Territorial Taxation for Overseas Americans: Section 911 Should Be Unlimited, Not Curtailed

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The United States is among the tiny handful of nations that imposes double-taxation on the labor income that individuals earn in other nations - even if the U.S. citizen is a full-time resident of the foreign jurisdiction. Yet since the "foreign-source" income of U.S. citizens already is subject to all applicable taxes that exist in other jurisdictions, an additional layer of U.S. tax is double-taxation - thus violating one of the most important principles of good tax policy. Almost every other country in the world taxes only income earned inside national borders - the common-sense principle of "territorial taxation." American legislators have tried to mitigate the adverse impact of worldwide taxation by allowing workers to protect annual earnings up to $80,000 from double-taxation. This policy, known as the Section 911 exclusion, is a small step in the right direction. Ideally, the U.S. government should not be taxing any income earned abroad - just as foreign governments should not be taxing any income earned in America. If policy makers created a level playing field by making Section 911 universal, more Americans could find jobs in the global economy, U.S. companies would become more internationally competitive, and U.S. exports would substantially increase.

Introduction

Because of globalization, it is now much easier for jobs and capital to cross national borders in search of better tax law. This mobility of the factors of production means the economic benefits of lower tax rates are greater than they have ever been, but also that the penalties for bad tax policy are greater than they have ever been. As such, it is increasingly important for America to have a pro-growth tax system. In general, this process of "tax competition" has been very beneficial to the United States.[1] Most of our major trading partners have higher tax rates and more oppressive tax burdens, and this has helped attract about $10 trillion of foreign capital to the U.S. economy.[2]

But America's tax system is far from perfect. In particular, the United States has a very onerous "worldwide" tax system, meaning that the IRS imposes tax on income earned by U.S. citizens in foreign jurisdictions. Yet since the "foreign-source" income of U.S. citizens already is subject to all applicable taxes that exist in other jurisdictions, an additional layer of U.S. tax is double-taxation - thus violating one of the most important principles of good tax policy.

Indeed, America has the world's harshest worldwide tax system. The United States, for instance, is among the tiny handful of nations that imposes double-taxation on the labor income that individuals earn in other nations.[3] This double-tax is imposed even if the U.S. citizen is a full-time resident of the foreign jurisdiction.[4] Almost every other country in the world, by contrast, taxes only income earned inside national borders - the common-sense principle of "territorial taxation."

Policy makers have tried to mitigate the adverse impact of worldwide taxation. For individual labor income, "Section 911" of the tax code protects workers from being double-taxed on annual earnings up to $80,000.[5] Technically know as the "foreign earned income exclusion," Section 911 is a small step in the right direction.[6] Ideally, the U.S. government should not be taxing any income earned abroad - just as foreign governments should not be taxing any income earned in America. Shifting to a territorial tax system would have significant benefits for the U.S. economy, including:

- Good tax policy - All tax reform plans, including the flat tax and the national sales tax, are based on key principles such as territorial taxation and taxing economic activity only one time. Making Section 911 universal would fulfill both of these principles.
  - Level playing field - Under current law, U.S. citizens competing for jobs overseas face a competitive disadvantage since they are subject to both foreign tax and U.S. tax. Citizens from virtually every other nation are not double-taxed when working

outside their country of citizenship. Making Section 911 universal would allow Americans to compete fairly with citizens from other countries.

- Increased employment - Since the playing field currently is biased against American citizens, this increases the cost of employing American workers - particularly for executive-level jobs and positions in marketing, management, and financial services. Making Section 911 universal would increase job opportunities for American citizens.

- Increased competitiveness - U.S.-chartered multinationals are hindered by double-taxation since the cost of deploying American workers around the world can be substantially higher than the cost faced by foreign multinationals. Making Section 911 universal would enable U.S. companies to compete on a level playing field in global markets.

- Increased exports - By making it difficult for U.S. companies and U.S. citizens to compete around the world, current law undermines U.S. exports. American companies operating abroad and U.S. citizens employed abroad are much more likely to purchase U.S. products than foreign companies and foreign citizens. Making Section 911 universal would significantly increase U.S. exports - and increase domestic employment in export-oriented industries.

- Tax simplification - The internal revenue code is fiendishly complex, but certain provisions are worse than others. The Section 911 rules almost always require taxpayers to obtain expensive professional assistance. Making Section 911 universal would eliminate this added burden.

