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Report to the Congress; by Elmer B. Staats, Comptroller General.

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In a supplement to a report, "Impact on Trade of Changes in Taxation of U.S. Citizens Employed Overseas," estimates were provided of U.S. tax liabilities of Americans overseas under a variety of optional taxing methods and of revenue that would be lost to the Treasury as a result of relief to taxpayers under each of the methods. For more than 50 years, the United States provided a special tax incentive to citizens employed abroad to promote U.S. exports and commercial competitiveness. In 1976 the Congress enacted amendments which substantially reduced the incentive, but the effective date of the reduction was postponed. Findings/Conclusions: The Congress is presently considering several proposals for tax relief, each involving a different cost in lost revenue. The methods of taxation involve flat exclusions, variable exclusions, administration deductions, and exclusions with an option of deductions. Calculations were made for each of these methods under conditions in which foreign taxes paid are fully credited and in which they are partially credited. The methods range in the degree of tax incentive or relief which would be provided from $551 million ($3,700 per tax return), or 82% of the total tax liability, to $161 million ($1,081 per return), or 25% of the total. As recommended previously, serious consideration should be given to providing an incentive for overseas employment, at least until more effective means for promoting U.S. exports and commercial competitiveness abroad are implemented. (HTW)

7144

BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Revenue Estimates Under Various Methods Of Taxing Americans Abroad

In 1976 the Congress substantially reduced a longstanding tax incentive for citizens employed abroad. This incentive was designed to promote U.S. exports and commercial competitiveness. In 1977 the effective date of the tax incentive reductions was postponed. The Congress is presently considering the appropriate form and level of relief. Until a system is established for evaluating the effectiveness of these incentives and the costs associated with them, policy formulations and congressional oversight will be hindered.

This report provides estimates of revenue costs to the Treasury (amounts of lost revenue resulting from the granting of relief) under a broad range of methods of taxing Americans abroad. Similar proposed methods could involve about the same amounts of lost revenue, so rough estimates can be made of many alternatives not evaluated in this report.

UNITED STATES GENERAL ACCOUNTING OFFICE

ID-78-52

JULY 27, 1978

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-137762

To the President of the Senate and the
Speaker of the House of Representatives

This is a supplement to our February 21, 1978, report, "Impact on Trade of Changes in Taxation of U.S. Citizens Employed Overseas." It provides estimates of the U.S. tax liabilities of Americans overseas under a variety of optional taxing methods. It also contains estimates of the amount of revenue that would be lost to the Treasury as a result of the granting of relief to such taxpayers under each of these methods.

For more than 50 years, the United States provided a special tax incentive to citizens employed abroad to promote U.S. exports and commercial competitiveness. No system has been established, however, to evaluate the effectiveness or the cost of the incentive. In 1976 the Congress enacted amendments which substantially reduced the incentive. A high degree of uncertainty existed at the time as to what the revenue impact of the reduction would be. Subsequently, in response to the wide-spread concern of U.S. citizens and firms overseas, the effective date of the reduction was postponed.

The Congress is currently working to establish the appropriate level and form of the tax relief. Several proposals have been offered for consideration, and each involves a different cost in lost revenue. Since each proposal must be costed separately, and the total cost depends on the interaction of the various elements in it, it is usually not possible to combine costs of specific elements from different proposals. For that reason, we have presented in this report a series of alternatives which represent a broad range of revenue costs. Proposals which are similar in effect to the ones covered here can be presumed to involve about the same amounts of revenue, so many alternatives not evaluated in this report can be roughly costed from the estimates given here.

We obtained the data necessary for preparing these estimates from 1975 income tax returns. We obtained the data in February 1978, pursuant to Public Law 95-125, signed on October 7, 1977. That law provides the General Accounting Office with access to data contained in income tax returns. For the most part, the assumptions we used in making the estimates are the same as those used by Treasury in a 1978 report. 1/

The estimates are projections for one tax year only and do not take into account the potential secondary effects of the various methods of taxing Americans overseas. These other effects, which may reinforce or diminish the primary revenue effects, were described in some detail in chapter 6 of our earlier report. Without any tax relief or incentive, the approximately 150,000 citizens employed abroad would have a tax liability of about $675 million, an average of about $4,500 per tax return.

In this report we provide estimates of the tax liabilities of American taxpayers overseas under various methods of granting them tax relief. These methods consist of various types of exclusions, deductions, or combinations of both. They are designed to provide an incentive for overseas employment and/or to relieve such taxpayers from being taxed on allowances which merely compensate them for excess living costs abroad.

We believe, and recommended in our earlier report, that serious consideration should be given to providing an incentive for overseas employment, at least until more effective policy instruments for promoting U.S. exports and commercial competitiveness abroad are identified and implemented. We believe that, to encourage Americans to work abroad, some incentive may be necessary over and above merely granting relief from excessive costs. The methods evaluated here were selected to provide congressional decisionmakers with the revenue costs and tax liabilities associated with a broad spectrum of proposals, and do not indicate that we endorse the adoption of one option over another.

The optional methods range in the degree of tax incentive or relief which would be provided from $551 million ($3,700 per tax return), or 82 percent of the total tax liability, at one extreme to $161 million ($1,081 per return), or 24 percent of the total tax liability, at the other extreme.

Due to data limitations, we had to use data and make assumptions which we recognize to be less than perfect,

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1/"Taxation of Americans Working Overseas: Revenue Aspects of Recent Legislative Changes and Proposals," Feb. 1978.

sometimes biasing the estimates upward, sometimes downward. Nonetheless, we believe the estimates presented in this report should provide congressional decisionmakers with broad estimates of tax liabilities under various methods of taxing Americans abroad and that the estimates are especially valid for purposes of comparing relative tax liabilities under various methods since the same basic assumptions and raw data are used in each.

We made our review pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53) and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

We are sending copies of this report to the Director, Office of Management and Budget, to the Secretaries of Commerce and the Treasury, and to the Commissioner of the Internal Revenue Service.

