

Our Taxed Expats

By Newt Gingrich
And Ken Kies

Suppose you are trying to come up with ways to change U.S. tax law to make American business less competitive in the global economy. Your list of ideas would likely include raising the U.S. corporate tax rate even higher than its current 35% rate, already tops in the OECD. You would try to make sure that U.S. companies are subject to higher taxes than foreign-based competitors when they do business abroad. And of course, you would attempt to change our tax system to discourage the hiring of Americans overseas. Americans working overseas might actually help promote the export of U.S. goods and services abroad.

Sadly, Congress has latched on to this last idea as part of the ironically titled "Tax Increase Prevention and Reconciliation Act," signed into law by President Bush on May 17. A provision inserted in the conference agreement dramatically rewrites the rules under section 911 that limit U.S. taxation of American citizens working abroad. Specifically, the proposal would tax U.S. citizens working overseas at higher marginal rates and subject their housing to higher taxes. Adding insult to injury, these changes were drafted to take effect retroactively, back to the beginning of this year.

Reading the newspapers in the days following the enactment of this legislation would have given you a sense of the shocked, and unhappy, reactions of Americans working overseas. But the larger issue is that section 911 rules are of great importance for American competitiveness, which is why Congress needs to revisit the new law's changes as soon as possible.

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The United States is the only major industrialized country in the world that taxes its citizens without regard to where they reside or work. Accordingly, if we are transferred abroad by our employer, we are subject to tax on our salary and on "stranger in a strange land" assistance that our employer may provide (e.g., the cost of sending our kids to an English-speaking school, or airfare for an annual trip home). We are subject not only to U.S. tax on these amounts, but also to taxes imposed by the foreign country.

All things being equal, it is cheaper for our employer to hire a non-American for a foreign position. If our employer moves us, it likely will have to raise our pay to cover these additional tax costs to get us to agree to the assignment. If our employer hires a foreign national, already onsite, it simply pays a base foreign salary.

Section 911 has long helped to mitigate this disincentive to hire Americans. In 2006, the provi-

sion allows U.S. citizens to exclude \$82,400 from income. Prior to the new legislation, income in excess of that amount was subject to U.S. tax at standard income-tax rates. Also prior to the new legislation, a U.S. citizen could deduct the cost of foreign housing above a base amount; alternatively, if our employer picked up this cost, the benefit was excludable.

Congress clobbers Americans abroad.

The new changes enacted by Congress provide that any income above and beyond the exclusion cap is taxed at rates that "pretend" that the exclusion does not exist. That is, the first dollar of income above the \$82,400 cap is taxed at a 25% rate, not at the 10% rate that previously applied. The new legislation also caps the foreign housing deduction/exclusion at \$11,536 (or \$961 a month). Congress did give Treasury the authority to adjust this amount for high-cost locations, but the extent to which meaningful relief will be provided is uncertain at best.



David Klein

What is undeniable is that U.S. workers abroad face a massive tax increase—\$2.1 billion over the next 10 years to be precise, according to Congress. U.S. workers in places like Hong Kong or Dubai may see tax increases in the tens of thousands of dollars. In the near term, some employers may respond by raising a worker's pay. If employers do nothing, a worker will be left to pick up the cost. And since the tax applies retroactively back to the beginning of the year, and since employees can't typically move back to the U.S. on a week's notice, this unfortunate person may be stuck with a salary structure he or she would never have agreed to had there been knowledge of the change to section 911.

So, you might say, maybe some U.S. employers pay more and some individuals get hurt. What's the big deal? First, the new tax increases can only mean that there will be fewer "Americans on the ground" in overseas markets going

forward. Studies have shown a direct correlation between employment of Americans overseas and U.S. exports. These studies confirm what one might assume—that Americans are best at selling America. That is, U.S. workers are most likely to specify and purchase U.S. goods and services where opportunities arise in foreign projects. A 1980 study by the Chase Econometrics Group found that a 10% drop in Americans overseas would result in a 5% drop in U.S. exports. A 1995 Price Waterhouse study found that repeal of section 911 would result in an \$8.7 billion reduction in U.S. exports, which would translate into the loss of approximately 143,000 U.S.-based jobs.

Second, where U.S. companies bid on overseas projects against foreign companies, they may have to bid, for a variety of reasons, on the assumption that they will employ U.S. citizens. Americans already are more expensive to employ in overseas locales. The added cost of the new section 911 tax increases will only raise the pricing of U.S. bids, and therefore mean U.S. companies get less work.

Third, the section 911 changes will hurt small and medium-sized businesses. Smaller firms are more likely than larger firms to use U.S. citizens when they first seek penetration of foreign markets. A 1995 study by professors at the Johns Hopkins University of Advanced International Studies found that 82% of surveyed small- and medium-sized businesses said loss of the section 911 exclusion would have a substantial impact on their ability to secure projects or compete overseas. These firms also are far less likely to be able to absorb the cost of adjusting employees' pay to offset the impact of the section 911 tax increases. Thus, the first and harshest effects of the legislation may be felt by these smaller companies.

We hope that a critical mass can drive corrective action. We would propose something radical. Why not follow the lead of our trading partners and exempt foreign-earned income completely? If that is too far-reaching, we should repeal the tax increase, effective back to its January start date, and restore the intended utility of section 911 by increasing the exemption amount to \$117,000, which would take into account inflation since the amount was originally set (at \$70,000) in 1982.

Either of those approaches would mean more U.S. players out on the field. Global business competition is already fierce enough. We shouldn't sabotage ourselves.

Mr. Gingrich, a senior fellow at the American Enterprise Institute, is former speaker of the House of Representatives. Mr. Kies, a managing director at Clark Consulting, served as chief of staff of the Joint Committee on Taxation 1995-98.