- Tax compliance - Because current law is complex, unfair, and difficult to enforce, it is believed that many U.S. citizens living abroad do not fully comply with the law. There are two ways of addressing this noncompliance. The IRS could become more intrusive and the U.S. government could antagonize foreign governments by seeking to more aggressively tax income earned in other countries. Making Section 911 universal would be a much better way to improve tax compliance, though, since it would simultaneously generate significant economic benefits.

Notwithstanding all these strong arguments for making Section 911 universal, there actually have been efforts to increase the double-taxation of Americans working abroad.[7] The Clinton Administration proposed to completely gut Section 911 in 1996.[8] Fortunately, Republicans in Congress rejected that initiative. More recently, the U.S. Senate sought to emasculate Section 911 - a misguided effort that was thwarted by Republican leaders in the House of Representatives.[9]

Policy makers should learn from history. At the behest of President Carter, Congress substantially weakened Section 911 in the late 1970s. Not surprisingly, U.S. competitiveness quickly suffered, and even President Carter's Export Council acknowledged that the increased double-taxation of overseas Americans was costing jobs and exports.[10] As part of his Economic Recovery Tax Act, President Reagan not only restored Section 911, he expanded the amount of income that U.S. citizens working abroad could protect from double-taxation.[11]

Key Things to Know About the Taxation of Overseas Americans

More than four million Americans reside in foreign countries.[12] Depending on their circumstances, many of these U.S. citizens are supposed to file tax returns with the IRS. According to the Government Accountability Office, "Section 6012 of the Internal Revenue Code (IRC) requires individuals to file tax returns if they meet certain gross income thresholds, regardless of whether or not they owe taxes. Individuals residing abroad must file tax returns even if they think their income is exempt from tax under the foreign earned income and housing expense exclusions."[13] This requirement does not seem to have much effect. According to IRS data, fewer than 300,000 tax returns reported foreign-earned income.[14]

Overseas Americans are not double-taxed by the IRS on the first $80,000 they earn. This is the so-called foreign earned income exclusion.[15] The U.S. government taxes their income above $80,000, though they are allowed a credit for some of the taxes paid to foreign governments on that income if they are a "qualified individual."[16] All of their income, of course, is subject to tax by their jurisdiction of residence - just as the U.S. government taxes the income of foreigners who work in America. Needless to say, the adverse impact of Section 911 is much greater in jurisdictions with low tax burdens. An American working in a high-tax nation like France, for instance, likely will have very little tax liability to the IRS after receiving a credit for taxes paid to France. An American working in a low-tax jurisdiction such as Hong Kong, by contrast, doubtlessly will face a large U.S. tax liability.

When the income tax was first implemented, it was not clear whether it applied to overseas income. Congress decided to tax foreign-source income in 1916,[17] though it soon became apparent that this policy was anti-competitive. In 1926, Congress decided to protect foreign-source income from double-taxation.[18] This put U.S. citizens on a level playing field with citizens of other nations.[19] Beginning in 1953, however, Congress decided to double-tax all overseas labor income above $20,000.[20] As mentioned earlier, the protection against double-taxation was weakened even further during the Carter Administration. Ronald Reagan improved U.S. competitiveness by increasing the "exclusion" to $80,000, which is where it remains today.

President Reagan's expansion of Section 911 was a big boost to U.S. competitiveness, but it was only a step in the right direction. And even that positive step has been diluted by inflation.[21] To have the same value today as it did twenty years ago, the Section 911 exclusion should be increased to about $150,000. In the final analysis, however, Section 911 should be universal. Territorial taxation is the right policy, and this means that there should be no double-taxation of income earned in other nations.

