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From:

Sent: Wednesday, November 28, 2012 3:23 PM

To:

Cc:

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Subject: Section 911 and Forms 2555 and 1040

Hello

Here is the information you requested about how the section 911 housing deduction should be calculated on Forms 1040 and 2555.

In general, the housing exclusion and the housing deduction under section 911 are calculated in such a way that two similarly situated taxpayers will pay the same amount of tax regardless of whether they take the exclusion or deduction. In order to achieve this, the deduction is calculated differently on Forms 1040 & 2555 than deductions are normally calculated.

The housing exclusion is the amount provided by the taxpayer's employer for housing expenses incurred while living and working in the foreign country. In contrast, the housing deduction is generally taken by self-employed individuals working abroad. The deduction is taken by taxpayers who do not receive a housing stipend from an employer (or whose employer-provided housing stipend is less than the actual cost of housing, subject to limitations), and their housing expenses are instead paid for out of their own income (at least partially). For purposes of calculating the section 911 housing exclusion and deduction, a qualifying taxpayer who is paid foreign earned income in the amount of \$x and a housing stipend in the amount of \$y from an employer will be treated the same as a qualifying self-employed taxpayer with income in the amount of \$x+y, where y is spent on housing. Assuming they are otherwise identically situated, they will owe the exact same amount of tax.

Here are how the mechanics of how the forms work:

First, the housing exclusion, housing deduction, and foreign earned income exclusion are all subtracted from total gross income on the Form 1040 at lines 21 and/or 36 to arrive at AGI on Form 1040, line 37. Next, exemptions and the itemized or standard deduction are subtracted from AGI at lines 40 and 42 to arrive at taxable income. The tax on this taxable income is determined on the Foreign Earned Income Tax Worksheet for Form 1040, line 44. The housing exclusion, housing deduction, and foreign earned income exclusion are all added to the taxable income amount; this ensures that the taxpayer's income that exceeds the amounts allowed under section 911 will be 'stacked' on top of the 911 amounts and thereby be taxed at the appropriate rates. The worksheet then calculates a total hypothetical tax that would apply to this grossed-up amount in the absence of section 911. Finally, the worksheet calculates a hypothetical amount of tax for the section 911 amounts. The difference between this amount and the hypothetical tax on the grossed-up amount is the taxpayer's actual tax liability.

By making the section 911 housing deduction an above-the-line deduction, adding it to taxable income to create a grossed-up amount, and then subtracting the tax attributable to that amount from the tax that would be owed on the grossed-up amount, Forms 2555 and 1040 work together to ensure that the

housing deduction and housing exclusion are effectively treated the same. If the housing deduction were instead simply deducted once when first calculating taxable income, a taxpayer taking the housing exclusion could end up paying more tax than a taxpayer taking the deduction because the taxpayers might otherwise fall in different tax brackets. That was not the intent of the statute, and the slightly more complicated approach taken above protects parity.

I hope this answers your question. Please let me know if you have more questions.

Thanks,