Elmer B. Staats

Comptroller General
of the United States

REVENUE ESTIMATES UNDER OPTIONAL METHODS

OF TAXING AMERICANS EMPLOYED OVERSEAS

The United States has taxed the worldwide income of its citizens, with specifically legislated exceptions, since initiating the Federal Income Tax in 1913. Approximately 150,000 (one-seventh of 1 percent) of the U.S. civilian work force of about 98 million are employed overseas. Since 1926 a special tax incentive has been granted to these employees in order to promote U.S. overseas employment. It was believed that such employment would promote U.S. exports and business in foreign markets. In 1976 two things occurred which reduced this incentive. First, the Tax Reform Act of 1976 substantially increased the tax liability of citizens employed abroad. Second, the U.S. Tax Court reaffirmed that the full local value of overseas allowances must be reported.

The effective date of the Tax Reform Act changes was retroactive to January 1, 1976. However, in May 1977 the Congress postponed the effective date for one year, or until January 1, 1977. Later in 1977 the House of Representatives passed a bill further extending the effective date of the changes for an additional year, and the Senate approved a similar extension in May 1978.

The Internal Revenue Service (IRS) extended, to August 15, 1978, the deadline for Americans living abroad to file their 1977 tax returns. The IRS action was prompted by the strong possibility that the rules for 1977 would be changed, but not until after the usual June 15 filing deadline.

A number of proposals for further modifying the relief granted to citizens employed abroad were introduced in late 1977 and early 1978. The Carter administration developed a proposal to adjust taxation of Americans overseas, which was presented at Ways and Means Committee hearings in February 1978. The Senate, on May 11, 1978, approved H.R. 9251, which postponed the effective date of the 1976 amendments to 1978 and included an amendment adopting a bill proposed by Senator Ribicoff. Both the administration proposal and the Senate bill provide relief from extraordinary living costs abroad; neither provides a flat exclusion as an incentive for overseas employment. On June 29, 1978, a Ways and Means subcommittee approved a legislative proposal that would greatly liberalize taxation of Americans overseas.

As this report goes to press, the full Ways and Means Committee has not voted on the Subcommittee bill, so no date can be set for a House-Senate conference to resolve their differences.

The Congress is not routinely informed of the effectiveness or cost of overseas employment tax incentives. In fact, there is no system in place for evaluating the effectiveness, the cost, or the economic impact of changes in the incentive. Accordingly, at the time the law was amended in 1976, it was not clear what effects the changes would have.

To enable the Congress to improve its oversight of this, in our February report we recommended that a system be established for evaluating and periodically reporting to the Congress the effectiveness of these incentives. The bill approved by the Ways and Means Subcommittee would require a report by Treasury to the Congress every 2 years. The administration proposal also provides this requirement.

Past efforts to address the relative effectiveness of this incentive have also been hampered by a lack of reliable information about its revenue costs. For example, during congressional deliberations over the Tax Reform Act of 1976, the impact of proposed changes to Section 911 was significantly underestimated. The Treasury Department estimated that the changes would result in additional tax revenues of $44 million in fiscal year 1977. Recognizing that the estimate was based on incomplete and outdated information, Treasury initiated a special project to secure better estimates, based on 1975 income tax return data. In its report, "Taxation of Americans Working Overseas: Revenue Aspects of Recent Legislative Changes and Proposals," issued in February 1978, Treasury increased its estimate of the additional tax revenue resulting from the Tax Reform Act changes to about $318 million.

Revenue costs have been a matter of particular focus in congressional deliberations to date. Most of the proposals for changing the present level or form of tax relief for citizens employed overseas have been costed out on an ad hoc basis. In table A, we provide estimates of the revenue costs associated with a variety of forms of tax relief and/or incentive, on a graduated basis, for citizens employed abroad. In the series of tables that follow (tables B through K), we provide estimates of the U.S. tax liabilities of Americans abroad, by groups of countries and by classes of income, under each method. Assumptions used in programing these estimates are described in "Notes to Tables," pages 19 to 25. The advantages and disadvantages of each method are discussed more fully in chapter 7 of our earlier report.

We first estimated overseas taxpayers' liabilities assuming no relief other than the foreign tax credit and then estimated their tax liabilities under the various methods. The difference between the total tax liability, assuming no relief, and the total liability under a particular method is the revenue cost to the Treasury associated with that method. These revenue costs are summarized in table A.

Table A

Revenue Costs Under Various

Methods of Taxing Americans Abroad

1975 practice (note a)	$516 million
1975 law (note a)	$450 million
1976 law (note a)	$175 million

	If foreign taxes paid are	
	Fully credited	Partially credited
	(millions)	
Flat exclusions (note b):		
$10,000	$305	$207
20,000	453	349
30,000	518	442
40,000	551	502
Variable exclusions (note c):		
Alone	$240	$161
Plus $10,000 flat exclusion	432	326
Plus $15,000	481	385
Plus $20,000	513	433
Administration deductions (note d):		
Alone	$246	$184
Plus cost of living allowance (COLA) (note e):	304	225
Plus annual home leave	280	210
Plus COLA and annual home leave	332	248

	If foreign taxes paid are Fully credited	Partially credited
	(millions)	
Administration deductions --itemized (note f):		
Alone	$229	
Plus COLA	288	
Plus annual home leave	264	
Plus COLA and annual home leave	318	
Exclusions with option of deductions (note g):		
$20,000 exclusion off top with option of administration deductions plus COLA and annual home leave	$461	$358
$20,000 exclusion off bottom with option of administration deductions plus COLA and annual home leave	374	285

a/See below and table B.
b/See p. 6 and tables C and D.
c/See p. 9 and tables E and F.
d/See p. 12 and tables G and H.
e/COLA is a flat amount computed at a GS-12, step 1 salary.
f/See p. 15 and table J.
g/See p. 17 and table K.