The revenue implications of double-taxing overseas Americans are surprisingly modest. When the U.S. Senate sought to double-tax all foreign income earned by individuals in 2003, the revenue gain over 10 years was estimated to total only $35 billion.[22] More recently, the Joint Committee on taxation estimated that the five-year "cost" of Section 911 is just $20.1 billion.[23] Ironically, if politicians succeeded in subjecting all overseas income to double-taxation, people making less than $80,000 per year would bear the heaviest burden. Indeed, more than three-fourths of overseas Americans filing a tax return reported less than $75,000 of income.[24]

While the revenue "gain" of repealing Section 911 is modest, the revenue "cost" of making Section 911 universal presumably is even smaller. The IRS states that U.S. taxpayers living abroad reported approximately $27.4 billion in foreign-earned income in 2001, but that $16 billion was protected by Section 911.[25] This leaves only $11.4 billion of income to be taxed by the IRS, but overseas Americans generally are allowed a credit for taxes paid to foreign governments. As such, it is quite likely that Section 911 could be made universal without "costing" the government more than $1-$2 billion annually. All of these numbers, incidentally, are based on "static" analysis, meaning that revenue-estimators implausibly assume that tax policy has no impact on aggregate economic performance. Using "dynamic" analysis, making Section 911 universal probably would result in higher tax revenue in the long term because of additional U.S. job creation and additional U.S. exports.

But the potential revenue gain is not a reason to make Section 911 universal. Instead, lawmakers should eliminate all double-taxation of overseas income and shift to territorial taxation because it is the right thing to do. As one expert noted during 1999 testimony, "Congress should remove the limitations on the Section 911 exclusion in order to give American workers an equal footing in the global marketplace. None of America's major trade competitors tax foreign earned income, and the U.S. should also move to an unlimited exclusion."[26] Even the Government Accountability Office reached the correct conclusion, writing,

"We believe that Congress should consider placing Americans working abroad on an income tax basis comparable with that of citizens of competitor countries who generally are not taxed on their foreign earned income."[27]

An Onerous Form of Double-Taxation

From a fiscal perspective, Americans working and living abroad are poorly treated by the U.S. government. They are required to pay tax on income that already is subject to tax. As one expert wrote: "Because all governments assert the right to control the taxation of income earned inside their borders, overseas Americans are obligated to pay all applicable taxes in the jurisdictions where they reside. When filing a U.S. tax return, they may claim a credit for taxes paid to those foreign government. At best, this is a very complicated system. If they live in jurisdictions with lower tax burdens than the U.S., they will pay additional tax to the IRS."[28]
The tax can be significant, particularly if the American citizen is working and living in a low-tax jurisdiction. According to the Government Accountability Office, "In 1995, individuals filing from abroad, excluding military personnel and nonresident aliens, had an average income tax liability of about $6,700 despite available exclusions and credits."[29] In testimony submitted to President Bush's Advisory Panel on Federal Tax Reform, one American noted that this double-taxation policy "...discriminates, not against foreigners, but exclusively against private U.S. citizens who, in addition to U.S. income tax, are always subject to the tax laws of the country where they live. Only diplomats are exempt from foreign income taxes."[30]

Ironically, this policy is contrary to the spirit of international tax treaties. Another American who submitted testimony the President's Tax Reform Panel commented on "...the bi-lateral treaties that the U.S. Government negotiates with foreign countries ostensibly to avoid double taxation of the same income. Treaties normally trump national legislation and this would threaten the whole concept of citizenship-based taxation. So, the U.S. Government simply issues a unilateral letter of interpretation stating that the treaty can't prevent double taxation of U.S. citizens by the United States, no matter what the language of each treaty might imply to the contrary. Foreigners get to compete on a level playing field in the United States. Americans overseas get no local level playing field."[31]

The current policy of double-taxing Americans who live and work overseas has a number of features that add insult to injury. For instance:

- Overseas Americans often have to pay Social Security taxes to both the foreign government and to the U.S. government. The U.S. does have "totalization agreements" with about 20 nations, but Americans residing in all other jurisdictions often are subject to both U.S. and foreign payroll taxes.[32]

- Americans abroad are unwillingly forced to become currency speculators since they usually are paid in foreign currencies and have to use dollars for their U.S. tax liability. This creates a foreign exchange risk, something that is not just a theoretical concern given recent shifts in the value of the U.S. dollar.[33]

- The tax trap on overseas Americans is compounded by the treatment of foreign currency holdings. As one American noted: "[W]hen you are paid a salary in a foreign currency, and you keep it in a foreign currency, you are starting a capital gains taxable event that terminates when this money is used to pay a bill in a foreign currency. If the value of the foreign currency goes up between the time of receipt and the time of expenditure, there will be a U.S. dollar denominated capital gain."[34]

