



BDO Seidman, LLP
Accountants and Consultants

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Subject:

IRS Determines Housing Costs Amounts Eligible for Section 911 Exclusion/Deduction for 2007

Expatriate Tax Alert

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Earlier this month the Internal Revenue Service issued an updated list for tax year 2007 of specific locations where it will allow more than the statutory limit for the Section 911 foreign housing expense exclusion due to the high cost of living in those areas. The adjustments are made on the basis of geographic differences in housing costs relative to housing costs in the United States. The new table with the adjusted housing expense limitations was published on September 10th in Notice 2007-77, *Determination of Housing Cost Amounts Eligible for Exclusion of Deduction for 2007*, and will appear in Internal Revenue Bulletin 2007-40 on October 1, 2007. Currently, the Notice with the full updated list of specific locations can be found at the website of the Department of Treasury at: <http://www.treas.gov/offices/tax-policy/library/N-07-77.pdf>.

The Notice is effective for taxable years beginning on or after January 1, 2007.

History and Background

Section 911(a) of the Internal Revenue Code allows a qualified individual to elect to exclude from gross income his/her foreign earned income and housing cost amount. The maximum foreign earned income exclusion for tax year 2006 was \$82,400 and for tax year 2007 will be \$85,700.

Prior to 2006, the foreign-based U.S. employees could exclude housing costs of “any reasonable” amount over a certain floor, i.e. there was a minimum limitation, but a maximum (ceiling) limitation never existed.

Under the Tax Increase Prevention and Reconciliation Act (Pub. L. No. 109-222), enacted in May 2006, from an unlimited “reasonable” amount the maximum housing exclusion which could be claimed was reduced to \$24,720, i.e. a maximum for the exclusion was established. With the Act, Congress cut the housing deductions available to U.S.

employees abroad, but it gave the IRS the authority to waive those limits in areas with high housing costs.

The IRS utilized the authority granted by Congress and with Notice 2006-87 in 2006 ([Determination of Housing Cost Amount Eligible for Exclusion or Deduction: http://www.irs.gov/pub/irs-drop/n-06-87.pdf](http://www.irs.gov/pub/irs-drop/n-06-87.pdf)) set a list with the 2006 ceiling limitations for various geographic locations. Now with Notice 2007-77 the IRS revised for 2007 the dollar limits for some of the areas and expanded the list of cities eligible for the higher housing exclusion.

Observations

The largest increases in the existing housing upper limits were to Calgary, Canada, Singapore, and Malaysia. New countries appearing for the first time on the adjusted limits listing were Australia, Philippines, and South Africa. The most expensive housing countries have been established as Hong Kong, with a limit of \$114,300 (unchanged from 2006), and Moscow with a new 2007 limit of \$90,900.

The resulting tax savings from these limit increases are not that significant, however, since whenever you increase your exclusion claim you also give up some foreign tax credit relief. Foreign tax credits eligible for claim must be reduced commensurate with your exclusion claim, since the IRS will not let you claim exclusion and foreign tax credit on the same income (i.e. no double dipping).

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