In table B, we first provide estimates of the tax liabilities of Americans overseas assuming no relief other than the foreign tax credit. We then provide estimates assuming first, 1975 practice (that is, the practice of taxpayers in 1975 before the Tax Reform Act was passed, and with under-reporting of allowances); second, 1975 law, that is, also pre-Tax Reform Act law, but with full reporting of allowances; and third, 1976 law (that is, law as outlined in the Tax Reform Act, and with full reporting of allowances). In its February report, Treasury's estimates under these same sets of assumptions are somewhat higher due to differences in programing. Except as outlined in "Notes to tables," our assumptions and use of raw data are the same as Treasury's.

APPENDIX I

Table B

Tax Liabilities of Americans Overseas

Full Credit for Foreign Taxes Paid

Country grouping	No relief Total	No relief Average liability	1975 practice Total	1975 practice Average liability	1975 law Total	1975 law Average liability	1976 law (note a) Total	1976 law (note a) Average liability
	(millions)		(millions)		(millions)		(millions)	
Canada	$ 12.8	$ 617	$ 7.6	$ 367	$ 7.7	$ 373	$ 10.8	$ 520
Latin America	97.3	5,421	22.5	1,254	32.3	1,798	74.4	4,144
Western Europe	230.5	5,044	71.1	1,557	81.2	1,777	179.8	3,935
Middle East and African Organization of Petroleum Exporting Countries (OPEC)	154.0	9,910	23.7	1,526	55.9	3,599	119.0	7,663
Japan	35.1	6,687	7.6	1,445	10.9	2,078	26.1	4,965
Oceania	23.2	2,382	4.2	430	5.1	520	11.8	1,213
Other Middle East and Africa	31.7	2,796	4.3	378	6.7	592	17.8	1,569
Asia	75.8	4,108	14.3	774	20.6	1,117	51.7	2,805
All other countries	14.3	3,113	3.8	830	4.3	938	8.1	1,766
Total	$674.7	$4,520	$159.1	$1,066	$224.7	$1,506	$499.6	$3,347
Income class								
Under $10,000	$ 17.7	$ 485	$ 0.4	$ 11	$ 0.4	$ 12	$ 0.8	$ 23
$10,000-20,000	72.4	1,703	5.5	130	8.7	204	22.0	517
$20,000-30,000	112.5	4,096	11.8	430	31.3	1,141	71.5	2,603
$30,000-40,000	107.4	6,369	15.1	897	27.0	1,598	81.6	4,840
$40,000-50,000	92.0	8,802	16.4	1,570	26.4	2,524	75.2	7,197
Over $50,000	272.6	17,616	109.8	7,093	130.9	8,460	248.4	16,053
Total	$674.7	$ 4,520	$159.1	$1,066	$224.7	$1,506	$499.6	$ 3,347

Note: Totals may not add due to rounding.

a/Partial credit for foreign taxes paid as outlined in the Tax Reform Act. (Disallowance of credit for foreign taxes attributable to excluded income.)

In tables C and D, we provide estimates of the tax liabilities of Americans overseas assuming flat exclusions "off the top" of $10,000, $20,000, $30,000, and $40,000. We assume, in table C, full credit for foreign taxes paid and in table D, partial credit (that is, disallowance of credit for foreign taxes paid on the excluded income).

The chief merit of the flat exclusion approach is that of simplicity; however, it does not take into account the fact that costs of living (and therefore compensation) vary significantly from country to country. While taxpayers in certain countries would receive what they consider to be adequate relief through an exclusion of $20,000, or even $10,000, taxpayers in other countries might still find themselves faced with what they consider "intolerable" tax burdens.

Table C

Tax Liabilities of Americans Overseas

Flat Exclusions--Full Credit for Foreign Taxes Paid

Country grouping	$10,000 exclusion Total	$10,000 exclusion Average liability	$20,000 exclusion Total	$20,000 exclusion Average liability	$30,000 exclusion Total	$30,000 exclusion Average liability	$40,000 exclusion Total	$40,000 exclusion Average liability
	(millions)		(millions)		(millions)		(millions)	
Canada	$ 9.5	$ 460	$ 7.7	$ 373	$ 6.9	$ 333	$ 6.4	$ 308
Latin America	56.3	3,1[illegible]4	33.5	1,866	21.8	1,214	16.7	932
Western Europe	122.7	2,686	78.8	1,725	62.9	1,376	55.1	1,205
Middle East and African OPEC	94.5	6,083	56.3	3,626	35.1	2,262	21.9	1,413
Japan	19.5	3,722	10.9	2,077	7.0	1,332	5.3	1,015
Oceania	10.0	1,026	5.0	516	3.4	347	2.9	295
Other Middle East and Africa	14.0	1,236	6.3	559	3.8	333	2.8	245
Asia	35.7	1,937	19.5	1,057	12.9	699	9.9	538
All other countries	7.3	1,582	4.0	866	2.9	632	2.6	565
Total	$369.6	$2,476	$222.1	$1,488	$156.6	$1,050	$123.6	$ 828
Income class								
Under $10,000	$ 0.6	$ 16	$ 0.4	$ 11	$ 0.4	$ 11	$ 0.4	$ 11
$10,000-20,000	16.9	398	6.2	145	5.3	124	5.2	123
$20,000-30,000	47.8	1,740	20.4	742	11.8	431	9.2	334
$30,000-40,000	53.7	3,188	26.5	1,569	16.7	990	12.0	714
$40,000-50,000	51.6	4,938	28.6	2,732	17.9	1,714	12.4	1,187
Over $50,000	198.9	12,852	140.1	9,055	104.6	6,756	84.4	5,454
Total	$369.6	$ 2,476	$222.1	$1,488	$156.7	$1,050	123.6	$ 828

Note: Totals may not add due to rounding.