- While adverse impact of double-taxation theoretically is mitigated since taxpayers receive a credit for taxes paid to foreign governments. But these credits are restricted. In testimony to the President's Tax Reform Advisory Panel, an American explained: "Foreign taxes paid by a U.S. citizen will therefore generally be recognized only if such tax is sufficiently similar to the tax policies of the United States. In other words, if they aren't doing it our way, you lose."[35]

- Complying with the current system of double-taxation is a costly exercise - in effect a tax on a tax. As a Government Accountability Office study reported: "An IRS/American Institute of Certified Public Accountants (AICPA) survey of tax practitioners conducted in 1989 found that individuals who were unfamiliar with the complexities of the foreign income and housing exclusion and the foreign tax credit could not file returns without the assistance of a tax practitioner. Such assistance can be very expensive in some foreign countries. IRS officials

reported costs of $900 to get a Form 1040EZ prepared in Indonesia and as much as $1,600 for an individual in Canada to file a return claiming the foreign income exclusion and the foreign tax credit."[36]

- Because the current system of double-taxation is so unfair and complicated, many Americans who live and work abroad knowingly or unknowingly fail to comply. The Government Accountability Office estimated that only 12 percent of overseas Americans filed tax returns.[37] Another estimate was even more dismal, concluding that there was only one tax return for every 14.3 overseas Americans.[38]

- Failing to comply with IRS rules is just the tip of the iceberg. Because of currency controls in many nations such as South Africa, overseas Americans often have to choose whether to break U.S. law or foreign law. One American with extensive international work experience explained: "Most developing countries, including China, Argentina and Venezuela, the Caribbean Republics and many more around the world, have strict exchange control laws which prohibit the conversion of local currency to dollars, or any other currency, for the purpose of paying taxes to a foreign government on income earned by foreign residents of those countries. Those countries generally do not recognize that the U.S. or any other country has authority to levy taxes on the income of their residents. U.S. tax laws require U.S. citizens to pay U.S. taxes in U.S. dollars, which in controlled-currency countries obligates them to make illicit currency transactions on the black market and to illegally smuggle out dollars to pay the IRS. These illegal currency activities, in most such countries, are felony offenses punishable by severe fines, imprisonment and confiscation of assets."[39]

- The U.S. government is aware of this problem, but its response is laughably inadequate. As another overseas American noted: "Some foreign countries have blocked currencies and you are not allowed to freely convert these to U.S. dollars. The U.S. Government will let you delay paying U.S. tax due on foreign income from these countries provided, however, that you do not use any of this income for local housing or living expenses. If the foreign country will not allow its local currency to be converted to pay U.S. taxes it is literally impossible to live in such a country without violating the laws of the U.S. or the country of foreign residence."[40]

Double-taxation is not a theoretical concern. Americans living and working overseas paid more than $9 billion in taxes to foreign governments in 2001.[41] Paying a second layer of tax on their income to Uncle Sam is both anti-competitive and inconsistent with good tax policy.

No Level Playing Field

The United States is one of the few nations to double-tax citizens who live and work abroad.[42] By contrast, most other governments do not tax their citizens who live and work in another country.[43] Indeed, the Wall Street Journal noted that, "No other industrialized country taxes its citizens abroad, which means Americans are already at a competitive disadvantage."[44] The National Foreign Trade Council echoed these thoughts, stating, "The U.S. is the only major industrial country that does not completely exempt from taxation the foreign earned income of its citizens working abroad."[45] This creates a distinct disadvantage for the U.S. economy, as illustrated in the accompanying table.

Comparative Tax Policies on Expatriates by Major Trading Countries

Country	Tax on Salary	Tax on Incentives / Bonuses	Tax on Benefits	Tax on Cost of Living Allowance	Tax on Additional Income Earned Out of Home Country	Government Subsidies (To Individuals)
USA	Yes	Yes	Yes	Yes	Yes	No
Japan	No	No	No	No	No	Yes
Italy	No	No	No	No	Complex formulas	Government owned companies
France	No	No	No	No	Complex formulas	Government owned companies
Korea	No	No	No	No	No	Yes
Germany	No	No	No	No	Some limitations. Generally liberal	Few
Canada	No	No	No	No	No	No
Sweden	No	No	No	No	No	Few
UK	No	No	No	No	Complex requirements	Few

Source: Jacqueline Bugnion, "We Need More Americans Abroad Promoting Exports: Citizenship-Based Taxation Must be Eliminated," May 2005.

