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BY THE COMPTROLLER GENERAL

# Report To The Congress

OF THE UNITED STATES

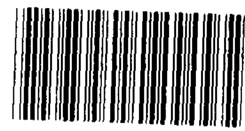
# American Employment Abroad Discouraged By U.S. Income Tax Laws

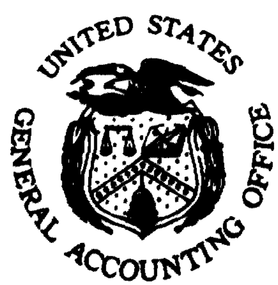
To adequately promote and service U.S. products and operations in foreign countries, U.S. companies employ a large force of U.S. citizens abroad. GAO surveyed a group of major U.S. companies which reported that U.S. tax provisions established by the Foreign Earned Income Act of 1978 are a major disincentive to employment of U.S. citizens overseas.

GAO found that the Act does not fully meet its goal of relieving taxes on income reflecting excessive costs of living abroad for the employees of these companies. Further, tax returns are difficult and expensive to prepare under the Act's complex rules.

Most of the companies surveyed reimburse U.S. employees abroad for excessive taxes, making them more costly than citizens of competing countries, who generally are not taxed by their home countries. The greater costs have led these companies to favor third-country nationals.

GAO urges that Congress consider placing Americans working abroad on an income tax basis comparable to that of citizens of competitor countries.

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

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

This report discusses U.S. taxation under the Foreign Earned Income Act of 1978 and how it discourages employment of Americans abroad.

We are sending copies of this report to the Director, Office of Management and Budget; the Secretaries of Commerce, State, and the Treasury; and the United States Trade Representative.

Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

# AMERICAN EMPLOYMENT ABROAD DISCOURAGED BY U.S. INCOME TAX LAWS

## DIGEST

The competitiveness of U.S. exports in the world market has become a major national concern because of the deficit in the U.S. balance of trade that developed in the 1970s and its implications for real income and employment in the United States. This problem has been the focus of major initiatives to improve Government export promotion programs and to identify and correct Government disincentives to exports.

To adequately promote and service U.S. products and operations in foreign countries, U.S. companies employ a large force of U.S. citizens abroad. There is widespread concern that tax provisions contained in the Foreign Earned Income Act (FEIA) (Public Law 95-615, Title II, Nov. 8, 1978) are proving a disincentive to employment of U.S. citizens abroad, and, therefore, adversely affecting exports.

A GAO survey of a group of major U.S. companies having substantial operations abroad revealed that U.S. taxes were an important factor in reducing the number of Americans employed overseas, because the:

--Tax laws do not fully relieve the companies' employees from taxes on income reflecting the excessive costs of living and working abroad.

--Companies generally reimburse overseas employees for their additional tax burden, making Americans more costly than citizens of competing countries, who generally are not taxed by their home countries.

--Complexity of the new tax laws makes compliance difficult and expensive.

## IMPACT ON EMPLOYMENT OF AMERICANS OVERSEAS

The United States is alone among the major industrial countries in taxing foreign-source income on a citizenship basis. It taxes not only base

salary but also overseas allowances to the extent they are not offset by deductions provided for in the Foreign Earned Income Act. (See p. 17.)

Most major U.S. firms that GAO surveyed operate programs to reimburse expatriate employees for the additional tax burdens resulting from their overseas assignments. These programs are usually available to both Americans and third-country nationals.1/ They are generally designed to ensure that the tax liabilities borne by employees do not exceed the home-country taxes on their base salaries. (See p. 18.)

GAO found that these programs are significantly more expensive for Americans than for third-country nationals, who generally are not taxed by their home countries. For example, a third-country national in Saudi Arabia, where there is no income tax, did not require a tax reimbursement. Americans, on the other hand, paid U.S. taxes substantially in excess of those that would normally apply to their base salaries. The companies provided Americans in Saudi Arabia with tax reimbursements averaging $18,889 for married employees in the $45,000 to $55,000 salary range and $10,558 for unmarried employees in the $25,000 to $45,000 salary range. (See pp. 13 and 20.)

The difference between the tax reimbursement payments provided to Americans by the companies and those made to third-country nationals contributed significantly to the relative costliness of Americans. Although it varied from country to country,2/ the difference was in all cases substantial, ranging from 24.5 percent of the differential in total compensation to over 100 percent. In the latter cases, the tax reimbursement made U.S. workers more costly even though their other compensation was lower than that of third-country nationals. (See pp. 21 to 23.)

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1/The third-country nationals included in GAO's survey were citizens of Canada, France, Japan, the United Kingdom, and West Germany.

2/The host countries included in GAO's survey are Brazil, Hong Kong, Japan, Saudi Arabia, the United Kingdom, and Venezuela.

This cost differential was reported by the U.S. firms as a major cause of the decrease in their employment of Americans overseas. Further, the relative number of Americans in overseas positions decreased in comparison with third-country nationals from 1976 to 1980. (See pp. 24 to 27.)

## APPARENT INADEQUACY AND COMPLEXITIES OF THE FOREIGN EARNED INCOME ACT

Congressional intent in passing the FEIA was twofold--to create greater equity between people working abroad and at home and to provide benefits for the U.S. economy by encouraging Americans to work in hardship areas. The first objective was to be achieved through a series of deductions for the excess costs of living overseas and the second through either an additional $5,000 hardship deduction or through a $20,000 exclusion (with no deductions) for individuals in designated hardship area camps. In practice, however, the law

--falls far short of its goal of providing equity, and

--runs counter to the general goal of simplifying U.S. tax returns. (See pp. 8 and 15.)

The FEIA provides a series of deductions for certain excess foreign living costs. In total, the deductions for cost of living, housing, schooling expenses, and home leave transportation do not appear to reduce income earned abroad by the actual costs of these items. Although the schooling and home leave transportation deductions were generally adequate according to data provided by U.S. company officials, the housing and cost of living deductions were often seriously inadequate in reducing income by actual allowances. In addition, the FEIA neglects to consider other costs, the most significant of which is the tax on the tax reimbursement designed to compensate employees for the excess taxes, both U.S. and foreign, that are incurred as a result of working overseas. Tax reimbursements were provided by 95 percent of the firms responding to our questionnaire. The tax reimbursement, while varying according to salary level, host country, and compensation package, often represented more than 30 percent of the individual's base salary. (See pp. 8 and 12.)

The apparent inadequacy of the FEIA deductions overall is demonstrated by the large amounts by which an individual's total allowances exceed his FEIA deductions. In six countries, the allowances exceeded the deductions by $29,000 to $53,000 for married individuals and $19,000 to $28,000 for unmarried individuals. These fiqures represent the extent to which the FEIA does not reduce taxable income related to the excessive costs of living overseas. In practice, major companies protect their employees from such taxation. (See pp. 13 and 19.)

GAO found a general consensus that the FEIA is unreasonably complex. Many individuals overseas are unable to prepare their own tax returns and many of the U.S. firms surveyed incur substantial costs for preparation of employee returns. The risk of incorrect preparation of returns is great, and individuals are often forced to seek outside assistance. The average estimated cost of preparing an employee's tax return, according to the companies surveyed, was almost $700 if prepared by the company and more than $1,100 if prepared by an accounting firm. (See p. 14.)

## MATTERS FOR CONSIDERATION BY THE CONGRESS

Taxation of Americans working abroad is part of the continuing conflict among the tax policy objectives of raising revenue, achieving tax equity, simplifying tax returns, and other special aims of public policy, such as promoting U.S. exports and competitiveness abroad. In considering the question of whether, and to what extent, Americans working abroad should be taxed, the Congress must decide what priority should be assigned to each of the conflicting policy objectives.

GAO believes that the Congress should consider placing Americans working abroad on an income tax basis comparable with that of citizens of competitor countries who generally are not taxed on their foreign earned income, because:

--Present U.S. tax provisions are widely regarded as discouraging employment of U.S. citizens abroad.

--Present tax provisions have reportedly made Americans relatively more expensive than competing third-country nationals, thereby reducing their share of employment abroad by major U.S. companies.

--Americans retained abroad by major companies are generally reimbursed for their higher taxes, adding to the companies' operating costs and making them less competitive.

A number of optional means of taxing Americans abroad have been proposed to the Congress. Two of these--complete exclusion or limited but generous exclusion of foreign earned income for qualifying taxpayers--would establish a basis of taxation comparable with that of competitor countries and, at the same time, would be relatively simple to administer. (See pp. 28 and 29.)

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ABBREVIATIONS

| | |
|---|---|
| FEIA | Foreign Earned Income Act |
| GAO | General Accounting Office |
| IRS | Internal Revenue Service |
| TCN | third-country national |

# CHAPTER 1

# INTRODUCTION

The competitiveness of U.S. exports in the world market has become a major national concern because of the deficit in the U.S. balance of trade that developed in the 1970s and because of its implications for real income and employment in the United States. This problem has been the focus of major initiatives to improve Government export promotion programs and to identify and correct Government disincentives to exports.

Employment of a large force of U.S. citizens abroad is viewed as essential to promote and service U.S. products and operations. Officials of major exporting companies consistently assert that an American presence abroad is vital to the success of their foreign sales and operations. Therefore, U.S. businessmen, pertinent Government officials, and some Members of Congress are strongly concerned that tax laws in the Foreign Earned Income Act of 1978 (Public Law 95-615, Title II, Nov. 8, 1978) are proving a disincentive to employment of U.S. citizens abroad and, therefore, adversely affecting exports. Because of this concern, we reviewed the taxation of U.S. citizens abroad, focusing on the following issues.

--Does the current tax law provide the benefits intended?

--Do the current tax provisions reduce the opportunities for, and attractiveness of, employment of Americans abroad?