APPENDIX I

APPENDIX I

Table D

Tax Liabilities of Americans Overseas

Flat Exclusions--Partial Credit for Foreign Taxes Paid

Country grouping	$10,000 exclusion Total	$10,000 exclusion Average liability	$20,000 exclusion Total	$20,000 exclusion Average liability	$30,000 exclusion Total	$30,000 exclusion Average liability	$40,000 exclusion Total	$40,000 exclusion Average liability
	(millions)		(millions)		(millions)		(millions)	
Canada	$ 10.4	$ 502	$ 8.6	$ 415	$ 7.7	$ 370	$ 7.1	$ 344
Latin America	69.8	3,885	50.3	2,802	36.8	2,050	26.8	1,491
Western Europe	166.9	3,653	123.8	2,710	95.1	2,080	76.5	1,673
Middle East and African OPEC	109.0	7,020	72.1	4,638	44.4	2,857	26.5	1,704
Japan	24.6	4,676	17.5	3,333	12.8	2,433	9.6	1,823
Oceania	12.1	1,245	6.7	686	4.6	476	3.7	382
Other Middle East and Africa	17.3	1,525	10.0	878	6.2	548	4.4	384
Asia	48.8	2,645	32.0	1,735	21.6	1,173	15.4	833
All other countries	8.4	1,815	5.0	1,081	3.6	780	2.9	636
Total	$467.2	$3,131	$325.9	$2,184	$232.8	$1,560	$172.8	$1,158
Income class								
Under $10,000	$ 1.0	$ 28	$ 0.4	$ 11	$ 0.4	$ 11	$ 0.4	$ 11
$10,000-20,000	26.1	613	7.0	166	5.3	125	5.2	123
$20,000-30,000	65.2	2,375	31.0	1,128	13.3	485	9.2	335
$30,000-40,000	73.4	4,353	45.6	2,702	25.2	1,493	13.9	823
$40,000-50,000	67.8	6,485	46.4	4,442	29.4	2,808	16.7	1,600
Over $50,000	233.7	15,103	195.5	12,630	159.2	10,288	127.4	8,231
Total	$467.2	$ 3,131	$325.9	$ 2,184	$232.8	$ 1,560	$172.8	$1,158

Note: Totals may not add due to rounding.

The estimates presented in tables E and F are based on variable exclusions, i.e., exclusions which vary from country to country, based on certain costs within a country, but which remain constant for all taxpayers within that country. For example, all taxpayers in Brazil would be able to exclude $12,000; while all taxpayers in Saudi Arabia would be able to exclude $15,000. (Note: The method used to calculate these amounts is described at the end of this appendix, in the section entitled, "Notes to tables.") In addition to the variable exclusion above, which is taken off the top, we have provided estimates assuming additional amounts of $10,000, $15,000, and $20,000 to be excluded. The estimates provided in table E assume full credit for foreign taxes paid, while those in table F assume partial credit (again, disallowance of credit for foreign taxes paid on the excluded income).

The variable exclusion approach--with or without an additional amount to be excluded as pure incentive--like that of the flat exclusion, is one of relative simplicity. In addition, it takes into account the variation in costs from country to country.

APPENDIX I

Table E

Tax Liabilities of Americans Overseas

Variable Exclusions--Full Credit for Foreign Taxes Paid

Country grouping	With no additional amount excluded: Total	With no additional amount excluded: Average liability	With an additional $10,000 excluded: Total	With an additional $10,000 excluded: Average liability	With an additional $15,000 excluded: Total	With an additional $15,000 excluded: Average liability	With an additional $20,000 excluded: Total	With an additional $20,000 excluded: Average liability
	(millions)		(millions)		(millions)		(millions)	
Canada	$ 11.5	$ 558	$ 8.9	$ 428	$ 8.0	$ 385	$ 7.4	$ 359
Latin America	61.7	3,434	34.1	1,898	26.6	1,484	22.1	1,229
Western Europe	156.9	3,434	91.3	1,997	76.7	1,678	67.5	1,477
Middle East and African OPEC	75.5	4,859	45.2	2,911	35.7	2,301	28.0	1,804
Japan	15.2	2,889	8.9	1,688	7.2	1,377	6.2	1,190
Oceania	18.5	1,901	9.1	936	6.3	645	4.7	479
Other Middle East and Africa	25.4	2,235	11.1	976	7.4	653	5.2	460
Asia	59.2	3,210	28.6	1,549	21.4	1,159	16.8	911
All other countries	11.0	2,391	5.8	1,251	4.3	939	3.5	765
Total	$434.8	$2,914	$242.8	$1,627	$193.6	$1,297	$161.5	$1,082
Income class								
Under $10,000	$ 5.3	$ 145	$ 0.4	$ 11	$ 0.4	$ 11	$ 0.4	$ 11
$10,000-20,000	34.7	817	8.6	203	5.7	135	5.3	124
$20,000-30,000	59.1	2,152	23.4	852	15.5	564	11.1	405
$30,000-40,000	62.5	3,706	28.5	1,693	21.2	1,259	16.8	995
$40,000-50,000	60.4	5,781	31.3	2,993	23.6	2,260	18.4	1,762
Over $50,000	212.8	13,748	150.5	9,724	127.2	8,216	109.5	7,076
Total	$434.8	$ 2,914	$242.8	$1,627	$193.6	$1,297	$161.5	$1,082

Note: Totals may not add due to rounding.