The United States certainly is not in very distinguished company. Nations that double-tax the labor income of overseas citizens include Bulgaria, Gabon, Honduras, Indonesia, Jamaica, Kenya, South Korea, The Philippines, Senegal, and Zambia.[46] Another source says that only Eritrea, North Korea, the Philippines, and Vietnam practice this self-destructive policy.[47]

In any event, the United States is shooting itself in the foot. The nations that compete with America do not put tax obstacles in the way of individuals and companies trying to compete in the global economy. America does. As one expert commented: "Foreign citizens from high tax countries resident in the U.S., like Germany and the UK, can compete with U. S. citizens for domestic jobs on an equal economic basis because they have no home-country tax obligation. U.S. citizens resident in all other countries are at an impossible competitive disadvantage because of the added U.S. tax liability on salary and out-of-pocket employer reimbursements."[48]

Policy makers certainly have been made aware of the problem. President Carter moved the law in the wrong direction, but at least his Export Council pointed out the mistake: "Recognizing that it is in the best interest of our nation to encourage Americans to work overseas, the Task Force recommends the adoption of tax policies that are comparable to those of major competing industrial nations, none of which now tax citizens who meet overseas residency tests. We urge the development and enactment of new legislation to put Americans who work in the private sector overseas on the same tax footing as citizens of competing industrial nations."[49] Ronald Reagan subsequently did expand Section 911, but there has been no improvement in the tax treatment of overseas Americans since that time.

Reducing Employment Options for U.S. Citizens

Double-taxing Americans who live and work abroad has a very negative effect on the competitiveness of U.S. workers who want to compete in the global economy. Simply stated, fewer Americans will get overseas jobs if their combined foreign and U.S. tax burden is higher than the tax burden on a worker from a country with a territorial tax system. And as the example in the accompanying table indicates, the tax differential can be significant.

Double-Taxation Makes American Workers More Expensive

	U.S. Expatriate	**Non-U.S. Expatriate**
Host Country Tax	$30,000	$30,000
U.S./Home Tax	$40,000	n/a
Foreign Tax Credit	($30,000)	n/a
Remaining Home Country Tax	$10,000	$0

Source: Peter Reinhardt, Eric Stevlingson, and Anton Ionov, "Effects of Section 911 Repeal on U.S. Citizens Working Abroad," Tax Notes International, September 27, 2004.

The reduction in jobs can be caused by both worker and employer choices. American workers may voluntarily decide to reject overseas jobs because the after-tax pay is insufficient, though the same compensation package may be attractive to someone from another country because their after-tax pay will be higher. Alternatively, companies may decide not to hire Americans since they would feel pressure to equalize the after-tax pay of employees performing the same function - a policy that would require higher total compensation costs for American workers.[50]

Empirical evidence illustrates the adverse impact of double-taxing American workers who live and work abroad. Research published in the Southern Economic Journal estimated that a 1.00 percent increase in required wages results in a 0.39 percent reduction in Americans employed abroad.[51] Looking at the issue from another angle, experts at PriceWaterhouse estimated that Americans working overseas would need 7.19 percent more pay to preserve after-tax income in the absence of Section 911.[52]

Anecdotal evidence is equally compelling. There is widespread agreement that the tax code is a significant impediment to the employment of American citizens around the world - and plenty of compelling stories that validate this consensus. For instance:

- A Government Accountability Office report found that double-taxing overseas Americans increased the cost of hiring U.S. citizens. Employers preferred non-Americans since workers from other nations are not subject to double-taxation.[53]

- The same study also reported: "The major U.S. firms we surveyed reported to us that this cost differential [additional tax cost attributable to the 1978 Act] was a major reason why they have decreased their employment of Americans overseas... Further, the relative number of Americans in overseas positions decreased compared with TCNs [third country nationals] from 1976 to 1980 in all of these industries."[54]

- The American Chamber of Commerce in Hong Kong explained: "Because no other developed country imposes tax on the foreign earned income of its citizens living overseas, America's foreign competitors do not need to incur such additional costs in order to retain their nationals in key foreign executive positions. This competitive disadvantage has led to an alarming trend where American companies are filling key overseas managerial positions with non-Americans... If the foreign earned income exclusion were reduced, overseas jobs would not disappear - they simply would be filled by non-Americans."[55]

