

# **US Taxes, US Exports and the Competitiveness of Overseas Americans in the World Economy**

## Contents

<b>Taxation of Overseas Americans has become Patently Unfair .....</b>	<b>3</b>
Why the President, Congress and the American People should care .....	3
How Intolerable!.....	4
Overseas Americans Recommendations .....	9
Conclusion: Urgent Need for an In-Depth Study and Appropriate Legislative Action.....	11
<b>US Taxation of Overseas Americans and Foreign Affiliates Impedes</b>	
<b>US Exports.....</b>	<b>13</b>
The Economic Framework.....	14
Exports Create Jobs and Tax Revenues.....	14
The Need to Encourage more Small- and Medium-sized Companies to Initiate Export Programs.....	16
The Need for Large US Companies to Target Products with Export Potential .....	16
The Need to Increase Geographic Diversification of Exports.....	17
Historical Background: How Overseas Americans Relate to Exports.....	18
The Roadblocks to Exports .....	20
US Taxes on Overseas Americans.....	20
US Taxes on Overseas Subsidiaries.....	21
Other Administrative Roadblocks .....	22
Overseas Americans Recommendations .....	23
Conclusion: The U.S. Must Develop an “Export Mentality” .....	24
<b>Notes .....</b>	<b>25</b>

- Part One -

## **Taxation of Overseas Americans has become Patently Unfair**

### **WHY THE PRESIDENT, CONGRESS AND THE AMERICAN PEOPLE SHOULD CARE**

The equal and fair treatment of its citizens has been the distinguishing character of the United States, in a world where, all too often, governments act to suppress the rights of their people. Our Founding Fathers, in their wisdom, established our nation on what they considered self-evident truths, that we are all equal and that we should enjoy the inalienable right to life, liberty and the pursuit of happiness. These rights apply to all citizens of the United States, and the framers of the Constitution made no distinction based on where Americans might choose to live or to work.

Unfortunately, despite the progress that we, as a Nation, have made over the past 235 years, current tax policies and tax laws flagrantly violate these precepts by not treating all Americans equally. Current tax legislation, in a very real sense, imposes a severe financial burden on Americans who live and work overseas, ultimately reducing an individual's ability to compete on an equal basis with citizens of other nations.

In other words, as Americans, our right to choose where to live and work is restricted, and in some cases denied; thus, our freedom to live and pursue happiness as we see fit is greatly curtailed by the tax policies of our Government.

Let us not be fooled, double-taxation is an issue of importance to all Americans. Our Nation's rebellion against the British was in part due to unfair taxation. How can we now allow an equally unfair system of double-taxation to persist?

This is why the President, Congress and the American people should care. Now is the time to act to restore much-needed fairness to our tax policy.

The present paper outlines the specific elements of the current unfair tax legislation and proposes a number of remedial measures.



## HOW INTOLERABLE!

*“After more than 10 years working and residing abroad, I gave up my US passport this year, joining the growing ranks of disaffected Americans overseas whose government has abandoned them and only views Americans overseas as likely tax dodgers, unpatriotic and a source of tax revenue with no constituency to be concerned about. This from Republicans and Democrats alike!”*

(Anonymous, November 2009)

This frustrated ex-American is not alone. One American abroad said: “People won’t work with me because of the tax, legal and reporting implications related to my nationality. Having an American nationality has become a liability in foreign countries.” International tax advisors are seeing a five-fold increase in information requests concerning procedures for renouncing US citizenship; delays for obtaining an appointment with the consular offices for this purpose have shot up from 2 months to 12 months in some countries. For the first time, associations representing overseas Americans are hearing that some American citizens residing abroad want to ensure that their children do not become American. Other Americans overseas are being forced to return to the United States to survive, giving up their careers and homes and leaving extended family members behind.

What has led to such an intolerable situation? Participants in Overseas Americans Week view this as a direct, clearly predictable and easily correctable consequence of the unfair tax treatment imposed on one group of US citizens - Americans domiciled abroad.

**Who actually are “overseas Americans”?** Approximately 5.2 million American citizens reside overseas, according to the State Department. This overseas population corresponds to that of the state of Minnesota, the 21st most populous state.<sup>1</sup> For any number of reasons, including increased mobility due to low-cost transportation and communications worldwide, junior years abroad in high school or college, a stint with the Peace Corps or other NGOs, marriage to a foreigner, birth in the United States to foreign parents who just happened to be temporarily in the US, birth abroad to an American parent, etc., a significant number of Americans are living their lives outside the borders of the United States. In a 2008 post-election survey, 72% of American voters overseas declared themselves to be long-term or permanent overseas residents. They are integrated into the local communities and represent a powerful force as unofficial advocates for the American culture and way of life. One-third of those surveyed stated that marriage was the principal reason for their residency abroad.<sup>2</sup>

Americans sent overseas for limited terms by American corporations on “expat packages” represent a tiny part of the overseas community.<sup>3</sup> In fact their numbers have already declined substantially and continue to drop. They are becoming insignificant as US tax policy simply makes them too expensive and non-competitive for most overseas assignments. They are



# OVERSEAS AMERICANS WEEK

[WWW.OVERSEASAMERICANSWEEK.COM](http://WWW.OVERSEASAMERICANSWEEK.COM)

replaced by foreign citizens who are not subject to double taxation. As one American manager on an “expat package” stated, “We are a dying breed.”

Americans living in the Cayman Islands or other tax havens represent a totally insignificant proportion of overseas Americans.<sup>4</sup>

Where do these overseas Americans live? According to the State Department’s May 2009 estimate, 2.2 million live in the Western Hemisphere, the great majority of these in Canada and Mexico. Another 1.5 million live in Western Europe. 754,000 live in East Asia and the Pacific. 586,000 live in the Middle East. 110,000 live in Africa and 97,000 live in South Central Asia.<sup>5</sup>

It is essential not to confuse Americans domiciled overseas with the US-domiciled tax evaders so much in the news and in the sights of the IRS now tracking down undeclared foreign bank accounts. There is an essential difference between wealthy US residents who have undeclared investment accounts overseas and middle-class American citizens residing abroad who must have foreign bank accounts for their daily living needs, to pay bills and receive salaries, and who pay taxes in the country where they reside as well as in the United States.

**The Fairness Argument:** The most recent revision of the taxation of overseas Americans was included as a revenue-raising measure in TIPRA, the Tax Income Prevention and Reconciliation Act of 2006. Senator Grassley (R-Iowa), then Chairman of the Senate Finance Committee, underlined how unfair it would be for Americans resident overseas to pay lower taxes than citizens resident in the US with similar economic circumstances. In 2003, he used the same argument in his attempt to eliminate the foreign-earned income exclusion (FEIE) and the exclusion or deduction for housing expenses abroad which are allowed under Section 911 of the US tax code.

**The “fairness argument” actually most often cuts the other way today.** The majority of overseas Americans pay more, rather than less, total taxes than their US resident counterparts.<sup>6</sup> This is because of double taxation, which is an inevitable by-product of US tax law.

Since its introduction, US federal taxation has been based upon citizenship as well as residency, implying that all Americans are subject to US taxes, wherever they live. This is virtually unique in the world. None of the industrialized countries tax their non-resident citizens. Up to 1962, however, Congress did not subject income earned abroad to US taxation, principally due to concern for competitiveness and the need to encourage exports. In 1962, the United States placed a cap on the FEIE applicable to citizens working and residing abroad, in the first of a series of ever more restrictive measures intended to increase US taxation on citizens residing overseas, the most recent being TIPRA.