This review also reflects a continuing interest in the subject. On February 21, 1978, we issued a related report, "Impact on Trade of Changes in Taxation of U.S. Citizens Employed Overseas," (ID-78-13), which focused on tax changes made by the Tax Reform Act of 1976. Because the thrust of that report's observations and many of the principles discussed therein appear pertinent to the current situation, we have included the digest as appendix I to this report.

## U.S. TAXATION OF FOREIGN EARNED INCOME: CONTINUING DISSATISFACTION

Income tax laws applicable to foreign earned income have been in an almost constant state of change in recent years. Taxpayer dissatisfaction and protests have been both a cause and a result of this state of change. The controversy continues today, with many different views on desirable further change. Most current proposals are aimed at further reducing taxes on overseas taxpayers and simplifying the governing rules.

The recent history of tax law changes began in 1975 with congressional initiatives to effect a major reform in income tax

law. The resulting Tax Reform Act of 1976 (Public Law 94-455, Oct. 4, 1976) affected taxation of foreign earned income by substantially increasing effective rates at which U.S. taxes would be paid. It reduced the former exclusion of $20,000 or $25,000 to $15,000 for most taxpayers; taxed non-excluded income at the higher bracket rates that would apply if there were no exclusion; and disallowed a credit for foreign taxes paid on excluded income. The Act was retroactive to tax years beginning in 1976. In addition, the Internal Revenue Service (IRS) won key court cases in 1976 that clearly established that employee benefits, such as housing and dependent education, were generally subject to U.S. income tax at their full value in the locality where provided. This ended an apparently longstanding taxpayer practice of not reporting such allowances or reporting them at the lower value they would have in the United States.

The 1976 tax changes led to widespread protests by overseas taxpayers and their employers. In May 1977, Congress removed the retroactive feature of the Act, making it effective for tax years beginning in 1977. However, throughout 1977 and much of 1978, protests and vigorous lobbying efforts continued. In addition to our February 21, 1978, report on the subject there were reports by the Departments of Commerce 1/, the Treasury 2/, and the Congressional Research Service 3/. After extensive hearings and debate, Congress passed the Foreign Earned Income Act (FEIA), which greatly changed the method of providing special treatment to taxpayers abroad.

The FEIA, first, deferred the effective date of the Tax Reform Act to tax years beginning in 1978. Second, it generally replaced the old exclusion system with a new deduction system designed primarily to provide tax relief on income needed to pay for the unusual and excessive costs of living abroad; it also provided a tax incentive for employment in hardship areas and retained an alternative income exclusion ($20,000) for taxpayers employed in camps in hardship areas. Third, it gave taxpayers the option of applying either the Tax Reform Act rules or the new rules for 1978 tax years. Thus, tax years beginning in 1979 were the first in which all taxpayers abroad would file under the FEIA.

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1/Blough, Roy, Dr., "U.S. Policy Toward the Taxation of Foreign Earnings of U.S. Citizens," Department of Commerce, Aug. 1978.

2/"Taxation of Americans Working Overseas: Revenue Aspects of Recent Legislative Changes and Proposals," Department of the Treasury, Feb. 1978.
Mutti, John, Prof.,"The American Presence Abroad and U.S. Exports," Department of the Treasury, Oct. 1978.

3/Gravelle, Jane G. and Kiefer, Donald F., "U.S. Taxation of Citizens Working in Other Countries: An Economic Analysis," Congressional Research Service, Apr. 1978.

The FEIA was not well received by all taxpayers. It was quickly perceived that some taxpayers would receive little or no benefit from the law and that it was very complex compared with prior tax laws. In the past 2 years, there have been continuing complaints and efforts to seek further changes. Most of the complaints could be summarized as follows.

--Competitiveness of U.S. workers--U.S. workers are disadvantaged in competing for overseas employment when compared to third-country nationals, who are not taxed by their home countries; the costs of reimbursing U.S. workers for higher taxes, a common practice, make these workers less attractive to employers.

--Competitiveness of U.S. firms--U.S. firms that hire Americans and reimburse them for their higher tax burdens have higher labor costs and, therefore, are less competitive than foreign firms who do not have the same added costs.

--Equity--The law does not fully eliminate taxes on income reflecting excessive costs of living overseas, as it was intended to do.

--Complexity--The law is so complex that it is very difficult for most taxpayers to complete their own tax returns and to maintain necessary records; this has led to increasing use of expensive tax return preparation services.

The complaints generated numerous legislative proposals in 1980, which were generally designed to provide more liberal tax benefits and, in some cases, to simplify the law.

## THE DIMENSIONS OF THE PROBLEM

In confronting the issue of how the tax law should be changed, Congress will face the important questions of (1) how effective are personal tax incentives in promoting exports and commercial competitiveness abroad?, (2) how many taxpayers abroad might be affected by such changes?, and (3) how are Federal tax revenues affected?

### Effectiveness

Little has been done to evaluate the effectiveness of personal tax incentives for promoting exports and commercial competitiveness abroad. The Department of the Treasury is presently evaluating the effectiveness of foreign earned income tax laws, including their revenue and economic effects, but no report is expected until the summer of this year. A few other studies have been made, but they have not been generally accepted

as authoritative. (See app. III.) While the results of these studies have been questioned because of data and methodology limitations and, therefore, cannot be accepted with great confidence, they do suggest a positive relationship between employment of Americans abroad and the level of U.S. exports.

Number of taxpayers affected

According to Department of the Treasury reports, private Americans abroad filed 174,000 income tax returns for the 1976 tax year, and about 140,000 of these taxpayers claimed the foreign earned income exclusion. A preliminary count of 1977 tax year returns showed a drop in total returns filed to about 150,000, but at least part of the drop was presumed to be due to delayed filing caused by changes in the tax law. The IRS is now processing 1979 tax year returns and should have an up-to-date count of overseas taxpayers by about June 1981, including subcounts showing geographic dispersal and numbers of taxpayers claiming FEIA benefits. Treasury recognizes that the tax return counts may not include all U.S. workers abroad, because some may not have filed for various reasons.

Revenue implications

The question of how Government tax revenues are affected by taxation of Americans abroad has not been fully resolved. The Treasury Department and the Joint Committee on Taxation both routinely prepare estimates of the revenue effects of proposed legislation. However, these estimates have certain limitations for measuring the full impact, because they

--do not attempt to measure the possible revenue effects of behavorial changes resulting from tax changes (such as reduced employment abroad due to tax increases and possible related economic effects, such as reduced exports, domestic employment, production and profits); and

--do not attempt to measure possible revenue consequences for other tax law provisions (such as the interrelationship of foreign taxes and credits and corporate taxes and deductions related to company reimbursements for higher employee taxes).

With these limitations in mind, however, it may be useful to consider the following revenue estimates.

--In July 1978, we estimated that if taxpayers abroad had been given no special relief other than foreign tax credits, their gross U.S. tax liability for 1977 would have been $675 million. The Tax Reform Act of 1976 would have reduced that liabiity by $175 million.

--In October 1978, the Joint Committee on Taxation estimated that the FEIA would reduce revenues by $421 million for 1978.

--In June 1980, the Joint Committee estimated that a Senate bill that would completely exclude foreign earned income of qualifying taxpayers would reduce 1981 revenues by $508 million compared with revenues under the FEIA.

On the other hand, some have contended that increased taxation of Americans abroad actually reduces Federal revenue. One private study 1/ postulated that, if such increased taxation led to a 5-percent reduction in exports, revenues would actually fall by some $6 billion. That study has been criticized by Treasury officials and others as based on inappropriate methodology and insufficient data.

OBJECTIVES, SCOPE, AND METHODOLOGY

The major objectives of this review, in light of the perceived importance of the employment of Americans abroad in promoting U.S. exports, were to:

--Assess the tax benefits of the FEIA for Americans employed abroad and determine whether compliance with the law is unduly complex.

--Determine the impact of U.S. income taxes on the comparative costs in selected countries of employing American citizens and citizens of competitor countries.

--Analyze trends by U.S. companies in overseas employment of Americans and third-country nationals.

Our review was constrained by a general lack of fully satisfactory data regarding the application of the new law and the supporting IRS rules, which were not fully applicable until the 1979 tax year, and by a relatively tight timeframe for reporting.

Our comparative analysis of foreign employment allowances and related deductions under the FEIA was based primarily on data collected through a survey questionnaire. The companies surveyed were in industries for which foreign operations were important and which generally employed large numbers of Americans abroad.

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1/Chase Econometric Associates, Inc., "Economic Impact of Changing Taxation of U.S. Workers Overseas," June 1980.

| Industry | Number of companies Surveyed | Responding |
|---|---|---|
| Construction and architect/engineering | 14 | 11 |
| Resource extraction | 10 | 7 |
| Aerospace | 8 | 4 |
| Other manufacturing | 18 | 12 |
| Financial and other services | 13 | 7 |
| Total | 63 | 41 |

The employee compensation and tax deduction data was obtained for six countries--Brazil, Hong Kong, Japan, Saudi Arabia, Venezuela, and the United Kingdom.

Because we surveyed only large firms, the data should not be regarded as representative of all Americans employed abroad; however, it does indicate the magnitude of the problem for a relatively large group. The companies responding had a worldwide expatriate workforce of 36,818 as of January 1, 1980, 16,322 Americans and 20,496 third-country nationals. The data suffers from the weaknesses of much survey data in that it was collected without verification from parties with a vested interest in the outcome of the study. Nevertheless, the data appears credible in that there was a general level of consistency across the sample. Therefore, we believe the information and analyses in the report serve as useful indicators. Individual income tax returns, an alternative source for the information used in this analysis, would be more complete, accurate, and free from possible bias, but a sample of data from those returns is not expected to be available until June 1981.

