UNITED STATES INDIVIDUAL INCOME TAX POLICY AS IT APPLIES TO AMERICANS RESIDENT OVERSEAS: OR,
If I’m Paying Taxes Equal To 72 Percent Of My Gross Income, I Must Be Living In Sweden

BRAINARD L. PATTON, JR.*

OUTLINE

I. Introduction—Profile of the Overseas American
   A. Political Status
   B. Economic Status
   C. Tax Status
   D. Status with Respect to Government Services

II. The United States Tax System
   A. Section 911—The Earned Income Exclusion
      (1) The History of Section 911
      (2) Operation of Section 911 in Theory
      (3) Section 911 in Practice
      (4) Reasons for Changing Section 911
   B. The Foreign Tax Credit
      (1) The Need for a Credit
      (2) Operation of the United States Foreign Tax Credit System
      (3) Faults in the Tax Credit System as it Applies to Americans Living Overseas
         (a) Foreign Tax Credit Carryover and Section 911
         (b) Source-of-Income Rules
         (c) Value-added Taxes
      (4) A Simple Comparison
   C. Noneconomic Considerations in Taxing Nonresident Americans

III. Solution
   A. A Proposal
   B. Problems and Answers
      (1) U.S. Income Tax Evasion
      (2) Splitting Income—Foreign Income Tax Evasion
      (3) Effect on U.S. Tax Revenues
      (4) Other Problems
   C. Conclusion

* BSBA 1966, University of Tennessee; J.D. 1969, Boston University; Member of the Bar of the Commonwealth of Massachusetts; in private practice in Paris as a corporate promoter.

The author expresses his appreciation for the valuable assistance given him by Price Waterhouse & Co.
Many citizens of the United States are residents of other countries, and generally subject to the taxes of their countries of residence. Under the current American tax system, they are also subject to United States income taxes, a situation which, despite the foreign tax credit and the limited exemption of income earned by United States citizens residing overseas, is complicated, inequitable, and inefficient. This Article will discuss the impact of the American tax structure on individual nonresident citizens, explore the weaknesses of that structure, and propose a fundamental change. First, however, it may be helpful to take a close look at Americans overseas to gain an understanding of what type of person is the victim of these taxes.

I. INTRODUCTION—PROFILE OF THE OVERSEAS AMERICAN

It was announced that 1973 would be “The year of Europe.” While events have fallen somewhat short of that expectation, Americans in ever larger numbers are moving to foreign countries and particularly to Europe. According to figures developed by the Department of State, in 1968 there were 812,386 Americans living overseas who were not connected with Government agencies. In 1973 there were 1,192,799, an increase of forty-seven percent in those five years.

6. U.S. Dept. of State, Dep. Director—Personnel & Management, Analysis & Requirements Div., U.S. Citizens Residing in Foreign Countries—FY 1973. This estimate is considerably larger than the figures developed by the Census Bureau, but the Census Bureau itself acknowledges that its figures were incomplete, partly because response to its questionnaires was voluntary. U.S. Bureau of the Census, Census of the Population, 1970, Subject Reports, Final Report PC(2)-10A, Americans Living Abroad, at VII. The State Department figures given in the text are believed to be correct.
Although there are undoubtedly a multitude of reasons for an individual to uproot his family and transplant it into a foreign culture, it appears the explanation may be found in constructive social areas, rather than in searching among the hedonistic and wealthy followers of a sun-worshipping lifestyle: it has been thirty-five years since F. Scott Fitzgerald published his study of Americans overseas in *Tender Is the Night*.

In fact, the country itself may determine to a great degree the reason for, and occupation of, Americans choosing to settle there. For example, according to the 1970 Census of Americans living abroad, while only 7.6 percent of the working male American population in Mexico were engineers, 16.98 percent of those in Australia were. On the other hand, while 10.61 percent in Mexico and 16.55 percent in Italy of the working American male population were religious workers, rarely did this figure exceed six percent in other countries. Finally, in almost all countries, at least twenty percent of the working American population were managers or administrators.

It is also interesting to note that only 7.55 percent of the American male labor force for all countries consisted of individuals under the age of sixty-five but not employed. (Presumably, this figure includes those who do not have to work for a living.) On the other hand, 9.58 percent of Americans overseas are over sixty-five years old, of whom 56.79 percent are unemployed. These 12,479 individuals undoubtedly include pensioners living on fixed incomes.

In sum, the statistics reveal a population of Americans overseas sufficient to populate the city of Atlanta or Denver, mostly motivated by the work ethic.

A. Political Status

Politically, these heterogeneous groups have one common element: they are totally disfranchised and must accept whatever is decided for them by their respective governments. Not being citizens of their countries of residence, they may not vote in national elections which may concern them intensely. Nor may they write to “their” senators in

---

7. See U.S. Bureau of the Census, *supra* note 6, at Table 25. The Census figures do not have a category for female engineers; female engineers are apparently included in the general category “professional, technical, and kindred workers.” It should be noted that although the total tally in the Census report is believed to be incorrect, see note 6 *supra*, it is assumed that the *proportions* determined by the Census (or derivable from the Census reports) are correct.

8. Id.

9. Id.

10. Id.
the United States; there are of course no senators or congressmen specifically representing the needs and rights of these 1.2 million Americans resident overseas as there are for, say, the states of Alaska and Wyoming, each of which has less than 400,000 inhabitants. Nevertheless it is true that Americans resident overseas may now vote by absentee ballot in United States presidential and vice-presidential elections. A problem arises, however, in that many Americans overseas have no state of domicile (the position of the New York State Department of Taxation notwithstanding) and thus are forced to resort to a fiction in order to vote. Secondly, many states exact a terrible price for this right; that is, they require the individual domiciled in the state to pay state taxes on all of his income as if he were a resident. It

11. The 1972 population of Alaska was 325,000, and that of Wyoming was 345,000. Statistical Abstract of the United States 1973, at 13. States with populations less than 1,192,799 as of the Census Bureau estimates for 1972 were

- Alaska 325,000
- Delaware 565,000
- Hawaii 809,000
- Idaho 756,000
- Maine 1,029,000
- Montana 719,000
- Nevada 527,000
- N. Hampshire 771,000
- N. Mexico 1,065,000
- N. Dakota 632,000
- Rhode Island 968,000
- S. Dakota 679,000
- Utah 1,126,000
- Vermont 462,000
- Wyoming 345,000

12. Voting Rights Act Amendments of 1970, 42 U.S.C. §§ 1973aa-1(c), (d). The overseas resident, however, must be otherwise qualified as a resident of the state in which he seeks to vote. Id.

13. It is not possible for a citizen to be without domicile, DesMare v. United States, 93 U.S. 605, 610 (1876), but the domicile need not be in the United States, see The Venus, 12 U.S. (8 Cranch) 253, 275-77 (1814); United States v. Chandler, 72 F. Supp. 230, 234 (D. Mass. 1947). The New York Department of Taxation, however, has taken the position that an American moving overseas prima facie cannot establish a new domicile because he presumably has the intent to return to the United States (not necessarily New York) at some unforeseen and possibly distant point in the future. 20 NYCRR § 102.2(d)(3) (1968). He is, accordingly, classed as a New York State domiciliary for the entire duration of his stay overseas, virtually regardless of whatever objective tests he may have met showing his intent not to return to the United States.