Most countries apply a different basic principle – taxation based solely on residency. All US residents pay the same taxes to the IRS, whether they are citizens, green card holders or, in some instances, even illegal immigrants. The same holds for residents of France, Germany and all other countries which levy income taxes on their residents. Consequently, Americans residing overseas are subject to both citizenship-based taxation by the United States, and residency-based taxation by the country where they live.



In fact, the vast majority of Americans residing abroad live in countries where the total amount of taxes raised in many forms, including consumption taxes (VAT, gasoline tax, etc.), social security taxes, personal income taxes, capital gains and wealth taxes, exceeds total taxation in the United States.<sup>7</sup> Total taxation as a percent of GDP is only 28% in the United States compared to 30.6% in Australia, 33.3% in Canada, 35.6% in Germany, 37.1% in the United Kingdom and 44.2% in France.<sup>8</sup> The tax alone on gasoline in Switzerland corresponds to about \$4.50 per gallon. Value-Added Tax in Europe averages around 18% on all purchases and services.

If an overseas American's foreign income tax equals his US federal income tax obligation, he can apply these foreign taxes as a tax credit against his US taxes. This is considered fair even though not one penny of this income tax is paid to the US. But if he lives in a country with a tax system that does not mirror that of the US, that for example generates all or a great part of its tax revenues through different kinds of taxes (consumption taxes and social contributions) instead of a US-style income tax, he is in effect required by the US government to pay the difference to the IRS. This is clearly not a revenue tax but a "punishment tax" for living in a country with a tax system that is different than that of the USA.

The rules applying to foreign tax credits often result in an unfairly high tax burden on Americans living and working abroad. All US persons (US citizens and green card holders, companies, associations, etc.) are similarly taxed on the basis of their worldwide income. For all taxpayers, certain types of income are excluded from US taxation by virtue of US law or a tax treaty. For the application of foreign tax credits, foreign income is broken down into several categories, known as "baskets": earned income is found in one basket; passive investment income (e.g. dividends, interest & rental income) in another; capital gains in yet another. One cannot apply credit for foreign taxes paid on one basket to another: this applies equally to all US persons worldwide. In practice, however, the rules discriminate against overseas Americans as they represent the vast majority of the Americans who are working and receiving foreign-earned income. If the foreign tax on earned income, for example, is higher than the US tax on that same income but the foreign tax on capital gains or rental income is lower than the equivalent US tax, the American abroad is denied the right to apply foreign tax credits on earned income against the US tax on these or other categories of passive income.

**Mitigating measures:** There is an inherent conflict between citizenship-based and residency-based taxation. This conflict leads to numerous instances of double taxation for American citizens domiciled abroad and has been recognized for a long time. Mitigating measures have been introduced in the legislation principally through two vehicles:

- Specific measures in the tax code under Section 911 exclude income earned overseas up to a threshold (\$91,400 in 2009) and allow exclusion of high rental costs exceeding usual US rents, up to a cap depending on the city of residence. Section 901 also allows for foreign tax credits whereby income taxes paid to foreign governments can be credited against US tax obligations, provided that the US accepts the foreign taxes as creditable.
- Double taxation treaties signed by the United States with numerous countries generally include provisions aiming to avoid, or at least reduce the scope of, double taxation, although each treaty includes a "savings clause" through which the United States maintains its right to tax its citizens



who reside in the foreign country as though they were residents of the United States and as if the treaty had not come into effect.

In practice, however, Americans resident overseas are subject to numerous, and increasing instances of double taxation. This is unavoidable. Five examples highlight this point:

- All OECD countries except the United States derive large revenues from Value Added Taxes (VAT) which is a consumption tax. General consumption taxes accounted for 19% of all OECD country taxes in 2006 whereas they accounted for only 7.6% of US taxes.<sup>9</sup> The United States does not, however, allow credit or deductions for foreign VAT taxes even though a deduction is allowed for U.S. sales taxes.
- Over the past 45 years, Social Security taxes have risen substantially in OECD countries. By 2006, social security taxes represented the largest source of tax revenue in 8 countries, including France, Germany and Japan where they exceed 36%. In contrast, social security taxes in the United States represented just 23.8% of total taxes.<sup>10</sup> The IRS 1040 tax form assumes that all social security taxes are comparable to US social security taxes; taxes are based on income before social security contributions. Americans abroad with higher social security contributions have lower take-home pay, but US taxes are based on the gross income.
- Some countries, including France, Holland and Switzerland, have a tax on net worth, i.e. total assets less personal liabilities; this tax can be quite significant, yet it cannot be credited against US taxes, either against income taxes or capital gains taxes.
- Not all countries have capital gains taxes, as they tax capital through other means and put more tax weight on other revenue sources. Hence, many Americans abroad pay higher total taxes in the country of residence than their US-domiciled counter-parts, yet still owe capital gains taxes to the US as no foreign tax credits are available.
- In many countries, self-employed people are required to pay both their resident country's social security charges and US social security charges (including US Medicare even though they are not eligible for Medicare benefits overseas).

This mismatch is an inevitable corollary of the fact that different countries have different tax principles and tax codes and that the US does not recognize certain foreign taxes as equivalent to US taxes. **In practice, mismatches always work to the detriment of American taxpayers residing overseas.** 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, overseas Americans 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 mitigating measures mentioned above are only partially effective as they have not kept up with economic reality and in fact have become more restrictive over time. **The present situation is not fair. On the contrary, it penalizes Americans domiciled abroad. Although most**

**Americans overseas live in countries with a substantially higher cost of living and higher total taxes, they still pay in addition several billion dollars of taxes to the United States.<sup>11</sup>**

Furthermore, Americans overseas earn their income and save in foreign currencies, but must use the US dollar for their US tax calculations. This has huge implications which have never been dealt with explicitly in the US tax regulations. In 1962, when the cap on the foreign-earned income exclusion was initiated, exchange rates were fixed on the gold standard. Subsequent to the introduction of floating exchange rates by President Nixon in 1971, the dollar has declined significantly against foreign currencies. In 1962, the dollar was worth 4.32 Swiss Francs; today it is on par with the Swiss Franc. During the late 1990s, it took less than \$1.00 to buy one Euro; today almost \$1.50 is required to buy one Euro. Americans abroad watch helplessly as their stable foreign salaries translate for US tax purposes into ever higher US dollar salaries, pushing them into higher US tax brackets. When the FEIE was introduced, it represented a top-level manager's income; today, it does not even match an engineer's salary.

In addition to important instances of double taxation mentioned above, US tax law contains numerous instances of discrimination against US citizens residing abroad, for instance:

- Everyone has the choice to opt for the standard deduction on the 1040 or to itemize deductions on Schedule A. However, the United States introduced a new measure in 2008 allowing an individual to take the standard deduction plus a deduction for real estate taxes on the 1040, but only if the residence is in the United States.
- Education credits for students are applicable only if the university qualifies for US government loans, which basically requires attendance at US universities.
- Energy saving credits for solar panels and hybrid cars are available only for a principal residence in the United States and for cars used in the United States.

Such measures are always a one-way street which systematically discriminates against American citizens residing abroad. How can legislators who invoke the fairness argument pass laws which clearly discriminate against one group of taxpayers – those residing overseas?

**Americans who reside and work abroad in low-tax countries face an overwhelming competitive disadvantage**, since the level of the foreign-earned income exclusion is inadequate and applicable foreign tax credits are insufficient; hence they pay substantial income taxes to the United States. As the United States is the only nation which taxes its citizens residing abroad, Americans must live with a significantly reduced take-home pay or be priced out of the market in low-income tax countries. And many of these low tax countries where significant international business takes place, such as Hong Kong, Singapore, Saudi Arabia and Dubai, have very high costs of living as well as “fees” on rents and services applicable only to foreigners which are not creditable against US taxes.

