



Stop killing the goose that lays the golden egg Stop the double taxation on Americans working abroad

The United States is the only industrialized nation that taxes its citizens on both a citizenship and residence basis. This means that it is only Americans working and residing overseas who, in addition to being taxed on their worldwide income by the country where they live and work, are also double taxed on this same income by their country of citizenship, the United States. No other industrialized country double-taxes its non-resident citizens. Section 911 of the U.S. Tax Code allows for a partial exclusion from U.S. double taxation of foreign earned income and income expended for high housing costs overseas. These limited exclusions along with the application of tax credits for foreign taxes against the U.S. double tax on foreign income alleviate somewhat the double taxation, but only partially.

Historical Background

Since 1962 when Congress first introduced the concept of taxing the earned income of non-resident U.S. citizens and established a limited exclusion of part of foreign earned income double taxed by the U.S., the issue has been a political football. Section 911 has been regularly subject to attack by certain members of Congress. Some have referred to Section 911 as a “subsidy” to or a “tax break” for Americans residing abroad, when in fact its purpose is only to partially mitigate the double taxation to which overseas Americans are subjected. Very briefly, here are the key highlights of this tumultuous history:

Prior to 1962, the U.S. like all other industrialized nations, did not double-tax the income of its citizens who were bona fide residents abroad.

In 1962, the amount earned abroad and excluded from U.S. income taxes was limited to \$20,000 a year, rising to \$35,000 after three years abroad.

In 1964, the exclusion was limited to \$20,000 a year, rising to only \$25,000 after three years abroad.

In 1974 and 1975 the House Ways and Means Committee attempted to double tax all foreign source income by abolishing the foreign earned income partial exclusion, but without success.

In late 1976, Congress successfully and retroactively to January 1, 1976 amended the tax law so that the overseas earned income exclusion would be reduced to \$15,000 (off the bottom). No foreign tax credit would be allowed for taxes paid abroad on excluded income. Following voluminous complaints from American companies employing Americans overseas and from overseas Americans who could not survive under the fiscal weight resulting from the 1976 Tax Reform Act, Congress postponed the effective date from January 1, 1976 to January 1, 1977.

In 1978, Congress voted for a total elimination of overseas earned income exclusion to be replaced by specific deductions including excess foreign housing costs, educational costs for children and cost of living.

In 1979, the President’s Export Council issued a report to the President, dated December 5, which starts with the following sentence. “The Executive Committee of the President’s Export Council has asked me

to express its strong concern over the adverse effects on exports of the present rules (Sections 911 and 913) concerning taxation of foreign earned income of Americans living overseas.” It stated that “Americans are being taxed out of competition in overseas markets. The result is a sharp loss in the U.S. share of overseas business volume in vital economic sectors. The current situation contributes to our negative balance of payments, a loss of U.S. jobs to competitors and the decline in the U.S. presence and prestige abroad.” It recommended “...enactment of a new tax law to put Americans working overseas on the same tax footing as citizens of competing industrial nations.”

In 1981, Congress recognized that replacing the earned income exclusion with deductions had aggravated rather than alleviating the problem; it introduced a \$75,000 maximum for foreign earned income exclusion from double taxation for physical presence and bona fide residents abroad; the exclusion cannot exceed the actual salary earned. Also introduced was an additional deduction or exclusion for excess cost of foreign housing. There were no provisions for deductions for educational costs for dependent children, who for reasons of language or religious laws are often not accepted to study in public schools of foreign countries and therefore are obliged to attend more costly English language private schools in order to transfer back to a U.S. school or to qualify upon graduation for entrance into a U.S. college or university.

In 1981, the General Accounting Office issued a report to Congress ID-81-29 entitled “American Employment Abroad Discouraged by US Income Tax Laws”, concluding that the 1978 law created a “disincentive to employment of U.S. citizens abroad and, therefore, adversely affects exports,” that employer tax reimbursements of U.S. citizens abroad “makes them substantially more expensive than 3rd country nationals” and that “Congress should consider placing Americans working abroad on an income tax basis comparable with citizens of competitor countries who generally are not taxed on their foreign income.”

In 1986, Congress reduced the maximum foreign earned income exclusion in Section 911 to \$70,000; separate foreign tax credit limitations were introduced for passive income. The new law also limited foreign tax credits for alternative minimum tax purposes to 90% of the alternative minimum tax before credits.