This provision is aggressively interpreted and vigorously enforced by the New York State Tax Department. In fact, the author is aware of a case recently contested where the taxpayer had been a nonresident of New York State for four years, maintained no residence in New York, had no contact whatsoever with New York, owned his residence in Switzerland, had married a Swiss citizen (who was a nonresident alien in the United States), and had applied for extended residence in order to become a Swiss citizen. The New York State Department of Taxation maintained that this individual was a New York State domiciliary for purposes of New York State income taxes.

should be clear that no benefit will be obtained by the payment of these taxes other than the privilege of voting thus purchased.

Finally, even if all states granted the unrestricted right to vote, the power of the overseas population would be spread so thinly that they would be unable to express themselves effectively on federal issues that concern them alone, such as whether or not to continue the relief granted by section 911 or whether or not to extend Medicare relief to Americans resident overseas. The American overseas is politically powerless to resist whatever action that may be taken on his behalf, whether well intentioned or not.

B. Economic Status

The economic situation of nonresident Americans also is often misunderstood. According to a State Department survey, rather than having their franc, mark, or lira go further than the equivalent in dollars would go in the United States, residents of most countries overseas have a higher cost of living than in the United States. This is based upon the cost of maintaining an American-type lifestyle in the foreign country, calculated by reference to a "local index" which "is used by many business firms and other nongovernmental organiza-

---

15. There is under consideration in both houses of Congress a bill that would greatly expand the rights of Americans overseas to vote in federal elections; this might answer, to some extent, the problems that Americans resident overseas face in dealing with states that tax nonresident "domiciliaries." This bill does not, however, direct itself to the important problem presented by the fact that Americans resident overseas would not be a constituency for any given Congressman and would, accordingly, have no real voting power as a group. See Overseas Citizens’ Voting Rights Act of 1975, H.R. 3211 and S. 95, 94th Cong., 1st Sess. (1975).

16. See U.S. DEP’T OF STATE, INDEXES OF LIVING COSTS ABROAD AND LIVING QUARTERS ALLOWANCES, October 1973, summarized as Appendix 3 to this Article.
tions to establish cost-of-living allowances for their employees stationed abroad."17 (The data summarized in Appendix 3 take on added significance when it is noted that those fourteen countries from the survey which are shown in that Appendix account for nearly three-fifths of all American overseas, or over 700,000 people.18) For example, an American in Paris will pay 154 percent of the amount he would pay in Washington, D.C., to maintain the same style of living.19 This comparison covers cost of living only, and excludes education and quarters, which are substantially more expensive in Europe and elsewhere than in the United States.

In regard to education, the United States does not provide financial assistance for any of the American schools abroad unless they are affiliated with one of the various American bases overseas. Thus, an American in Paris wishing to send his child to first grade in the American School in St. Cloud (the only American grade school in Paris) must be prepared for an outlay of at least $1,700 for each child, exclusive of board. Although the cost is not altogether unreasonable when compared to the cost of private schooling in the United States, it must be stressed that for Americans overseas there is no choice, as there is in the United States, between private schooling and adequate, free, public schooling. Overseas, the sole alternative to the expensive private school is to send the child to school in the local language, an option unacceptable to some parents.20 There is also a dilemma at the collegiate level, since none of the leading American universities are overseas, though there are a few good American colleges operating in foreign countries.

17. Id. at 2.
18. See U.S. Dep't of State, supra note 6, the relevant portions of which are summarized in Appendix 4.
20. The House Committee on Ways and Means is aware at least of the increased educational costs attributable to overseas residence and recently proposed a special tuition deduction for children of Americans resident overseas who attend schools in foreign locations. H.R. REP. NO. 1502, 93d Cong., 2d Sess. 118-19 (1974). This proposed deduction was, however, limited to $100 per month per qualifying student-dependent, which would leave the taxpayer with approximately $500 of nondeductible costs for each child in the American school in St. Cloud, France. Moreover, the proposed deduction was limited to the amount of foreign-source earned income of the taxpayer, a limitation which would almost certainly be used by the Internal Revenue Service as an argument for allocating this deduction directly against foreign-source income in computing the allowable foreign income tax credit. See Example 5 infra for an illustration of the allocation of deductions. Because of this fact, and because the bill providing for the deduction provided as well for the repeal of the earned income exclusion under section 911 (see text accompanying notes 37-50 infra), the benefit of the bill would have been either negligible or nonexistent. In any event, no action was taken by Congress on this bill and it died at the end of the 93d Congress.
The cost of quarters is similarly more expensive overseas. The United States government and many multinational corporations grant large allowances to overseas employees to help finance their housing. Generally, these allowances are determined by location, family size, and salary range. For example, a married United States government employee with no children, living in Geneva and earning $25,000, would receive an annual quarters allowance in the amount of $6,600, in addition to his regular pay, to compensate for higher housing costs.\(^\text{21}\)

It will be observed, of course, that although the United States government and many multinational corporations grant allowances to compensate overseas employees and their families for the otherwise heavy economic and social burden of overseas residence, there are many individuals who are self-employed, who work for local enterprises, or who are living on fixed retirement incomes. Persons in the latter groups must personally bear the entire economic load resulting from the choice to live overseas. While it is appropriate that the individual bear the economic consequences of his decision to live in a foreign country, this fact in no way justifies the United States government in extracting a further toll from the American resident overseas in the form of an additional tax burden. The rationale for taxing the overseas American must be found in other areas.

C. Tax Status

An individual who has chosen to live abroad then pays dearly for his decision in increased living costs. In addition, Americans overseas are, of course, subject to the taxing jurisdiction of any country in which they establish residence, and the income taxes vary from country to country. For example, in the United Kingdom for tax years ending before April 6, 1974, it was possible for an individual to be resident but not domiciled within the United Kingdom, to work within the country for a foreign employer, and, through a complex arrangement, to receive “capital” from sources outside the country; he could thus avoid United Kingdom taxation almost entirely.\(^\text{22}\) Few countries are so liberal, however, and many countries tax residents on worldwide income at very high individual income tax rates.

\(^{21}\) U.S. DEP’T OF STATE, supra note 16. See Appendix 3.

\(^{22}\) Income and Corporations Taxes Act 1970, C.1, § 181. This system was revised considerably by the Finance Act 1974, but it is still possible under certain circumstances for an individual to reside in the United Kingdom while paying tax on only fifty percent of his earned income. See Finance Act 1974, C.30, Pt. II, § 21.
In addition to these income taxes, all countries in Europe rely to a large degree on consumption taxes or value-added tax, which are included in the price of almost every article purchased by, or service rendered to, the consumer in the country utilizing this tax system. Because the burden of these taxes upon any given individual will vary according to his lifestyle (that is, the amount and type of purchases he makes), it is difficult to quantify the burden on an individual from country to country. Nevertheless, certain general conclusions may validly be drawn, and will be discussed in detail below.

Although certain countries tax on the forfeitary basis (such as Spain, Switzerland, and sometimes France), the Americans availing themselves of these provisions are by definition not working executives or technicians (whose incomes come from salaries within the country and thus are subject to full taxation) and undoubtedly account for a relatively small percentage of the American population overseas. Further, the bulk of income for these individuals is probably fixed (dividends and interest) and already subjected to fixed withholding taxes by the country of source.

As shown in Appendix 2 of this Article, the average American resident overseas probably pays much more in foreign income and consumption taxes combined than he would have paid on the same amount of earnings had he remained in the United States. In addition, we have discussed the other costs of residing overseas arising from the increased costs of living and education and quarters.

In view of these considerations, it appears that the average American resident overseas is at an economic disadvantage compared to his compatriot living in the United States without the additional imposition of an income tax payable to the United States.

