rules have been developed. As a result, there has been an inevitable nonuniformity of treatment of taxpayers who receive different types of benefits even though the benefits may have approximately the same economic value.

The appropriate income tax treatment of various fringe benefits has led to a number of problems aside from the issue of whether a benefit constitutes taxable compensation. Although there are some differences between includible "compensation" for income tax purposes and "wages" for payroll tax purposes, the terms are generally synonymous. Thus, employers may be presented with the question of whether employment taxes should be withheld from an employee's wages on account of non-cash benefits being provided to employees. In addition, both taxpayers and the Internal Revenue Service must face difficult problems of valuing benefits provided in kind.

While the committee recognizes that the Internal Revenue Service constantly is reexamining the treatment of fringe benefits in accordance with its obligations to enforce the tax laws, the committee also recognizes that it is primarily the responsibility of the Congress to legislate uniform and equitable tax laws.

Explanation of provision

The bill provides that the Internal Revenue Service is precluded from issuing final regulations, under section 61, which would govern the income tax treatment of fringe benefits prior to July 1, 1978. While the bill would prevent the IRS from deviating from the present administration of the tax laws as they concern the taxation of fringe benefits as compensation, the bill would not prevent the IRS from continuing to study the question of the appropriate tax treatment of fringe benefits.

This provision is the same as in the House bill.

Effective date

The provision is effective upon enactment.

Revenue effect

This provision will not affect estimated budget receipts since it, in effect, continues present administrative practice.

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[3] 41 Fed. Reg. 56334 (Dec. 28, 1976).

C. The Tax Treatment of Income Earned Abroad by U.S. Citizens in Private Employment (sec. 4 of the bill and secs. 221 and 911 of the Code)

Present law

Law prior to the Tax Reform Act of 1976.—United States citizens are generally taxed by the United States on their worldwide income with the allowance of a foreign tax credit for foreign taxes paid. However, for years prior to 1977, U.S. citizens working abroad could exclude up to $20,000 earned income a year, provided the year fell within a period during which they were present in a foreign country for 17 out of 18 months or during which they were *bona fide* residents of a foreign country (sec. 911). In the case of individuals who had been *bona fide* residents of foreign countries for three years or more, the exclusion was increased to $25,000 of earned income. In addition, under the law prior to 1977, foreign taxes paid on the excluded income were creditable against the U.S. tax on any foreign income above the $20,000 (or $25,000) limit.

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

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

Under certain circumstances, any employee (whether working in the United States or overseas) is entitled to exclude from gross income the value of lodging furnished in kind by his employer (sec. 119). The value of employer-provided lodging is excludible from the employee's gross income if three tests are met: (1) the lodging is furnished on the business premises of the employer, (2) the lodging is furnished for the convenience of the employer, and (3) the employee is required to accept the lodging as a condition of his employment. The third requirement is not satisfied merely by an employment contract provision which requires the employee to accept the lodging; rather, it means that it is necessary for the employee to accept the lodging in order to perform the duties of his employment (for example, when the employer furnishes the lodging because the employee is required to be on duty at all times or because the employee could not perform the services required of him unless he is furnished the lodging). For employees working abroad, this exclusion for employer-provided housing is available in addition to the earned income exclusion.

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

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

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

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

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

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

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

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

Reasons for change

The committee believes that the provisions of section 911, as in effect prior to the 1976 Act, should be continued for taxable years beginning prior to January 1, 1979, and that subsequent to that time a new, more balanced approach to the taxation of U.S. citizens working abroad should be taken.

The committee believes that, because of the extraordinary costs of overseas living in many situations, special consideration must be given to individuals working abroad in order to treat them equitably for

tax purposes. Provisions of law both before and after passage of the Tax Reform Act of 1976 provided relief through a flat annual exclusion. The committee believes that relief based on a flat exclusion is arbitrary and unfair. The amount excluded is the same regardless of whether the individual's living expenses abroad are higher than, the same as, or lower than comparable costs in the United States. Equitable treatment of individuals working abroad requires that relief be more closely related to the actual increased expenses which the individual must incur while working abroad. Moreover, the tax treatment of U.S. workers abroad should not place them at a disadvantage in relation to foreign workers with whom they compete for jobs. In certain situations employers may find it impossible to continue to employ U.S. citizens abroad instead of foreign nationals unless some form of relief is provided.