Our analyses of the comparative costs and trends in employment of Americans and third-country nationals abroad were also based on data provided by the 41 respondents. (However, data for employment trends was collected on a worldwide basis, not just from the six countries.) Accordingly, the analyses cannot be regarded as representative of all American companies with foreign operations, but we believe it is indicative of the problems. The nature of the data used in these analyses was such that it could be provided only by the companies concerned.

Information on the tax laws of competitor countries was primarily obtained from special studies conducted by the Library of Congress. It was supplemented to some extent by information which American Embassy personnel obtained from foreign governments and provided to us. In addition, a number of foreign banks in several foreign countries gave us information on how those tax laws are actually applied.

Numerical data and other information concerning the problems and complexity of the FEIA were collected in the same six countries from about 90 U.S. taxpayers, about 60 overseas employers,

and several major U.S. accounting firms. The IRS gave us information on the development of pertinent regulations and cost of living deduction tables.

Finally, we examined numerous reports and other literature and consulted with officials of the Departments of Commerce and the Treasury to obtain information on the policy issues related to taxation of Americans abroad and to determine the extent to which those issues had been analyzed.

## CHAPTER 2

## APPARENT INADEQUACY AND COMPLEXITY OF THE FOREIGN EARNED INCOME ACT

When Congress passed the Foreign Earned Income Act of 1978, its intent was twofold--to create equity between people working abroad and at home and to benefit the U.S. economy by encouraging Americans to work in hardship areas. The Act falls short of providing equity between people working abroad and at home. Moreover, it greatly complicates the preparation of tax returns by Americans overseas.

### INTENDED BENEFITS

The FEIA was intended to create greater equity between people working abroad and at home and to provide an incentive to Americans working in hardship areas. Equity was to be achieved through a series of four deductions for excess foreign living costs--the general cost of living, housing, education, and home leave costs. An additional $5,000 deduction was established for workers in hardship areas. For employees in camps in hardship areas, an alternative $20,000 exclusion was to be allowed in lieu of deductions for hardship and cost of living expenses. Eligibility requirements under the FEIA are much the same as under prior law; i.e., U.S. citizens will be eligible if they are bona fide residents of a foreign country or countries for a period which includes an entire taxable year or if they are physically present in a foreign country or countries for 510 days out of 18 months.

### BENEFITS RECEIVED

Through our interviews with individuals in Brazil, Hong Kong, Japan, Saudi Arabia, the United Kingdom, and Venezuela and with officers of domestic corporations that have employees in these countries, we learned that, in practice, the FEIA meets neither the specific equity objective of the law nor the more general objective of tax simplification.

#### Equity for Americans overseas not always achieved

Although the FEIA was intended to achieve greater equity for Americans working overseas and those at home, this objective often is not met. The Act falls short of providing adequate relief from taxation of recognized allowances. Section 913, as outlined in the FEIA, provided for five separately calculated deductions for cost of living, housing, schooling expenses, home leave transportation, and hardship post. The cost-based deductions permitted under the Act (i.e., those other than the hardship post deduction) do not reduce taxable income of employees to the same extent that

it is inflated by the actual allowances provided by their employers. According to statements made and data provided by U.S. company officials, although the schooling and home leave transportation deductions were generally adequate, the housing and cost of living deductions were often seriously inadequate in reducing foreign earned income by actual allowances for these items. The hardship post deduction, often significantly less than the hardship allowance provided by U.S. companies operating in such areas, is discussed later in this chapter. We found that the total Section 913 deductions may often be less than $20,000, the amount excluded by overseas taxpayers prior to the Tax Reform Act of 1976.

### Housing deduction

The housing deduction fails to provide adequate relief from taxation on the excess costs incurred for this aspect of living overseas. Housing has become the major additional expense involved in living abroad in many countries. This is evident in the large allowances that firms give their employees for housing and the large costs actually incurred for housing. The first two columns of table 1 show the average housing allowance and housing deduction for married employees of the firms we surveyed. These employees generally had two children and a base salary of between $45,000 and $55,000. The fourth and fifth columns show the average housing allowance and deduction for unmarried employees with a base salary of generally between $25,000 and $35,000. The average housing allowances are net figures; i.e., firms generally provide an amount equal to actual housing expenses less a hypothetical amount that the individual would normally incur for housing expenses had he remained in the United States. Under the Act, it was intended that the housing deductions should approximately equal the average housing allowance; i.e., the individual would deduct the amount of housing expenses representing excess housing costs abroad. As table 1 shows, however, this is not the case. In short, the individual is still being taxed on a significant amount of the housing allowance provided for excess housing costs. These amounts, the differences between the housing allowances and the housing deductions, are shown in the third and sixth columns of the table.

Table 1 1979

| | Married individual | | | Unmarried individual | | |
|---|---|---|---|---|---|---|
| Country | Average Allowance | Housing Deduction | Excess Allowance Taxable | Average Allowance | Housing Deduction | Excess Allowance Taxable |
| Brazil | $14,457 | $ 4,428 | $10,029 | $10,761 | $ 3,361 | $ 7,400 |
| Hong Kong | 30,280 | 19,896 | 10,348 | 18,037 | 9,493 | 8,544 |
| Japan | 24,748 | 11,337 | 13,411 | 13,716 | 5,216 | 8,500 |
| Saudi Arabia | 23,608 | 14,323 | 9,285 | 21,480 | 14,481 | 6,999 |
| United Kingdom | 14,238 | 4,055 | 10,183 | 9,471 | 3,198 | 6,273 |
| Venezuela | 15,067 | 5,914 | 9,153 | 10,257 | 4,747 | 5,510 |

Under FEIA, the housing deduction is an amount equal to the individual's reasonable actual housing expenses minus what is called the "base housing amount," which, in principle, should be the amount the individual would pay for housing were he living in the United States. The method of computing this hypothetical housing cost, however, may cause it to be highly inflated. It is computed as 20 percent of foreign earned income net of (1) actual housing expenses, (2) the four other FEIA deductions, and (3) other allocable deductions. The income earned abroad amount is not reduced by any tax reimbursement or by any other miscellaneous allowances. (See p. 19.) Furthermore, because the cost of living deduction is often substantially less than the allowance actually provided by the firm, the foreign earned income amount is further inflated, which results in the base housing amount (20 percent of that figure) also being inflated. When the housing deduction is computed by subtracting the inflated base housing amount from actual housing expenses, the deduction is often substantially smaller than the housing allowance. Indeed, in many cases, the allowable deduction is actually zero, because the base housing amount exceeds the actual housing expenses. Information provided by U.S. firms for 141 employees, both married and unmarried, in the same six countries showed that 30 of them had a housing deduction of zero.

Cost of living deduction

The cost of living deduction is often inadequate, according to individuals we interviewed in six countries and the U.S. firms we surveyed. There are wide variances between the cost of living allowances provided by U.S. firms and the cost of living deductions taken in line with IRS tables. Table 2 shows cost of living allowances and deductions for married individuals, generally with two children and a base salary of between $45,000 and $55,000, and for unmarried individuals with a base salary of generally between $25,000 and $35,000. In short, the individual is still being taxed on a significant amount of the allowance provided by the firm for the higher general cost of living overseas. The average amounts by which the cost of living allowance exceeds the cost of living deduction are also shown in the table.

Table 2 1979

| | Married individual | | | Unmarried individual | | |
|---|---|---|---|---|---|---|
| Country | Average Cost of Living Allowance | Deduction | Excess Allowance Taxable | Average Cost of Living Allowance | Deduction | Excess Allowance Taxable |
| Brazil | $ 5,036 | $ 1,216 | $ 3,820 | $ 2,005 | $ 500 | $ 1,505 |
| Hong Kong | 5,529 | 775 | 4,754 | 3,704 | 500 | 3,204 |
| Japan | 17,161 | 9,702 | 7,459 | 10,121 | 7,125 | 2,996 |
| Saudi Arabia | 8,937 | 6,299 | 2,638 | 5,983 | 4,650 | 1,333 |
| United Kingdom | 9,393 | 4,851 | 4,542 | 6,325 | 3,264 | 3,061 |
| Venezuela | 7,021 | 5,449 | 1,572 | 4,641 | 3,480 | 1,161 |

Clearly, there is a discrepancy between the allowances provided by U.S. firms and the amounts IRS allows as deductions. The discrepancy results from the variance in methods the Treasury Department uses in deriving its tables and U.S. firms or their consultants use in deriving the amounts of their allowances. The FEIA specifies certain criteria that Treasury must use in deriving its tables which tend to reduce the amounts allowable as deductions. It specifies that (1) the metropolitan area which has the highest cost of living in the continental United States (excluding Alaska) is to be the point of comparison and (2) the deduction is to be based on the reasonable daily living expenses of a person with a GS-14, step 1, salary, and is not to be variable by income.

In contrast, an official of a consulting firm that markets suggested overseas allowance data advised that many large U.S. companies use either a national composite or their corporate headquarters' city as their base of comparison rather than Boston, the metropolitan area identified by Treasury as that area with the highest general cost of living. Also, although the consulting firm uses concepts similar to those used by Treasury in deriving its indices for various foreign locations, there are fundamental measurement differences. First, the consulting firm's indices are derived from a market basket of goods for a family whose income is somewhat higher than that of the average family used in deriving Treasury's indices. Second, the consulting firm applies the indices thus derived to a range of incomes that exceed by far the salary of GS-14, step 1, specified in the law. This is because the consulting firm is catering to its corporate customers, many of whose overseas employees earn far in excess of that salary. Although spendable income is calculated at a lesser percentage of base salary for higher income employees, it is still significantly larger than for the GS-14, step 1, employee, whose spendable income was calculated at less than $15,000 for 1979. Clearly, the same index applied to a higher spendable income results in a higher suggested allowance.