**Required tax filing is burdensome:** Overseas Americans must file tax returns not only with the government where they reside but also with the United States. Filing with the IRS brings additional challenges and costs of compliance. The volume of IRS regulations and filing procedures applicable to foreign-resident US citizens is currently more than double that for citizens residing in the United States. IRS Publication 4732, “Federal Tax Information for U.S.



# OVERSEAS AMERICANS WEEK

[WWW.OVERSEASAMERICANSWEEK.COM](http://WWW.OVERSEASAMERICANSWEEK.COM)

Taxpayers Living Abroad”, lists the relevant IRS documents. They total 618 pages of instructions plus another 234 pages of forms with their related instructions. Going a step further, if the additional IRS publications referred to by each IRS document mentioned in Publication 4732 are included in the count, the total of pages reaches 4,723 after eliminating double counting of references. How can average overseas American be expected to cope with such massive complexity? Furthermore, 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.

US tax filing for overseas American entrepreneurs and the self-employed is literally a nightmare. Americans owning businesses abroad must file the IRS Controlled-Foreign-Corporation Form 5471, which is so complex that even IRS staffers say that they are not permitted to answer questions related to the forms. IRS instructions for Form 5471 recognize that 80 hours are required to complete it. All reporting for Form 5471 must be done in accordance with US GAAP whereas the rest of the world follows International Accounting Standards. Compliance requires costly recourse to a professional international tax preparer as severe penalties are listed in the IRS code for failure to complete the form correctly. This creates a major cost penalty on American entrepreneurs. It severely impedes the ability of overseas Americans to be competitive abroad and to enter into partnerships with foreigners.

The requirement that the US dollar be used for IRS reporting, coupled with normal fluctuations of foreign exchange rates dramatically complicates tax filing compliance, and particularly the calculation of US capital gains for foreign-resident filers. Currently there are only four IRS offices, each with limited business hours, located outside the US to service foreign-resident US filers. Professional tax advisors with expertise in international tax are relatively rare and extremely expensive. **US citizens residing abroad pay a high price in time and/or money to merely comply with IRS reporting requirements.**

## OVERSEAS AMERICANS RECOMMENDATIONS

Overseas Americans, through their partner organizations in OAW, urge Congress to correct the gross unfairness of the present tax situation through appropriate revisions of the tax code.

- **Increase the Foreign Earned Income Exclusion** from \$91,400 (2009) to at least \$250,000 in 2010 and subsequently index it to inflation. The current level is totally inadequate. If the initial 1962 amount of FEIE had been regularly indexed to inflation, it would exceed \$250,000 today, and this does not take into consideration the declining value of the dollar versus other currencies which artificially inflates overseas salaries for U.S. tax purposes. Through its failure to track inflation and currency-exchange trends, the cap on the FEIE is now more than seven times less than when it was initiated, representing a dramatic variation from the original spirit of the cap – to allow middle-class Americans to be competitive overseas. Increasing the FEIE would greatly simplify tax reporting for over 90% of overseas Americans who would no longer need to use the complicated Form 1116 to claim foreign tax credits on their foreign-earned income in excess of the FEIE cap. Yet the eventual revenue loss for the US Treasury would not be significant as the increased exclusion on earned income would be offset by lower foreign tax credit claims. The



very high-income overseas Americans, who are few in number but account for a high proportion of taxes paid by overseas residents, would continue to pay substantial taxes to the United States.<sup>12</sup>

- **Grant overseas Americans the option to adopt the currency of the country of residence as the functional currency** for calculating capital gains for US tax reporting, as is currently allowed for corporations. The gain would be determined in the local currency and would be translated into US dollars at the exchange rate valid on the date of sale. Over 70% of Americans overseas are long-term overseas residents who save primarily in the currency of the country of residence. With the declining value of the US dollar in relation to other currencies, the US capital gains tax, which currently requires converting purchases and sales of foreign assets at the exchange rates available on the transaction dates, unfairly penalizes overseas Americans. It currently works as a tax on the declining value of the US dollar.
- **Simplify the housing exclusion / deduction** under Section 911, to allow “the lower of actual housing costs or the maximum cap set by the Treasury Department”. This single maximum cap would be based on the Treasury’s current highest cap allowed. Today there are hundreds of caps for specific cities, often very arbitrary and discriminatory, which create a heavy administrative burden on the IRS as well as on taxpayers and an unfair “zip-code tax” lottery on Americans abroad.
- **Recognize foreign taxes on net worth as creditable against US tax liability.** This correction would eliminate a key source of double taxation.
- **Stop discriminatory taxation of contributions to foreign pension funds** as well as income and gains on those funds. Contributions and returns on US domestic pension funds are not subject to US taxation, whereas those on foreign pensions not recognized by the US are subject to US taxation.
- **Allow foreign social security and pension income to be taxed only by the country of residence** for all overseas residents, as is currently the case in a few double taxation treaties, for instance between the United Kingdom and the United States.<sup>13</sup> Modification of the US Tax Code should generalize the principal of only residency-based taxation on foreign source retirement income.
- **Remove the excessively complicated filing requirement for controlled-foreign-corporations** for Americans who (1) live abroad, and (2) run businesses in the country where they live.
- **Recognize VAT taxes as the equivalent of sales taxes for US tax purposes.**
- **Eliminate the tax on US corporations for employing US citizens abroad.** Employer reimbursements for extra costs incurred living abroad, such as transportation for obligatory home leaves, children’s tuition in English-language schools, purchasing power cost-of-living adjustments, housing provided by the employer, etc., are presently considered as part of the taxable foreign-earned income for private citizens. Since most “expat packages” compensate the employee abroad for higher US taxes than would have been paid if the person had remained in the United States, taxing the reimbursements for expenses linked to overseas employment

becomes a tax on US corporations discouraging them from employing Americans abroad. Originally, compensation for expenses directly linked to overseas employment was not subject to US taxation for private citizens; it still is not subject to taxation for diplomats and federal employees deployed abroad. While the US government recognizes these additional expenses as justified to encourage its employees to accept posts abroad, US tax policy severely penalizes the private citizen, and hence the US corporate employer. Excluding taxation on justified expense compensation in “expat packages” along with an increase in the FEIE would incite American corporations to once again deploy American staff abroad. A reinforced presence of Americans representing their companies’ interests and products abroad would create jobs for American citizens at home as well as abroad since it would enhance the export potential and competitiveness of American companies.

- **Stop the specific tax discrimination against the 1,200 American citizens who live abroad and have been hired as Locally Employed Staff (LES) at some 80 US diplomatic missions.** These American citizens are subject to both US taxation and in their country of residence. But they cannot apply the Foreign Earned Income Exclusion (FEIE) on their US tax returns because of specific wording in Section 911. Consequently, this specific group of overseas American citizens experiences a disproportionate tax burden. Their particular situation clearly illustrates the essential importance of the FEIE to promote fair taxation and to allow American citizens working abroad to be competitive.

## **CONCLUSION: URGENT NEED FOR AN IN-DEPTH STUDY AND APPROPRIATE LEGISLATIVE ACTION**

Overseas Americans urge **President Obama** to manifest his leadership and to bring about the needed reforms. It is time to move beyond the shortsighted view in Congress that overseas Americans should be penalized for making a personal decision, or accepting an assignment, to live abroad. This is a fundamental issue of freedom to migrate without penalty. Nor should Americans abroad be viewed as simply a potential, easy source of additional tax revenue, even if the amounts collected are only the equivalent of a rounding error in the overall U.S. budget. For the individuals concerned, the taxes are not a rounding error, but an unfair burden.

