

June 1, 2006

NEW LAW IMPACTS 2006 INCOME TAX LIABILITY OF U.S. CITIZENS AND RESIDENTS WORKING ABROAD

The new tax act signed by the President (the "Act") amended several provisions in the Internal Revenue Code resulting in changes to the taxation of U.S. citizens and residents working abroad. The Act modified the income exclusion limit and provided for earlier inflation indexing in 2006. The Act also modified the amount of the housing exclusion allowance for individuals working abroad, and modified the tax rates applicable to non-excluded income.

While the first change is beneficial to U.S. citizens working abroad, the change in the tax rates causes individuals working abroad to be subject to the same tax rates as individuals working in the United States. This change in rates results from stacking the excluded and non-excluded income of the individuals to determine the marginal tax rate, and may result in higher marginal tax rates and additional taxes due. Since these changes are effective for all of calendar year 2006, U.S. citizens and residents working abroad should consider whether they need to adjust their tax withholdings or estimated tax payments for 2006. While income tax withholding is applied throughout the year, estimated tax payments are treated as paid on each of the estimated tax due dates, so if the individuals pays his taxes in part using estimated tax payments there could be an underpayment penalty if an adjustment is necessary. Thus it is important for expatriates who use estimated tax payments to review promptly their estimated payments considering the changes in the law. The next estimated tax payment is due June 15, 2006. Expatriates who pay their U.S. federal income taxes via payroll withholding should also review their tax situation considering the Act's changes.

If you have any questions regarding the foregoing, please feel free to contact one of the attorneys listed below.

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