



BDO Seidman, LLP
Accountants and Consultants

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Subject:

IRS Notice 2006-87 Publishes Increased Foreign Housing Allowances For Sec. 911

Expatriate Tax Alert

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In May 2006, the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) retroactively hiked taxes for Americans living abroad by changing the application of the foreign earned income and housing cost exclusion provisions (broadly referred to as Sec. 911). The changes had the following distinct aspects:

- a) The new provisions enacted a “ceiling” on the amount of housing costs that could be excluded. The maximum amount of housing costs that could be excluded was limited to 30% of the foreign earned income exclusion computed on a daily basis. If based on a calendar year, the maximum amount of exclusion for housing would be \$24,720 ($\$82,400 \times .3$) except in certain locations. In such high cost localities, the taxpayer would be able to use a higher amount of housing in lieu of the \$24,720. The adjustment of the 30% limit on the basis of geographic differences in housing costs was to be elaborated by the IRS in subsequent guidance.
- b) Revised the floor on the expenses to equal 16% of the foreign earned income exclusion of \$82,400 for a calendar year.
- c) Amended the rate structure for non excluded income such that the exclusion would be disallowed for computation of tax on such income.

IRS Notice 2006-87 issued on October 6, 2006, which can be viewed at <http://www.irs.gov/pub/irs-drop/n-06-87.pdf>, elaborates the adjustments that are available to taxpayers qualifying for the housing exclusion in high cost localities in lieu of the 30% ceiling to the housing exclusion amount. As an example, a taxpayer living in Singapore for all of 2006 may exclude from his income \$29,716 (the \$42,900 annual limitation in the table minus \$13,184, which is the 16% x \$82,400).

The table included in this Notice, which was derived from the Living Quarters Allowance table prepared by the Office of Allowances of the U.S. Department of State will be updated each year by administrative pronouncement (for example, through issuing a notice or amending Form 2555).

Although the new higher housing expense amounts just announced are welcome, for higher income taxpayers, the exclusions, even as adjusted, do not provide the amount of relief they used to, because the unexcluded income is now taxed at much higher average U.S. rates.

Also, it seems as if the IRS has adopted the highest allowances reflected by the Office of Allowances of the U.S. Department of State for employees who are in Group 2, with family. However, the family size contemplated by the U.S. Department of State for this information was a family size of two, with suggested increments for additional members of the family. These family size increments are not factored into the limits set by the IRS. Therefore, those expatriates with children who have acquired housing commensurate with their family size, or those expatriate executives who have acquired housing in line with their standard of living, may find that the new housing expense limits are still not high enough for them. For example, an expatriate living in Singapore with a salary of approximately \$170,000 and a family of four, could spend an average of \$68,000 annually on housing, while the maximum amount that can be used in calculating the housing exclusion per the Notice is \$42,900.

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