- An American who used to work as an executive in foreign countries noted: "It is a punitive tax that raises insignificant revenue but discourages U.S. and foreign companies from employing U.S. citizens abroad by punishing them with costly double taxation. This has resulted in the wholesale replacement by 3rd country nationals of tens of thousands of Americans formerly assigned abroad, disqualified U.S. citizens from consideration for new jobs abroad."[56]

- A coalition of American companies warned against expansion of the double-taxation of overseas Americans: "Repeal or modification of Section 911 will not only result in the shift of tens of thousands of jobs now held by U.S. citizens working abroad to foreign nationals, it could also significantly increase the financial burden of any U.S. multinational wishing to retain them, thus reducing their ability to keep pace with their foreign competitors."[57]

- An expert testifying before a congressional committee observed: "U.S. Government tax policies, by contrast, have generally discouraged Americans from working abroad. Alone among the world's industrialized nations, the United States still taxes its citizens on the basis of citizenship rather than residence. Further, overseas Americans must also pay U.S. income tax on benefits, allowances, and overseas adjustments. The practical effects of this tax policy are clear: Americans overseas are at a significant competitive disadvantage and are being priced out of foreign markets because prospective employers must provide more income to compensate American workers for these additional tax burdens. Overseas employers are faced with a choice: They must pay an American worker more than they would pay other comparably qualified nationals (so that the American may keep a comparable after-tax income) or they must utilize a tax equalization program to keep the employee whole for his or her additional tax burden. Both approaches involve additional costs to the employer -- a burden that many employers are

unwilling to accept even if the American worker is more productive and has better professional qualifications than the competition."[58]

- The Wall Street Journal cautioned lawmakers that: "[O]ne of the 'offsets' Republican lawmakers are reportedly considering is the elimination of an $80,000 tax exemption for American citizens living abroad. Now that would have less of an impact in high-tax Europe, because most tax treaties allow you to deduct tax paid in the country of residence from any U.S. tax bill. But in Asia, where local taxes are lower, this could mean a large bite from the income of a middle-class family. And it could affect the hiring decisions of American companies."[59]

- Explaining President Reagan's reforms, a Joint Committee on Taxation report noted that the Carter-era policy had a negative impact: "[S]ome U.S. companies either cut back their foreign operations or replaced American citizens in key executive positions with foreign nationals."[60]

- The organization representing U.S. citizens living abroad wrote: "This handicap acts just like an export tax on American labor. It gives a very strong incentive to both U.S. and foreign corporations to reduce to a minimum the number of U.S. citizens on their payrolls abroad."[61]

- The group, American Citizens Abroad, further explained: "[C]onsider the temptation of a corporate manager abroad under pressure to maintain profitability. By merely replacing an American with someone of any other nationality, a company can save perhaps 30-40% in the personnel budget. This may not only be hard to resist, but might also be essential for the business to remain competitive and survive. And this incentive to get rid of the U.S. employee is due exclusively to the export tax on American labor that has been imposed unilaterally by the U.S. Government."[62]

- A presentation to a Capitol Hill seminar revealed: "A Department of Commerce study on the citizens employed by foreign subsidiaries of U.S. multinational corporations showed that the number of Americans dropped by 50 % from 41,200 in 1982 to only 20,200 in 1999. At the same time, the total number of employees of these affiliates abroad grew 45% from 5.3 million to 7.7 million. One might argue that, as these foreign subsidiaries of US multinationals become more mature, it is only natural that more local employees take the place of the original U.S. citizens, be they executives, technical experts or workers. But the top jobs in these affiliates today are often being filled by well educated, articulate, highly paid executives from countries other than those where these entities are located, just as long as they are not Americans."[63]

- The same presentation also explained: "Young Americans are shut out because they must of necessity be paid more to compensate for the double taxation to which they alone are subjected, since no other industrial nation taxes expatriate citizens. When the topic turns to recruiting for companies operating in the Middle East, where several countries have no income tax, the comment is even more brutal. To quote a senior international recruiter - 'An American will require a salary 50 % higher than a national of any other country because of the unique home-country tax liability. He is totally priced out the market. Not one American will have access to the multiple jobs currently opening up, at all job levels, in the Middle East.'"[64]