In many instances, employees of U.S. employers working abroad are reimbursed for such increased expenses in the form of housing, education, cost of living, and other allowances. Alternatively, the employer may provide the employee with education for his children or housing. Such an employee does not bear the cost of such excess expenses himself. However, allowances and benefits of the type described above are included in the gross income of the employee at their local fair market value.[1] Therefore, unless the employee is allowed a corresponding deduction, he must include the cash reimbursements or the fair market value of housing or services received in his taxable income. A flat exclusion from gross income, as provided under current law, is a poor approximation of such amounts, which vary considerably depending on family size and location of employment. Moreover, the problem of employer-provided benefits has become more significant in recent years. The committee understands that increased capability of the Internal Revenue Service to audit taxpayers abroad and increased taxpayer awareness of the includability of the value of such benefits has substantially increased the amount of such allowances actually included in gross income.

Implementation of the new system of deductions provided in the committee amendment for excess foreign living costs is delayed until 1979 to permit Americans working overseas and their employers to take the new system into account in their personal planning.

Explanation of provisions

Postponement of 1976 Act changes.—The committee amendment extends the law in effect prior to adoption of the Tax Reform Act of 1976 to taxable years beginning prior to January 1, 1979. The House bill would have extended pre-1976 Act law only to taxable years beginning prior to January 1, 1978. Individuals who take the standard deduction but do not qualify for the earned income exclusion will be able to claim the foreign tax credit for taxable years beginning December 31, 1976.

New deductions for excess foreign living costs.—Under the committee amendment, the changes in the earned income exclusion (sec. 911) made by the 1976 Act will not take effect. Instead, the exclusion will be replaced for taxable years beginning after December 31, 1978, by

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

a deduction for excess housing and education costs and the excess costs of living (apart from housing and education) for individuals working abroad.

Those persons eligible for the new deduction will generally be the same as are now eligible for the earned income exclusion.[2] U.S. citizens (other than U.S. Government employees) will be eligible if they are *bona fide* residents of a foreign country or countries for a period which includes an entire taxable year, or if they are physically present in a foreign country or countries for 510 days out of a period of 18 months. Also, resident aliens who are nationals of a foreign country having a tax treaty with the United States which contains nondiscrimination provisions will be entitled under such tax treaty to the deduction if they otherwise meet the eligibility requirements imposed on U.S. citizens.

The committee amendment makes the deduction for additional foreign living costs a deduction from gross income in determining adjusted gross income. As a result, a taxpayer will be able to claim the deduction for additional foreign living costs without losing the ability to claim the standard deduction.

GENERAL RULE

In general, the elements of the deduction for additional foreign living costs would be as follows:

a. Cost of living

This element of the deduction would be equal to the lesser of the amount reimbursed by the taxpayer's employer for this purpose (exclusive of education and housing costs) or the amount set forth in a table issued by the Internal Revenue Service. The IRS table would show, for various foreign places, the amount by which the costs of living (excluding education and housing) exceed the costs of living in the United States based on the salary of a Federal employee in step 1 of grade GS–12 (currently $21,883) with families of various sizes. The tables would be adjusted to reflect future changes in that salary.

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

b. Education

This element of the deduction applies to the cost of tuition, books, and local transportation for the education, from kindergarten through

[2] Under present law, the earned income exclusion is available only with respect to amounts which are not "paid by the United States or any agency thereof." However, the special exclusions for certain governmental allowances (sec. 912 of present law, redesignated by the committee amendment as sec. 911) are available only to "civilian officers and employees of the Government of the United States" and to Peace Corps volunteers. Certain individuals (such as teachers in embassy schools and commissary workers) have been treated by the Internal Revenue Service as paid by the United States but not officers or employees thereof. Such persons will be eligible for the new deduction if the other eligibility requirements are met.

grade 12, of dependent children in American-type schools located outside the United States. The education element would cover room and board (but not non-local travel) only where there is no local American-type school within a reasonable daily commuting distance of the location where the taxpayer or his spouse is resident or present. The deduction would be the least of (i) the amount reimbursed by the taxpayer's employer for this purpose, (ii) the actual amount expended by the taxpayer for this purpose, and (iii) the amount set forth in a table issued by the Internal Revenue Service. The IRS table would show for various foreign places the reasonable amount of such costs for American-type education. The school to which the child is sent need not be in the place where the taxpayer is resident or present, but the applicable table limitation would be for that place, not the place of the school. Where there is no local American-type school in the place of employment, the amount set forth in the IRS table as the general worldwide average of foreign school costs is to be used.

c. Housing

The housing element of the deduction would be the excess of (i) the amount spent by or on behalf of the taxpayer for U.S.-style housing, over (ii) the cost of housing which that taxpayer would typically incur were he residing in the U.S. The housing element of the deduction is allowable only to the extent that the housing is not lavish or extravagant and the cost is reasonably comparable to the cost of typical U.S.-style housing in the foreign place. A deduction is allowed only to the extent that the employer provides reimbursement for those housing costs or furnishes the housing in kind.