It is neither normal nor fair that cumulative discriminatory tax policies are now pushing loyal individuals over the cliff and are forcing them to renounce their US citizenship which is a fundamental part of their heritage and personal identity. It is particularly perverse at a time when other nations are undertaking special efforts to maintain mutually beneficial contact with their overseas communities while not subjecting them to citizenship-based taxation. In today’s global world, there is an inherent advantage for the United States to have worldwide membership in the international community.

It is also time to adopt a global view of the full implications of US tax policy towards overseas Americans on the nation’s long-term global economic and other interests. This issue is covered in



# OVERSEAS AMERICANS WEEK

[WWW.OVERSEASAMERICANSWEEK.COM](http://WWW.OVERSEASAMERICANSWEEK.COM)

a complementary OAW position paper - “**US Taxation of Overseas Americans and Foreign Affiliates Impedes US Exports**”.

Overseas Americans specifically ask the **Honorable Paul Volcker**, Chairman of the President’s Economic Recovery Advisory Board, to work closely with the **Honorable Gary Locke**, Secretary of Commerce coordinating the **National Export Initiative**, the **Honorable Timothy Geithner**, Secretary of the Treasury and the **Honorable Douglas Schulman**, IRS Commissioner, to evaluate current tax policy regarding overseas Americans and its long-term implications on the well-being of its citizens overseas and the need for the United States to create jobs through increased exports. This study should lead to a determination of the fairness of the US tax code. Close coordination with the Congress on this issue is essential. The community of Americans abroad strongly urges **Senator Baucus and Congressman Levin**, respective Chairmen of the Senate Committee on Finance and the House Committee on Ways and Means, to bring about the necessary tax legislative reforms in conformity with the recommendations above.



- Part 2 -

## **US Taxation of Overseas Americans and Foreign Affiliates Impedes US Exports**

*"We need to export more of our goods. Because the more products we make and sell to other countries, the more jobs we support right here in America. So tonight, we set a new goal: We will double our exports over the next five years, an increase that will support two million jobs in America. To help meet this goal, we're launching a National Export Initiative that will help farmers and small businesses increase their exports, and reform export controls consistent with national security.*

*We have to seek new markets aggressively, just as our competitors are. If America sits on the sidelines while other nations sign trade deals, we will lose the chance to create jobs on our shores. But realizing those benefits also means enforcing those agreements so our trading partners play by the rules. And that's why we'll continue to shape a Doha trade agreement that opens global markets, and why we will strengthen our trade relations in Asia and with key partners like South Korea and Panama and Colombia."*

President Barack Obama  
State of the Union Speech  
January 27, 2010

Overseas Americans can only be delighted to see President Obama provide vigorous leadership to increase US exports through the creation of the National Export Initiative (NEI). As announced by Secretary of Commerce Gary Locke on February 4<sup>th</sup>, NEI will create an Export Promotion Cabinet reporting to the President that will consist of top leaders from the Commerce, Treasury and State Departments, the Department of Agriculture, the Export-Import Bank, the office of the United States Trade Representative and the Small Business Administration, to give export development "all-the-time-focus". The government will increase resources available to promote exports, tackle credit issues and remove trade barriers. All of these initiatives are to be lauded as this is the first time ever that the United States has undertaken to develop a comprehensive export policy. **But they are not enough.**

Americans working and living abroad have an international perspective on requirements for successful exporting. They are not only convinced that increasing exports is the key to US prosperity in today's competitive global economy, but are also certain that the United States must



# OVERSEAS AMERICANS WEEK

[WWW.OVERSEASAMERICANSWEEK.COM](http://WWW.OVERSEASAMERICANSWEEK.COM)

integrate specific tax and administrative measures into its NEI to allow American citizens working abroad and American companies involved in exporting to be competitive in world markets.

In this paper, non-partisan, non-political organizations sponsoring Overseas Americans Week will:

- provide a short summary of the role of exports in the US and in other world economies;
- review the relationship between overseas Americans, exports and the fiscal policies of the United States during the last 35 years;
- identify fiscal and administrative roadblocks which inhibit US exports, specifically:
  - US tax policy which discourages American companies from employing American staff in their overseas operations;
  - US tax policies and reporting burdens which discourage small- and medium-sized companies from setting up sales subsidiaries abroad;
  - the QI and FBAR regulations which impede the ability of American entrepreneurs and small businesses to do business abroad;
- suggest ways by which the United States can facilitate a dramatic increase in exports by removing specific fiscal and administrative roadblocks.

## THE ECONOMIC FRAMEWORK

President Obama has set a goal of doubling US exports in five years. The goal is ambitious, but achievable. A few simple numbers can provide perspective on the issue. Exports of goods in 2009 amounted to \$1 trillion. Over the last decade, US exports of goods and services have represented 10% to 11% of GDP whereas imports have grown from 13% to nearly 18%. While services have sustained the US trade surplus, the trade deficit in goods has ballooned, reaching a peak of \$840 billion in 2008. The consequence has been an annual trade deficit in the range of \$700 billion in 2007 and in 2008, corresponding to 5% of GDP. In 2009, the annual trade deficit declined to \$381 billion, due to the recession. This imbalance requires the US to borrow funds from abroad, thereby making the entire economy dependent on, and vulnerable to, foreign creditors. In fact, the trade deficit represents spending of \$1.3 million a minute, 24 hours a day, every day of the year, all of which will have to be repaid, with interest, at some point in the future. Doubling US exports in five years would sharply reduce, if not eliminate, the US trade deficit.

## EXPORTS CREATE JOBS AND TAX REVENUES

The National Economic Council (NEC) in President Obama's Administration emphasizes the need for the US to develop, in particular, a clear export policy for manufactured goods, which will increase manufacturing jobs. As stated by Secretary Locke, for every \$1 billion in exports, 6,250 manufacturing jobs are created or supported. Each job in manufacturing is estimated in one study to generate three additional jobs in the economy.<sup>14</sup> Doubling exports of manufactured goods would lead to millions of new jobs in the United States, generating significant new tax revenue for the federal government, based on the historical 18% share for federal taxes in GDP.



Doubling exports in five years implies an average annual growth rate of 15%, but since the US manufacturing sector is significantly larger than goods exports, increasing exports by 15% would correspond to less than a 10% annual increase in manufacturing activity. While this represents a big challenge, it is achievable, particularly if President Obama leads and Congress and industrial leaders place top priority on export development. It is encouraging that the US Chamber of Commerce has also set the goal of doubling exports over the next five years.<sup>15</sup>

The United States is still highly competitive. In its September 2009 report, the World Economic Forum in Geneva, Switzerland, places the US in a virtual tie with Switzerland as the No. 1 most competitive economy in the world.<sup>16</sup> The question we need to face and answer head-on is why did Switzerland end 2008 with a job-creating \$18 billion trade surplus whereas the U.S. ended with a job-destroying \$700 billion trade deficit? Why was the U.S. the only one of the ten most competitive economies in the world with a trade deficit whereas every one of the other 9 achieved record or near-record trade surpluses? Switzerland imports 4.1 times as much per capita but exports 7.4 times as much as per capita as the U.S. It has a growing trade surplus with China even though the Swiss Franc has increased 63% in value with respect to the U.S. dollar and the Chinese Yuan over the past 8 years. Switzerland is currently negotiating a free trade agreement with China with the full support of Swiss labor unions that recognize it will create more high-paying jobs for Swiss workers.

Switzerland is not alone in its export strength. As the table below shows, exports of goods in important industrialized nations represent a significantly higher proportion of GDP than in the United States.

