

HR & Tax Alert



United States: Settlement Initiative Allows Employees of Certain Foreign Employers to Correct Employment-Related Income Tax Matters

November 2006

Executive Summary

The Internal Revenue Service has announced (Announcement 2006-95) a settlement initiative under which current and former employees of foreign embassies, foreign consular offices, or international organizations can resolve income tax matters related to their employment and unwind their participation in a Simplified Employee Pension/Individual Retirement Account (SEP/IRA) which they erroneously established. The settlement initiative will expire on February 20, 2007.

Background

The IRS has determined that a significant number of U.S. citizens and lawful permanent residents (LPRs) employed at foreign embassies, foreign consular offices and international organizations in the United States have failed to fulfill their U.S. income tax responsibilities. Also, many of these individuals have erroneously established SEP/IRA plans, claimed deductions for contributions to the plans, and used the plans as part of their retirement planning. Because U.S. citizens and LPRs who perform services in the United States as common law employees of foreign governments are not considered to be self-employed, they may not contribute to SEP/IRA plans based on their employment with foreign embassies, foreign consular offices and international organizations. However, U.S. citizens in such employment are generally considered to be

self-employed for purposes of paying self-employment tax and for U.S. Social Security coverage.

Settlement Initiative

Eligibility

The settlement initiative is limited to employees and former employees of foreign embassies, foreign consular offices or international organizations who are either currently employed or were employed as such in the United States. It is limited to taxation issues for tax years 2003, 2004, and 2005. Taxpayers who are LPRs must represent that they have signed and filed a U.S. Citizenship and Immigration Services (USCIS) Form I-508 (Waiver of Rights, Privileges, Exemptions and Immunities under Section 274(b) of the Immigration and Nationality Act). Taxpayers who contributed to SEP/IRA plans based on their employment with foreign embassies, foreign consular offices and international organizations, must comply, where applicable, with all requirements of both parts of the settlement initiative. Persons under a tax-related criminal investigation, or who have been notified that they will be the subject of a tax-related criminal investigation, are not eligible to participate.

Income Tax Portion of Initiative

Under this portion of the initiative, taxpayers agree to take a number of actions, including submitting correct original or amended tax

returns for years 2003-2005, paying all taxes and statutory interest, and paying a reduced amount of penalties.

SEP/IRA Portion of Initiative

Under this portion of the initiative, taxpayers agree to take a number of steps to correct their erroneous SEP/IRA accounts, including paying all taxes and interest related to deductions claimed for contributions to such accounts, having disallowed contributions distributed from such accounts and paying a reduced amount of penalties.

Election

Taxpayers electing to participate in the initiative must send a Notice of Election as specified in the announcement on or before Tuesday, February 20, 2007.

Closing Agreement and Payment

After receiving the Notice of Election and any additional requested information, the IRS will prepare a closing agreement reflecting the terms of the settlement. A taxpayer participating in the initiative must fully pay all taxes, additions to tax, penalties, and statutory interest due when the signed closing agreement is returned to the IRS. If a taxpayer is unable to make full payment at that time, the taxpayer must submit complete financial statements and agree to financial arrangements that are acceptable to the IRS before the IRS will execute the closing agreement.

For further information, please contact your local Ernst & Young Human Capital professional.

Next Steps

U.S. citizens and lawful permanent residents who are or were employed in the U.S. by a foreign embassy, consular office or international organization should review Announcement 2006-95 and related Frequently Asked Questions to determine whether they might be eligible to participate in the settlement initiative. Taxpayers are advised to review the program with a tax professional.

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