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# Taxation of Overseas Americans

Status & Trends  
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## Unique American System of Citizenship-Based Taxation



The United States is the only country that taxes its non-resident citizens on the basis of their citizenship.

Two provisions exist to reduce the burden of double-taxation on non-resident US citizens:

- A certain amount of foreign-sourced earned income (\$91,400 in 2009) can be excluded for purposes of computing income tax via IRS Form 2555.
- Alternatively, taxes paid to foreign governments that correspond to certain analogous US taxes can be partially credited or deducted via IRS Form 1116.

## Expatriate Tax Contributions – An Incomplete Picture



Form 2555 filings in 2006, with detail on OECD countries having the largest number of 2555 filers:

Form 2555 filings		
Country	No. of filings	% of total
Australia	6,420	1.9
Canada	30,067	9.0
France	9,653	2.9
Germany	21,735	6.4
Japan	23,529	7.0
Mexico	6,112	1.8
Switzerland	7,093	2.1
United Kingdom	28,409	8.5
<b>Total of selection</b>	<b>133,018</b>	<b>39.7</b>
Other OECD countries	37,038	11.1
Non-OECD countries	164,795	49.2
<b>All 2555 filings</b>	<b>334,851</b>	<b>100.0</b>

A total of \$4.2B was collected in 2006 from 335,000 foreign-resident filers of Form 2555, an average of over \$12,500 per filer.

No analogous data are available for foreign-residents who opt instead to file Form 1116, as Form 1116 is also used by American residents with foreign investments, and no separate distinction is made for residence status.

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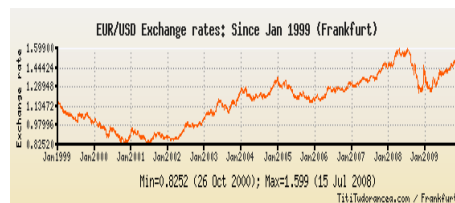
## Exclusion Limits Lagging Currency Exchange Rates



Foreign income is typically earned and paid in non-US currency.

Foreign currencies have generally appreciated against the US dollar since the establishment in 1962 of the cap on foreign earned income exclusion.

The trend has been particularly dramatic in the past ten years:



Since its creation and using German currency as an example, the cap on foreign earned income exclusion has been outstripped by currency trends by roughly 280%.

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## Exclusion Limits Lagging Inflation



The cap on foreign earned income exclusion, \$91,400 in 2009, has been indexed to inflation only since 2006.

Had the initial cap of \$35,000 established in 1962 been indexed to inflation, it would currently amount to over \$250,000.

- ➔ Since its creation, the cap on foreign earned income exclusion has been outstripped by inflation by more than 275%.
- ➔ Including both inflation and exchange-rate effects, the maximum allowed foreign earned income exclusion is more than seven times smaller than when it was first introduced.

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## Foreign Tax Rates Outstripping US Tax Rates



In the past 40 years, the overall tax burden in other OECD countries has grown faster than in the US:

Total tax revenue as a percentage of GDP			
Country	1965	2006	Change
Australia	21.0	30.6	9.6
Canada	25.7	33.3	7.6
France	34.1	44.2	10.1
Germany	31.6	35.6	4.0
Japan	18.2	27.9	10.3
Mexico	16.2 (1980) <sup>2</sup>	20.6	4.4
Switzerland	17.5	29.6	12.1
United Kingdom	30.4	37.1	6.7
<b>United States</b>	<b>24.7</b>	<b>28.0</b>	<b>3.3</b>

1. Source of data for OECD countries: 2008 annual report of the Organization for Economic Co-operation & Development (OECD) titled *Revenue Statistics 1965-2007*  
2. First year reported for Mexico was 1980.

- ➔ **Not including their US tax obligations, many US citizens residing in foreign countries are now subject to a higher overall level of taxation than if they were resident in the US.**

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## Shift from Income Taxes to other “Non-Relieved” Taxes



In the past 40 years, tax structures in other OECD countries have shifted away from personal income taxes toward consumption, social security, and wealth taxes:

Country	1965	1980	2006
Australia	34.4	44.0	37.4
Canada	22.6	34.1	36.3
France	10.6	11.6	17.5
Germany	26.0	29.6	24.5
Japan	21.7	24.3	18.5
Mexico <sup>1</sup>		29.8	25.1
Switzerland	33.4	38.9	35.6
United Kingdom	33.1	29.4	28.6
<b>United States</b>	<b>31.7</b>	<b>39.1</b>	<b>36.5</b>

1. Includes personal and corporate income tax. OECD was not able to separate the two taxes. First year reported for Mexico was 1980.

In most cases, there are no US tax credits or deductions allowed for consumption taxes, social security taxes, or wealth taxes paid to foreign governments.



A shift in foreign tax structures away from personal income tax to other forms of taxation results in an increased overall tax burden on foreign-resident US citizens.

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## Increase in Foreign Consumption Taxes



Consumption taxes include VAT and indirect taxes on gasoline and other consumer products.