The Top 20 Jurisdictions for America's Global Workforce

United Kingdom	33,344	Switzerland	6,370
Canada	24,790	Mexico	5,571
Japan	24,578	China	5,103
Germany	23,432	South Korea	4,885
Hong Kong	12,476	Singapore	4,624
France	8,975	Brazil	4,466
Israel	8,491	Italy	4,301
Australia	7,864	UAE	4,100
Saudi Arabia	7,449	Netherlands	3,926
Taiwan	6,840	Thailand	3,368

Source: Jeff Curry and Maureen Keenan Kahr, "Individual Foreign Earned Income and Foreign Tax Credit, 2001," Statistics of Income, Internal Revenue Service, 2004. Available at http://www.irs.gov/pub/irs-soi/ftcredit.pdf.

- An article in Tax Notes International stated: "In countries that have lower tax rates than the United States (for example, Russia, Ukraine, Singapore, and some Middle Eastern countries), foreign tax credits, even dollar-for-dollar, may not fully cover the U.S. tax liability, creating a situation in which a U.S. expatriate has a tax liability in both the home and host country. As most countries do not impose tax based on citizenship, U.S. expatriates are at a disadvantage from a worldwide tax liability perspective, because most of their non-U.S. expatriate counterparts do not have a home tax liability merely based on their citizenship."[65]

- Last but not least, President Carter's Export Council in 1979 reported on the adverse impact of legislation that expanded double-taxation of Americans working overseas:[66]

    1. "Recruiting firms in France, Germany, Italy and the United Kingdom report they are swamped with requests for qualified citizens of their respective countries to replace Americans who are being forced home by U.S. tax policies."

    2. "Several leading U.S. contractors in the Middle East have reduced their American staffs by more than half, and adopted hiring policies overseas that specifically exclude Americans on future work."

    3. "The University of Petroleum and Minerals in Saudi Arabia says Americans now make up less that 30 percent of its teaching staff, compared to more than 80 percent several years ago."

The United States is the only industrialized nation to double-tax citizens who live and work in other nations. This policy is self-destructive. This policy is inconsistent with good tax law. This policy should be repealed. Section 911 should be expanded to cover all income.

Lowering Exports from America

By making it more expensive to employ Americans overseas, the tax code therefore makes it more difficult for U.S. companies to compete around the world. To be sure, U.S. companies theoretically could employ only foreigners at their foreign subsidiaries and branches. As the preceding section indicated, many companies are reducing the number of Americans, but this presumably imposes a cost on the efficient internal operations of a company.

If there are fewer Americans employed around the world, and fewer U.S. multinational competing around the world, U.S. exports surely will suffer. This is because American citizens and American companies are more likely to purchase inputs and raw materials from American suppliers. PriceWaterhouse explained: "First, Americans living abroad tend to purchase U.S. made good both for personal consumption and their businesses. Second, Americans living abroad increase purchases of U.S. goods by foreigners by, in effect, setting an example. Also, Americans living abroad also may be directly engaged in marketing U.S. made goods, in which case the connection between Americans living abroad and U.S. exports is quite direct."[67]

The American Citizens Abroad (ACA) reached a similar conclusion: "While some key raw materials and components are controlled by standard worldwide factors, many others are within the purview of the local procurement department. An American in a key job can help steer such decisions toward the American suppliers he/she knows and trusts. His/her replacement by someone of another nationality can just as easily, and will in fact is most likely, steer such purchases to a non-U.S. source better known and trusted."[68] And the Government Accountability Office also found that, "Employment of a large force of U.S. citizens abroad is viewed as essential to promote and service U.S. products and operations."[69]

The Joint Committee on Taxation also agreed, explaining that, "...foreign nationals may purchase goods and services for their companies from their home countries, rather than the United States, because they often are more familiar with those goods and services."[70] Unfortunately, this is exactly what is happening around the world - even inside U.S.-chartered businesses. As the ACA notes, "Important decisions about purchasing raw materials and components for assembly by American companies abroad are now being

made more and more by non-Americans. These often lead to preferences for suppliers from the home countries of these foreign buyers."[71]