The Secretary of the Treasury has decided that the deduction tables will be revised only once a year, the minimum required by law. The consulting firm revised its tables more frequently. The potential impact of less frequent revision is indicated by changes in the cost of living deduction allowable for a family of four in the United Kingdom, which jumped from $300 in 1978 to $4,500 in 1979 and to $7,900 in 1980. However, it should be noted that more frequent revision would not always benefit the taxpayer. For example, the dollar exchange rate strengthened throughout 1980 against many currencies, and more frequent revision under such circumstances would have tended to reduce allowable deductions.

On the other hand, the present practice of basing tables on mid-year data tends to provide deductions that are representative of the whole year, assuming a constant rate of inflation. Further, according to an IRS official, the use of single yearly tables enables taxpayers to file more accurate declarations of estimated tax and the added administrative costs of revising the tables more frequently must be considered.

Hardship post deduction

The hardship post deduction is $5,000 annually available to those taxpayers in designated hardship areas only. This deduction is a tax incentive to promote employment of U.S. nationals in such areas. Therefore, tax equity arguments that apply to the other four deductions are not applicable. Of the six countries for which we obtained information, only Saudi Arabia was designated as a hardship area across the board. Nonetheless, according to data provided by firms with operations in those six countries, a few employees in countries other than Saudi Arabia were in fact given hardship allowances. Such allowances were not deductible, nor were parts of the allowances to individuals in Saudi Arabia which were in excess of the $5,000 amount. These payments are in essence bonuses, and the deductions should be evaluated on the basis of their effectiveness in promoting the desired employment rather than compared with allowances received.

Schooling and home leave transportation deductions

Some company officials indicated that there were technical difficulties involved with deductions for schooling and home leave transportation expenses. However, our comparison of allowances and deductions for individuals in the six countries indicated that these deductions were generally adequate in relation to the allowances.

Tax reimbursements and other allowances for living overseas

If the FEIA achieved equity by reducing inflated foreign income by all the excess costs of foreign employment, then the overseas American's taxable income would be the same as if he had remained in the United States, and no tax reimbursement benefits for higher U.S. taxes would be necessary. In practice, however, the new law does not reduce the inflated foreign income sufficiently to make that possible. In addition, the payment of tax reimbursements raises taxable income even more and a cycle is established whereby a tax reimbursement becomes necessary, in part, in 1980 because one was paid in 1979. For example, if an individual during his first year abroad had income exclusively earned abroad, a tax liability to country X of $15,000 and a U.S. tax liability of $20,000, then he would first pay $15,000 to country X and then $5,000 to the United States. (The U.S. foreign tax credit provision entitles him to credit for foreign taxes paid or accrued.) His total worldwide taxes paid are $20,000, an amount, let us say, which is $12,000 more than he would have paid had he remained in the United States and earned only his base salary. If his company reimburses him for the additional $12,000, then that amount becomes taxable income in the year received. He would consequently incur additional taxes on that tax reimbursement, with country X having first claim and the United States receiving only the excess of the U.S. taxes over the country X tax on that reimbursement.

The extent to which the tax reimbursement inflates taxable income is shown through an analysis of data provided by domestic firms we surveyed. Almost 95 percent of these firms indicated that they provided tax reimbursements to all or most of their American employees working overseas in 1979. The reimbursement, of course, varied according to salary level, host country, compensation package, and family status, etc., but often represented more than 30 percent of the individual's base salary. Table 3 shows the average tax reimbursement allowance provided to married and unmarried individuals in six countries. The married individuals generally had two children and base salaries between $45,000 and $55,000; the unmarried individuals had base salaries generally between $25,000 and $35,000. Also shown is the tax reimbursement as a percent of base salary.

Table 3

Average Tax Reimbursement Allowance - 1979

| Country | Married individual | | Unmarried individual | |
|---|---|---|---|---|
| | Amount | Percent of base salary | Amount | Percent of base salary |
| Brazil | $22,724 | 49.3 | $14,488 | 44.9 |
| Hong Kong | 18,775 | 39.2 | 11,739 | 39.7 |
| Japan | 29,131 | 64.7 | 14,557 | 52.9 |
| Saudi Arabia | 18,889 | 39.6 | 10,558 | 34.3 |
| United Kingdom | 19,734 | 41.1 | 13,841 | 46.8 |
| Venezuela | 18,413 | 40.4 | 12,486 | 39.5 |

The tax liability resulting from such reimbursements is the most significant tax consideration of working overseas that is not addressed in the FEIA. Other costs of employing Americans overseas, which meet needs of overseas living and yet are not deductible, vary from company to company but may include car protection, storage, and certain moving costs, etc.

Still other costs of employing Americans overseas include foreign service or overseas premiums, rest and relaxation allowances, etc. These payments do provide economic benefits to their recipients. Nonetheless, they not only inflate taxable income but, like the tax reimbursement, also reduce the amount of the housing deduction.

## Comparison of allowances and tax deductions

Table 4 shows the average total allowances and deductions for married and unmarried individuals in six countries. The total allowance figure excludes any foreign service or overseas premium which may be considered bonus or incentive income. As is evident, the amounts by which the total allowances exceed the total deductions are significant. These amounts represent income, designed to compensate individuals for excess costs of living overseas, which the FEIA does not relieve from taxation.

Table 4

1979

| Country | Married individual: Average Total Allowances (note a) | Married individual: Average Total Deductions (note b) | Married individual: Excess Allowance Taxable | Unmarried individual: Average Total Allowances (note a) | Unmarried individual: Average Total Deductions (note b) | Unmarried individual: Excess Allowance Taxable |
|---|---|---|---|---|---|---|
| Brazil | $62,343 | $16,526 | $45,817 | $32,125 | $ 7,216 | $24,909 |
| Hong Kong | 70,433 | 31,498 | 38,935 | 37,324 | 11,398 | 25,926 |
| Japan | 82,264 | 29,408 | 52,856 | 43,663 | 15,408 | 28,255 |
| Saudi Arabia | 58,836 | 30,304 | 28,532 | 36,334 | 17,120 | 19,214 |
| United Kingdom | 55,648 | 17,896 | 37,752 | 32,710 | 8,250 | 24,460 |
| Venezuela | 54,913 | 21,213 | 33,700 | 31,761 | 10,225 | 21,536 |

a/Allowances include not only schooling, home leave transportation, housing and cost of living allowances, but also the tax reimbursement and moving and other allowances. Any hardship allowance is not included.

b/In addition to the schooling, home leave transportation, housing, and cost of living deductions, any moving expense deduction was included to afford a better comparison with the total allowance figure which did include moving expenses. (The FEIA does provide a deduction for moving expenses.) Any hardship deduction is not included.

### Hardship camp exclusion

An alternative $20,000 exclusion is available to individuals employed in camps in hardship areas. In addition to that exclusion, the employee is allowed to exclude from income the value of employer-furnished meals and lodging if he is required to accept the meals and lodging as a condition of employment and they are provided for the convenience of his employer. The definition of "camp" has been an area of controversy during the last 2 years. Temporary regulations issued by the IRS were considered overly restrictive by individuals and their U.S. employers overseas. Regulations issued subsequently, however, appear to be satisfactory. The adequacy of the $20,000 exclusion should be evaluated in terms of its effectiveness in providing the necessary incentive for Americans to work in hardship area camps.

## COMPLEXITY OF THE LAW

We found a general consensus that the FEIA is unreasonably complex. Most Americans overseas are unable to prepare their own returns, and U.S. firms incur high costs to have employee returns prepared inhouse or by outside accountants.

Most individuals we interviewed in the six countries complained of the complexity of the law. For those taxpayers who prepare their returns themselves, according to tax professionals, the risk of incorrect preparation is great. The various deductions and the way in which they are calculated are difficult for the average taxpayer to understand, and the effort required is much greater than would be required of a taxpayer in the United States. In addition, the recordkeeping required by the law is

burdensome. A tax professional estimated that a tax return with supporting schedules would run to 25 pages. IRS representatives in the United Kingdom and Saudi Arabia agreed that the current tax law was both complex and confusing to the average taxpayer.

The complexities of the FEIA force many taxpayers to seek expensive professional tax assistance. The large U.S. accounting firms in the United Kingdom, for example, charge between $700 and $1,200 to compute individual returns, depending on such things as whether the individuals moved during the tax year and whether the United Kingdom returns are prepared concurrently. Smaller accounting firms charge slightly less for preparing tax returns.

Most large U.S. firms recognize the need for preparation assistance and pay for these services as part of their compensation packages. Such corporate programs have increased dramatically since the FEIA, and in the United Kingdom, for example, now account for the overwhelming majority of the individual returns prepared by the eight large U.S. affiliated accounting firms.

More than 60 percent of the domestic firms responding to our questionnaire either prepared their employees' returns inhouse or had them prepared by a third party the firm selected and paid for. The estimates for inhouse cost averaged almost $700 and for preparation by a third party, more than $1,100.

## CONCLUSIONS

The FEIA of 1978 falls far short of meeting the equity objective of the law as intended by the Congress. It does not, for the most part, lead to equity between Americans working overseas and those working at home. However, the firms we surveyed reimburse most of their employees for these extra taxes. The mechanics of the law are such that various deductions fail to fully relieve Americans of taxation on certain income reflecting excess costs of living overseas, most notably allowances associated with housing and the general cost of living. Furthermore, the FEIA does not even consider certain income reflecting other excess foreign living costs. The tax reimbursement is by far the most significant item of additional income. It is given by a firm to compensate an employee for excess taxes, both U.S. and foreign, that are incurred as a result of overseas employment. This tax reimbursement may often amount to more than 30 percent of an individual's base salary.