Typical U.S. housing costs are assumed, based on data compiled by the Bureau of Labor Statistics, to be one-sixth (16⅔ percent) of the taxpayer's earned income (exclusive of excess cost-of-living, education and housing costs allowed by the committee amendment). The mathematical equivalent of 16⅔ percent of the taxpayer's earned income minus certain allocable business deductions, his excess foreign cost-of-living and education allowances, and his *excess* housing costs is 20 percent of the taxpayer's earned income minus the allocable business deductions, the allowable deductions for excess foreign cost-of-living and education allowances, and minus the *full* cost of the employee's housing. For simplicity, the committee amendment adopts the latter method to compute excess housing costs.

This rule may be illustrated by the following example of an individual who works abroad with a base salary of $12,000. It is assumed that he would spend $2,000 (16⅔ percent of $12,000) in the United States on housing. Abroad, his actual housing costs are $5,000, of which $3,000 is reimbursed by his employer. He has no excess cost-of-living or education adjustments. Under the committee amendment, the taxpayer calculates his excess housing costs by deducting the entire housing cost ($5,000) from his earned income ($12,000 plus the $3,000 reimbursement, or $15,000). The difference ($10,000) is multiplied by 20 percent and the product, $2,000, is equal to the amount which it is assumed the taxpayer would have spent on housing had he been in the U.S. The $3,000 excess of his reimbursed housing costs ($5,000) over the $2,000 base would be deductible under the committee amendment.

If the employer had reimbursed the full $5,000 of foreign housing costs, the employee would in effect have received a $2,000 increase in compensation. In that case, his earned income would have been $17,000 ($12,000 plus $5,000). He would have deducted his $5,000 in housing costs and the difference ($12,000) would be multiplied by 20 percent to determine the base ($2,400). The housing cost deduction would be $5,000 minus $2,400, or $2,600.

The committee recognizes that many employers, while providing housing in kind, will charge the employee what the employer regards as an appropriate amount to represent U.S. housing costs. The deduction for excess housing costs will be limited to the excess of the value of the housing provided over the charge. The deduction is computed in the same manner as if the employee had secured housing himself and had been partially reimbursed by his employer. That is, the excess of the value of the housing over the charge is treated as an amount paid by the employer on behalf of the employee for housing.

Employees would be required to file with their tax returns an employer certification attesting to the fact that the reimbursements for all elements of the deduction are in addition to, rather than in place of, normal compensation. With respect to the housing element, the certification must also state that the amount of the reimbursement does not exceed what the employer regards as a reasonable cost in the foreign country for typical U.S.-style housing and does not exceed what it or others (to the best of its knowledge) pay as reimbursements to employees performing similar services in the same area. The committee believes that the employer reimbursement and certification requirements, together with the limitations of the cost-of-living and education expense tables, should serve as a useful check that claimed deductions are in fact for amounts received as a result of excess living costs abroad.

Taxpayers who claim the deduction for additional foreign living costs may claim the foreign tax credit for income taxes paid to foreign countries, but the foreign tax credit limitation is to be computed by considering the deduction for additional foreign living costs as entirely related to foreign source income.

The amount of the deduction for additional foreign living costs cannot exceed the amount of the taxpayer's earned income from sources without the United States attributable to services performed during the period in which the taxpayer is resident or present in the foreign country or countries, reduced by certain business expenses. For this purpose, a pension or annuity is not considered earned income. The definition of "earned income" is the same as under present law.

Where the taxpayer's employer furnishes goods or services (including housing) in kind or charges less than local fair market value for items furnished, the local value, or the excess of the local value over the amount charged, is earned income of the employee. (This provision is declarative of existing law.) The amount is to be treated as an amount expended for housing, goods or services by the taxpayer and reimbursed by his employer.

It is provided that itemized deductions or exclusions cannot be taken a second time to the extent that they are part of the deduction for additional foreign living costs. Any moving expense deduction otherwise allowable under section 217 is not disallowed if the taxpayer also

claims a deduction for excess foreign living costs (sec. 221) because the elements of the section 221 deduction do not encompass moving expenses. Also, if an employee buys a house abroad, his mortgage interest and real property tax payments would be fully deductible. However, any additional costs, such as utilities, could be deducted only to the extent allowed under the housing cost element of the new deduction.

