



BDO Seidman, LLP  
Accountants and Consultants

February 2007

## Subject:

### IRS to Waive Estimated Tax Penalty for U.S. Citizens or Residents Living and Working Abroad

# Expatriate Tax Alert

The Tax Practice at **BDO Seidman, LLP** is among the largest tax advisory practices in the United States. With 34 offices and more than 300 independent alliance firm locations in the United States, BDO Seidman has the bench strength and coverage to serve you.

As a Member Firm of **BDO International**, BDO Seidman, LLP serves multi-national clients by leveraging a global network of resources comprised of 621 Member Firm offices in 107 countries. BDO International is a worldwide network of public accounting firms, called BDO Member Firms, serving international clients. Each BDO Member Firm is an independent legal entity in its own country.

For more information, please contact:

#### Jack Frame

330 Madison Ave  
New York, NY 10017  
Phone: 212-885-8125  
[jframe@bdo.com](mailto:jframe@bdo.com)

#### Issue

The Internal Revenue Service and U.S. Treasury recently announced that the estimated tax penalty for citizens or residents of the United States living and working abroad will be waived for the year of 2006 to the extent that the penalty is caused by the TIPRA changes.

#### Details

The changes related the Foreign Earned Income Exclusion and Housing Exclusions made by the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA), were made retroactive to the beginning of 2006. TIPRA increased the maximum amount of foreign earned income that may be excluded from gross income to \$82,400. The law also limited the amount of housing costs that may be excluded or deducted under Section 911. Also, income not covered by the foreign income exclusion will be taxed at the marginal bracket that would have applied had the exclusion not been elected. These changes are effective for taxable years beginning after December 31, 2005.

Individuals who relied on the law as it existed prior to the enactment of TIPRA in May 2006 may have underpaid their estimated tax liabilities for 2006, and may be charged certain (Section 6654(a)) interest and penalties for underpayment. The IRS will waive such additions to tax to the extent the underpayment is attributable to the changes enacted under TIPRA.

This waiver is only available to qualified individuals who file a Form 2555, Foreign Earned Income, or Form 2555-EZ, Foreign Earned Income Exclusion, with their timely filed Form 1040, U.S. Individual Income Tax Return, or Form 1040X, Amended U.S. Individual Income Tax Return.

The IRS has confirmed to BDO Seidman that the waiver can be claimed by completing Form 2210, Box B and attaching a statement to the return explaining the reasons for the request. Appropriate documentation, in addition to Form 2555, would have to be referred to in the statement, and attached if not already part of the return. The portion of interest and penalties that would be waived would only be the portion resulting from the above mentioned changes.

## **Back Dated Options – Impact on 2007 Employee Compensation**

If an employee exercised a ‘backdated’ stock option in 2006, the employee may owe an additional 20 percent tax, plus an interest tax in addition to the income tax on the difference between the value at the date of grant and exercise.

An initiative, announced by the Internal Revenue Service (IRS), allows employers to pay the additional 20-percent tax and any interest tax that “rank-and-file” employees owe. The initiative does not permit payment of the additional tax for stock options exercised by its top executives or other insiders. The taxes paid by the employers on behalf of the employees will be treated as additional 2007 compensation income for those employees in the 2007 tax year.

Employers must notify the IRS of their intent to participate by Feb. 28, 2007 and contact affected employees by Mar. 15, 2007 to inform them of the intended participation in this program. Corporations that elect to participate and relieve their affected employees will be required to provide the specific details about the options, including specifics on the tax calculation to the IRS.

---

*The information in this newsletter is for general guidance only and is not a substitute for professional advice. The BDO Member Firms accept no responsibility for any actions taken or not taken on the basis of the information in this newsletter.*

*To ensure compliance with Treasury Department regulations, we wish to inform you that any tax advice that may be contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding tax-related penalties under the Internal Revenue Code or applicable state or local tax or (ii) promoting, marketing or recommending to another party any tax-related tax-related penalties under the Internal Revenue Code or applicable state or local tax law provisions or (ii) promoting, marketing or recommending to another party any tax-related matters addressed herein.*