The end result of the FEIA's failure to meet its equity objective is a taxable income and, hence, tax liability, often far in excess of what an individual would have incurred had he remained in the United States. Employees of large corporations generally receive tax reimbursements from their employers, but this in turn is taxed, adding to taxable income and tax liability.

Not all firms provide tax reimbursements, however. Employees of such firms, as well as self-employed individuals, must reevaluate their decisions to continue working overseas.

Simplification has been a general goal of national tax policy during the last several years. The FEIA does not realize this goal. It is extremely difficult for an American working abroad to correctly prepare a tax return under the new law. Consequently, many firms provide expensive tax preparation services to such employees. Employees of firms that do not provide such services and self-employed individuals must incur substantial added costs.

## CHAPTER 3

## U.S. INCOME TAXES ENCOURAGE U.S.

## FIRMS TO REPLACE AMERICANS OVERSEAS

The major U.S. companies we surveyed reported they are reducing their overseas employment of Americans and cited the additional tax costs of Americans as a major reason. The United States is alone among the major industrial powers in taxing foreign source income on a citizenship basis. Nationals of other countries can usually avoid such taxation by taking measures to sever residency ties with their home countries. The United States taxes not only base salary but also overseas allowances to the extent they are not offset by allowable deductions. Most major U.S. firms reimburse employees for the amount their worldwide tax liability exceeds the home-country tax on base salary. The surveyed firms reported that the difference in reimbursement payments received by Americans and third-country nationals (TCNs) has contributed significantly to a shift toward hiring TCNs at the expense of Americans.

### INCOME TAXES AS A COMPETITIVE FACTOR

Home country income taxes can affect the ability of Americans to compete for foreign jobs, particularly where host-country income taxes are relatively low. Citizens of major U.S. trade competitors can, and generally do, avoid liability for home-country taxes. Foreign countries, including Canada, France, Germany, Japan, and the United Kingdom, do not tax the foreign earned income of nonresident citizens. 1/ U.S. expatriates cannot obtain the same advantage because the United States asserts tax jurisdiction over all its citizens on their worldwide income. Furthermore, citizens of competitor countries (except Canada) who do not attain nonresident status may still qualify for preferential tax treatment of foreign earned income that is generally more favorable than that provided under the U.S. Foreign Earned Income Act.

Most countries impose some form of tax on income which has its source within their respective jurisdictions, although the form and levels vary significantly from country to country. Thus, if all countries imposed income taxes on a source basis, income taxes would not be a factor in the competition for jobs

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1/The tests to establish nonresidency vary in difficulty from country to country. However, a privately employed citizen would likely meet the tests of any of these countries if he worked abroad continuously for more than 2 years, was accompanied abroad by immediate family members, gave up his home-country residence, and severed other ties, such as property ownership and financial interests. Thus, with some sacrifice and planning, citizens of these countries could avoid home-country taxes.

in a specific country. However, many countries assert tax jurisdiction over the worldwide income of workers deemed to be residents or domiciliaries, and a few countries, notably the United States, assert tax jurisdiction over the worldwide income of all their citizens. Although these countries generally allow a credit against home country taxes for income taxes paid to thc country of employment, any residual tax payments to the home country may affect the competitiveness of expatriates in the international job market.

Where host-country taxes are greater than a worker's home-country taxes, he will be liable only for host-country taxes and his competitive position will not be affected. Where host country taxes are lower, however, the tax payments to his home country will alter his situation relative to other expatriates who have lesser, or no, home-country tax liabilities. A U.S. worker may decline to accept overseas employment at his prevailing wage because he must accept a lower level of disposable income. Expatriates of other countries do not have the same problem. Another possibility, of course, is that the employer will compensate the worker for the higher taxes; the implications of these added costs for both the number of Americans the employer will hire and the employee's competitiveness abroad are discussed later in this chapter.

We attempted to determine the numbers of citizens of competitor countries who have qualified for nonresident status and avoid home country taxes. Officials of Canada, France and the United Kingdom reported that such data was not available; Germany and Japan did not respond. We did collect some information which does indicate that competitor country citizens generally do make the effort to avoid home-country taxes. Officials of some 20 competitor country banks in selected third countries advised us that their home-country employees were not subject to home-country taxes. In addition, representatives of some of the major companies we interviewed in the United States stated that TCN employees generally were not subject to home-country taxes and, therefore, tax considerations did not affect their employment opportunities.

An expatriate who does not have access to the favorable tax treatment afforded to nonresidents may improve his opportunities for foreign employment if his home country provides preferential tax treatment for foreign income of its citizens. The U.S. Foreign Earned Income Act is an example of such preferential tax treatment. Major competitor countries, except Canada, also provide some form of preferential treatment for those who meet certain tests, and Canada is considering adopting a partial foreign earned income exemption. (See app. II.)

## COSTS OF U.S. COMPANIES' FOREIGN OPERATIONS INCREASED BY TAX REIMBURSEMENT PROGRAMS FOR EMPLOYEES

Overseas employees of major U.S. companies, in most cases, are reimbursed for any additional tax burdens resulting from

their overseas assignments. Tax reimbursement programs are usually available to all expatriate employees, whether American or third-country nationals. These programs, although they differ in details, are generally designed to "keep the expatriate employee whole," that is, to assure that the employee's tax liability does not exceed the home-country tax on his base salary. Under these programs, the company computes a hypothetical home-country tax and reimburses the employee for any worldwide tax liability over and above the hypothetical tax. As a consequence, to the extent that U.S. nationals have higher worldwide taxes, these U.S. firms will likely have higher labor costs, and the number of U.S. workers abroad will be lower than it would be otherwise.

Tax reimbursement programs of major U.S. companies

Of the 41 companies responding to our survey, 39 provide tax reimbursement payments to American employees assigned on a long-term basis overseas. Thirty six of these companies make reimbursements available to all or most American employees, and three make reimbursements available only to some. A number of companies may provide other income protection or incentives, such as job completion bonuses or augmented salaries to employees who do not receive tax reimbursements.

Almost three-fourths of these companies also provide tax reimbursement payments to their TCN employees. 1/ Of these, most respondents make payments available to all TCNs. Several companies indicated that they may provide other income protection or incentives to TCN employees for whom tax reimbursement payments are not made available.

Tax reimbursement programs generally take the form of tax protection or tax equalization. These alternatives differ primarily with respect to their treatment of undertaxation. An employee receiving tax protection is assured that, at any given income level, his tax liability will not exceed what it would have been were he not employed abroad. The employer compares worldwide tax liability to the hypothetical home-country tax, and reimburses the employee for any amount above the hypothetical tax. Otherwise, no adjustment is made and the employee gains from a lower tax burden. This opportunity is, of course, not available to U.S. citizens. Company representatives explained that a major drawback to this type program is that TCNs often resist being transferred from low-tax to higher tax countries because of the resultant decrease in actual pay it entails.

Under a tax equalization program, the employee does not benefit from undertaxation. The employer usually withholds the hypothetical home-country tax from the employee's paycheck on

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1/37 firms that employed TCNs answered the question. 2 firms did not answer the question, and 2 said they employ no TCNs.

a pro-rata basis, and, at the end of the year, reimburses the employee for any additional home-country tax and all host-country tax incurred. Should the individual be liable for home-country tax, the money withheld by the company is forwarded to the tax authorities; if not, it remains with the company.

Tax reimbursement programs also differ with respect to the types of income and taxation covered. Some companies reimburse only for additional tax incurred on company-source income. Other firms also cover additional tax incurred on outside income (such as stock dividends) caused by "bracket creep", which results when the inclusion of the overseas allowances in the taxpayer's income moves his overall tax bracket up and increases the tax on outside income. Such expansion of coverage is necessary to maintain tax equity for individuals with significant outside income, who may otherwise resist overseas assignments. Similarly, two companies also reimburse for additional State income tax incurred due to the overseas assignment.

Reimbursement programs more costly for American than for TCN employees

Because of the differing policies regarding taxation of foreign-source income between the United States and other major industrial countries, Americans generally require much larger tax reimbursement payments than do nationals of other countries. Additionally, there are substantial indirect costs which are associated solely with the provision of tax reimbursements to Americans.

As table 5 shows, reimbursement payments comprise a significant portion of the total compensation costs of Americans.

Table 5

Reimbursement Payments as percent of Total Compensation

| Country | Unmarried American | Unmarried TCN | Married American | Married TCN |
|---|---|---|---|---|
| | (percent) | | | |
| Brazil | 20.1 | 14.6 | 16.4 | 16.6 |
| Hong Kong | 17.7 | 0.9 | 13.3 | 1.9 |
| Japan | 21.9 | 10.9 | 16.8 | 18.6 |
| Saudi Arabia | 10.0 | 0 | 13.1 | 0 |
| United Kingdom | 17.8 | 2.1 | 14.3 | 6.9 |
| Venezuela | 11.4 | 0 | 11.9 | 5.5 |

The reimbursements to Americans in these six countries range from a low of 10.0 percent of total compensation to a high of 21.9 percent.

In contrast, the tax reimbursement payments to TCNs are generally insignificant relative to their total compensation except in Japan and Brazil, where tax reimbursements are primarily due to host-country taxes. For example, our sample companies reported that they did not reimburse TCNs working in Saudi Arabia or unmarried TCNs working in Venezuela.

The indirect, administrative costs of computing and processing tax reimbursement payments for Americans, while not as easily quantified, are also significant. One company uses three professional staff full time from mid-December to mid-April to operate its reimbursement program. The program also requires substantial staff time during the remainder of the year. Various factors were cited as contributing to this administrative burden, for example:

--Numerous tax deductions, many of which vary from country to country or even from region to region within countries, must be pro-rated on a daily basis for employees who often change location.