APPENDIX I

Table F

Tax Liabilities of Americans Overseas

Variable Exclusions--Partial Credit for Foreign Taxes Paid

Country grouping	With no additional amount excluded: Total	With no additional amount excluded: Average liability	With an additional $10,000 excluded: Total	$10,000 excluded: Average liability	$15,000 excluded: Total	$15,000 excluded: Average liability	$20,000 excluded: Total	$20,000 excluded: Average liability
	(millions)		(millions)		(millions)		(millions)	
Canada	$ 12.0	$ 582	$ 9.8	$ 472	$ 8.8	$ 427	$ 8.0	$ 387
Latin America	73.8	4,109	52.1	2,901	44.1	2,453	37.2	2,071
Western Europe	188.6	4,126	138.1	3,021	119.3	2,611	104.1	2,277
Middle East and African OPEC	92.0	5,922	58.8	3,785	45.9	2,956	35.2	2,263
Japan	21.2	4,039	15.4	2,932	13.2	2,509	11.4	2,172
Oceania	20.9	2,145	11.0	1,128	7.9	815	6.1	630
Other Middle East and Africa	26.6	2,342	14.6	1,290	11.1	975	8.5	751
Asia	66.5	3,606	42.0	2,277	33.7	1,829	27.1	1,468
All other countries	11.7	2,542	6.9	1,488	5.3	1,160	4.3	924
Total	$513.2	$3,439	$348.6	$2,335	$289.4	$1,939	$241.8	$ 1,620
Income class								
Under $10,000	$ 5.9	$ 163	$ 0.4	$ 12	$ 0.4	$ 11	$ 0.4	$ 11
$10,000-20,000	42.7	1,003	11.3	266	6.3	149	5.3	125
$20,000-30,000	73.7	2,683	36.2	1,317	22.4	817	13.4	489
$30,000-40,000	78.8	4,671	49.0	2,908	36.9	2,188	26.7	1,582
$40,000-50,000	71.9	6,881	49.8	4,760	40.2	3,849	31.5	3,015
Over $50,000	240.2	15,524	201.9	13,044	183.1	11,830	164.5	10,628
Total	$513.2	$ 3,439	$348.6	$ 2,335	$289.4	$ 1,939	$241.8	$ 1,620

Note: Totals may not add due to rounding.

The estimates in tables G and H are based on a proposal--submitted by the administration in February 1978--which uses a "deductions" approach. In addition to estimates of tax liabilities assuming only the deductions proposed by the administration (namely, deductions for education costs, home-leave transportation costs, and a portion of housing costs), we provide estimates assuming (1) an additional deduction for a cost-of-living allowance (COLA), (2) a deduction for home leave annually instead of once every 2 years, and (3) both 1 and 2 above. Estimates in table G assume full credit for foreign taxes paid while those in table H assume partial credit, as defined previously.

The administration proposal, with or without the additional deductions, would permit overseas taxpayers to deduct certain expenses not normally deductible by domestic taxpayers, thereby providing relief from taxation on amounts received to compensate for excess costs of living overseas. It would not provide, however, a specific tax incentive for Americans to work overseas.

APPENDIX I

Table G

Tax Liabilities of Americans Overseas

Administration Deductions--Full Credit for Foreign Taxes Paid

	Administration deductions only		With deductions for: COLA		With deductions for: Annual home leave		With deductions for: COLA and annual home leave	
Country grouping	Total	Average liability	Total	Average liability	Total	Average liability	Total	Average liability
	(millions)		(millions)		(millions)		(millions)	
Canada	$ 12.0	$ 582	$ 11.5	$ 557	$ 12.0	$ 579	$ 11.5	$ 554
Latin America	64.0	3,565	58.4	3,251	60.3	3,357	54.9	3,056
Western Europe	165.7	3,625	140.4	3,071	156.3	3,419	132.8	2,906
Middle East and African OPEC	75.2	4,841	66.8	4,299	68.9	4,435	61.0	3,930
Japan	21.8	4,158	15.0	2,862	19.6	3,732	13.5	2,573
Oceania	15.4	1,587	14.9	1,536	13.4	1,376	13.0	1,339
Other Middle East and Africa	18.6	1,642	15.0	1,323	16.3	1,440	13.1	1,154
Asia	44.2	2,396	39.8	2,157	37.0	2,004	33.4	1,812
All other countries	11.1	2,419	9.3	2,027	10.7	2,320	9.0	1,944
Total	$428.2	$2,869	$371.1	$2,487	$394.4	$2,642	$342.2	$2,293
Income class								
Under $10,000	$ 1.4	$ 37	$ 0.6	$ 17	$ 0.8	$ 23	$ 0.4	$ 11
$10,000-20,000	30.7	721	22.6	531	25.4	598	18.6	437
$20,000-30,000	56.4	2,052	44.7	1,627	49.4	1,797	39.0	1,422
$30,000-40,000	57.5	3,408	49.0	2,907	51.3	3,043	43.7	2,593
$40,000-50,000	59.5	5,693	51.1	4,892	54.2	5,189	46.6	4,462
Over $50,000	222.8	14,397	203.1	13,122	213.2	13,777	193.8	12,525
Total	$428.2	$2,869	$371.1	$2,487	$394.4	$2,642	$342.2	$2,293

Note: Totals may not add due to rounding.

Table H

Tax Liabilities of Americans Overseas

Administration Deductions--Partial Credit for Foreign Taxes Paid

Country grouping	Administration deductions only: Total	Administration deductions only: Average liability	With deductions for COLA: Total	With deductions for COLA: Average liability	With deductions for Annual home leave: Total	With deductions for Annual home leave: Average liability	With deductions for COLA and annual home leave: Total	With deductions for COLA and annual home leave: Average liability
	(millions)		(millions)		(millions)		(millions)	
Canada	$ 12.1	$ 584	$ 11.7	$ 567	$ 12.0	$ 582	$ 11.7	$ 565
Latin America	73.4	4,091	69.3	3,862	70.9	3,948	66.9	3,727
Western Europe	187.0	4,092	171.7	3,757	181.7	3,975	166.8	3,650
Middle East and African OPEC	90.4	5,822	82.6	5,315	84.2	5,419	76.5	4,926
Japan	25.3	4,821	20.2	3,855	23.7	4,509	19.0	3,609
Oceania	16.9	1,734	16.5	1,695	15.0	1,544	14.7	1,510
Other Middle East and Africa	20.6	1,815	17.6	1,547	18.7	1,646	15.9	1,405
Asia	53.2	2,883	50.2	2,722	47.6	2,5[illegible]2	44.9	2,434
All other countries	11.6	2,524	10.1	2,190	11.3	2,444	9.8	2,118
Total	$490.5	$3,287	$449.9	$3,014	$465.0	3,116	$426.2	$2,855
Income class								
Under $10,000	$ 1.6	$ 45	$ 0.7	$ 20	$ 1.0	$ 27	$ 0.5	$ 12
$10,000-20,000	38.0	894	29.3	689	32.4	762	24.5	577
$20,000-30,000	68.7	2,503	59.1	2,152	62.7	2,284	53.5	1,948
$30,000-40,000	72.3	4,286	66.2	3,924	67.6	4,011	61.7	3,659
$40,000-50,000	69.0	6,603	63.7	6,094	65.6	6,274	60.4	5,775
Over $50,000	240.9	15,564	230.9	14,917	235.6	15,226	225.6	14,576
Total	$490.5	$3,287	$449.9	$3,014	$465.0	$3,116	$426.2	$2,855

Note: Totals may not add due to rounding.