23. See notes 89-93 infra and accompanying text for an explanation of the value-added tax.

24. See text accompanying notes 89-93 infra.

25. The forfeitary basis of taxation applies in those limited circumstances when the individual receives the bulk of his income from sources outside of his country of residence and prefers (legally) not to declare this income to the taxation authorities. Rather than attempt to verify the sources and amounts of this taxpayer's income, the taxation authorities apply a formula which assumes a certain level of income based on what they believe it would require to support his standard of living. Into this formula are typically taken factors such as amount of annual rent, number of primary and secondary residences, automobiles, airplanes, yachts, racehorses, etc. The taxpayer, to the extent he keeps a low consumption profile, can benefit by the application of these provisions. The typical American, however, is a salaried employee in his country of residence and therefore receives the bulk of his income for services performed in this country. This income is reported to the taxation authorities by law and does not qualify for forfeitary tax treatment.
D. Status with Respect to Government Services

Individuals resident throughout the world are benefiting from as many government spending policies as there are governments. These policies can vary considerably from country to country. In Europe, for example, there is a tendency toward national health systems funded by mandatory contributions (called premiums, social security, or income taxes), while in America there is still a high reliance on the free enterprise system to allocate medical services fairly. One thread of common intent runs through these policies, however: each government expends funds to benefit primarily the residents of its own territory.26

It should be clear that an individual is going to benefit from governmental expenditures only when he is in a country and utilizing the services supported by those expenditures.27 A citizen of any country who is resident outside of his country is going to benefit only peripherally (if at all) from any expenditure of funds by his own government. Furthermore, this benefit will accrue to him exactly as it would to any nonresident, whether or not a citizen of that country. Accordingly, it should be clear that an American overseas is not benefiting from the expenditure of any government funds in the United States: he receives no benefit from United States police protection; he is not obtaining government aid in respect of his medical needs; he is not receiving pay as an employee of one of the many federal agencies; he is not working on federally funded projects and thus looking to the government indirectly for his livelihood; and he may never need the United States armed forces to protect himself or his property from aggression by any foreign power.28

26. That is, services in general are provided to or for residents. Armed forces defend persons and property within the national territory, not just citizens, and generally not including citizens outside the country. Similarly, in the myriad other programs of economic assistance, price supports, law enforcement, and transportation, governments do not spend money to benefit merely their own citizens, and they are not attempting to benefit citizens residing in other countries.

27. For example, an American resident in France receives his medical treatment at low cost not because of anything the United States government does, but because the medical system in that country is widely and effectively supported by the French government through contributions from the taxpaying public. Similarly, an American resident in Frankfurt taking a train from that city to Hamburg is not affected by any United States programs, but rather is benefiting directly and tangibly from the fact that a part of his fare is being subsidized by West Germany. Finally, an American in London can leave the theater late and walk safely to his flat largely because of the protection offered by the British police system and financed by British residents.

28. It may be suggested that an American residing overseas benefits from embassy and consular services. Although there are United States Embassies and Consulates in
While in a less civilized (or at least less settled) age it might have been true that "government, by its very nature, benefits the citizen and his property wherever found," it now appears that the days when United States citizens had need to call upon the government to come forth to protect their foreign personal and property rights are gone forever, at least at the level of the individual citizen in all but the most extraordinary cases. The author believes that it is inappropriate to attempt to justify the taxation of individual American citizens resident overseas on a quid pro quo theory. The tax dollar collected from the American resident overseas does not generate a benefit for him while he is a nonresident of the United States.  

II. THE UNITED STATES TAX SYSTEM

The United States tax system works on an exception basis. That is, all income that comes within its purview is taxed unless there is an exception for some item of income or class of taxpayer. The American living abroad is subjected to American taxation on his worldwide income by virtue of the fact that he is a United States citizen and thus falls within the taxing jurisdiction of the United States. It should be emphasized that the United States is the only country in the world that

30. In this context, it cannot be emphasized too heavily that while foreign subsidiaries of United States corporations may well be considered to be operating within the domestic economic system, obtaining benefits from the system, requiring the protection of the government occasionally, and therefore logically falling subject to the taxing jurisdiction of the United States, this is not the case for individual citizens living and working in foreign countries.
32. Resident aliens are also taxed as United States citizens even though they may be living overseas, Treas. Reg. § 1.1-1(b) (1956), but theirs is a special case in that they are electing to be subject to United States tax jurisdiction in order to be eligible for United States citizenship, to have unlimited right of entry into the United States, and so forth.
effectively uses citizenship of individuals as a basis for establishing taxing jurisdiction: for a number of good reasons, virtually all other countries have chosen to limit their taxing jurisdiction over individuals to those who have an established residence within the country.\textsuperscript{33}

For the American resident outside the United States, there is but one substantive provision in the Internal Revenue Code recognizing his special status. That provision is section 911, which allows up to $25,000 of foreign-source earned income to be excluded from taxation in the United States. The foreign tax credit rules\textsuperscript{34} provide some protection for the nonresident individual, but they apply in exactly the same fashion to all United States taxpayers—corporate or individual—regardless of the country of residence and thus give no consideration to the special circumstances of the American resident overseas.

Since these two sets of rules provide for the principal tax relief in regard to the American resident overseas, we shall consider them in depth.

\textit{A. Section 911—The Earned Income Exclusion}

The Internal Revenue Code of 1954 provides in section 911 that

(a) \textbf{General Rule}: The following items shall not be included in gross income and shall be exempt from taxation under this subtitle:

(1) \textbf{Bona Fide Resident of Foreign Country}. In the case of an individual citizen of the United States who establishes to the satisfaction of the Secretary or his delegate that he has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof) which constitute earned income attributable to services performed during such uninterrupted period. The amount excluded under this paragraph shall be computed by applying the special rules contained in subsection (c).\textsuperscript{35}

\textsuperscript{33} \textit{See}, e.g., Belgium: \textit{C. DES IMP. SUR LES REV.}, art. 139-41 (Les Codes Larcier 1965); France: \textit{C. GEN. DES IMP.}, art. 4 (Petits Codes Dalloz 1966); Germany: \textit{EINKOMMENSTEUERGESETZ}, \textsection 1; United Kingdom: \textit{Income and Corporations Taxes Act 1970}, c. 10, \textsection 49, 50. The Philippines is one country that could qualify as an exception to this statement, \textit{see} \textit{Nat. I.R.C.} \textsection 21, but that government has apparently been unable to enforce this provision.

\textsuperscript{34} \textit{Int. Rev. Code of} 1954, \textsection 901-06, discussed at text accompanying notes 70-103 infra.

\textsuperscript{35} \textit{Int. Rev. Code of} 1954, \textsection 911(a)(1). The requirement of residence for the "entire" taxable year is strictly construed: \textit{see} Donald F. Dawson, \textit{59 T.C.} 264, 270-72 (1972), where the taxpayer was held to have failed to qualify because he did not arrive
Subsection (c) provides that the maximum amount excludable under subsection (a)(1) shall not exceed $25,000 each year.\(^{36}\)

**The History of Section 911.** Section 911 was spawned by the Revenue Act of 1926\(^ {37}\) and has been subjected to close scrutiny by Congress ever since. Unfortunately, the original reasons for establishing the exclusion, as well as the basis for the subsequent challenges to the exclusion, were somewhat misdirected.

It appears that Congress has never seriously considered that, from a fairness point of view, the United States should not tax Americans who reside overseas. To the contrary, most discussion has started with the assumption that the exclusion provides a benefit to Americans living overseas vis-à-vis their compatriots living in the United States.