--Allowance and deduction entitlements cannot be accounted for until the individual has been overseas long enough to qualify for the FEIA deductions, at which time records must be adjusted retroactively by hand and entered into the computerized payroll system.

Should the employee be in a high-tax country, the company is implementing this time consuming procedure only to pay a substantial portion, if not all of the tax reimbursement to the host country.

One additional cost for providing tax reimbursements to Americans is the cost of tax return preparation. The FEIA regulations are so complex as to make it extremely difficult for individuals to correctly prepare their own tax returns. Approximately 45 percent of the firms in our survey arrange for public accounting firms to prepare the U.S. tax returns of their American expatriate employees at company expense. Public accounting firms also provide related services such as preparing foreign tax returns, computing the tax reimbursement payment, and briefing employees being transferred overseas. About 16 percent of the companies prepare the returns inhouse, in part, because of the prohibitively high fees charged by the public accounting firms. (See pp. 14 and 15.) The remaining firms indicated that they do not provide tax return assistance.

## TAX REIMBURSEMENTS COMPRISE MAJOR PROPORTION OF COST DIFFERENTIAL BETWEEN EMPLOYING AMERICANS AND TCNs

The difference between the tax reimbursements for Americans and TCNs contributes significantly to the relative costliness of employing Americans. In some cases, it makes already expensive U.S. workers even more costly. However, in a number of instances, it makes U.S. workers whose income and other compensation are lower than foreign nationals absolutely more costly.

We compared the data provided on the compensation packages paid to married and unmarried TCNs and Americans. The TCNs were the citizens of Canada, France, Japan, the United Kingdom, and West Germany. The host countries were Brazil, Hong Kong, Japan, Saudi Arabia, the United Kingdom, and Venezuela. Each of these countries, with the exceptions of Japan and Brazil, are considered to be low-tax countries.

Our methodology consisted essentially of computing arithmetic averages for American employees and the nationals of each of the competitor countries. The data for the Americans varies in each comparison because we used only matched sets of data representing cases in which the American directly competed with a specific TCN. For example, the American/German comparison consists only of those cases for which a company reported data for both nationalities in the same country. Further, the matched sets of data tended to run in a narrow band of occupations associated with the few industries we surveyed, and there were no more than 14 cases for each comparison. Accordingly, the results of this analysis cannot be considered as representative of the entire population or occupations of Americans employed abroad.

The significance of the tax reimbursement was most pronounced in the comparison of Americans with French and West German nationals. Before tax considerations, the combined pay (base salary, overseas premium, and allowance package) of TCNs from France and West Germany generally exceeds that of Americans. Despite this, Americans tend to be more costly because they generally receive larger tax reimbursements which outweigh the difference in the other components of compensation.

The tax reimbursement is also a substantial proportion of the difference in total compensation between Americans and TCNs from Canada, Japan, and the United Kingdom. The reimbursement differential is not as significant as in the comparison with French and West German TCNs because Americans generally also command higher base salaries, overseas premiums, and allowance packages. Nevertheless, the Americans' higher tax reimbursements represent a major portion of the excess costs of Americans. Clearly, substantially reduced tax reimbursement payments to Americans would improve their attractiveness for overseas positions relative to the nationals of these three countries. Because of the similarity in language and culture, Britons and Canadians are among Americans' primary competitors for overseas positions.

Greater details on how reimbursements increase the relative costliness of Americans overseas are shown in table 6.

Table 6

The Difference in Tax Reimbursements as a Percent of the Additional Costs of Americans Compared with Selected TCNs

| Country | Briton | | Canadian | | French | | Japanese | | West German | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Unmarried | Married | Unmarried | Married | Unmarried | Married | Unmarried | Married | Unmarried | Married |
| Brazil | 45.9 | 49.2 | 74.4 | 75.6 | (a) | (a) | 24.5 | 100.0+ | 100.0+ | (a) |
| Hong Kong | 55.2 | 43.7 | 63.4 | 77.3 | 100.0+ | 100.0+ | 40.9 | 37.8 | 100.0+ | (a) |
| Japan | 55.3 | 47.5 | 72.8 | 52.2 | 71.5 | (a) | - | - | 100.0+ | (a) |
| Saudi Arabia | 39.6 | 46.8 | 52.2 | 64.1 | 85.9 | 91.0 | 71.0 | 79.5 | 100.0+ | 100.0+ |
| United Kingdom | - | - | 68.0 | 76.5 | 94.5 | 69.5 | 65.9 | (a) | 100.0+ | 56.3 |
| Venezuela | 34.8 | 50.9 | 54.5 | 68.0 | 100.0+ | 100.0+ | 63.6 | 100.0+ | 100.0+ | 100.0+ |

a/ The TCN receives higher total compensation than an American counterpart in these instances.

GAO note: Where the difference in tax reimbursements is over 100 percent of the additional cost of Americans, it makes U.S. workers whose before-tax compensation is lower than that of the TCN absolutely more expensive.

## U.S. FIRMS DECREASING EMPLOYMENT OF AMERICANS OVERSEAS

The U.S. firms we surveyed reported that, because of the relative costliness of Americans, they have decreased their employment of Americans in overseas positions, both absolutely and relative to TCNs. They reported that the U.S. tax policy for foreign earned income has contributed significantly to this decreasing trend.

To ascertain overseas employment trends, we surveyed major firms in four industries. Those responding to our questionnaire included 11 firms in the construction and architect/engineering industry, 4 firms in the aerospace industry, 7 firms in the resource extraction industry, and 11 firms in the manufacturing industry 1/. These firms had a total of 322,673 employees overseas--16,322 Americans, 20,496 TCNs, and 285,855 local nationals as of January 1, 1980.

As shown in table 7, employment of Americans abroad in three of the industry samples decreased since 1978, the year the FEIA was passed.

Table 7

Changes in overseas employment of Americans

| Industry (selected companies) | 1976 to 1978 (percent) | 1978 to 1980 |
|---|---|---|
| Construction and architect/engineering | +49.9 | -10.2 |
| Aerospace | +32.9 | -19.1 |
| Resource extraction | +14.3 | +34.1 |
| Manufacturing | - 4.3 | -11.9 |

This represents a shift in direction from the prior 2-year period in two of the industries and an accelerated negative trend in one other industry. It is important to note that this data is not adjusted to account for exogenous shocks such as the Iranian revolution. Any conclusion drawn from this data must be qualified to reflect this consideration. Therefore, more significance should be attached to the change in ratio of Americans and TCNs employed overseas than to changes in the absolute numbers.

### Construction and architect/engineering

Employment of Americans overseas by the construction and architect/engineering firms we surveyed decreased 10.2 percent from 1978 to 1980. This represents a significant shift from the previous 2-year period, during which employment of American

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1/One responding company did not answer the questions on employment trends.

expatriates increased 49.9 percent. Industry spokesmen explained that the additional costs of employing Americans, including the tax reimbursement payment, have caused U.S. firms to be less competitive, and, consequently, to limit the hiring of Americans wherever possible.

For the most part, construction and architect/engineering firms obtain contracts through competitive bidding. Normally, firms from various countries bid on a particular project. U.S. firms no longer enjoy a technical superiority in many areas of the construction and architect/engineering field; consequently, price looms as a much more important factor. Many components go into a bid; these can be broadly broken down into compensation costs, material and equipment costs, general and administrative costs, a risk contingency cost, and profit. According to company representatives, U.S. firms are losing an increasing portion of competitive bids, in part because the compensation costs for Americans are higher than those for foreign nationals. For the firms surveyed, the value of foreign projects as a percent of total revenue decreased from 39.8 percent in 1976 to 35.9 percent in 1979. This decrease in overseas projects has, of course, contributed to a decreased number of Americans working abroad for construction and architect/engineering firms.

There has also been a marked decrease in the relative number of expatriate Americans compared with TCNs employed by the surveyed firms. From 1976 to 1980, Americans decreased from 65.1 percent of the total expatriate workforce to 44.7 percent. Company representatives explained that the high costs of maintaining Americans abroad has caused firms to use TCNs where they would previously have used Americans. Increasingly, nationals of the United Kingdom are taking the middle-management positions. The skill levels of Britons, in many cases, are equal to those of Americans. In fact, one of the firms in our survey operates an active recruitment program in the United Kingdom.

Aerospace

Employment of Americans abroad by the surveyed firms in the aerospace industry has decreased 19.1 percent since 1978. Similar to the construction and architect/engineering industry, this represents a dramatic shift in employment trends from the previous 2-year period, during which employment of Americans increased 32.9 percent.

Company representatives explained that the high costs of employing Americans abroad, a large part of which is the tax reimbursement, has caused aerospace firms to increase their hiring of TCNs at the expense of Americans. The number of TCNs as a percent of total expatriate employment increased from 25.2 percent in 1976 to 37.9 percent in 1980, while the number of Americans decreased from 74.8 percent to 62.1 percent. Company representatives agreed that cost has become a much

more important factor in making hiring decisions. One aerospace company is seriously considering using TCNs and local nationals exclusively in overseas positions.

On certain projects, however, aerospace companies are unable to use TCNs. We were told that the U.S. Government serves as the prime contractor on all foreign military projects, with the firm actually providing the service or product serving as a subcontractor. The Government requires that firms use Americans on such projects for security reasons. As a consequence, the aerospace firms must either absorb the additional costs of the Americans or pass the costs onto the customers.

Resource extraction

Although the absolute number of Americans working abroad for the surveyed resource extraction firms has increased, their employment has decreased substantially relative to employment of TCNs. As a percent of the total expatriate workforce, Americans decreased from 52.1 percent in 1976 to 34.6 percent in 1980, while TCNs increased from 47.9 percent in 1976 to 65.4 percent in 1980.