In 1988, Congress through the Technical and Miscellaneous Revenue Act of 1988 eliminated the marital deduction for property passing upon death from a U.S. citizen to a non-U.S. citizen. An annual gift tax exclusion of \$100,000 was introduced for gifts to non-U.S. citizen spouses.

In 1992, Revenue Ruling 90-79 provided that an exchange rate loss on a foreign currency mortgage could not be used to offset an exchange rate taxable gain on the sale of a house in a foreign country, even if the mortgage was used to finance the purchase of the house.

In 1997, Congress increased the maximum foreign earned income exclusion by \$2,000 per year (from 1998 to 2002) to a new maximum of \$80,000.

In 2004, Congress removed the 90% limit on foreign tax credits for AMT which had been introduced in 1986. Once again, 100% of foreign taxes paid could be credited against tax arising from AMT calculations in the United States.

Current Status

In May 2006, Congress inserted and passed a last- minute provision, with neither discussion nor hearing, that was a significant tax hike on overseas Americans in the “Tax Increase Prevention and Reconciliation Act of 2005” (TIRPA).

With the passage of TIRPA, the unfavorable tax situation for overseas Americans has become significantly worse. Section 515 of TIRPA “Modification of exclusion for citizens living abroad” under “Title V Revenue Offset Provisions” specifically aims to increase taxes on overseas Americans.

- Section 515 raised the maximum foreign earned income exclusion from \$80,000 to \$82,400.
- It simultaneously introduced a low annual cap of \$11,536 on the exclusion for foreign housing costs. This cap is determined by subtracting a *housing cost floor* (rent which would be considered a normal base rent not excludable) from the *actual rent cost* which can be a maximum of 30% of

the \$82,4000 foreign earned income exclusion allowed, or \$24,720. The housing cost floor is set at 16% of the foreign earned income exclusion allowed, i.e. \$13,184. Hence, the maximum net housing exclusion allowed is the difference between the maximum actual rent cost and the housing cost floor, or \$11,536. Prior to this, “reasonable housing costs” without a cap, less a housing cost floor, were excludable.

- Nevertheless, the law states that the Secretary of the Treasury may issue regulations or other guidance providing for the adjustment of the percentage of the actual rent cost limit. In fact, this allows the Treasury department to establish a list of cities of exception considered to have rents exceeding \$24,720.
- Section 515 also pushed overseas Americans into higher tax brackets by a stacking measure which requires that the tax rate applicable to taxable non-excluded income be determined by adding back the excluded income under Section 911 to the taxable income. Previously, the tax rate applicable to non-excluded income was determined only by the amount of the taxable income.
- Furthermore Section 515 was enacted in May 2006 with retroactive effect to January 1, 2006.

The cumulative affect of these measures is that many Americans working and living overseas will see their 2006 U.S. tax bill double or triple, or increase in by even more, as compared to 2005. It is forcing more Americans overseas to return home, particularly middle income families living in high rent, low tax countries. Its clear consequence is for U.S. corporations to cut back even more on American overseas staff.

Double Taxation Discriminates Against Americans Working Overseas

Intentionally or otherwise, current US tax policy concerning Americans residing overseas **penalizes Americans who work overseas**. Furthermore, it **forces American companies to employ non-U.S. citizens for key overseas assignments**. U.S. double taxation of Americans working overseas, in addition to the taxes paid in the country of residence, simply makes American citizens too costly. **This double-taxation denies U.S. citizens an equal opportunity to compete for jobs abroad**. In today’s highly competitive world market, long gone is the time when American companies could afford to employ American citizens overseas irrespective of costs. Over the last twenty years, the number of Americans working overseas for Americans corporations has been cut by more than half, according to published Commerce Department data. This is a very dangerous trend clearly foreseen in the President’s Export Council Report in December 1979 and in the GAO 1981 Report to Congress ID-81-29. It is particularly dangerous when globalization of the world economy is accelerating and American presence in international markets is ever more important to combat the serious shortfall of American exports that is causing unsustainable trade deficits. The tax hike on overseas Americans passed in May 2006 within the framework of TIRPA seriously accentuates the penalty on Americans overseas.