APPENDIX I

The estimates in table J, like those in tables G and H, are based on the administration proposal of February 1978. In table J, however, the deductions--the additional ones as well as those proposed by the administration--are treated as itemized deductions. Such a proposal is somewhat less generous to overseas taxpayers and, consequently, their tax liabilities are higher.

APPENDIX I

Table J

Tax Liabilities of Americans Overseas

Administration Deductions (Itemized)--Full Credit for Foreign Taxes Paid

Country grouping	Administration deductions only: Total	Administration deductions only: Average liability	With deductions for COLA: Total	COLA: Average liability	Annual home leave: Total	Annual home leave: Average liability	COLA and annual home leave: Total	COLA and annual home leave: Average liability
	(millions)		(millions)		(millions)		(millions)	
Canada	$ 12.2	$ 592	$ 11.9	$ 577	$ 12.2	$ 590	$ 11.9	$ 576
Latin America	66.4	3,698	60.6	3,373	62.5	3,479	56.9	3,168
Western Europe	171.9	3,761	145.4	3,182	162.3	3,552	137.6	3,012
Middle East and African OPEC	77.5	4,989	68.8	4,427	70.9	4,567	62.9	4,046
Japan	22.8	4,335	15.4	2,941	20.4	3,881	13.9	2,638
Oceania	16.6	1,707	16.1	1,651	14.5	1,489	14.1	1,453
Other Middle East and Africa	20.3	1,791	16.5	1,458	18.0	1,584	14.4	1,265
Asia	46.7	2,531	42.0	2,279	39.0	2,116	35.3	1,912
All other countries	11.7	2,550	10.0	2,168	11.3	2,454	9.6	2,076
Total	$446.1	$2,989	$386.7	$2,591	$411.1	$2,754	$356.5	$2,388
Income class								
Under $10,000	$ 3.3	$ 89	$ 1.9	$ 52	$ 2.2	$ 61	$ 1.3	$ 34
$10,000-20,000	39.2	922	30.2	709	33.4	785	25.4	598
$20,000-30,000	61.4	2,237	49.1	1,789	54.2	1,973	43.2	1,573
$30,000-40,000	58.9	3,495	50.3	2,984	52.8	3,130	45.0	2,671
$40,000-50,000	60.0	5,744	51.7	4,943	54.8	5,246	47.2	4,516
Over $50,000	223.3	14,427	203.6	13,153	213.7	13,807	194.3	12,554
Total	$446.1	$2,989	$386.7	$2,591	$411.1	$2,754	$356.5	$2,388

Note: Totals may not add due to rounding.

Table K contains estimates of tax liabilities assuming taxpayers have the option of taking the deductions provided for in the administration proposal, plus the deductions for a cost-of-living allowance and home-leave transportation costs annually instead of twice a year, <u>or</u> a flat exclusion of $20,000. We provide estimates assuming, first, that the exclusion is to be taken "off the top," and, next, "off the bottom." Estimates assuming, first, full credit for foreign taxes paid, and, then, partial credit for foreign taxes paid, are included in table K.

While the options approach would provide an incentive for taxpayers to work overseas in certain countries, in others it would provide only relief from taxation of certain allowances designed to compensate for excess costs of living in those countries.

APPENDIX I

Table K

Tax Liabilities of Americans Overseas

Option of Administration Deductions 1/ or Flat Exclusion of $20,000

Country grouping	Full credit for foreign taxes paid: Exclusion off the top: Total	Full credit: Exclusion off the top: Average liability	Full credit: Exclusion off the bottom: Total	Full credit: Exclusion off the bottom: Average liability	Partial credit for foreign taxes paid: Exclusion off the top: Total	Partial credit: Exclusion off the top: Average liability	Partial credit: Exclusion off the bottom: Total	Partial credit: Exclusion off the bottom: Average liability
	(millions)		(millions)		(millions)		(millions)	
Canada	$ 7.6	$ 367	$ 10.4	$ 501	$ 8.5	$ 410	$ 10.9	$ 525
Latin America	32.8	1,826	48.7	2,711	49.6	2,761	61.7	3,436
Western Europe	77.7	1,701	115.2	2,521	122.6	2,682	153.8	3,366
Middle East and African OPEC	51.3	3,305	59.9	3,857	66.5	4,279	75.2	4,839
Japan	10.4	1,977	13.1	2,496	16.7	3,174	18.5	3,519
Oceania	5.0	510	8.0	827	6.6	680	9.5	981
Other Middle East and Africa	6.2	546	10.2	896	9.8	864	13.2	1,159
Asia	18.9	1,027	28.7	1,558	31.1	1,687	40.3	2,186
All other countries	3.9	850	6.1	1,328	4.9	1,064	7.0	1,527
Total	$213.9	$1,433	$300.3	$2,012	$316.2	$2,118	$390.1	$2,614
Income class								
Under $10,000	$ 0.2	$ 6	$ 0.2	$ 6	$ 0.2	$ 6	$ 0.2	$ 6
$10,000-20,000	5.4	128	7.3	172	6.1	143	8.7	205
$20,000-30,000	18.3	667	27.7	1,009	28.6	1,040	42.4	1,545
$30,000-40,000	24.8	1,468	37.5	2,223	43.5	2,581	58.2	3,450
$40,000-50,000	27.4	2,618	41.8	3,994	45.0	4,306	58.4	5,589
Over $50,000	137.7	8,901	185.9	12,010	192.8	12,456	222.1	14,350
Total	$213.9	$1,433	$300.3	$2,012	$316.2	$2,118	$390.1	$2,614

1/With deductions for COLA and annual home leave.