To prevent duplication of benefits, if a taxpayer's spouse excludes government allowances (under sec. 912 of present law, redesignated by the committee amendment as sec. 911), the amount allowed to the taxpayer as a deduction for excess foreign living costs must be reduced by the amount of government allowances excluded by the taxpayer's spouse if the amount excluded duplicates an item for which a deduction would otherwise be allowed for excess foreign living costs. For example, if the spouse excludes a cost-of-living allowance, the taxpayer's deduction for excess foreign living costs would be reduced to the extent of the duplication. However, if the spouse excludes an allowance for emergency home leave, the exclusion would not reduce the taxpayer's deduction.

SPECIAL CATEGORIES OF TAXPAYERS

The deduction for additional foreign living costs would be determined under special rules for four categories of qualifying individuals: (i) the self-employed; (ii) employees of entities or individuals which are not U.S. persons (other than entities which are controlled by U.S. persons) and which are not engaged in trade or business in the U.S.; (iii) employees of domestic charitable organizations; and (iv) employees who are furnished housing by their employers which qualifies for exclusion from the employee's income under section 119 or which is located in a camp.

To determine the deduction for additional foreign living costs for qualifying individuals in the four special categories, the IRS is to develop tables annually which set forth the average amounts for each of the three elements of the deduction, for various foreign places, claimed in the preceding year by individuals claiming such element of the deduction who were not in one of the four special categories. The average cost-of-living deduction table would be based on family size. The table relating to educational expenses would set forth, for each foreign place, a flat amount per student. The average housing deduction table would not vary with family size or earned income.

For self-employed individuals, the average tables limit the allowable deduction in the same manner as the employer reimbursement requirement under the general rule. Such tables are also used for employees of foreign persons because the Internal Revenue Service would have no effective control over employer certifications by such foreign persons. For employees of domestic charitable organizations and certain employees furnished housing by their employers, the table is intended to provide benefits (as described below) which might otherwise not be available.

a. Self-employed persons and employees of foreign persons

For self-employed individuals and employees of certain foreign employers (including international and foreign charities), or individuals,

the general cost-of-living element of the deduction for additional foreign living costs would be the amount set forth in the average table issued by the IRS. The education element would be the lesser of (i) the amount set forth in the average table issued by the IRS, and (ii) the actual amount expended by the taxpayer for this purpose. The housing element would be the lesser of (i) the amount set forth in the average table issued by the IRS, and (ii) the excess of the actual amount reasonably expended by the taxpayer for U.S.-style housing in the foreign country over the cost of housing which that taxpayer would typically incur were he residing in the U.S. Typical U.S. housing costs would be determined in the same way as for employees of U.S. employers.

b. Employees of charities and certain employees furnished housing

For employees of domestic charitable organizations, for employees furnished housing on the business premises the value of which would qualify for exclusion (under section 119) but for an election not to have that exclusion apply, and for employees living in camps provided by their employers, the average table would be used to determine all elements of the deduction, except that the education element could not exceed the amount actually expended by the taxpayer for that purpose. Employees who would otherwise be entitled to the benefits of the section 119 housing exclusion will not be able to claim the deduction for excess foreign living costs unless they waive the benefits of section 119.

The reason for this special treatment for charitable and camp employees is that they are typically required to make an unusual sacrifice in their standard of living when they go overseas. In order to avoid imposing additional hardship on Americans in such categories, the committee amendment provides the same deductions as are available to other U.S. citizens in foreign places. The committee anticipates that the deductions will ordinarily be larger than if the general rule were applied to these individuals. However, the deductions will be computed under the special rule even if an individual would be entitled to a larger deduction under the general rule.

The committee's intention in providing special treatment for employees in camps is to extend relief to employees generally located in remote areas where, because of circumstances beyond the control of the employer, the "business premises" requirement of section 119 cannot be met. In order to qualify for the special treatment, the value of the camp housing provided must qualify for exclusion from the employee's income under section 119 in all respects other than location on the business premises of the employer, and the camp must be located, as near as practicable, in the vicinity of the employer's business premises or the place where the taxpayer renders services.