Thus, the Sixty-ninth Congress, in initially putting forward the idea of the exclusion, was not particularly concerned with equitable treatment of Americans overseas, but rather was certain it was granting an incentive which would encourage Americans to live overseas and sell American products abroad. For example, the House explained that

\[\text{[i]n an endeavor to take one further step toward increasing our foreign trade, it is recommended in this paragraph that there shall be excluded from gross income in the case of our citizens employed abroad in selling our merchandise amounts received as salary or commission for the sale for export of tangible personal property produced in the United States in respect of such sales made while they are actually employed outside of} \]

\[\text{in Australia until January 3, even though January 1 and 2 were Australian legal holidays when the taxpayer admittedly could not have worked. This section also provides an alternative exclusion for any citizen who “during any period of 18 consecutive months is present in a foreign country or countries during at least 510 full days,” INT. REV. CODE OF 1954 § 911(a)(2). See note 43 infra and accompanying text. Income paid by the federal government is excluded from both of these provisions by their terms and is therefore fully taxable. However, income paid by an agency of the United States to an American citizen is rarely taxable in the country of residence, so the lack of section 911 relief for federal employees is not a burden on them: for tax purposes they might as well be working on American soil.} \]

\[36. \text{INT. REV. CODE OF 1954, § 911(c)(1)(B). This $25,000 maximum applies only after the taxpayer “has been a bona fide resident of a foreign country or countries for an uninterrupted period of 3 consecutive years.” Id. Individuals who do not qualify under the three-year rule are limited to an exclusion of $20,000. Id., § 911(c)(1)(A). The $20,000 limit applies also to taxpayers who qualify under the 510-day test of section 911(a)(2) (see note 35 supra) but not under the entire-taxable-year test of section 911(a)(1) (see text accompanying note 35 supra). Id., § 911(c)(1)(A).} \]

\[37. \text{Revenue Act of 1926, § 213(b)(14), Law of Feb. 26, 1926, ch. 27, 44 Stat. 9 (now INT. REV. CODE OF 1939, § 116(a)).} \]
the United States, if they are so employed for more than six months during a taxable year.\textsuperscript{38}

Although the provision as enacted was not limited to this suggested "foreign trade" exemption, it appears that the Congress entertained some interesting ideas regarding the mobility of Americans and the structure and impact of taxation of residents by foreign countries.

Throughout the years, the exclusion has been challenged, amended, and limited as it descended to its present form in section 911. Originally a taxpayer could qualify for an unlimited exclusion by remaining outside the United States for six months regardless of where he actually resided;\textsuperscript{39} however, this apparently led to abuses of the system without accomplishing the intended result.\textsuperscript{40} The rule was subsequently amended to require that an individual be a bona fide resident of a foreign country (and therefore a bona fide nonresident of the United States) in order to qualify for the exclusion,\textsuperscript{41} and then to limit the maximum amount excludable.\textsuperscript{42} An additional provision, known as the "physical presence" rule, allows the exclusion of earned income up to $20,000 annually for individuals remaining outside the United States for 510 days (seventeen thirty-day months) in any eighteen-month period, regardless of whether or not those individuals are taxed as residents of any other nation.\textsuperscript{43} Because individuals relying on this second provision are not paying income taxes to, and are not utilizing the services of, any particular country as residents, they are outside the scope of this discussion.

From 1926 to 1962 Congress allowed an unlimited exclusion for bona fide residents of a foreign country, and at least one of the committee reports from that era did indicate an awareness that Americans

\textsuperscript{38} H.R. REP. No. 1, 69th Cong., 1st Sess. 7 (1924).
\textsuperscript{39} Int. Rev. Code of 1939, § 116(a); Commissioner v. Fiske's Estate, 128 F.2d 487, 490 (7th Cir.), cert. denied, 317 U.S. 635 (1942).
\textsuperscript{40} S. REP. No. 1631, 77th Cong., 2d Sess. 54 (1942).
\textsuperscript{41} Revenue Act of 1942, c. 619, § 148, 56 Stat. 841.
\textsuperscript{42} Revenue Act of 1962, Pub. L. No. 87-834, § 11(a), 76 Stat. 1004; Revenue Act of 1964, Pub. L. No. 88-272, § 237(a), 78 Stat. 128. There was already a limitation on the exclusion, but it did not apply to persons qualifying as bona fide residents under the entire-taxable-year test of section 911(a)(1), quoted in text accompanying note 35 supra, and therefore does not concern us here.
\textsuperscript{43} Int. Rev. Code of 1954, § 911(a)(2). See note 35 supra.
resident overseas were already bearing a heavy tax burden in their
country of residence.\textsuperscript{44} Nevertheless, in 1962 the Kennedy admin-
istration was successful in limiting the exclusion to $20,000 annually for
the first three years of bona fide residence and $35,000 annually
thereafter.\textsuperscript{46} In fact, it was then recommended that the exclusion be
eliminated entirely for developed countries,\textsuperscript{48} but Congress decided
against a distinction between less-developed countries and developed
countries. In 1964 the limit was reduced to $25,000 annually for each
year of residence after the first three full years.\textsuperscript{47} There have been no
subsequent amendments to section 911, although virtually every year
the House Committee on Ways and Means ponders whether or not to
continue the benefit granted by this provision, a fact which perturbs
in no small manner the community of Americans resident overseas.

Last year was no exception, for in 1974 the House Committee
on Ways and Means presented a bill which proposed, among other
items, a three-year phaseout of section 911, starting in 1975.\textsuperscript{48} The
bill was not introduced until late in the year, however, and died with-
out further action. Interestingly, the report of the Ways and Means
Committee on this bill indicates quite clearly that the Committee is
still unaware of the real tax situation of the American citizen resident
overseas. The Committee report stated that

\begin{quote}
[i]the exclusion of $20,000 (or $25,000) of income earned abroad . . .
\textit{provides a tax advantage} to those U.S. citizens who live and work
abroad compared with those who live and work in the United States.
. . . Moreover, in those cases \textit{where a foreign tax is paid by the U.S.
citizen, that tax is creditable} against any U.S. tax that might otherwise
exist on income above the $20,000 or $25,000 excludable limits.\textsuperscript{49}
\end{quote}

As will be seen, the foregoing statements are not correct.\textsuperscript{50}

\begin{footnotes}
\item 44. S. Rep. No. 1631, 77th Cong., 2d Sess. 54 (1942).
\item 47. Revenue Act of 1964, Pub. L. No. 88-272, § 237(a), 78 Stat. 128. This change
§ 311.
\item 50. In brief, they are inaccurate because, first, the exclusion does not place overseas
Americans at any advantage at all: it merely limits the United States taxation on income
already taxed—usually more heavily than the United States would tax it—by another
country; and, second, the foreign tax credit applies only to foreign \textit{income} taxes. This
author suggests that the Committee's failure to distinguish in its report between a foreign
tax credit and a foreign \textit{income} tax credit is significant: the most important and power-
ful tax committee in the Congress is recommending to a busy House of Representatives
that section 911 be repealed, and is supporting that recommendation by the argument
\end{footnotes}
Operation of Section 911 in Theory. The theoretical operation of section 911 can be demonstrated through the use of a simple illustration. In this example, it is assumed that the United States-source salary is generated by business trips to the United States and therefore is not excludable, despite being totally taxed in the country of residence. The source of dividends is irrelevant in considering the application of section 911 (which applies only to earned income), though it must be considered in computing the foreign tax credit, as will be seen. It is assumed that the taxpayer has a full year of overseas residence but has not completed his third year of residence.