**BALANCE OF TRADE DATA**  
 2008 Economic Data<sup>17</sup>

COUNTRY	Population (Million) July 2009	GDP		Exports			Imports		Trade Balance (US\$ Billion)
		Total (US\$ Billion)	Per Capita US\$	Total (US\$ Billion)	Per Capita US\$	Total % of GDP	Total (US\$ Billion)	Per Capita US\$	
Canada	33.5	1,500.0	44,776	459.1	13,704	30.6	415.2	12,394	43.9
France	64.1	2,867.0	44,726	601.9	9,390	9.4	692.0	10,760	(90.1)
Germany	82.3	3,673.0	44,629	1,498.0	18,202	40.8	1,232.0	14,970	266.0
Italy	58.1	2,314.0	39,828	546.9	9,413	23.6	546.9	9,413	0
Japan	127.1	4,911.0	38,639	746.5	5,873	15.2	708.3	5,573	38.2
Netherlands	16.7	877.0	52,515	531.7	31,838	60.6	474.8	28,431	56.9
S. Korea	48.5	929.1	19,157	433.5	8,938	46.7	427.4	8,812	6.1
Switzerland	7.6	500.3	65,829	241.3	31,750	48.2	227.4	29,921	13.9
<b>U.S.A.</b>	<b>307.2</b>	<b>14,440.0</b>	<b>47,005</b>	<b>1,277.0</b>	<b>4,157</b>	<b>8.8</b>	<b>2,117.0</b>	<b>7,087</b>	<b>(840.0)</b>



## THE NEED TO ENCOURAGE MORE SMALL- AND MEDIUM-SIZED COMPANIES TO INITIATE EXPORT PROGRAMS

Since exports currently represent a relatively small proportion of US GDP, the potential for expansion is significant. The growth possibilities for US exports are enormous, particularly if multitude of small and medium-sized companies can be truly encouraged to venture into overseas markets and set up sales subsidiaries. Taken together, these companies are the largest employers in the manufacturing sector of the US economy. Yet today, their participation in exports is negligible. Howard F. Rosen of the Peterson Institute for International Economics noted in his report to the Senate Finance Committee<sup>18</sup>:

*“Given all its benefits, it is surprising that so few US companies export.*

- *Only 4 percent of US companies export.*
- *Five hundred companies account for 60 percent of US exports.*
- *Companies with more than 500 employees, which constitute only 3 percent of our exporting companies, account for 70 percent of US exports.*
- *Less than 0.5 percent of US companies operate in more than one country.*
- *Fifty-eight percent of exporting companies trade with only one country.”*

Venturing abroad to set up a foreign sales subsidiary is a major step into the unknown for small- and medium-sized US companies. However, in addition to this challenge, the companies face US reporting and tax policies detailed later in this paper which strongly discourage the establishment of overseas sales subsidiaries.

## THE NEED FOR LARGE US COMPANIES TO TARGET PRODUCTS WITH EXPORT POTENTIAL

Americans living abroad are often astounded and annoyed by the negligible presence of American products in foreign markets. As an illustration, one American couple was building a house in Europe and wanted to acquire American oak parquet produced by Armstrong World Industries, Inc. They not only liked the appearance and quality, but were also enthusiastic because it reminded them of the United States. They couldn't find any distributor of the product and finally called the company. Armstrong's reply was: *“We don't export that product.”*

Another example is “Cling Plus” transparent wrap made by S.C. Johnson & Son, Inc. Its quality far exceeds anything found overseas and yet it is not available abroad. When overseas Americans vacation in the United States, they return with three packages of “Cling Plus” to carry them over until the next trip.

Still another example involves an American businessman who was setting up a manufacturing subsidiary in China to penetrate that market. He wanted to install the US-made machine tools he had in his plants in the United States. Their manufacturer was not present in China. His German competitors were, however. They had not only a well established sales subsidiary, but also a complete backup service program for their products. The Germans got the business.

If large US manufacturing companies are going to be serious about exports, they need to have a top level corporate export manager reporting to the CEO, responsible for getting all divisions involved.

**THE NEED TO INCREASE GEOGRAPHIC DIVERSIFICATION OF EXPORTS**

An effective US export policy will require increasing exports through much broader geographic diversification of exports. One-third of all US exports go to Canada and Mexico combined, yet their economies are far from representing one-third of global GDP, and many of these exports are linked to industrial structures which result in the products being re-imported to the United States. The level of exports to Europe is only 25% more than exports to Canada, yet Europe has a population exceeding 400 million compared to Canada’s 30 million. Exports to the Pacific Rim should be much more substantial, given the growth of the Chinese market, the highly developed Japanese market and the dynamism of Southeast Asia. US Exports to India are virtually insignificant.

The evident under-representation of US exports in key markets illustrates the need for an *export mentality* in the United States. The nation systematically has a goods trade deficit with all geographic regions except South and Central America, as shown in the following table. We can hope that the NEI will foster this “export mentality”.

**US Exports of Goods by Geographic Region**  
 (11 months 2009) (in billions of dollars) <sup>19</sup>

	<u>Exports</u>	<u>Trade Deficit</u>	<u>Exports, % of total</u>
Canada	186.5	-17.7	19.60%
Mexico	117.2	-42.3	12.30%
Europe	236.3	-84.4	24.80%
Pacific Rim	227.7	-256.6	23.90%
South, Central America	99.4	1.5	10.50%
OPEC	44.4	-55.1	4.70%
Africa	22.2	-33.0	2.40%
India	15.7	-4.3	1.70%

It is not only possible for the United States to double exports in the next five years, it is absolutely indispensable. As Mr. Rosen of the Peterson Institute for International Economics stated in *The Export Imperative*, dated December 9, 2009, for his testimony to the Senate Finance Committee-Subcommittee on International Trade:

*“Increasing exports is the only option available to help the United States get out of the economic mess it currently finds itself in without sacrificing US living standards. The US government, together with private sector representatives, should move aggressively to set medium- and long-term targets for increasing US exports and expanding the pool of exporting companies.”*

Howard F. Rosen, Visiting Fellow, Peterson Institute for International Economics



## **HISTORICAL BACKGROUND: HOW OVERSEAS AMERICANS RELATE TO EXPORTS**

One important reason why US exports of goods are insufficient is that there are simply not enough Americans sent overseas by US corporations to develop exports of goods “made in the USA”. US tax policy is largely responsible for this. The Reform Act of 1976, signed by President Ford on October 4 and made retroactive to January 1, 1976, was immediately responsible for a sharp cutback on employment of American citizens abroad. The direct result was absolute panic. Reimbursements by US employers for high living costs, in-kind housing, children’s tuition for English language schooling, all of which remain tax-free to US government employees abroad, were made taxable for private citizens living and working abroad. The 1976 Act drastically increased the double taxation of US citizens living and working abroad, who were already subject to taxation of their worldwide income in addition to all sorts of other foreign taxes in accordance with the laws of their host countries.