Company representatives explained that many resource extraction companies have substantially stepped up their overseas exploration activities. This accounts for the increase in the absolute number of Americans abroad, since foreign nationals often do not have the necessary expertise to work on exploration projects. Nevertheless, these firms are tightly restricting the use of Americans in all other foreign operations due to their relatively high cost. Company representatives agreed that the tax reimbursement payment is a significant component of the additional cost of Americans.

Most resource extraction firms usually reserve only high-level management positions in their overseas operations for Americans and fill other positions with TCNs and local nationals wherever possible. A number of companies stated that they have stepped up their overseas recruitment programs to fill middle-management and skilled-labor positions. The companies do not hire TCNs and local nationals in high-level management positions because (1) foreign government officials, particularly in the Middle East, often prefer dealing with Americans when dealing with U.S. firms, and (2) company policy usually requires that senior positions be filled with individuals who have come up through the ranks. One company, however, is presently attempting to fill the top-management positions in its European headquarters with TCNs and local nationals already working with the company.

Manufacturing

Multinational manufacturing firms normally have long-standing policies of using local nationals to fill overseas positions. In 1980, Americans and TCNs employed by the surveyed

multinational manufacturing firms represented only 1.7 and 1.1 percent of total overseas employment, respectively, compared with 97.2 percent local nationals. According to company representatives, local nationals are preferred because they are often better able to relate to others in the country, as well as to local governments, especially where language and culture barriers may significantly hamper the effectiveness of foreigners.

Americans are placed in overseas positions only when no one with the necessary expertise can be found locally or for career development purposes. Consequently, these companies use Americans most frequently to start up new overseas plants and are continually training local nationals to fill overseas positions held by Americans. This policy is economically feasible, since manufacturing firms plan to be incountry indefinitely and can, therefore, expect to recoup their investments in the individuals they train. This is not as feasible for firms that work on a project basis and, therefore, are incountry for relatively short periods.

According to company officials, however, passage of the FEIA has caused many manufacturing firms to accelerate the process of replacing Americans with local nationals and to send fewer Americans abroad for career development purposes. The rate of decrease in the number of Americans from 1978 to 1980 almost tripled compared with the rate of decrease during the prior 2-year period. Consequently, while the number of Americans decreased from 60.0 percent of the expartriate workforce in 1976 to 56.0 percent in 1980, the number of TCNs increased from 40.0 to 44.0 percent. Company officials stated that the relative costliness of Americans, including the tax reimbursement payment, is a significant factor in this trend.

## CONCLUSIONS

The United States is alone among the major industrial countries in taxing foreign-source income on a citizenship basis. The nationals of other countries are usually able to avoid home-country taxation by taking measures to sever residency ties. The United States taxes not only base salary but also overseas allowances to the extent they are not offset by current deductions.

Most major U.S. firms we surveyed operate programs to reimburse expatriate employees for the additional tax burdens resulting from their overseas assignments. These programs are usually available to both Americans and third-country nationals. The programs are generally designed to ensure that the employee's tax liability does not exceed the home-country tax on his base salary.

Our analysis indicates that these programs are significantly more expensive for Americans than for TCNs. Since most countries,

in effect, do not tax foreign-source income, companies need to make reimbursements to TCNs only to the extent that the host-country tax exceeds the hypothetical home-country tax on base salary. In contrast, a firm must reimburse Americans to the extent that their actual worldwide tax liability, including home-country tax on total compensation, exceeds the hypothetical U.S. tax on base salary. The difference between the tax reimbursement payments provided to Americans and those made to TCNs contributes significantly to the relative costliness of employing Americans.

The major U.S. firms we surveyed reported to us that this cost differential was a major reason why they have decreased their employment of Americans overseas. Most of these firms were in the construction and architect/engineering, aerospace, resource extraction, and manufacturing industries. Employment of Americans abroad by the firms decreased absolutely from 1979 to 1980 in three of these industries. Further, the relative number of Americans in overseas positions decreased compared with TCNs from 1976 to 1980 in all of these industries.

## MATTERS FOR CONSIDERATION BY THE CONGRESS

Taxation of Americans working abroad is part of the continuing conflict among the tax policy objectives of raising revenue, achieving tax equity, simplifying tax returns, and other special aims of public policy, such as promoting U.S. exports and competitiveness abroad. In considering the question of whether, and to what extent, Americans working abroad should be taxed, the Congress must decide what priority should be assigned to each of the conflicting policy objectives.

We believe that the Congress should consider placing Americans working abroad on an income tax basis comparable with that of citizens of competitor countries who generally are not taxed on their foreign earned income, because

--Present U.S. tax provisions are widely regarded as discouraging employment of U.S. citizens abroad.

--Present tax provisions have reportedly made Americans relatively more expensive than competing third-country nationals, thereby reducing their share of employment abroad by major U.S. companies.

--Americans retained abroad by major companies are generally reimbursed for their higher taxes, adding to the companies' operating costs and making them less competitive.

A number of optional means of taxing Americans abroad have been proposed to the Congress. Two of these--complete exclusion or a limited but generous exclusion of foreign earned income for

qualifying taxpayers--would establish a basis of taxation comparable with that of competitor countries and, at the same time, be relatively simple to administer.

COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

IMPACT ON TRADE OF CHANGES IN TAXATION OF U.S. CITIZENS EMPLOYED OVERSEAS

## D I G E S T

For many years the United States generated most of its own raw materials and consumed most of the products it manufactured--exporting less than 7 percent of its gross national product. Today it is running out of raw materials.

Now the United States is increasingly importing raw materials at higher costs to operate its factories. These imports must be paid for by increased exports or by increases in net repatriated profits on foreign investments.

In this situation the United States must remain competitive. To do so, it is essential to maintain a large force of U.S. citizens abroad to promote and service U.S. products and operations. Major industrial competitors of the U.S. do not tax their nonresident citizens. The United States does. This reduces U.S. competitiveness in overseas markets.

For more than 50 years, the United States provided a substantial tax incentive to citizens employed abroad to promote U.S. exports and commercial competitiveness. In 1976 two things occurred which reduced this incentive.

--The Tax Reform Act of 1976 substantially increased the tax liability of citizens employed abroad.

--The U.S. Tax Court reaffirmed the taxable status of some overseas allowances. The Internal Revenue Service now requires that the full value of allowances be reported.

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February 21, 1978

These actions increased the estimated tax liability of the approximately 150,000 citizens employed abroad by more than $290 million. 1/

Over the years, little, if any, attention has been given to evaluating the impact of changes such as these in tax incentives. A high degree of uncertainty existed at the time the Tax Reform Act of 1976 was passed as to what would be the probable result.

To find out, GAO surveyed a sample of 367 U.S. citizens working in 11 countries and 183 U.S. firms employing Americans abroad.

IMPACT ON U.S. ECONOMY BY REDUCTION OF TAX INCENTIVE

GAO obtained views of U.S. company officials and found:

--A concern with the "ripple effect" on subcontractors or suppliers, should a primary company lose a contract due to higher costs associated with tax reimbursements or should Americans be replaced by other nationals who might deal with their own countries' firms rather than with U.S. firms.

--Most of the headquarters' officials believed that few if any firms in their industries would close down operations as a result of the tax changes, but over half of the overseas officials believed that at least 5 percent of the U.S. companies would close down their overseas operations.

1/ As this report went to press, the Department of the Treasury increased this estimate. Here and elsewhere in this report we use the estimates published by Treasury in October 1977.

--Over 80 percent were of the opinion that the tax changes would result in at least a 5 percent reduction of U.S. exports. (See p. 10.)

On the assumption that the tax increase would be passed along to customers, an econometric model was used to estimate the economic impact of the reduced incentives on the U.S. gross national product, exports, and employment. The results showed a generally smaller effect than was forecast by company officials. However, the full impact of the tax increase on the U.S. economy cannot be objectively measured due to data limitations as well as to intangible values accruing from having Americans employed abroad. (See pp. 19 to 23.)

Impact on firms

Of the companies surveyed, 77 percent reimburse their American employees for all or part of the additional taxes incurred as a result of living abroad. These companies must absorb the potential tax increase, pass the increased costs on to customers, or replace American employees with less costly local or third-country nationals. Companies that do not reimburse their American employees may lose them because of the higher tax burdens. According to the survey:

--Companies relying heavily on American employees would experience a greater impact than those that have only a few Americans in key positions. The former tend to be in the building/construction and service industries operating incountry for a relatively short time and on a contract/project basis.

--Living costs and tax structures of other countries are significant to the impact of the tax changes. Companies operating where the living costs are high and/or where little or no taxes are imposed on foreigners would experience the greatest impact.

--About 60 percent of the companies surveyed in the United States and 42 percent overseas currently had plans to reduce the number of American employees abroad due to the tax change. Many were adopting a "wait and see" approach.

--About 65 percent of the companies estimated their increased costs if they reimbursed employees for the tax increases. Half of these thought the amount would represent 5 percent or less of their total employee compensation costs; 70 percent thought the increases would represent 5 percent or less of their total operating costs. (See pp. 28 to 45.)

Impact on individuals

The GAO survey, together with a preliminary analysis by the Treasury of a sample of tax returns claiming overseas tax incentives in 1975, suggests that the potential tax increases will vary greatly according to income levels, employer compensation policies, and geographic locations. (See p. 46.)

--45 percent of those responding to the survey expected to return home on or before the end of their present tour because of the tax changes. About 29 percent of these were planning to return even though they expected to be reimbursed by their employers for most of the tax increase.