In addition to satisfying all the requirements of section 119 other than the business premises test, housing in fact must be "camp" type housing in order to qualify for the special treatment. "Camp" housing means housing furnished in a common area or enclave of employees apart from housing in foreign cities or towns. "Camp" housing includes living quarters which the employee is required by the employer to share with unrelated co-employees (e.g., barracks). However, camp

housing is not intended to be limited to temporary structures. An example of eligible housing would be a camp for construction workers employed at a remote job site in the Mideast where, because of the inaccessibility of facilities for the employees who are working at the job site to obtain lodging, the employer is required to furnish lodging to employees in the vicinity of the job site in order to carry on the construction project. If it is not possible for the employer to provide adequate housing at the job site, lodging furnished to the employees in a camp located in the vicinity of the job site (or as close as practicable under the circumstances) would qualify for the special treatment of this provision.

For taxable years beginning in 1979, it will not be possible to compile average tables because no deductions will have been taken for excess foreign living costs during the previous year. Therefore, for taxable years beginning in 1979 only, a special transitional rule is provided for the four special categories of taxpayers. Under this transitional rule, the excess cost-of-living deduction will equal the IRS table amount prescribed for taxpayers under the general rules. The excess housing costs deduction will equal an amount set forth in a table prescribed by the IRS, in consultation with the State Department, showing for each foreign place the amount by which it is estimated that the average costs of typical United States housing exceed the average housing costs in the United States. The excess education costs deduction will equal school fees actually paid or incurred.

Effective date

The committee amendment is effective upon the date of enactment of this Act. It modifies the present law exclusion for taxable years beginning in 1977 and 1978. The replacement of that exclusion with the new allowance deduction is effective for taxable years beginning in 1979.

Revenue effect

The application of the pre-1976 Act law to taxable years beginning in 1977 and 1978 will reduce budget receipts by $322 million in fiscal year 1978 [3] and $292 million in 1979. The new deductions for excess foreign living costs applicable to taxable years beginning after 1978 will reduce budget receipts by $23 million in fiscal year 1979 and $166 million in fiscal year 1980.

D. Salary Reduction Plans, Cash and Deferred Profit-Sharing Plans, and Cafeteria Plans (sec. 5 of the bill and sec. 2006 of the Employee Retirement Income Security Act of 1974)

Present law

On December 6, 1972, the Internal Revenue Service issued proposed regulations which would have changed the tax treatment of employees

[3] The estimate reflects amounts determined after a Treasury re-estimate of the revenue loss from the exclusion. This revised estimate was not available at the time the Second Budget Resolution for fiscal 1978 was adopted. Thus, that resolution reflects a much smaller revenue increase ($45 million) resulting from the effect of the 1976 Act changes than the revised estimate indicates. The revised estimate means that fiscal 1978 revenues are underestimated by $277 million ($322 million less $45 million) prior to this bill.

under salary reduction plans, and which called into question the tax treatment of employees under cash and deferred profit-sharing plans and so-called "cafeteria plans." The Employee Retirement Income Security Act of 1974 froze the tax treatment of these plans for two years, and the Tax Reform Act of 1976 extended the freeze until December 31, 1977.

Reasons for change

The committee believes that additional time is required to design appropriate rules for the tax treatment of employees under the above-mentioned pension plans.

Explanation of provision

Under the bill, the "freeze" on existing tax treatment of salary reduction plans, cash and deferred profit-sharing plans and "cafeteria" plans is extended until January 1, 1980.

The provision is the same as the House bill.

Effective date

This provision is effective upon enactment.

Revenue effect

This provision has no effect on revenues.

E. Special Limitations on Net Operating Loss Carryovers (sec. 6 of the bill and secs. 382 and 383 of the Code)

Present law

Prior to enactment of the Tax Reform Act of 1976, the tax law generally provided that where new owners purchased 50 percent or more of the stock of a loss corporation during a 2-year period, its loss carryovers from prior years were allowed in full if the corporation continued to conduct its prior trade or business or substantially the same kind of business. If the same business was not continued, however, loss carryovers were completely lost. This "purchase" rule applied where one or more of the 10 largest shareholders increased their stock ownership, within a 2-year period, by 50 percentage points or more in a transaction in which the purchasers took a cost basis in their stock (except where the stock was acquired from "related" persons).

In the case of a tax-free reorganization, loss carryovers were allowed on a declining scale. If the former owners of the loss company received 20 percent or more of the fair market value of the stock of the acquiring company, the loss carryovers were allowed in full. For each percentage point less than 20 which the former owners received, the loss carryover was reduced by 5 percentage points. It was immaterial whether the business of the loss company was continued after the reorganization.

The 1976 Act extensively revised the Code provisions dealing with the carryover of net operating losses in cases of acquisitions of loss corporations. The limitations on loss carryover attributes apply to acquisitions made by purchase or through corporate reorganizations.