In sworn testimony before Congress in 1978 on the disastrous results of the Tax Reform Act of 1976, Robert M. Gants testified as the representative of US and Overseas Employees Tax Fairness Committee, a group representing 43 engineering and construction firms and their suppliers in the US. He stated: “*Many Americans in high living cost areas overseas, which accounts for 75% of our people, are now subject to taxes in excess of what they make in salary.*”<sup>20</sup> These firms were active in engineering and construction projects in the Middle East where, up until this legislation, US firms were #1 in market share. US companies have little share today in this market. The business has gone to foreign competitors who only naturally specify equipment and materials from their own countries. By forcing withdrawal from this market, US tax laws have destroyed untold billions in export sales. As Robert M. Gants testified, “*These changes have placed our industry overseas on a ball and chain at a time when competing nations are adopting tax policies which put their engineers and contractors in track shoes and cleats.*”<sup>21</sup>

The result was that tens of thousands of US citizens working abroad could not survive and came back home. This Act severely crippled the effective network of Americans abroad that had always ensured a US trade surplus. US companies cut back their US staff abroad, totally abandoning formerly profitable markets. One man’s statement says it all. He had started up an export business for US telecommunications equipment in Brazil and was forced back to the United States by the 1976 tax law. He remembers, “*The French quickly moved into the market and just ten years later the business topped \$1 billion. The US share of that market today is zero. Only 800 cases like mine, and there were many more, explain why the US today has an \$800 billion trade deficit in goods.*”<sup>22</sup>

In 1975, the United States enjoyed its largest ever trade surplus, \$12.1 billion. In 1976, just one year later, the trade pattern turned sharply negative with a trade deficit of \$6.1 billion. The following year, in 1977, the trade deficit grew by a factor of 4.5 to \$27.2 billion! It has gone downhill ever since. The United States has not recorded a single trade surplus in 34 years and the nation’s cumulative foreign debt now exceeds \$7.2 trillion. What caused such a sudden dramatic negative shift? The oil crisis of the 1970s and increasing competition from Japanese and European companies are part of the answer, but the impact of the Tax Reform Act of 1976 was both immediate and disastrous. The outcry from industry led to a series of Congressional and Presidential Reports.



The GAO study, **The Impact on Trade of Changes in Taxation of U.S. Citizens Employed Abroad** was issued on February 21, 1978. The study included a survey of 145 corporations and 167 individuals working overseas. The results showed that 45% of the individual taxpayers expected to return home on or before the end of their present tour because of the tax change; there would be an adverse effect on exports and on GDP. There was concern about a “ripple effect” on sub-contractors or suppliers, should a primary company lose a contract due to higher costs incurred in tax reimbursement to US employees, or should Americans be replaced by other nationals who might choose to deal with their own countries’ firms rather than with US firms.

A year later, the President’s Export Council created a special **Task Force to Study the Tax Treatment of Americans Working Overseas**. Their report of December 10, 1979, confirmed the predictions of the GAO study. Then in 1981, the GAO produced another study (ID-81-29) entitled **American Employment Abroad Discouraged by U.S. Income Tax Laws**. Although Congress had passed a new law, the *Foreign Earned Income Act of 1978*, to cancel the worst provisions of the 1976 Act, the 1981 GAO report noted that “*tax provisions in the Foreign Earned Income Act of 1978 are proving a disincentive to employment of US citizens abroad, and, therefore, adversely affecting exports.*” This is beyond all doubt still the case, nearly 30 years later!

All three studies concluded that US tax policies on American citizens abroad were negatively impacting US exports and jobs in the US and that it was essential to maintain a large force of US citizens abroad to promote and service US products and operations. They all recommended the adoption of tax policies comparable to those of all other major industrial nations, none of which taxes citizens who meet overseas residency tests.

Despite the concerns expressed by these serious studies, Congress ignored their recommendations and, in fact, has leaned towards increasing taxes on overseas Americans. American citizens continue to suffer a major competitive disadvantage in world markets due to a unique mix of tax and administrative regulations.

The result has been as predicted – the United States has not had a trade surplus since 1975. US Department of Commerce statistics show that the number of US citizens employed by foreign subsidiaries of US multinationals dropped by half from 41,200 in 1982 to 20,200 in 1999, while total employment by foreign affiliates grew from 5.8 million to 7.8 million. The Department of Commerce stopped showing employment of US citizens abroad after 1999. One must suppose that the number became too insignificant to report. It is not surprising that some 25 years after the flurry of Congressional reports Lissa Redmiles, an economist with the Special Studies Returns Analysis Section of the IRS wrote the following in the *Statistics of Income Studies of International Income and Taxes*. “*One noticeable shift 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.*”

US multinationals continue to cut back on the presence of Americans overseas. Headhunters working to fill overseas positions state frankly that they do not even consider American candidates because the tax situation makes them too expensive to employ. The outcome is that America’s exports have not kept up with growth in world trade and future American business leaders are not gaining the international experience required in today’s ever more global economy. A top-level



manager of a Dow Jones company noted recently that, most likely, the next CEO would be a foreigner because none of the US candidates had an adequate level of international experience.

Up to now, Washington has blamed foreign barriers against exports and the level of the Chinese Yuan for the nation's massive trade deficit. This is why President Obama's remarks in his State of the Union message of January 27, 2010 and the launch of the NEI represent a turning point. President Obama's leadership should stop the blame game and begin to orient thinking toward what the United States needs to do to regain control and to increase exports. Promoting exports does not "make exports happen". Secretary Locke stated that, "*American companies need advocates on the ground who will fight for business.*", but he was only referring to government employees assisting companies. Secretary Locke is correct in principle, but his concept of those on the ground fighting for business must be broadened to include American citizens sent overseas by their companies to sell products made in the USA. All of the government promotional efforts in the world will be fruitless unless they are accompanied by the rapid elimination of self-imposed roadblocks to exports.

## THE ROADBLOCKS TO EXPORTS

Developing a true export policy will undoubtedly involve a multifaceted approach on broad fronts, as outlined by Secretary Locke. This paper, however, will focus on just three factors which concern overseas Americans and which they have identified as serious roadblocks to exports:

- **US tax policy as it applies to American citizens working and residing abroad**
  - This policy discourages American companies from employing American staff in their overseas operations.
- **US tax and reporting policies on Controlled Foreign Corporations**
  - These policies discourage small- and medium-sized companies from setting up sale subsidiaries abroad.
- **Other administrative roadblocks, such as US QI regulations and FBAR reporting**
  - These regulations impede the ability of American entrepreneurs and small businesses to do business abroad.

## US TAXES ON OVERSEAS AMERICANS

The current US Tax Code is the result of Congress opportunistically increasing taxes on Americans abroad to compensate for domestic tax reductions. TIPRA, passed in 2006, is a prime example. The US Code makes it too expensive to employ US citizens abroad:

- The United States taxes its citizens overseas on a citizenship-basis. Yet overseas Americans also pay taxes to the country where they reside. Incompatibilities in tax systems inevitably lead to double taxation.
- Compensation paid to employees sent abroad for expenses directly linked to their overseas posts, such as high living costs and education in English-speaking schools abroad for children, are



included in the employee's taxable salary if paid by private employers, while they are tax-free when paid by the US government to its own staff abroad. This pushes the private sector American citizen into higher US tax brackets and raises taxes. The tax penalization, in fact, becomes a cost to the US employer who compensates his overseas employee for excess US taxes; this tax compensation also becomes taxable income, thereby leading to a spiral of ever higher taxation. It is not surprising that the number of Americans employed abroad by large US multinationals has dropped to statistical insignificance.

- The Foreign Earned Income Exclusion (FEIE) has not kept up with reality. It is intended as a mitigation measure under Section 911 of the US tax code to avoid double taxation for US citizens abroad who already pay taxes to their country of residence. The FEIE stands at \$91,400 in 2009. If the original FEIE of 1962 had been systematically adjusted for inflation in accordance with the Consumer Price Index, it would exceed \$250,000 today.
- The housing exclusion rules in Section 911 of the US tax code are unrealistic and do not reflect realities abroad.
- Salaries paid in foreign currencies to employees overseas must be translated into US dollars for US tax purposes. With the dollar declining, foreign currency-based salaries are artificially inflated when expressed in US dollars, reducing the value of the FEIE and artificially pushing overseas Americans into higher tax brackets.