For Americans to be competitive when working overseas, they must cost no more to their employers than either qualified local nationals or expatriates from other countries. At the same time, they must be able to have a standard of living comparable to that of their foreign colleagues with equal rank, skills, experience and responsibility. With U.S. tax rules in place, Americans in countries with low income tax or no income tax, such as the Gulf countries or Hong Kong, find themselves in the dilemma of either having to accept a lower standard of living compared to other foreign nationals because they are the only persons with dual fiscal obligations to their country of citizenship or of being paid wages over the general market because of their U.S. citizenship to maintain the same standard as their foreign competitors, which is a patently illegal alternative in countries prohibiting salary discrimination based on nationality or national origin. It is not surprising that Lissa Redmiles, an economist with the Special Studies Returns Analysis Section of the IRS writes the following in the *Statistics of Income Studies of International Income and Taxes*. “One noticeable shift however is the steady decline of foreign income earned in Saudi Arabia. In 1987 some 13,407 U.S. individuals living in Saudi Arabia reported almost 10% of the total foreign-earned income. In 2001, 7,449 such individuals earned 3% of the total foreign-earned income.”

A Vital Issue for the Nation's Competitiveness

Although taxation of overseas Americans concerns less than one quarter of a one percent of all U.S. tax filings, it is an issue of vital importance for the nation's competitiveness. Employment within the United States, particularly in export oriented industries and services, is undoubtedly and substantially affected by the overseas presence of fellow citizens representing the vanguard of our international trade. Already in 1979, the Report of the President's Export Council noted that the employment of foreigners instead of American citizens "has brought about a sharp loss in the U.S. share of overseas business volume in vital economic sectors, largely because third party nationals tend to specify and order equipment from sources they know and trust in their home country, whereas American citizens would specify and order U.S. equipment with which they are most familiar." They cite, in particular, a dramatic drop in total contracts in the Mid-East from over 10% to less than 2% of the market in just one year, following the change in fiscal status of Americans overseas and the subsequent repatriation of Americans. The GAO reached an identical conclusion with its 1981 report, ID-81-29, entitled "American Employment Abroad Discouraged by U.S. Income Tax Laws".

Private Americans working overseas are our nation's first line ambassadors and play an important role as strategic decision makers for investing overseas and for expanding U.S. exports while identifying overseas market trends and business opportunities. As our nation's tax policies impede the free movement of Americans working overseas, they are self-inflicting serious damage to the American economy by unnecessarily destroying potential domestic jobs in manufacturing for export. More and more overseas subsidiaries of American companies are headed up by foreigners who do not have the same intrinsic orientation as Americans to favor American products or services in international commerce and who favor recruiting foreign citizens with international experience. If American managers are not directly exposed to working in international markets, how can the future leaders of our industry have the perspective necessary to effectively compete in the global economy?

This is not a new issue. But unfortunately legislators have ignored the warnings and conclusions of the President's Export Council in 1979 and of the GAO study in 1981. Trade statistics show the dramatic consequences. The U.S. trade balance turned negative for the very first time in the 20th century in 1971. Our last-ever trade surplus was in 1975. In the late 70's the trade deficit was around 1% of GDP. Today, with the rapidly increasing trade deficit currently running close to an unsustainable 7% of GDP and the nation's competitiveness becoming a growing concern, it is high time for Congress to wake up and act to remove this anti-American job destroying barrier that it has erected against American exports.

Course of Action

To alleviate the double taxation burden on Americans working overseas, [American Citizens Abroad](#) suggests the following urgent five step course of action:

- **First, encourage the President's Export Council to update its 1979 report.**
- **Second, request an update to the 1981 GAO report ID-81-29.**
- **Third, call for Congressional hearings on this issue.**
- **Fourth, cancel immediately the retroactive tax hike in Section 515 of TIRPA, enacted in May 2006.**
- **Fifth, work on a bi-partisan basis to bring about fundamental tax reform for overseas Americans as rapidly as possible through support for the *Working American Competitiveness Act*.**

Repeal Immediately the Retroactive Tax Hike Enacted in May 2006

The Senate Finance Committee estimated that \$200 million of revenue per year would be raised through Section 515 of TIRPA. While this amount is very significant for the overseas Americans concerned, it is an insignificant rounding error in the U.S. government budget and can easily be compensated by the elimination of one or more of the thousands of pork barrel expenditure bills passed in 2006. In 2006, Congress allocated a record \$71.77 billion to 15,832 special projects, more than double the \$29.11 billion spent on 4,155 pork-barrel projects in 1994.