--Almost half of the estimated $292 million in increased taxes will be paid by those who have adjusted gross incomes, including allowances, of more than $50,000--about 10 percent of the overseas taxpayers.

--Taxpayers reporting less than $20,000 income, 53 percent of the total, would have average tax increases of about $120.

--Americans living in the oil-producing countries of the Middle East and Africa will have the largest tax increases, averaging $4,700 per return. Americans working in these countries generally receive relatively large taxable allowances.

--In certain extreme cases in extraordinarily high-cost countries, some individuals who receive large cash allowances may have tax liabilities nearly equal to their basic cash salaries. (See pp. 46 to 60.)

POLICY ISSUES

In the 1970s, for the first time in this century, the United States had a deficit trade balance. Simultaneously, foreign investment in the U.S. is increasing faster than U.S. investment abroad. These trends underline the importance of identifying and implementing public policies that have the greatest potential for strengthening the U.S. international economic position.

These circumstances focus attention on the following issues.

--How can Government policy and resources be used most effectively to promote U.S. exports and competitiveness abroad?

--What policy instruments are available for these purposes? Which are the most cost effective? Is there an effective alternative to the subject tax incentives?

--How significant are the benefits of having a large force of U.S. businessmen abroad influencing world

economic affairs as well as representing the U.S. system of values and culture?

A system should be established for evaluating and reporting periodically to the Congress the effectiveness of this tax incentive program. This could provide a solid foundation for deciding which of the available instruments for promoting U.S. exports and competitiveness abroad are most effective. (See pp. 94 to 98.)

POLICY OPTIONS

Taxation of Americans working abroad is part of the continuing conflict among the tax policy objectives of raising revenue, achieving tax equity, achieving tax simplification, and achieving other special aims of public policy. Basic options include fully taxing, partially taxing, or making tax free all allowances and foreign-earned income. Options for granting a greater or lesser tax incentive than now exists include adjusting the existing general exclusion, granting special deductions for extraordinary costs, or modifying available tax credits. GAO identifies a variety of suboptions within each option together with the advantages and disadvantages of each. (See pp. 74 to 94.)

The preferred option must be chosen by the Congress in the light of the objectives it defines.

Because of the seriousness of the deteriorating U.S. international economic position, the relatively few policy instruments available for promoting U.S. exports and commercial competitiveness abroad, and uncertainties about the effectiveness of these, serious consideration should be given to continuing Section 911-type incentives of the Internal Revenue Code, at least until more effective policy instruments are identified and implemented. (See p. 98.)

This report was reviewed informally by officials of Commerce and the Treasury. Their comments were considered in its preparation.

INCOME TAX LAWS OF MAJOR

U.S. TRADE COMPETITORS

Canada, the Federal Republic of Germany, France, Japan, and the United Kingdom, the major U.S. trade competitors, generally assert tax jurisdiction over (1) the worldwide income of residents and (2) income of nonresidents which originates within their respective borders. They do not impose income tax on foreign source income of nonresident citizens. Their citizens may attain nonresident status, and thereby avoid home-country income taxes on foreign income, by meeting certain tests. These tests vary from country to country, but a privately employed citizen would likely meet the tests of any of these countries if he worked abroad continuously for more than 2 years, was accompanied abroad by immediate family members, gave up his home-country residence, and severed other ties, such as property ownership and financial interests.

Each of the countries also has certain income tax provisions that may benefit citizens who work overseas but retain their resident status. They all may allow a tax credit for income taxes paid to the host country and have entered into income tax treaties with some countries to prevent double taxation. In addition, each country except Canada, has special provisions that provide some degree of preferential treatment for foreign source income of residents; Canada is presently considering such a provision.

The United Kingdom apparently has the most liberal special provisions, permitting a resident to deduct 100 percent of his foreign earned income if he "performed employment functions abroad" for a continuous period of 365 days or more. The resident may return to the United Kingdom for visits aggregating not more than 62 days, or one-sixth of the days in the period, without jeopardizing the deduction. A resident who works abroad for a minimum of 30 days, not necessarily consecutive, is allowed a deduction of 25 percent of his foreign earned income. In addition, residents employed abroad are allowed deductions for: traveling expenses to and from the United Kingdom; expenses such as housing and boarding, that enable them to work overseas; and visitation travel expenses.

The Federal Republic of Germany (West Germany) has a special provision that exempts cost of living allowances paid to employees abroad by German employers to the extent they do not exceed comparable allowances paid by the West German Government. Under certain conditions, West Germany also exempts the wages of residents (domiciliaries) working abroad in constructing or assembling machinery or plant installations or in exploring for or exploiting natural resources. The conditions require that the work be based on a contract between a German employer and a foreign principal, duration of services be not less than 3 months or more than 2 years (or completion of a particular project), and income is subject to a foreign tax that is substantially similar to the German wage tax.

French tax laws provide that residents (domiciliaries) working abroad for a French-based employer are taxable in France only on the salary they would have received if their services had been performed in France. This provision has been interpreted to exclude special allowances attributable to employment abroad. In addition, residents working abroad for a French-based employer may be exempt from French tax if they were

1. employed abroad more than one year and prove that earnings were in fact subject to a host-country income tax at least equal to two-thirds of the amount that French taxes would have been on the same tax base, or

2. employed abroad more than 183 days during a period of 12 consecutive months and the income was related to constructing, assembling, starting up, and exploiting plants or industrial entities, or prospecting for or extracting natural resources.

Japan has a special provision that permits residents working abroad to exclude overseas allowances to the extent they increase compensation above the level the taxpayer would ordinarily receive for services in Japan. In addition, allowances for work-related travel and movement of household goods are excluded.

Canada has no special income tax provisions for residents working abroad. In 1980, however, the Ministry of Finance developed a proposed amendment to the income tax act that would provide a substantial exemption for residents who work abroad for more than 6 consecutive months and meet certain tests. The work must be in connection with a Canadian employer's contract related to a construction, installation, agricultural, or engineering project; to exploring for or exploiting mineral resources; or to other activities to be prescribed in regulations. The exemption would be one-half of the employee's overseas remuneration up to a maximum of $50,000 on an annual basis. The proposed amendment was developed as a consequence of a July 1979 Department of Revenue ruling that significantly restricted the ability of Canadian citizens to attain the status of nonresidents for tax purposes. The intent of the proposed amendment is to maintain Canadian competitiveness in overseas contracts by permitting Canadian employers to reduce cost while maintaining the after-tax value of remuneration to employees.

## RECENT STUDIES ON EFFECTIVENESS OF PERSONAL TAX INCENTIVES IN PROMOTING EXPORTS

Few recent reports have been made to evaluate the effectiveness of personal tax incentives in promoting exports. One study, published by Treasury in October 1978, was an econometric analysis which the author described as preliminary and in need of further efforts to improve the data used and the procedures applied. A December 1979 report by the President's Export Council consisted of a limited number of case examples rather than a comprehensive econometric analysis. A third study was published by Chase Econometrics in June 1980.

The Treasury study, "The American Presence Abroad and U.S. Exports," by Professor John Mutti, examined the relationships between the magnitude of the tax incentive and the numbers of Americans employed abroad and between the tax incentive and manufactured exports. It concluded that

--the number of Americans resident in a country had a statistically significant relationship to the value of U.S. exports;

--any tax increase was estimated to have a small effect on the number of Americans working abroad; and

--complete elimination of the tax incentive provided by the 1975 tax law would lead to a drop of 2.7 percent in manufactured exports.

The author of the study noted that his findings were based on a preliminary attempt to analyze the issues, both the procedures and data used needed improvement, and the results should be used with caution.

The report by the President's Export Council, a group of prominent leaders from business, labor, government, and the Congress, was entitled "Report of the Task Force to Study the Tax Treatment of Americans Working Overseas." Its arguments may be summarized as follows.

--U.S. tax laws make Americans abroad less competitive than nationals of other countries, who generally are not taxed on their foreign income.

--High U.S. tax costs lead to the replacement of Americans by workers from other countries; this tends to reduce U.S. exports because the foreign workers will not favor U.S. goods for use in overseas projects and operations as the Americans did.

The evidence offered to support the arguments consists of a number of examples selected to show that (1) Americans have lost overseas jobs, (2) U.S. companies have lost business in selected markets, and (3) replacement of Americans can lead to reduced exports. It does not, however, present comparative analyses of the many factors that may have caused a drop in American employment abroad, reasons that may cause U.S. companies to become less competitive abroad, or relationship between exports and Americans employed abroad.

The report recommended that the current tax law and related regulations should be interpreted in the least restrictive and simplest manner and that work should begin immediately to encourage enactment of a new tax law to place Americans working overseas on the same tax footing as citizens from competing industrial nations.

The Chase Econometrics report, "Economic Impact of Changing Taxation of U.S. Workers Overseas," stated that its survey and analysis strongly indicated that the FEIA has an adverse impact on exports, thereby causing a reduction in overall tax receipts far greater than the taxes paid by overseas workers. The report's principal findings concluded that:

--The increased cost of employing U.S. workers overseas and the reduction in the number of such workers reduces the competitiveness of U.S. goods and services abroad and results in a significant drop in exports.

--Survey results and other analyses indicate that the overall drop in real U.S. exports amounts to about 5 percent.

--The drop in U.S. income due to a 5-percent drop in real exports will raise domestic unemployment by 80,000 and reduce Federal receipts from personal and corporate income taxes by more than $6 billion in 1980, many times the value of tax expenditures under the FEIA.

The Chase report was criticized by a high-level Treasury official and others as based on inappropriate methodology and insufficient data. The criticism particularly focused on the claimed 5-percent drop in exports, which was regarded as overstated and little more than an assumption. This casts doubt on the macroeconomic measurements as well, because they were based on the drop in exports.

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