Foreign competitors, whose governments do not tax their citizens who work and live abroad, have total flexibility to send staff where needed to open up markets and establish strong export networks. Many companies require their managers to have foreign experience, as a condition for advancing in the corporate structure. The United States must match this competitive stance.

Part I of this paper entitled **Taxation of Overseas Americans has become Patently Unfair** details measures required to make overseas Americans competitive.

## US TAXES ON OVERSEAS SUBSIDIARIES

As the United States taxes US corporations on worldwide income, each foreign subsidiary must file Form 5471 for Controlled Foreign Corporations (CFC) in addition to the tax returns of its country of residence. While large multinationals may be able to handle the administrative burden of Form 5471, CFC reporting creates a major barrier for small and medium-sized corporations which might otherwise be interested in developing exports.

The IRS estimates that completing Form 5471 takes 80 hours, the equivalent of two full weeks of work. How can a small operation overseas justify such an effort, particularly since the corporation abroad also has to report and pay taxes to its country of residence? Furthermore, US tax reporting requires application of US General Accounting Principles while the rest of the world uses International Accounting Standards (IAS). The overseas subsidiary must maintain two sets of books, one for business and one for US tax reporting, one in local currency, one in the US dollar.



Professional American tax preparers abroad speak of Form 5471 as an administrative horror. Form 5471 is so incredibly difficult to prepare that even the IRS staff is not permitted to answer questions related to the forms. IRS support for overseas tax filers is totally inadequate, according to "Access to the IRS by Individual Taxpayers Located outside the United States", published by The Taxpayer Advocate Service.<sup>23</sup>

The estimated cost of hiring a professional tax advisor to complete Form 5471 for just a small company ranges from \$5,000 to \$25,000, depending on complexity of operations. If the big accounting firms are hired, the fees are even more. And this cost is associated with each and every subsidiary established abroad. Foreign competitors, whose countries do not raise corporate taxes on a worldwide basis, but on a residency basis, have a significant competitive advantage.

### OTHER ADMINISTRATIVE ROADBLOCKS

A US company which sets up a foreign sales subsidiary will necessarily open local bank accounts. This requires filing the Treasury's *Report of Foreign Bank and Financial Accounts* (FBAR) in addition to the CFC reporting. Under the Treasury's new FBAR reporting rules, any American citizen with signatory authority over any foreign bank account, even if he or she has no financial interest in the account, must file the FBAR report. An American manager of a US overseas subsidiary will find his personal tax reporting complicated by this requirement.

Furthermore, the US reporting requirements shut out many possibilities for American companies to enter into joint ventures with foreigners to promote US exports. If an American company or individual owns just 10% of a foreign corporation, it falls under the CFC rules. Foreigners understandably refuse to get involved in CFC and FBAR reporting. These same impediments on competitiveness apply to American entrepreneurs and self-employed who already reside overseas and who could potentially be extremely well-positioned to assist US small- and medium-sized companies to establish sales networks overseas. But, as one frustrated overseas American stated, "People won't work with me because of the tax, legal and reporting implications related to my nationality. Having an American passport has become a liability in foreign countries."

The new Qualified Intermediary Regulations (QI) that the United States is proposing for foreign and American banks operating overseas are such that many overseas banks are refusing to open or maintain accounts for American citizens. The Foreign Account Tax Compliance Act (FATCA), currently before Congress, will extend and reinforce the QI regulations to several forms of economic entities and will turn overseas Americans into pariahs in the international banking world. It will increase the competitive disadvantage of Americans businessmen overseas and US foreign subsidiaries may find it difficult to open and maintain bank accounts abroad. The Department of Treasury goes even further in the *Administration's Fiscal Year 2011 Revenue Proposals* dated February 2010. US citizens with signature authority on foreign bank accounts would be required to report all bank account movements on their 1040, which would create an unduly heavy administrative burden on US citizens working abroad and on the IRS.

Another barrier for small- and medium-sized companies to venture abroad may be their corporate structure. Many of these companies are organized as S corporations. Setting up a foreign sales



subsidiary will definitely complicate their corporate structure and may require them to transform the S company into an incorporated company. This additional complication on top of the excessively heavy reporting for foreign subsidiaries simply stops many small- and medium-sized corporations from moving into foreign markets.

When the cost and burden of filing Form 5471 and the FBAR, the reporting requirements in the framework of QI and FACTA and the potential need to reorganize a corporate legal structure are added to the high cost of sending American staff overseas due to US taxation, an overwhelming wall of multiple barriers confront small- and medium-sized companies even considering initiating a program to set up foreign sales subsidiaries.

This burden certainly contributes to the significant under-representation of small and medium-sized companies in exports. Yet for new overseas operations to be successful, it is essential to have American staff on the ground that can liaise effectively with the US headquarters and implement the company's strategy, who can acquire first-hand understanding of competitors' strategies and establish commercial contacts and distribution networks overseas, and who can sell and service US products. There is enormous export potential for US exports if more small- and medium-sized companies can be enticed to tackle foreign markets. For this, the barriers must go.

All of the regulations mentioned (taxation, FBAR, QI, FACTA) are clear handicaps imposed either by Congress or by the Administration on the ability of the US economy to compete in the world arena. Levelling the playing field by removing these roadblocks should be viewed as a prerequisite towards the goal stated by President Obama in his State of the Union message of January 27, 2010 "to double exports in five years. If these roadblocks are not removed, this goal will not be achievable."

## OVERSEAS AMERICANS RECOMMENDATIONS

Overseas Americans strongly recommend that:

- The Executive Office working on the National Export Initiative should work towards the elimination of the self-defeating US tax and reporting environment that inhibits export development.
- **Congress, in coordination with the *National Export Initiative***, should up-date the 1981 GAO report on taxation of overseas Americans and adapt US fiscal policies to the competitive framework in which US citizens and US companies overseas operate in the global economy.

More specifically, the OAW organizations view the following measures to be essential steps:

- 1) **Stop the tax practices which price American citizens out of** overseas markets so as to encourage US corporations to once again employ American staff abroad to promote exports. Employer compensation for expenses linked to the overseas post should not be included in the employee's taxable salary; the foreign earned income exclusion should be increased; the housing exclusion should be simplified and made fair.



- 2) **Simplify the tax reporting requirements for Controlled Foreign Corporations.** It is essential to alleviate the reporting burden of the CFC for subsidiaries of small and medium-sized enterprises as well as self-employed US citizen entrepreneurs abroad. Means should be found to facilitate, not discourage, the setting up of overseas sales subsidiaries by small and medium-size companies organized as S corporations.
- 3) **Incite US companies to initiate export programs.** To jump-start the establishment of foreign sales networks by small and medium-sized companies, the United States should consider a specific tax break for export initiatives. Tax laws should maintain the deferred US taxation on overseas earnings and should, **in addition**, make dividend remittances from overseas subsidiaries to US parent corporations exempt of US tax or taxed at a low rate, as long as the foreign subsidiaries can justify their role in increasing US exports. The increase in domestic jobs and profits through increased export sales would generate substantially more tax revenue for the US government than the income “lost” on non-taxed or low-taxed dividend remittances. With the possibility of free capital flows, companies would be able to expand production facilities in the US and/or set up additional foreign subsidiaries geared to exporting more US products. The experience of the Jobs Creation Act of 2004 clearly demonstrated the sensitivity of US corporations to taxation on intra-corporate dividends.<sup>24</sup> US corporations need to be put on an equal footing with their foreign competitors, which are taxed on a residency basis.
- 4) **Encourage broader geographic diversification of exports.** This requires the US government to have adequate export guarantee and financing programs to mitigate perceived financial risks. It also requires availability of good information programs and guidelines by country and region for businesses to find their way to export markets for the first time. The proposed activities of the International Trade Administration in the Department of Commerce, as outlined by Secretary Locke, are promising in this respect.
- 5) **Develop a partnership between the overseas American community, US business and the government to encourage exports.** A survey among overseas Americans about the American products they have looked for and have not found abroad should produce a multitude of ideas of products with export potential. Many overseas Americans would envision working with US companies on export programs. The new *CommerceConnect* website being prepared by the Department of Commerce should include an information exchange page for US companies and overseas Americans to match interests and needs.