The new provisions change the basic concepts underlying the rules by deleting continuity of business requirements for purchases and establishing a new continuity of ownership tests applicable to both purchases and reorganizations.

These new provisions apply to plans of reorganization adopted on or after January 1, 1978, and to sales or exchanges in taxable years beginning after June 30, 1978.

Reasons for change

A number of technical problems regarding the 1976 Act revisions to the net operating loss carryover rules have been brought to the committee's attention which will require consideration of additional revision of the rules.

Explanation of the provision

The bill delays the effective date of the changes made by the 1976 Act for two additional years. As extended, the 1976 Act provisions will not take effect until January 1, 1980, with respect to plans of reorganization adopted on or after that date, or until June 30, 1980, with respect to sales or exchanges in taxable years beginning after that date.

This provision is the same as in the House bill.

Revenue effect

The 2-year delay in the effective date of the provision is estimated to reduce budget receipts by less than $5 million annually in fiscal years 1978, 1979, and 1980.

F. State Legislators' Travel Expenses Away From Home (sec. 7 of the bill and sec. 162 of the Code)

Present law

Under present law, an individual is allowed a deduction for traveling expenses (including amounts expended for meals and lodging) while away from home in the pursuit of a trade or business (sec. 162 (a)). These expenses are deductible only if they are reasonable and necessary in the taxpayer's business and directly attributable to it. "Lavish or extravagant" expenses are not allowable deductions. In addition, no deductions are allowed for personal, living, and family expenses except as expressly allowed under the Code (sec. 262).

Generally, under section 262, expenses and losses attributable to a dwelling unit which is occupied by a taxpayer as his personal residence are not deductible. However, deductions for interest, certain taxes, and casualty losses attributable to a personal residence are expressly allowed under other provisions of the tax laws (secs. 163, 164, and 165).

A taxpayer's "home" for purposes of the deduction of traveling expenses generally means his principal place of business or employment. Where a taxpayer has more than one trade or business, or a single trade or business which requires him to spend a substantial amount of time at two or more localities, his "home" is held to be at his principal place of business. A taxpayer's principal place of business is determined on an objective basis taking into account the facts and circumstances in

each case. The more important factors to be considered in determining the taxpayer's principal place of business (or tax home) are: (1) the total time ordinarily spent by the taxpayer at each of his business posts, (2) the degree of business activity at each location, (3) the amount of income derived from each location, and (4) other significant contacts of the taxpayer at each location. No one factor is determinative.

In 1952, a provision was adopted with respect to the living expenses paid or incurred by a Member of Congress (including a Delegate or Resident Commissioner). Under these rules, the place of residence of a Member of Congress within the congressional district which he represents in Congress is considered his tax home. However, amounts expended by the Member within each taxable year for living expenses are not deductible in excess of $3,000. Prior to the Tax Reform Act of 1976, no rule similar to the special rules for ascertaining the place of residence for a Member of Congress applied in the case of a State legislator. As a result, the tax home of a State legislator was determined in accordance with the general rule described above.

The Tax Reform Act of 1976 provided an election for the tax treatment of State legislators for taxable years beginning before January 1, 1976. This was extended for one year by the Tax Reduction and Simplification Act of 1977 to taxable years beginning before January 1, 1977.

Under this election, a State legislator may, for any such taxable year, treat his place of residence within his legislative district as his tax home for purposes of computing the deduction for living expenses. If this election is made, the legislator is treated as having expended for living expenses an amount equal to the sum of the daily amount of per diem generally allowed to employees of the U.S. government for traveling away from home, multiplied by the number of days during that year that the State legislature was in session, including any day in which the legislature was in recess for a period of four or less consecutive days. In addition, if the State legislature was in recess for more than four consecutive days, a State legislator may count each day in which his physical presence was formally recorded at a meeting of a committee of the State legislature. For this purpose, the rate of per diem to be used is to be the rate that was in effect during the period for which the deduction was claimed.

These limitations apply only with respect to living expenses incurred in connection with the trade or business of being a legislator. The 1976 Act did not impose a limitation on living expenses incurred by a legislator in connection with a trade or business other than that of being a legislator. As to any other trade or business, the ordinary and necessary test of prior law will continue to apply.

Reasons for change

The provision which allows a State legislator to treat his place of residence within his legislative district as his tax home for purposes of computing the deduction for living expenses only applies to taxable years beginning before January 1, 1977. The committee believes this provision should be extended for a one-year period during which time the problem can be given further consideration and a permanent rule can be developed.