Example 1

<table>
<thead>
<tr>
<th>SOURCE OF INCOME</th>
<th>U.S.</th>
<th>Foreign</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salary</td>
<td>$1,000</td>
<td>$24,000</td>
<td>$25,000</td>
</tr>
<tr>
<td>Section 911 Exclusion</td>
<td></td>
<td>(20,000)</td>
<td></td>
</tr>
<tr>
<td>Net Salary</td>
<td>$1,000</td>
<td>$4,000</td>
<td>$5,000</td>
</tr>
<tr>
<td>Dividends &amp; Interest</td>
<td>500</td>
<td></td>
<td>500</td>
</tr>
<tr>
<td>Gross Income</td>
<td>$1,500</td>
<td>$4,000</td>
<td>$5,500</td>
</tr>
<tr>
<td>Less: Itemized Deductions</td>
<td></td>
<td>(200)</td>
<td>($200)</td>
</tr>
<tr>
<td>Exemptions (3 x $750)</td>
<td></td>
<td>(2,250)</td>
<td></td>
</tr>
<tr>
<td>TAXABLE INCOME</td>
<td></td>
<td></td>
<td>$3,050</td>
</tr>
</tbody>
</table>

that foreign taxes are creditable while totally ignoring the fact that foreign “value-added” taxes are not creditable under United States tax law. In fact, at only one point in the Committee Report discussion of the proposed elimination of section 911 does the Committee use the words “income tax.” Since the full House would probably defer to the more detailed knowledge of the Committee on Ways and Means when considering this bill, the Committee’s failure to make this distinction clear appears to be a breach of responsibility, the seriousness of which will become more evident with the discussion of value-added taxes accompanying notes 89-93 infra. See also note 101 infra and accompanying text.

      52. See text accompanying notes 73-79 infra.
      53. The reader will note that most examples in this discussion are based upon an amount of itemized deductions which may appear to be disproportionately small for the amount of salary and income shown. Unfortunately for the majority of Americans resident overseas, however, there are few areas where the taxpayer’s expenditures result in a tax deduction for United States income tax purposes. For example: few Americans overseas own their own residences (the price of a one hundred square meter apartment in Paris is usually more than $100,000) so they have no deduction for mortgage interest or real estate taxes; there is no provision in the Internal Revenue Code allowing a deduction for foreign consumption taxes; and even a contribution to maintain the taxpayer’s favorite cathedral in France is likewise not deductible. See Int. Rev. Code of 1954, § 170(c)(2)(A); Louise K. Herter, 20 CCH Tax Ct. Mem. 78, 86 (1961) (applying the predecessor of section 170(c)). In fact, the author has seen countless tax returns where
The example shows that, in theory, the exemption provided by section 911 is easy to understand and simple to apply. Everyone who enjoys the benefits provided by the application of the rule seems to be receiving ample consideration for the fact of his residence overseas.

Operation of Section 911 in Practice. In practice, however, this exclusion is not such a clear and significant benefit. Although in a great many cases the exclusion provided by section 911 totally eliminates United States income taxes for an individual living overseas, in many cases it does not, and it may in fact provide merely marginal benefit or even be a detriment.

For example, a partner of a firm with both foreign and United States income who resides overseas may be unable to claim relief under section 911, because his income is not salary but rather is his share of the profits of the partnership, which retains the same foreign-to-total ratio as the total partnership income. If the partnership has overall foreign losses, which often is the case, the partner will not be able to claim relief under section 911 because he will have no foreign income to exclude; nor will he be able to claim credit for the foreign income taxes that he paid, since he will have had no net taxable foreign income. This individual will receive no relief at all unless his firm establishes a structured minimum guarantee of up to $20,000 to qualify as salary. He would still, however, obtain no credit for his

the most important itemized deduction was the tax accounting fee attributable to the preparation of the taxpayer's prior year United States income tax return.

Accordingly, the low amount of itemized deductions claimed in the examples is believed to be realistic.

55. As will be discussed, see notes 73-77 infra and accompanying text, the credit for foreign taxes is limited to that part of total foreign taxes paid that bears the same proportion to United States tax due as foreign taxable income bears to total taxable income (the “overall limitation”), INT. REV. CODE OF 1954, § 904(a)(2), or to that part of foreign taxes paid to each country that bears the same proportion to United States tax due as foreign taxable income from that country bears to total taxable income (the “per-country limitation”), id. § 904(a)(1), the taxpayer electing the more advantageous limitation. If under United States definitions there is no foreign taxable income, there can be no foreign tax credit, even though foreign taxes may have been paid; this situation can arise when foreign income is less than the amount excludable under section 911, in which case foreign taxable income is zero, since the excluded income is not taxable and therefore is subtracted from both foreign and total taxable incomes. Rev. Rul. 68-622, 1968-2 CUM. BULL. 298, 299.

For the reasons discussed in note 75 infra, the per-country limitation will not be considered further in this Article.

56. This tactic succeeded in Andrew O. Miller, Jr., 52 T.C. 752, 761-62 (1969) (Acq.) (relying in part upon a holding, id. at 760, that the guaranteed payment qualified under INT. REV. CODE OF 1954, § 707(c)) (Paris partner of a New York law firm);
foreign income taxes, except in the unlikely event his minimum guarantee exceeded the amount excludable.

For individuals engaged in businesses where capital is a significant factor (stock traders, for example), the maximum that may be claimed as earned income available for the section 911 exclusion is thirty percent of net profit derived from the business.\(^{57}\) Thus, in order to obtain full benefit of the exclusion, the individual will be required to earn net profits of $66,667. It would seem, however, that a stock trader who has the talent to generate income at this level consistently is not deriving the income from capital, but rather from personal services and expertise. In addition, unless he utilizes the services of a foreign exchange, he will receive no foreign tax credit against United States taxes attributable to gains from the stock sales.\(^{58}\)

Expenses relating to the production of income excluded under section 911 are not deductible,\(^{59}\) even though the funds supplied to pay for the expenses were derived from income that is taxable. Thus, an American overseas with United States-source dividends and interest may use that income to finance his unincorporated film production company or to start an art gallery which in early years will

---

57. Int. Rev. Code of 1954, § 911(a). This section provides that

[(in the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income-producing factors, under regulations prescribed by the Secretary or his delegate, a reasonable allowance as compensation for the personal services rendered by the taxpayer, not in excess of 30 percent of his share of the net profits of such trade of business, shall be considered as earned income.]

58. This is because, under United States tax law, capital gains income resulting from the disposition of personal property (such as stock shares) is sourced according to where title to the property passes. See Int. Rev. Code of 1954, § 862(a)(6); Treas. Reg. § 1.862-1(a)(6). Because most stock traders habitually utilize the services of the New York Stock Exchange, the title passes in New York and the resulting capital gains income is considered as arising from United States sources. In order to generate foreign-source capital gains which would increase the allowable foreign tax credit, the trader will have to turn to one of the foreign exchanges, which differ greatly in operating technique from the United States exchanges and which list substantially fewer American securities. There is also the problem that if the IRS determines that the sale was consummated abroad “for the primary purpose of tax avoidance,” then “the sale will be treated as having been consummated at the place where the substance of the sale occurred.” Treas. Reg. § 1.861-7(c). Nevertheless, this alternative can be attractive from a tax point of view, to the detriment of the United States securities market.

