Sent by fax and regular mail

The Honorable Henry M. Paulson Jr.
Secretary of the Treasury
1500 Pennsylvania Avenue N.W.
Washington, D.C. 20220
United States of America

August 16, 2006

Concerns: **Support for passage of the Working American Competitiveness Act**

Dear Mr. Secretary,

American Citizens Abroad (ACA) is a not-for-profit, non-partisan, volunteer organization representing the rights of American citizens residing overseas. ACA was founded in 1978 and has thousands of members all over the world.

We are delighted that you, with such a vast international business experience, have accepted to take on the post of Secretary of the Treasury. An international perspective is vital today to the U.S. economy.

The ACA board wants to encourage your support for the passage of the **Working American Competitiveness Act** which has recently been introduced into the Senate by Senator Jim DeMint (R-SC) (S.3496) and into the House by Congressman Chris Chocola (H.R. 5986). This act would eliminate the cap on the foreign earnings income exclusion of Americans working overseas.

As long-time observers of the situation of Americans overseas, we can assure you that the double taxation on overseas Americans has damaged the international economic strength of the United States. The United States is the only developed nation that taxes its citizens residing overseas, thereby making American personnel too expensive and uncompetitive in the world market. Furthermore, the extension of the American fiscal system overseas unfairly penalizes our citizens. The repercussions for the United States are very serious. The United States trade deficit is running at over 6% of GDP per year and the nation's foreign debt is increasing at the rate of $100 million an hour. Exports need to nearly double to close the gap.

The situation for Americans overseas has become dramatically worse since the disproportionate, highly selective tax increase on overseas Americans was included as a compensating revenue measure in the Tax Increase Prevention Act passed by Congress in May 2006. American Chambers of Commerce and organizations representing Americans overseas are infuriated. Many Americans, particularly independent professionals and small businessmen, may have to return home; the increase in double taxation simply makes it impossible to live and work overseas. American companies, both large and small, are analyzing the impact of the new law; they will most likely replace more American staff with foreigners. This would accelerate the trend already underway for some 30 years, starting with the Tax Reform Act of 1976 which resulted in thousands of overseas Americans losing their overseas jobs and which, according to the Commerce Department, has led to a 50% drop over 25 years in the number of Americans employed overseas by American multinationals.

Many more Americans should be overseas promoting their companies and products but are not, simply because the U.S. tax laws on corporate structures and American personnel make the potential foreign operation too onerous. Taxing Americans working abroad is a form of export tax on labor. It restricts the freedom of Americans to pursue international careers. American companies become more and more dependent on foreigners in key positions, people who tend to favor foreign suppliers. Over the long-term, an insufficient number of Americans have strong international experience and hence American corporations and the U.S. economy are missing out on opportunities in the global economy. We know that in certain industries, such as telecommunications and heavy construction engineering, American companies have lost major export markets due to their inability to competitively employ Americans overseas. Headhunters openly state that American candidates are priced out of the market in regions such as the Middle East. Already in 1981 the GAO report ID-81-29 studied the issue in its report "American Employment Abroad Discouraged by U.S. Income Tax Laws" and recommended that Congress "consider placing Americans working abroad on an income tax basis comparable to that of citizens of competitor countries." The GAO should surely update this study – 25 years later.

We consider as highly erroneous the view enounced by the Senate Finance Committee that the foreign earned income exemption and housing deduction in Section 911 are "subsidies" for Americans overseas. To the contrary, these measures were introduced to help alleviate the penalty of double taxation which the U.S. imposes on its citizens residing overseas. The "subsidy" view compares tax revenues on comparable salaries in the U.S., conveniently forgetting that Americans abroad are also paying taxes in the country where they reside, are often living in high cost countries with high VAT and social security taxes (not deductible for U.S. tax purposes), may require high cost housing for security reasons, are earning and spending money in a foreign currency, are subject to arbitrary increases in taxable income due to currency fluctuations and have no choice but to send their children to private schools to provide them with an American or English-language education. The subsidy view also imposes an indirect cost on those American corporations with tax compensation plans for their American employees; furthermore, such tax compensation payments to employees become taxable income on the next round.

U.S. government policies should encourage, not discourage the employment of Americans abroad. Sending Americans overseas is not a luxury for the privileged but a necessity to maintain and advance America's position in the global economy. Americans working overseas should not be taxed as though they were living at home, but in accordance with the competitive working environment abroad.

Let's put this issue in perspective in the U.S. budget. Total tax revenue from overseas Americans filing 2555 (those with the foreign earned income exemption) amounts to something just over $ 3 billion a year – proof of double taxation since most of these Americans are also paying taxes overseas where they reside. The new tax increase resulting from the change in Section 911 in May 2006 is expected to bring in another $200 million a year. These amounts represent a tiny fraction of one percent of total U.S. tax revenues, totally insignificant, a rounding error in the total American budget. But the damaging influence of these penalizing tax measures has for effect to restrain American companies from sending Americans overseas to promote U.S. products. Employing Americans in corporations overseas does make a difference in promoting U.S. interests.

Until the 1970's, the U.S. never had a trade deficit. Since 1976, the same year Congress voted the Tax Reform Act forcing so many Americans overseas to return home, the U.S. has never had a trade surplus. The U.S. used to be the world's largest exporter. It lost this position to Germany a couple of years ago. Why is Germany, with higher salaries than the U.S., able to export more worldwide with just one-quarter the population and have a large trade surplus despite the fact that it imports 70% more per capita that the U.S.? Why is it that the European Union, with about the same population as the United States, exports 50% more to China than the United States? Why is the U.S. ranking only fifth among importers into China? Certainly part of the answer to these questions is the fact that U.S. tax laws discourage American companies from sending people overseas and prevent small and medium sized corporations from setting up foreign subsidiaries to push exports. Germany is an export oriented country with exports representing over 40% of GDP. The United States has to do everything possible to become more export oriented. U.S. exports have fluctuated between 9 to 11 % of U.S. GDP over the past twenty years. They need to double to close the trade gap.

One of your principal concerns as Secretary of the Treasury is the chronic trade imbalance of the United States with the rest of the world. For this reason, ACA strongly encourages you in the context of the tax reform review currently underway to support the concepts in the **Working American Competitiveness Act**. This would put Americans working overseas on a level playing field and would allow American companies to send Americans overseas to promote U.S. exports. It is estimated that around 20,000 jobs nationwide are created for each $ 1 billion of additional exports. The tax revenue which would be collected from increased domestic manufacturing activity would more than compensate the tax loss linked to Americans working overseas.

Thank you for your consideration. We are sending copies of this letter to Senator DeMint and Congressman Chocola as well as to the three individuals in the Department of the Treasury whom the ACA delegation met in Washington this past June during Overseas Americans Week.

Sincerely yours,

Jacqueline Bugnion
Director of American Citizens Abroad

CC:
Senator Jim DeMint
Congressman Chris Chocola
Mr. Russell L. Munk, Assistant General Counsel, International Affairs, Department of the Treasury
Mr. John L. Harrington, Associate International Tax Counsel, Department of the Treasury
Mr. Charles G. Schott, Deputy Assistant Secretary, Trade & Investment Policy, Department of the Treasury