Explanation of provision

The committee amendment further extends the effective date of the provision adopted by the Tax Reform Act of 1976 (and extended by the Tax Reduction and Simplification Act of 1977) for one more year, or to taxable years beginning before January 1, 1978.

The House bill has no comparable provision. However, on March 13, 1978, the House passed an identical provision in H.R. 11055 (House Rept. No. 95-929).

Effective date

This amendment applies to taxable years beginning before January 1, 1978.

Revenue effect

This provision will reduce budget receipts by $4 million in fiscal year 1978.

G. Awards Under the Public Health Services Act (sec. 8 of the bill and sec. 117 of the Code)

Present law

Unless specifically excluded, all income from any source and in any form must be included in gross income and thus subject to the Federal income tax (sec. 61). Certain amounts received in connection with education may be excluded if they qualify as scholarships or fellowships under section 117. The exclusion for scholarships and fellowships is restricted to "no-strings attached" educational grants by relatively disinterested grantors who do not require any significant consideration (e.g., promises of future services) from the recipient. The National Research Service Awards (NSRA) under the Public Health Services Act of 1974[1] never have been covered by a special statutory provision which would exclude them from income for Federal income tax purposes.

In Revenue Ruling 77-319, the Internal Revenue Service ruled that amounts received as National Research Services Awards for biomedical and behavioral research under the Public Health Service Act of 1974[1] are not excludable scholarships or fellowship grants under section 117 of the Code.

In return for an NRSA award, the recipient must engage in health research or teaching or some equivalent service and also must allow the government royalty-free use of any copyrighted materials produced as a result of research performed during the award period. Within two years after the award period, a recipient must engage in health research or teaching or in some other service designated by the Secretary of Health, Education and Welfare for a period equal to the award period. If a recipient fails to complete the post-award service requirements, he must repay an amount determined under a formula which takes into account the amount of the award, the length of the service obligation, and any actual post-award service.

An annual predoctoral award paid directly to an individual amounts to $3,900 for living expenses. Institutions sponsoring NRSA programs at the predoctoral level are reimbursed directly for their expenses.

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[1] Public Law 93-348, Sec. 472, as amended; 42 U.S.C. sec. 2891(1).

There is no payback requirement imposed on an individual recipient for any amount paid directly to an institution by the Federal Government as part of the NRSA program. Postdoctoral awards generally range between $10,000 and $15,000 annually paid directly to the recipient and usually do not exceed three years. Either type of award may be supplemented by non-Federal funds and by explicitly authorized Federal funds from other programs.

The IRS ruling stated that the NRSA awards do not qualify as excludable scholarships or fellowship grants for two principal reasons: (1) the post-award service requirement imposes a substantial *quid pro quo* for the award, and (2) the government's interest in maintaining biomedical and behavioral research and its royalty-free right to materials produced as a result of research performed during the award period indicate that the awards are not disinterested, "no-strings" educational grants but instead are made primarily for the benefit of the grantor (the government).

Reasons for change

The committee believes that temporary relief should be granted NSRA recipients pending completion of the study by the staff of the Joint Committee on Taxation on the entire area of scholarships and fellowships.

Explanation of provision

The committee amendment provides that any amounts which are paid to or on behalf of any individual as National Research Service Awards under section 472 of the Public Health Services Act of 1974, as amended, are to be treated as scholarships or fellowships under section 117 of the Internal Revenue Code. The amendment would allow predoctoral award recipients to exclude the entire amount of their awards. Postdoctoral recipients would be allowed to exclude up to $300 per month for a maximum of 36 months. The amendment applies to amounts received during calendar years 1974 through 1979.

Effective date

The amendment applies to amounts received in calendar years 1974 through 1979 and is effective on the date of enactment.

Revenue effect

This provision will reduce budget receipts by $22 million in fiscal 1978, $12 million in fiscal 1979, and by $13 million in fiscal 1980. The fiscal 1978 estimate includes the effect of retroactively including amounts received in calendar years 1974 through 1976.