## CONCLUSION: THE U.S. MUST DEVELOP AN “EXPORT MENTALITY”

On January 27, 2010, President Obama opened a new chapter of our economic history by placing a priority on export development. With an “export mentality”, the United States can build on the enormous export potential among its small and medium-sized companies as well as the large multinationals to propose new products to foreign markets and to enter into new foreign markets. This would lead to increased investment in domestic manufacturing facilities to supply the goods for export. The United States would find itself in a win-win situation – creating domestic jobs, reducing the trade deficit, lowering the government deficit, providing the nation with new economic vitality and ensuring America’s place as the world’s economic leader.



If the country is to become truly export-oriented, government programs must incorporate the changes needed in tax policies to encourage both American citizens and American companies to establish themselves overseas for this purpose.

## Notes

- <sup>1</sup> United States Census Bureau, July 1, 2009. [http://factfinder.census.gov/servlet/GCTTable?\\_bm=y&-geo\\_id=01000US&-box\\_head\\_nbr=GCT-T1-R&-ds\\_name=PEP\\_2009\\_EST&-format=US-40S](http://factfinder.census.gov/servlet/GCTTable?_bm=y&-geo_id=01000US&-box_head_nbr=GCT-T1-R&-ds_name=PEP_2009_EST&-format=US-40S).
- <sup>2</sup> Source: [www.overseasvotefoundation.org](http://www.overseasvotefoundation.org). The 2008 post-election survey showed that 72% of respondents considered themselves long-term or permanent overseas residents.
- <sup>3</sup> U.S. Department of Commerce statistics show that the number of U.S. citizens employed by foreign subsidiaries of U.S. multinational companies dropped by half from 41,200 in 1982 to 20,200 in 1999 while total employment by foreign affiliates grew from 5.8 million to 7.8 million. The Department of Commerce stopped showing employment of U.S. citizens abroad after 1999.
- <sup>4</sup> Only 6,816 Forms 2555 were filed in 2006 by Americans residing in the Caribbean Islands, of which only 354 were resident in the Cayman Islands. Source: <http://www.irs.gov>
- <sup>5</sup> Department of State: letter from Ed Betancourt, May 9, 2009. These data relate to American citizens not affiliated with the United States government; i.e. private American citizens abroad.
- <sup>6</sup> Source of data for OECD countries: 2008 annual report of the Organization for Economic Co-operation & Development (OECD) titled *Revenue Statistics 1965-2007* and <http://www.irs.gov>. The thirty OECD countries account for 50.8% of the total 335,000 filings of Form 2555 and for the most part are high-tax countries. Many non-OECD countries can also be considered high-tax countries.
- <sup>7</sup> Based on analysis of IRS statistics - Form 2555 returns for 2006. Source: <http://www.irs.gov>.
- <sup>8</sup> 2008 publication of the Organization for Economic Co-operation & Development (OECD) titled *Revenue Statistics 1965-2007*. The full report can be downloaded from <http://www.oecd.org>. Go to Publications and search for "Revenue Statistics 1965-2007". The percentages cited relate to 2006, the most recent year cited in the report.
- <sup>9</sup> Ibid.
- <sup>10</sup> Ibid.
- <sup>11</sup> IRS statistics on tax filings with Form 2555 and Form 1116. In 2006, a total of \$4.2 billion was collected from 335,000 foreign-resident filers of Form 2555 used to apply the Foreign Earned Income Exclusion. No analogous data are available for foreign residents who opt instead to file Form 1116 to apply foreign tax credits, as Form 1116 is also used by US residents with foreign investments, and no distinction is made for residency status.
- <sup>12</sup> IRS statistics on tax filings with Form 2555 show that 11% of all returns in the group with adjusted gross income exceeding \$200,000 paid 79% of all US taxes paid by filers of 2555.
- <sup>13</sup> The double taxation treaty between the United States and United Kingdom allows in Article 17 that only the country of residence can tax pensions (para. 1), social security payments (para. 3) and annuities (para. 4). Paragraph 2 is the one exception that deals with a lump-sum payment derived from a pension scheme; this lump-sum payment is taxed only by the country of source. This treaty took effect January 1, 2004.
- <sup>14</sup> National Economic Council, *Revitalizing American Manufacturing*, December 2009, p. 6. "The National Association of Manufacturers has estimated that "every \$1.00 in manufactured goods generates an additional \$1.37 worth of additional economic activity - more than any other economic sector." This also helps create jobs – one study found

- that each job in manufacturing supported three jobs in the rest of the economy.”  
<http://www.whitehouse.gov/sites/default/files/microsites/20091216-manufacturing-framework.pdf>
- <sup>15</sup> Mr. Thomas J. Donahue, President and CEO, U.S. Chamber of Commerce on September 15th in a speech in Michigan: *Creating American Jobs through Global Trade*.
- <sup>16</sup> <http://www.weforum.org/en/initiatives/gcp/Global%20Competitiveness%20Report/index.htm>
- <sup>17</sup> <https://www.cia.gov/library/publications/the-world-factbook/index.html> *Balance of Trade Data – 2008*
- <sup>18</sup> *The Export Imperative* by Howard F. Rosen, Visiting Fellow, Peterson Institute for International Economics. Testimony for the Senate Finance Committee Subcommittee on International Trade. December 9, 2009. Mr. Rosen's statistics on exporting companies reference the US Department of Commerce. 2009. *A Profile of US Exporting Companies, 2006–2007*. US Census Bureau News, April 9.
- <sup>19</sup> Source of geographic distribution of US exports <http://www.census.gov/foreign-trade/balance/>
- <sup>20</sup> The sworn testimony was in the February 23 and 24, 1978 hearings before the House Committee on Ways and Means as reported in the 1978 GAO in-depth report prepared at the request of Congress *Impact on Trade of Changes in Taxation of US Citizens Employed Overseas* ID-78-13 of 2/21/1978, p. 33.
- <sup>21</sup> Ibid.
- <sup>22</sup> Statement of Roger Conklin, one of the 130 US business executives who testified before the House Committee on Ways and Means hearings of February 23 and 24, 1978. Following these hearings, Congress voted to retroactively delay the effective date of the 1976 legislation by one year. But the irreversible damage had already been done. The overseas Americans had already returned home.
- <sup>23</sup> The National Taxpayer Advocate Service, *2008 Annual Report to Congress*, Volume One.
- <sup>24</sup> The Jobs Creation Act of 2004, which effectively reduced US taxes on dividend remittances from overseas subsidiaries from 35% to 5%, resulted in a multiple jump in dividend remittances during the two years the measure was applicable, as outlined in *US Multinational Companies, Dividends and Taxes* by Ralph Kozlow and Patricia Abaroa, US Bureau of Economic Analysis, p. 7. This paper was presented at the International Association of Official Statistics, Ottawa, September 6-8, 2006. <http://www.docstoc.com/docs/19855003/US-Multinational-Companies-Dividends-and-Taxes>