The new cap on the housing exclusion/deduction is most seriously impacting middle-income families and affects, in particular, American companies and their overseas employees. While the Treasury Department has established a list of “exception cities” where rents are evidently significantly higher than the cap provided in the law, the need for such exceptions only reinforces the arbitrariness of the law. In fact, the Treasury list is based on locations known to the State Department and has missed some important economic centers with high rents where Americans work. For example, The Treasury Department set the maximum actual rent cost for Geneva, Switzerland at \$70,300 and for Bern at \$50,900, but made no specific mention of Zurich which was included in “all other cities” of Switzerland with a maximum rent cost of \$32,900. Yet rent costs are very similar in Geneva and Zurich. Similarly, if one lives in a suburb of Geneva, which has rents comparable to the city of Geneva, the maximum rent cost of \$32,900 is applicable. This law also creates a disproportionate administrative burden on the IRS and the Treasury Department; it is not the business of the Treasury or the IRS to survey rents worldwide. Putting a cap on the foreign housing exclusion/deduction is fundamentally bad tax law.

It is also essential that the stacking measure introduced in Section 515 be eliminated, as its sole purpose is to push Americans resident abroad into higher tax brackets in the U.S.; this seriously accentuates the double taxation. For example, an American taxpayer overseas with a salary of \$85,000 and a rent allowance of \$48,000 will have a total income of \$133,000. His taxable income after exclusions will jump from around \$17,000 in 2005 to \$39,000 2006 due to the new cap on the housing exclusion; in addition, he will find himself in the 28% tax bracket in 2006, based on \$133,000 total income, compared to the 10% bracket in 2005, based on \$17,000. This leads to a **six-fold** increase in U.S. taxes due. It must not be forgotten that Americans residing overseas pay first and foremost taxes in the country of residence. It is necessary to return to the status in Section 911 whereby tax rates on Americans resident overseas are determined only by the level of income exceeding the foreign earned income and housing exclusions, not total income including those exemptions. This will eliminate a severe tax penalty on the middle income managers and professionals.

Bring About Fundamental Tax Reform Concerning Overseas Americans

The most fundamental tax reform for Americans residing overseas would require the United States to adopt, like all other industrial countries, residency-based taxation for its nationals rather than citizenship based taxation. However, since it is feared that U.S. billionaires might change residency just to escape US taxes, there is understandably great resistance in Washington to this most fundamental reform. Nevertheless, **the current situation where Americans citizens are excluded from overseas employment by American companies is not only detrimental to the vital interests of the nation but also contrary to the spirit of the Equal Opportunity Employment Act of 1965 which outlaws job discrimination, in this case against our own citizens, based on national origin.**

U.S. exports must grow more rapidly. U.S. exports have systematically remained in the range of 10% of GDP for the past 25 years, but currently cover only about two-thirds of imports; in order to close the gap with imports, exports need to increase by more than 50%. If American industry is encouraged to work

towards this objective and is freed up from constraining U.S. fiscal laws for its overseas subsidiaries and its American employees abroad, a significant increase in exports is possible, particularly in China and the other rapidly growing markets in Asia and Latin America where U.S. exports are seriously underrepresented today.

The *Working American Competitiveness Act*, initially introduced in the 109th Congress (**S-3496; H.R.-5986**) provides a good solution to begin the tax reform process for Americans overseas. However, it concerns only salaried Americans and does not address other tax issues faced by Americans overseas, issues which are also of serious concern to American Citizens Abroad, but are beyond the scope of this paper. To note just in passing, one of these issues concerns the severe fiscal restraint on Americans overseas when setting up their own corporations for business activity overseas because of the tax burden and administrative nightmare linked to the U.S. tax rules for Controlled Foreign Corporations and Passive Foreign Investment Companies. Another issue is the inherent incompatibility between the U.S. and foreign tax regimes, for example the fact that contributions to foreign savings or retirement plans cannot be used to reduce U.S. taxes and that an American overseas can be double taxed on his net assets, i.e. subject to U.S. capital gains tax and simultaneously to an annual foreign net worth tax which may not deductible for U.S. tax purposes. Last but not least is the key issue that relates to the double taxation by the U.S. of Americans retired abroad! These various issues reinforce the prejudice of the limited foreign earned income exclusion and seriously discourage Americans from venturing abroad to represent U.S. interests overseas.