This will become clearer with the discussion of the foreign tax credit at notes 70-103 infra and accompanying text.

generate little or no income. If he incurs $50,000 of expenses to generate $5,000 of excludable income, all of the expenses are nondeductible; he will receive no deduction against the United States-source income which supplied the cash to pay for the expenses incurred.\textsuperscript{60}

In a very interesting case,\textsuperscript{61} one Mrs. Brewster, a United States citizen living in Ireland and engaged in farming and raising cattle and horses, had a net loss on her operation for the taxable year, but had other income from sources in the United States. She did not claim the section 911 exclusion, and deducted the normal farm expenses from otherwise taxable United States income. The court of appeals held the exclusion was mandatory, and that it applied even where there was net loss, since it was an exclusion from gross income. Mrs. Brewster was therefore required to exclude that portion of the farm's gross income held to be attributable to her personal services rather than to capital, and the deductions then allocable to that earned income were disallowed. The court, moreover, held that the proportion of gross income attributable to her personal services was not limited by the thirty-percent limitation just discussed, on questionable reasoning. Because the limitation is stated as a percentage of net profits, and the taxpayer had no net profits, the limitation was held not to apply.\textsuperscript{62} It would seem more reasonable to say that since her net profits were zero, the maximum amount attributable to Mrs. Brewster's personal services was zero. In short, the holding was that a part of the gross income of the farm was to be deemed earned income, in spite of the fact that the taxpayer had a net loss on the farm and without regard to the limitation of earned income to thirty percent of net profits; this "earned income" was required to be excluded, and deductions for farm expenses were disallowed in the proportion that earned income bore to gross income from the farm.

Although the record does not disclose the actual figures, the ef-
Effect of section 911 in this case may be demonstrated as follows, assuming that fifty percent of gross income is deemed "earned income":

**Example 2**

<table>
<thead>
<tr>
<th>COMPUTATION OF TAXABLE INCOME</th>
<th>Per Return as Filed</th>
<th>Per Court Interpretation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from Irish Farm:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross Income</td>
<td>$20,000</td>
<td>$20,000</td>
</tr>
<tr>
<td>Less: Section 911 exclusion</td>
<td>—</td>
<td>(10,000)</td>
</tr>
<tr>
<td>Adjusted Income</td>
<td>$20,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>Less: Operating Expenses of the Farm</td>
<td>40,000</td>
<td>40,000</td>
</tr>
<tr>
<td>Net Farm Loss</td>
<td>$(20,000)</td>
<td>$(30,000)</td>
</tr>
<tr>
<td>Add back: Expenses relating to income excluded pursuant to Section 911-($10,000/($20,000) x 40,000)</td>
<td>—</td>
<td>20,000</td>
</tr>
<tr>
<td>Adjusted Net Farm Loss</td>
<td>$(20,000)</td>
<td>$(10,000)</td>
</tr>
<tr>
<td>Add: U.S.-Source Dividend Income</td>
<td>25,000</td>
<td>25,000</td>
</tr>
<tr>
<td>Adjusted Gross Income</td>
<td>$5,000</td>
<td>$15,000</td>
</tr>
<tr>
<td>Loss: Itemized deductions</td>
<td>(1,000)</td>
<td>(1,000)</td>
</tr>
<tr>
<td>Personal exemption</td>
<td>(750)</td>
<td>(750)</td>
</tr>
<tr>
<td>TAXABLE INCOME</td>
<td>$3,250</td>
<td>$13,250</td>
</tr>
<tr>
<td>Tax Thereon(^63)</td>
<td>$548</td>
<td>$2,993</td>
</tr>
<tr>
<td>DIFFERENCE—Cost of Section 911</td>
<td></td>
<td>$2,445</td>
</tr>
</tbody>
</table>

In a typical "Mrs. Brewster" situation, the mandatory application of section 911 can work a substantial inequity. Moreover, the interesting point about the Brewster case is that the IRS did not merely disallow certain expenses of an aggressive taxpayer. The Service sought out a case and applied section 911 as a repressive tool to disallow legitimate deductions. The court of appeals, in condoning this treatment, said, "The Tax Court's construction, which follows the liberal [sic] wording of §911(b), does not do violence to the basic purpose of §911, to permit American businessmen to compete abroad with foreign entrepreneurs, without being subject to double taxation possibilities.\(^64\) Once again, the function of section 911 has been misinterpreted and its application misdirected: the law should be protecting overseas Americans from the inequities that result from being subject to the taxing jurisdiction of two nations, but the Brewster court used it to increase taxes.

\(^{63}\) In this example the tax is computed on the assumption that Mrs. Brewster is an unmarried individual. All the other examples in this Article assume that the taxpayer is a married individual filing jointly.

\(^{64}\) Id. at 163. The word "liberal" may have been intended to be "literal."
The severity of the disallowance problem is a function of the amount of gross receipts of the enterprise. For example, assume two photographers operating studios overseas, one with gross receipts of $100,000 and net income of $25,000, and the other with $30,000 of gross income but also netting $25,000. Section 911 affects them as follows:

**Example 3**

<table>
<thead>
<tr>
<th></th>
<th>PHOTOGRAPHER</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>A</td>
<td>B</td>
</tr>
<tr>
<td>Gross Receipts</td>
<td>$100,000</td>
<td>$ 30,000</td>
</tr>
<tr>
<td>Less: Section 911 Exclusion</td>
<td>20,000</td>
<td>20,000</td>
</tr>
<tr>
<td>Adjusted Income</td>
<td>$ 80,000</td>
<td>$ 10,000</td>
</tr>
<tr>
<td>Less: Expenses of Operations</td>
<td>75,000</td>
<td>5,000</td>
</tr>
<tr>
<td>Taxable Income from the Studio</td>
<td>$ 5,000</td>
<td>$ 5,000</td>
</tr>
<tr>
<td>Add back: Expenses relating to income excluded pursuant to Section 911:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>A: ($20,000/$100,000) x $75,000</td>
<td>15,000</td>
<td></td>
</tr>
<tr>
<td>B: ($20,000/$30,000) x $5,000</td>
<td></td>
<td>3,333</td>
</tr>
<tr>
<td>ADJUSTED TAXABLE INCOME</td>
<td>$ 20,000</td>
<td>$ 8,333</td>
</tr>
</tbody>
</table>

The individual with higher expenses thus pays higher taxes on the same net profit. The inequity of this application is obvious, but this interpretation follows from the present position of the IRS.

Finally, in stretching the doctrine to new lengths, the IRS recently appealed and won a case holding that moving expenses relating to a transfer overseas are deemed related to income excluded under section 911 during the period of overseas residence, and thus are to be proportionately disallowed. This is notwithstanding the fact that the entire reimbursement received for the move must be included in gross income. The result is unfathomable to the average taxpayer, but is now being pursued with vigor by the Service. Further, the IRS maintains that expenses of the move back to the United States are also related to the income earned overseas and are to be proportionately disallowed.

For taxpayers living overseas in countries which have higher average income tax rates than the United States, section 911 provides little or no immediate benefit, except that the average effective tax rate on United States-source income may be somewhat reduced.