III. EFFECT OF THE BILL ON THE BUDGET AND VOTE OF THE COMMITTEE IN REPORTING THE BILL, AS AMENDED

Budget Effects

In compliance with section 252(a) of the Legislative Reorganization Act of 1970, the following statement is made about the effect on the budget of this bill, H.R. 9251, as amended. The committee estimates

that the provisions contained in the bill, as amended, will have the following revenue effect for fiscal years 1978-83:

[In millions of dollars]

Provision	Fiscal year—					
	1978	1979	1980	1981	1982	1983
A. Deferral of Treasury commuting expense ruling						
B. Deferral of new Treasury fringe benefits ruling						
C. 1. 2-yr extension for changes to sec. 911 exclusion[1]	−322	−292				
2. New deductions for certain expenses incurred living abroad		−23	−166	−180	−196	−197
D. 2-yr extension of study for salary reduction, etc., pension plans						
E. Delay of effective dates for NOL "trafficking" rules	([2])	([2])	([2])			
F. 1-yr extention of State legislators' travel expense provision	−4					
G. Exclusion for Public Health Services Act awards	−22	−12	−13			
Total revenue impact	−348	−327	−179	−180	−196	−197

[1] The estimate reflects amounts determined after a Treasury re-estimate of the revenue loss from the exclusion. This revised estimate was not available at the time the 2d budget resolution for fiscal 1978 was adopted. Thus, that resolution reflects a much smaller revenue increase ($45,000,000) resulting from the effect of the 1976 Act changes than the revised estimate indicates. The revised estimate means that fiscal 1978 revenues are underestimated by $277,000,000 ($322,000,000 less $45,000,000) prior to this bill.

[2] Less than $5,000,000.

Vote of the Committee

In compliance with Section 133 of the Legislative Reorganization Act of 1946, the following statement is made about the vote of the committee to report H.R. 9251, as amended. The bill, as amended, was ordered favorably reported by voice vote.

IV. REGULATORY IMPACT OF THE BILL AS REPORTED AND OTHER MATTERS TO BE DISCUSSED UNDER SENATE RULES

Regulatory Impact

Pursuant to Rule XXIX of the Standing Rules of the Senate, as amended by S. Res. 4 (February 4, 1977), the committee makes the following statement concerning the regulatory impact that might be incurred in carrying out the provisions of the bill as reported by the committee.

A. Numbers of individuals and businesses who would be regulated and economic impact of regulation.—The primary effect of the bill will

be to reduce the tax liability of those individual taxpayers (U.S. citizens) living abroad who are subject to Federal income tax by extending for two more years the pre-1976 Act tax treatment of income earned abroad and to modify the future tax treatment of such income by providing deductions for certain costs incurred while living abroad.

B. Impact on personal privacy.—The provisions of this bill make no changes in those provisions of Federal law affecting the personal privacy of taxpayers.

C. Determination of the amount of paperwork.—This bill will have little impact on the amount of paperwork of taxpayers involved for these provisions that merely extend present law treatment. Beginning in 1979, the new deductions for excess foreign living costs will involve certain recordkeeping and certification requirements necessary to substantiate the deductions and will involve new tax forms and tables.

Consultation with Congressional Budget Officials on Budget Estimates

In accordance with section 403 of the Budget Act, the committee advises that the Director of the Congressional Budget Office has examined the committee's budget estimates (as indicated in part III of this report) and agrees with the methodology used and the resulting dollar estimates for those items.

New Budget Authority and Allocation of Budget Authority

In accordance with section 403 of the Budget Act and after consultation with the Director of the Congressional Budget Office, the committee states that the changes made to existing law by this bill involve no new budget authority, and there is no allocation of budget authority involved.

Tax Expenditures

The bill, as amended, involves the following increased and new tax expenditures for fiscal years 1978–83:

[In millions of dollars]

Provision	Fiscal year—					
	1978	1979	1980	1981	1982	1983
2-yr extension of 1976 Act changes to sec. 911 exclusion [1]	−322	−292				
New deductions for certain expenses incurred living abroad (repeal of sec. 911) [2]		−23	−166	−180	−196	−197
Exclusion for Public Health Services Act awards [2]	−22	−12	−13			
Total	−344	−327	−179	−180	−196	−197

[1] The estimate reflects amounts determined after a Treasury re-estimate of the revenue loss from the exclusion. This revised estimate was not available at the time the 2d budget resolution for fiscal 1978 was adopted. Thus, that resolution reflects a much smaller revenue increase ($45,000,000) resulting from the effect of the 1976 Act changes than the revised estimate indicates. The revised estimate means that fiscal 1978 revenues are underestimated by $277,000,000 ($322,000,000 less $45,000,000) prior to this bill.

[2] New tax expenditures.

V. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In the opinion of the committee, it is necessary in order to expedite the business of the Senate, to dispense with the requirements of subsection 4 of rule XXIX of the Standing Rules of the Senate (relating to the showing of changes in existing law made by the bill, as reported).