There is some empirical evidence to augment this common-sense analysis. The research has focused on the degree to which exports would fall if Section 911 was repealed and there was an increase in the double-taxation of overseas Americans. This research obviously suggests that exports would rise if Section 911 became universal and the U.S. government stopped double-taxing Americans who live and work overseas. Some of the key findings include:

- The National Foreign Trade Council estimated in 1996 that, "Without Section 911, exports would decline by approximately $10 billion. This translates into a loss of at least 140,000 U.S.-based jobs."[72]

- A business coalition informed Congress: "In 1978, Congress briefly repealed the provision and, although it was replaced with a less comprehensive measure, the General Accounting Office (GAO) reported a significant decline in the number of Americans working abroad. A 1980 study by Chase Econometrics entitled, The Economic Impact of Changing Taxation of U.S. Workers Overseas, analyzed the IRC Section 911 repeal and concluded that for every ten percent drop in Americans overseas, a five percent drop in U.S. exports would result."[73]

- PriceWaterhouse estimated that repeal of Section 911 would result in a 1.89 percent drop in U.S. exports.[74]

- Regarding the importance of having U.S. companies effectively competing around the world, a study from the Organisation for Economic Cooperation and Development found that every dollar of direct investment overseas by a nation's companies yields $2 of additional exports for that country.[75]

- Another way of measuring the value of U.S. companies operating in global markets is to examine the relationship between foreign production and exports. A survey of the academic literature reveals that one dollar of overseas production by U.S. affiliates generates an average of $0.16 in exports from the United States.[76]

- According to Commerce Department figures, U.S. companies sold $232 billion worth of American-produced goods to their overseas affiliates in 2000. This is impressive, but exports surely would be much higher if U.S. companies competing abroad were not hamstrung by worldwide taxation.[77]

The empirical data and common-sense observations make a strong case that America should shift to a territorial tax system and stop double-taxing Americans who live and work abroad. But this is hardly a new insight. The President's Export Council in 1979 stated: "Americans working overseas are essential to a viable export program. An increase in the number of Americans assigned abroad can increase our exports, reduce the negative balance of payments, enhance our country's image, and raise employment in the U.S. [78]

It is difficult to predict the exact impact if policy makers do the right thing and make Section 911 universal. A representative of ACA hypothesizes that the effect could be significant: "Let's assume that just 50,000 Americans go abroad with the express purpose of promoting exports and that each generates $1 million in new export sales. This would generate $50 billion in new exports. Well, 50,000 is a small number of people for a country the size of the United States and $1 million in sales per employee is highly conservative. If we just assume 100,000 more Americans abroad each generating $2 million in new exports sales, we get $200 billion in new exports."[79]

Whether exports would rise by more than that or less than that is unknown. But what is certain is that good tax policy is based on the logical principle of territorial taxation. Each nation gets to control the taxation of income earned inside its national borders - but they do not try to double-tax the income earned inside their neighbors' borders.

Conclusion

Section 911 should be made universal. All tax reform plans envision a territorial tax system. Eliminating double-taxation of income earned by Americans in other jurisdictions would yield significant economic benefits. Employment would increase, as would exports. As one expert noted:

> *"America's trade competitors realized long ago that encouraging their citizens to work overseas has a pronounced, salutary impact on their domestic economies. Sending their workers abroad has become an integral part of these nations' export strategies. To facilitate this "export" of their citizens (and thus the export of products and services), other governments do not tax their citizens on the money they make while working abroad. This makes these citizens extremely competitive in foreign markets. U.S. Government tax policies, by contrast, have generally discouraged Americans from working abroad. Alone among the world's industrialized nations, the United States still taxes its citizens on the basis of citizenship rather than residence. Further, overseas Americans must also pay U.S. income tax on benefits, allowances, and overseas adjustments. The practical effects of this tax policy are clear: Americans overseas are at a significant competitive disadvantage and are being priced out of foreign markets because prospective employers must provide more income to compensate American workers for these additional tax burdens."*[80]

Sadly, this issue has not been addressed since Ronald Reagan dramatically expanded Section 911 and helped overseas Americans protect more of their income from double-taxation. Indeed, politicians today seem more interested in repealing Section 911 and making the law even worse for U.S. citizens and U.S. companies competing in the global marketplace.

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Endotes:

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