---


66. However, the excess foreign tax credits generated may be carried back or over and utilized in a future year. Int. Rev. Code of 1954, § 904(d). See notes 80-87 infra and accompanying text.
For the purpose of illustrating this concept, let us assume an individual lives in Sweden and pays tax on his $50,000 salary in Sweden at an average rate of forty percent, for a total of $20,000 in Swedish income taxes. We will also assume that he receives dividends and interest income from the United States in the amount of $5,000 but we will ignore any Swedish income tax that may be imposed on this income since he is already paying more foreign income taxes than he can credit. The benefit of section 911 to him may be illustrated as follows:

**Example 4**

<table>
<thead>
<tr>
<th>U.S. INCOME TAX COMPUTED ASSUMING</th>
</tr>
</thead>
<tbody>
<tr>
<td>$20,000 Exclusion Under Section 911</td>
</tr>
<tr>
<td>-----------------------------------</td>
</tr>
<tr>
<td><strong>Total Salary &amp; Allowances (foreign)</strong></td>
</tr>
<tr>
<td>Less: <strong>Section 911 Exclusion</strong></td>
</tr>
<tr>
<td><strong>Net Salary</strong></td>
</tr>
<tr>
<td>Add: <strong>U.S.-source Dividends and Interest</strong></td>
</tr>
<tr>
<td><strong>Adjusted Gross Income</strong></td>
</tr>
<tr>
<td>Less: <strong>Itemized deductions</strong></td>
</tr>
<tr>
<td>Exemptions (4 x $750)</td>
</tr>
<tr>
<td><strong>Taxable Income</strong></td>
</tr>
<tr>
<td><strong>U.S. Income Tax Thereon</strong></td>
</tr>
<tr>
<td>Less: <strong>Foreign Tax Credit:</strong></td>
</tr>
<tr>
<td>(1) Amount paid—$20,000</td>
</tr>
<tr>
<td>(2) Amount allowable:</td>
</tr>
<tr>
<td>($30,000/35,000) x $8,270</td>
</tr>
<tr>
<td>($50,000/55,000) x $17,560</td>
</tr>
<tr>
<td><strong>Net U.S. Income Tax Liability</strong></td>
</tr>
<tr>
<td><strong>DIFFERENCE—Benefit of Section 911</strong></td>
</tr>
</tbody>
</table>

The advantage offered by section 911 in this example is solely attributable to the difference in the average United States income tax rate on United States-source dividends and interest received in the amount of $5,000 in each of the two cases.

This example accurately depicts the benefit of section 911 to many Americans in Germany, the Netherlands, Switzerland, the Scandinavian countries, and France (although France has special

67. We have assumed for this example that no itemized deductions are allocable directly to a source of income for purposes of computing the foreign tax credit. We have thus eliminated the redundant step of apportioning all itemized deductions to United States-source and foreign-source income, and have instead computed the allowable foreign tax credit using the ratio of net foreign salary to total adjusted gross income. A more complicated case involving the allocation of deductions to a source of income is demonstrated in Example 5.
rules regarding the taxation of foreign residents that often mitigate this problem\textsuperscript{68}).

Reasons for Changing Section 911. From the foregoing, it appears that section 911 could not in fact serve the general purpose of encouraging American citizens to relocate overseas, even if that were still the objective that Congress hoped to accomplish by retaining the provision. It is also apparent that section 911 is being distorted by the IRS and by the courts and that it is being gradually limited in its effectiveness.

Because of the results of the statute in practice, the objective of encouraging overseas transfers is being pursued unilaterally by multinational corporations, through the use of allowances and tax equalization policies guaranteeing to the employee that he will enjoy as high a standard of living overseas as he would have enjoyed at home with the same basic salary level. Thus, many companies, in order to avoid the "country shopping" encouraged by section 911, will require an employee to pay directly to the employer a hypothetical income tax equal to that which he would have paid in the United States on his base salary. Any additional taxes on that income (whether foreign income taxes or United States income taxes) are then reimbursed by the company. Of course, this payment is often considered taxable income by the country of residence as well as by the United States; thus, a "snowball" effect is started. This can reach unreasonable proportions for residents of high tax areas like Germany and Scandinavia, especially in those cases where children's tuitions to American schools are reimbursed (four children times $2,000 equals $8,000 tuition—if the taxpayer is in a 60 percent bracket overseas, the company must then pay him $20,000 to cover the tax on the reimbursement). Under these common circumstances, it becomes apparent that the encouragement offered by Congress through section 911 is but a hollow gesture, with multinational corporations providing the real impetus that sends many Americans overseas, especially Americans involved in the sale of American products abroad.\textsuperscript{69}

Further, section 911 makes no distinction between those countries that want Americans to immigrate (permanently or temporarily) and those that do not. This point relates in part to the distinction sug-

\textsuperscript{68}. C. Gen. des Imp., Art. 164(1). This statute excludes from taxable income any income of a foreigner which has been subjected to a tax on worldwide income by his own country. While this statute by its terms applies to all foreigners, in practice only United States citizens qualify. See note 33 supra and accompanying text.

\textsuperscript{69}. This practice may sometimes be a stimulus to evade foreign taxes. See text accompanying note 119 infra.
gested in 1962 between developed and undeveloped countries, and in part to the fact that some countries, developed or not, advertise low income tax rates to encourage certain individuals to reside within their borders.

For almost fifty years then Congress has retained a statute which has lacked a well-defined and continuing purpose and which has been eroded in a piecemeal manner by judges who either have lacked an understanding of the effect of the statute or have reinterpreted the purpose of the statute in accordance with their own prejudices. From this it appears that Congress could fruitfully reconsider whether it would like

1. to encourage Americans to sell American products abroad,
2. to encourage Americans to lend their technological abilities to countries and people in need of them, or
3. to ease what it suspects, but is not sure, is an inequitable tax burden on American residents overseas.

It is likely that Congress has not recently examined the alternatives—and it appears that section 911 does little in any of the three directions indicated.

In fact, section 911 does nothing so well as befuddle the ordinary taxpayer who cannot understand the source-of-income rules, the relationship between section 911 and the foreign tax credit rules, or why his moving expenses are disallowed just because he happened to move overseas. This provision of the United States tax system fails to perform its proper functions and in fact often works inequitably. Before considering what action is appropriate to resolve the problem, however, let us examine a second provision that ostensibly aids the overseas American: the credit for foreign taxes paid.

B. The Foreign Tax Credit

The Need for a Credit. While the benefit provided by section 911 was originally designed to promote an activity, that is, to encourage American citizens to work overseas, the foreign tax credit rules exist to prevent an inequity, namely, to provide relief from the double taxation which results when two countries exercise tax jurisdiction over the same item of income. This conflict may result because one country has jurisdiction over the source of the income while a different country has control over the recipient of that income, or because, as in the case of American citizens resident overseas, two countries have jurisdiction over the recipient. The foreign tax credit rules are designed to nullify the effect of double taxation.
The lengths to which a country will go to eliminate double taxation will depend on a number of factors. As Elisabeth A. Owens said in her definitive book on the foreign tax credit,

The type of limitation [system] which is used arises in part out of concepts as to what constitutes double taxation and as to what the responsibility of the crediting country is, relative to that of other countries, for mitigating double taxation.\textsuperscript{70}

Although Owens does not specifically say so, there are proper grounds for distinguishing between the degree of injustice caused by subjecting a corporation to double taxation and that caused by subjecting an individual to double taxation. In the case of the corporation, the question is simply economics: the type of system chosen "reflects policy with respect to the encouragement of foreign trade and investment and the amount of revenue which can be feasibly relinquished for this purpose."\textsuperscript{71} This reasoning, however, has no application in the case of an individual living overseas. Any citizen of the United States should be able to live anywhere in the world, wherever he may be accepted, without being penalized for the effect his decision may have on the national balance of payments. It is hardly consistent with the American tradition of individual freedom for the free movement of citizens to be restricted by tax rules grounded in economic policy.\textsuperscript{72}

Thus, the question of whether the United States has the right to tax an individual citizen on income that has previously been subjected to tax in another country has distinct moral overtones. When the citizen lives overseas and his sole connection with the United States is citizenship, the right of this country to tax him on income already taxed is tenuous. This is particularly so because, as will be shown, the average citizen overseas pays more taxes to his country of residence than

\textsuperscript{70} E. Owens, The Foreign Tax Credit, § 4/7, at 291 (1961).