Note: Totals may not add due to rounding.

NOTES TO TABLES

All the estimates of tax liabilities in tables B through K, and of revenue costs in table A, are derived from a representative sample of 1975 tax returns filed by taxpayers claiming an exclusion for income earned abroad (as outlined in Section 911 of the Internal Revenue Code). The sample was weighted to represent the population of all Americans filing such returns. To update the information to 1977, money amounts were inflated by 14.1 percent. To represent persons not meeting the filing requirements in 1975 but possibly meeting them in 1977 (or under various options), the number of nontaxable returns and all money amounts on them were increased by an additional 15 percent.

We used Treasury data files and the basic Treasury computer programs, including almost all of the built-in assumptions discussed below, to produce our estimates. We modified and expanded the programs where necessary to evaluate our different options, but we adopted the deliberate policy of making changes only where we had a firm basis for a different approach.

U.S. tax rates, and rules regarding deductions and most other provisions--except those relating to foreign income--were those in effect for 1977. Holding everything constant except Section 911 and related provisions is necessary to isolate the effects of changing these provisions.

One change between 1975 and 1977 was in the relationship of the foreign tax credit to the standard deduction. The law prior to the Tax Reform Act permitted foreign tax credits only to taxpayers who itemized deductions. The act allowed anyone to claim a foreign tax credit. Treasury kept prior-law treatment of this provision (for the most part); we believed, however, that for purposes of comparing "pure" Section 911 changes, the treatment should be that of the Tax Reform Act. We therefore "imputed" a standard deduction to those taxpayers claiming a smaller amount of itemized deductions in the reported data. This, plus some small refinements in the Treasury program, resulted in a total revenue gain from repeal of Section 911 of about $70 million less than Treasury had calculated, and correspondingly different revenue changes from the various options.

Treatment of allowances

Treasury assumed that the 1975 returns used as the data base did not include employer reimbursements for excess housing costs, educational expenses for dependents, and home-leave travel costs. The basis for this assumption was the widespread taxpayer belief that these allowances were not subject to U.S. tax, at least not at their local market value. It was further assumed that all taxpayers should have reported such allowances with two exceptions: (1) educational allowances were assumed to have been given only to taxpayers with dependents and (2) one half the taxpayers with less than $10,000 adjusted gross income (AGI) were assumed not to have received housing allowances. Reported AGI was, therefore, increased by the amount of these assumed allowances. Other allowances, such as cost of living, were assumed to have been reported.

We adopted these same assumptions in the absence of anything better, but there are certain problems. Some overseas taxpayers certainly did not receive allowances (the self-employed, for example), and undoubtedly some reported the allowances they did receive. On the other hand, the way the housing allowance was calculated, as discussed below, and the use of slightly dated State Department data, probably understated the assumed allowances, especially in the upper income categories, so errors in the assumptions which overstate the underreporting of allowances should be offset somewhat. The level of uncertainty in all this, however, suggests caution in the use of the estimates, especially in comparing one income class to another.

The amounts of the assumed allowances for education and housing were based on the allowances that the State Department pays its employees. The education allowance was estimated by multiplying State's allowance (for a 10-month school year) by one-half of the exemptions in excess of two, on the assumption that, on average, one-half of the dependents would be in elementary or secondary school and receiving a reimbursement. (The reimbursements were assumed not to cover postsecondary education.)

The assumed housing allowance was more complicated. While the State Department reimburses for the total cost of housing (up to a limit based on average housing costs in the area), it was assumed that most private employers reimburse only for those costs deemed to be in excess of what would have been spent in the United States. The assumed allowance was computed as follows: from the State Department's upper limit of reimbursement for each income class (considered "actual housing" costs), an amount equal to 16-2/3 percent of "base pay" was subtracted. Base pay was taken to be inflated reported income, less unearned income and an assumed COLA.

Reimbursed home-leave travel was assumed to be equal to one round-trip economy-class airfare between the country's capital city and Washington, D.C., every other year for each exemption (or, for calculation purposes, for one-half of the reported exemptions on each tax return).

The assumptions behind the education and home leave allowances seem as reasonable as could be made with the information available. The assumed housing allowance presents several problems, however. There are areas for which the State Department figures are widely acknowledged to be too low, e.g., Tokyo and Middle East OPEC countries. For several such known areas, Treasury chose somewhat arbitrary, higher amounts--based on figures reported in newspapers or by U.S. companies and taxpayers--to use for "actual housing" costs. Also, the city of residence is not available in the data base, so the State Department figures used for each country were those for the principal city, with costs probably higher than those for other cities in which Americans live. Furthermore, the method of calculation produces something of an anomaly for upper-income taxpayers. While there are ceilings on the figures for actual housing costs, there is no comparable limit on 16-2/3 percent of base pay. Consequently, the assumed housing allowances for upper income taxpayers are progressively smaller, and the allowances for those with very high incomes may be computed to be zero--an unlikely compensation pattern for most private employees.

However, there are offsetting considerations. Some of those in the higher income class groups may have been in those groups because they did report their allowances; and, presumably, many of the self-employed, who did not receive allowances, are also in the higher income categories (to be able to afford the excess living costs). In either case, their reported income should not have been increased by the assumed allowances, and a diminishing housing allowance should have helped to compensate for this unquantifiable factor.

Calculations for some options required COLA data. This was computed based on State Department's "local index" of living costs other than housing and education, which is used by many private employers to set COLA's. It shows the typical living expenses of Americans in various foreign locations, rated on a scale in which Washington, D.C., equals 100.