The *Working American Competitiveness Act* would definitely be a good first corrective step. It would **eliminate the cap on foreign earned income exclusion** and would **eliminate the need for a separate housing exclusion**. The *Working American Competitiveness Act* would:

- put Americans working overseas on a more level playing field with foreign nationals abroad who, unlike Americans, are never double taxed by their home countries
- encourage American corporations to send more Americans overseas
- reinforce the nation's competitiveness in world markets
- simplify the law
- reduce double taxation on Americans working overseas
- maintain the current requirement that all Americans resident overseas file U.S. tax forms and meet their U.S. tax obligations on passive income and on capital gains. The billionaires remain in the system.

The purpose of the foreign earned income exclusion is to avoid double taxation on earnings for Americans working and residing overseas. The problem with a cap is that it does not keep up with reality. The current cap of \$82,400 for the foreign earned income exclusion is ridiculously low. The foreign earned income exclusion established in the mid sixties for bona fide overseas residents was \$25,000. Today, that \$25,000 would be worth \$150,416 if indexed with the CPI of the USA. And this does not take into consideration the substantial change in exchange rates and relative overseas purchasing power.

For example, the U.S. dollar has declined over 40 years from CHF 4.30 (Swiss Francs) in 1966 to CHF 1.20 in December 2006. Hence, the 1966 foreign earned income exclusion of \$25,000 compensated for a salary of CHF 107,500 whereas the 2006 exclusion of \$82,400 at the exchange rate of 1.20 compensated for a salary of only CHF 98,880, which is 8% less in absolute terms than in 1966. If the CHF 107,500 allowed in 1966 were adjusted for inflation by the Swiss CPI, the exempted Swiss Franc salary in 2006 would need to be CHF 352,000, 3.27 times the 1966 salary level. In other words, a foreign earned income exclusion of \$300,000 today, not \$82,400, would be comparable to the foreign earned income exclusion of \$25,000 in 1966.

A more recent example of foreign exchange movements illustrates only too well the tax lottery faced by Americans working overseas due to the cap on foreign earned income exclusion.. The euro and dollar

were exactly at parity on November 6, 2002; by November 6, 2006 – just 4 years later, the dollar was worth only € 0.78670. An overseas American resident in Europe who was paid €100,000 in Nov 2002 and was still earning that €100,000 in 2006, is considered by the U.S. government to have had a salary increase from \$100,000 to \$127,114 – a 27% increase. With the U.S. dollar continuing to decline against other currencies, this distortion will become more perverse with each passing day.

The ***Working American Competitiveness Act*** would avoid these problems and would allow Americans, particularly middle-income managers and professionals with families, to compete in international markets. Most importantly, it would allow American companies to begin hiring once again Americans for important overseas positions.

Estimated Cost of this tax reform: Based on the IRS tax statistics of 2001 (latest available) for Americans filing form 2555, **American Citizens Abroad** estimates that elimination of the cap on the foreign earned income exclusion would cause a direct tax revenue shortfall to the United States in the range of \$1 to \$2 billion per year. This shortfall in U.S. tax revenue can be compensated by cutting out more pork-barrel expenditures. However, from a dynamic economic perspective, a reinforced presence of Americans in American overseas operations should stimulate exports of American goods and create domestic jobs. Tax revenues from this increased domestic economic activity would more than compensate for the tax shortfall from overseas Americans.

Thank You for Your Support

On behalf of all Americans residing overseas, **American Citizens Abroad** thanks you for your interest and comprehension. The taxation of Americans working and residing overseas concerns the nation's interests, not just those individuals residing overseas.

We strongly encourage you to contact your fellow Congressmen who supported the ***Working American Competitiveness Act*** in the 109th Congressional session – S-3496 and H.R.-5986. We hope that similar proposed legislation will be rapidly reintroduced into the 110th session with **bi-partisan support**.

American Citizens Abroad would be pleased to provide you with any additional information you may request and to answer any questions you may have. Kindly send an e-mail to info.aca@gmail.com, attention Tax Committee.

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This position paper on the double taxation of Americans working and residing abroad has been prepared by **American Citizens Abroad (ACA)**, a non-profit, non-partisan association representing the interests of private American citizens residing abroad. Based in Geneva, Switzerland, ACA has membership in over 90 countries. Since its founding in 1978, ACA has been one of the leading organizations speaking out on behalf of the millions of U.S. citizens living abroad, by testifying before Congress, and providing information to overseas Americans and to the press. ACA has brought about changes in a number of laws, improving overseas American rights in the areas of citizenship of their children born overseas, taxation, voting and a number of other issues.

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