Consumption taxes are much larger in other OECD countries than in the US, and have grown as a fraction of total taxation:

Country	1965	1980	2006
Australia	7.4	11.5	14.0
Canada	17.8	11.5	14.0
France	23.3	21.1	16.9
Germany	16.5	16.6	17.8
Japan		4.4 (1990) <sup>1</sup>	9.2
Mexico		51.2 <sup>2</sup>	56.3
Switzerland	10.6	10.3	13.2
United Kingdom	5.9	14.7	18.1
<b>United States</b>	<b>4.8</b>	<b>7.0</b>	<b>7.8</b>

1. First year reported for Japan was 1990.  
2. First year reported for Mexico was 1980.

Although US state sales taxes can be deducted for purposes of US federal tax filing, there is no credit or deduction allowed for foreign consumption taxes.

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## Increasing Social Security Taxes in Foreign Countries



Over the past 40 years, social security taxes have grown as a share of overall taxes in almost all OECD countries.

In some countries, social security tax rates far exceed those in the US:

Social security contributions as a percentage of total taxation			
Country	1965	1980	2006
Australia <sup>1</sup>	0.0	0.0	0.0
Canada	5.6	10.5	14.8
France	34.2	42.7	37.0
Germany	26.8	34.3	38.4
Japan	21.8	29.1	36.6
Mexico <sup>2</sup>		14.1	14.9
Switzerland	14.9	23.4	23.3
United Kingdom	15.4	16.7	18.5
United States	13.3	21.9	23.8

1. Australia does not have a separate contribution for social security; such payments are included in general income taxes  
2. First year reported for Mexico was 1980.

For foreign-resident US citizens, there is no US tax credit or deduction allowed for social security taxes paid to a foreign government.

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## Special Problems with Foreign Pensions



Contributions to pension funds are often larger than contributions to social security.

Although not technically taxes, contributions to pension funds are obligatory in a number of foreign countries.

For US citizens residing in the US:

- Pension fund contributions are deductible for US income tax purposes
- Employers' pension contributions are not added to personal gross income

For foreign-resident US citizens:

- Pension fund contributions are non-deductible for US income tax purposes
- Foreign employers' pension contributions are added to personal gross income



Foreign-resident US citizens face significant additional tax burdens on both their pension contributions and their pension distributions.

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## US Capital Gains Tax Imposes Unintended Burdens



Many foreign countries do not have a tax on capital gains.

Only foreign taxes on capital gains can be credited against US capital gains tax.

➔ In addition to any “non-relieved” foreign taxes they pay on consumption, social security, pensions, and personal wealth, foreign-resident US citizens are often subject to US capital gains taxes for which no offsetting foreign credit is available.

Further, for US citizens who are long-term foreign residents, the decline in the value of the US dollar versus their local currency results in US capital gains tax on their homes, pension funds, and local investments irrespective of any real appreciation as measured in their local currency.

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## Additional Challenges & Costs of Compliance



The volume of IRS regulations and filing procedures applicable to foreign-resident US citizens and for which they are responsible is currently more than two times larger than that for US citizens residing in the US.

The content and format of tax-related compensation and income reports published by foreign employers and financial institutions is rarely in harmony with information required by the IRS.

The restriction that the US dollar be used as the functional currency for IRS reporting, coupled with normal fluctuations in foreign currency exchange rate, dramatically complicates calculation of US capital gains for foreign-resident filers.

There are currently only four IRS offices, each with limited business hours, located outside the US to serve foreign-resident US filers.

Professional tax advisors with expertise in international tax are relatively rare and relatively expensive.

➔ Foreign-resident US citizens pay a high price in time and/or money to merely comply with IRS reporting requirements.

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## Conclusions



The total amount of taxes paid to the US by foreign-resident US citizens is not known. The subset of filers opting for Form 2555 paid \$4.2B in 2006, an average of \$12,500 per filer.

Not including their US tax obligations, many US citizens residing in foreign countries currently face a higher overall level of taxation than if they were resident in the US.

Through its failure to track inflation and currency-exchange trends, the cap on Foreign Earned Income Exclusion is now more than seven times smaller than when it was initiated, representing a dramatic variation from the original spirit of the cap.

With more foreign taxes not creditable or deductible for US tax purposes, and US capital gains tax often lacking a foreign equivalent offering a corresponding credit, foreign-resident US citizens suffer from a growing ratchet-effect whereby variations in tax structure and administration between the US and their country of residence drive spiraling additional taxation.

The effort and expense of tax-reporting compliance has itself become a significant burden to foreign-resident US citizens.

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## Recommendations for Further Study



The current work focused primarily on OECD countries where US citizens are foreign residents. Further study is warranted focusing on Asian and Middle Eastern countries:

- 41% of recent Form 2555 filers are based in Asia and the Middle East.
- Economic growth is currently fastest in these countries.
- The dynamics of expat taxation in these countries are generally different than in OECD countries in that personal income tax rates tend to be low while indirect, "non-relieved" taxes tend to be high.

A fuller understanding of the current situation in US expat taxation requires more highly-resolved examination of IRS data than what was presented in the current work. In particular, it should be investigated how best to recover the following key data refinements:

- Separation of Form 1116 statistics according to country of residence showing associated US taxes paid.
- Separation of foreign-resident filers of Form 1116 who are not also filing Form 2225, showing associated US taxes paid by country of residence.
- Separation of Form 2225 statistics into US income tax and US capital gains tax paid.
- Refinement of Form 2225 statistics to show tax revenue collected by country.

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