COLA's are generally computed by multiplying the employee's "spendable income" (excluding housing and education costs) by the amount by which the index for his location exceeds 100. We computed the COLA by multiplying the salary of a GS-12, step 1, by State's spendable income fractions for that income level, by the excess of the index over 100 (converted to a decimal fraction); i.e., we assumed that all income levels received the same COLA. 1/

Foreign tax credits

To compute U.S. tax liabilities after credits, it is necessary to know the amounts of foreign tax credits and, to determine such amounts, a figure for total foreign income taxes paid is needed. This figure is not available in the data base, however, so Treasury, through a special sample of foreign tax credit returns filed by persons claiming the foreign earned income exemption in 1975, computed an average effective foreign tax rate by income class for most countries. For a few countries, the IRS sample could not be used, so a publication by Price Waterhouse, "Individual Taxes in 80 Countries," was consulted to compute average tax rates for these countries. The average tax rates for each income class were applied to reported, inflated, foreign earned income to compute total foreign taxes assumed to have been paid.

The two sources of foreign tax rates are not entirely comparable. The IRS data is the effective rate actually paid, while the Price Waterhouse figures are based on a reading of the countries' tax laws. Nonetheless, these appear to be the best sources available.

It was assumed that foreign income taxes were not imposed on the allowances not reported for U.S. tax purposes (housing, education, and home-leave allowances). This is known to be the case in some foreign countries. It was further assumed that the Tax Court-ordered change in the handling of these allowances for U.S. tax purposes would not affect their status under foreign tax systems. While the latter is a shakier assumption, both seemed necessary for the sake of consistency in the absence of any better assumptions.

1/This was the method of computation used by Treasury in estimating tax liabilities of Americans overseas under a proposal submitted by Senator Ribicoff.

Variable exclusion approach

In practice, use of a variable exclusion would probably require that Treasury determine an exclusion amount for each foreign country based on State Department data. For purposes of our estimates of tax liabilities, we constructed exclusion amounts from data used to compute COLA and housing allowances. Since these, in turn, come from State Department figures, the results should be roughly comparable.

The COLA amount discussed previously represents an index of excess living costs, excluding housing and education, assuming everyone earned the salary of a GS-12, step 1. This seemed a reasonable starting point for a variable exclusion. To this amount was added the excess of the State Department's housing allowance over typical housing costs in Washington, D.C., for approximately the same income level.

"Administration deductions" approach

The basis for these programs was the administration's proposal to allow deductions for housing costs in excess of 20 percent of earned income net of actual housing costs; for school tuition, books, and room and board of up to $4,000 per child; and for one economy-class round trip airfare to the United States every other year for each family member. With this as the basic "administration deductions" approach, estimates of tax liabilities under various options (additional deductions and/or itemized deductions instead of deductions from gross income) were made.

The housing deduction was programed exactly as stated (the excess of "actual housing" costs over 20 percent of total income less actual housing costs and less unearned income.) In some cases, this would produce slightly different results from simply deducting the amount of the assumed housing allowance previously added to income, but such could be presumed to happen in actual practice.

The education and home-leave travel deductions were made equal to the amounts previously added back as assumed allowances. There was no practical way to test the effects of the limit on the education deduction (since there were no actual educational expenses to limit). Assuming that everyone would take the full home-leave travel deduction may overstate its effects; Treasury assumed that only 80 percent of the assumed allowances would be deductible because some people would use the allowances for other purposes. There are so many uncertainties in the calculation of the amount, however, that we used the full amount of the once-every-other-year travel deduction. In some options, a deduction for annual home leave was included, and in those cases, we did not assume the full potential deduction, since an annual trip, even when partially paid for by tax deductions, could amount to a greater expenditure than many overseas taxpayers would want to make. For these options, we assumed a deduction equal to 1.75 times the assumed allowance.

The administration proposal included provisions allowing taxpayers living in construction camps to exclude the value of their food and lodging under Section 119 of the Internal Revenue Code. Based on information from the construction industry, Treasury estimated that there were about 7,000 persons in this category, mostly located in the African and Middle East OPEC countries, and that the average cost of their room and board was about $5,000. There was no way to identify these persons in the data base, however, so an approximation was devised. It was assumed that all 7,000 persons were located in the African and Middle East countries, where they constituted 46 percent of overseas American taxpayers. Tax liabilities for individuals in this region were then computed twice, once with, and once without, an additional $5,000 deduction. Forty-six percent of the total liability computed with the extra deduction, and 54 percent of the liability computed without the deduction, were added to produce the estimated total liabilities for this region. (It should be noted that camp employees were not given the COLA deduction, on the assumption that they were already being allowed an equivalent deduction.)

Liberalized moving expenses were also a part of the administration proposal. Treasury computed an extra deduction to take care of this, calculated by assuming one move every fourth year, with three-quarters of total foreign moving expenses attributed to excludable foreign income and therefore not deductible, and with some assumed average cost of foreign moves. For calculation purposes, each return was allowed a deduction equal to one-fourth (or $1,200) of the assumed moving expenses ($4,800).

In one set of options, deductions--other than for moving expenses and the camp allowance--were considered as itemized deductions rather than as deductions in computing adjusted gross income. This has the effect of reducing the amount of the deductions by part or all of the standard deduction ($2,200 for single taxpayers and $3,200 for married ones) for those taxpayers taking the standard deduction. For those already itemizing deductions, it has no effect which could be tested in these programs. Once a taxpayer was able to itemize because of the foreign deductions, it could be presumed that he would be able to add to them other deductible items, such as charitable contributions and State income taxes. We assumed an arbitrary $1,000 per return in deductible items.

Treatment of credit for foreign taxes paid

The Tax Reform Act of 1976 introduced into the law the concept of denying a credit for foreign taxes attributable to income exempt from U.S. tax. The foreign taxes were attributed to the excluded income based on U.S., not foreign, law; the amount disallowed was to be the share of total foreign taxes proportionate to the share of U.S. taxes on the same income. To program this, we used the formula given in the Technical Corrections Bill: total foreign taxes times U.S. tax on excluded income divided by the sum of U.S. tax on excluded income and the foreign tax credit limitation. This differs slightly from the method used by Treasury in making its estimates of tax liabilities under 1976 law.

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