\textsuperscript{71} Id.

\textsuperscript{72} It might be suggested that American tax policy should be designed to encourage American citizens overseas to return to the United States in order to use their management abilities to develop jobs and industry in the United States (although not all Americans resident overseas are managers or executives). The complete unacceptability of this approach should be manifest; it will be even clearer when it is noticed that the same result could be effected much more simply, and at least as equitably, by a simple exit tax on departing citizens, based upon, for example, the level of education of the departing citizen, or the importance of his skills to the economy.

Amounts paid pursuant to this provision would, as under the present system, have no relation to any benefits that the citizen might receive from the United States government while overseas, and would serve to discourage (or even prevent) Americans from relocating overseas.
his compatriots in the United States pay in the form of federal, state, and local taxes.

Operation of the United States Foreign Tax Credit System. If, as stated, the purpose of the foreign tax credit system is to prevent double taxation, then there is a need for a standard to determine which nation has the right to tax what income, in order to determine the priority of taxation and thus avoid jurisdictional disputes at the international level.

Consequently, the tax credit system is based upon two principles: first, that the place of source has the first claim on the taxpayer's income and second, that the crediting country, as the country of nationality, may properly impose an additional tax to the extent income has not already been taxed at its source at a rate as high as that of the crediting country.\textsuperscript{73}

Section 904(a)(2),\textsuperscript{74} which sets forth the American formula for determining allowable foreign tax credit, in effect follows the above rationale:

OVERALL LIMITATION. In the case of any taxpayer who elects the limitation provided by this paragraph, the total amount of the credit in respect of taxes paid or accrued to all foreign countries and possessions of the United States shall not exceed the same proportion of the tax against which such credit is taken which the taxpayer's taxable income from sources without the United States (but not in excess of the taxpayer's entire taxable income) bears to his entire taxable income for the same taxable year.\textsuperscript{75}

\textsuperscript{73} E. Owens, supra note 70, at 296.

\textsuperscript{74} Int. Rev. Code of 1954, § 904(a)(2).

\textsuperscript{75} Id. The basic provision allowing the foreign tax credit is section 901. Section 904(a) provides alternative limitations on the credit: the "overall limitation" of section 904(a)(2), which is discussed in the text, and section 904(a)(1) which provides for an alternative computation of the allowable foreign tax credit known as the "per-country limitation." This limitation is more restrictive in its application than is the overall limitation, in that income taxes arising in a country may be offset pursuant to this provision only against United States taxes on income arising in that same country. Because the overall limitation evidences a much more liberal approach on the part of Congress to providing equitable treatment for individuals (or corporations) paying foreign income taxes, the author has chosen the overall limitation for discussion purposes.

In addition, few individuals overseas, in the author's experience, are able to benefit from the application of the per-country limitation, since any benefit from this limitation arises only when the taxpayer has operations in several countries, one of which is generating a loss. While some American individuals find themselves benefiting from this provision, these cases are relatively uncommon. (The foreign tax credit rules make no distinction between individuals and corporations, the latter of which are much more likely to be able to benefit by the application of the alternative per-country limitation.)

For these reasons, the per-county limitation will be ignored in the remainder of this Article.
The credit allowed is thus limited to an amount equal to this product: foreign taxable income divided by total taxable income, multiplied by United States income tax. This formula is known as the "allowable fraction." This provision may be illustrated by the following example for an individual with dividends from a Swiss corporation. The taxpayer lives in the United States. She has $3000 in itemized deductions, which comprise $100 allocable to foreign income, $200 allocable to domestic income, and $2700 allocable to neither and therefore apportionable.

Example 5

<table>
<thead>
<tr>
<th>TAXABLE INCOME</th>
<th>U.S.</th>
<th>Foreign</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Income:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salary</td>
<td>$30,000</td>
<td>—</td>
<td>$30,000</td>
</tr>
<tr>
<td>Dividends</td>
<td>1,000</td>
<td>$4,000</td>
<td>5,000</td>
</tr>
<tr>
<td>Interest</td>
<td>1,000</td>
<td>—</td>
<td>1,000</td>
</tr>
<tr>
<td>Total Gross Income</td>
<td>$32,000</td>
<td>$4,000</td>
<td>$36,000</td>
</tr>
</tbody>
</table>

Less: Itemized Deductions:

<table>
<thead>
<tr>
<th>Allocated directly to a source of income:</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign bank charges</td>
<td>—</td>
<td>$(100)</td>
<td>—</td>
</tr>
<tr>
<td>Interest expense on margin account to purchase U.S. securities</td>
<td>—</td>
<td>$(200)</td>
<td>—</td>
</tr>
<tr>
<td>Apportionable in ratio of gross income:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign ($2,700) x ($4,000/$36,000)</td>
<td>—</td>
<td>(300)</td>
<td></td>
</tr>
<tr>
<td>United States ($2,700) x ($32,000/$36,000)</td>
<td>—</td>
<td>(2,700)</td>
<td></td>
</tr>
<tr>
<td>Total Itemized Deductions</td>
<td>$(2,600)</td>
<td>$(400)</td>
<td>$(3,000)</td>
</tr>
</tbody>
</table>

Taxable Income before Exemptions: $29,400

Less: Exemptions (4 x $750) | (3,000)

Taxable Income | $30,000

United States Income Tax | $7,880

Foreign Tax Credit:

1. Income Tax Paid to Switzerland on Dividends—(30% x $4,000) | $1,200

2. Amount of Credit Allowable—($3,600/$33,000) x ($7,880) | $860

Credit: Lesser of (1) or (2) above | (860)

TAX PAYABLE TO THE UNITED STATES | $7,020

In recognition of the right of Switzerland to tax the income from that country first, the United States allows the taxpayer to offset against his United States tax some of the foreign tax he has paid to

76. See id. § 904(a)(2).

77. This example shows also that an increase in the itemized deductions allocated directly to foreign-source income has the effect of decreasing the allowable foreign tax credit. This is because the allowable fraction—the formula used to compute the allowable credit—has as its numerator taxable income from foreign sources. Increasing deductions from foreign-source income reduces foreign-source taxable income, thus reducing the allowable fraction. Accordingly, the IRS has taken an aggressive position regarding allocation of deductions.
Switzerland on the dividend income derived from that country. Failure to provide this credit and thereby to recognize the right of the country of source to withhold tax on income derived therefrom would be patently inequitable to United States citizens and either would freeze capital within the United States or would lead to a confrontation at the highest level between the United States and the foreign country. In fact, it is now a recognized principal that the country-of-source has the first right of taxation of income. The net effect is that for American citizens the United States government will allow a credit for foreign taxes, but will not allow the credit to reduce United States income taxes attributable to United States-source income.

Owens states, "If an overall limitation is used, however, the United States either recognizes the right of a foreign country to assert jurisdiction over income from sources in all other countries except the United States, or allows a foreign country, because it has a tax rate higher than the United States tax rate, a claim prior to that of the United States on the income from all other countries except the United States." Consequently, in computing the allowable tax credit, the world is separated into two parts: the United States and the rest of the world. The treatment mitigates, to some extent, the effect when a foreign country has a rate of tax substantially higher than the United States, since the United States will allow a credit against tax on foreign income which in fact has not been taxed in any foreign country.

The liberal United States rules for determining foreign income tax credit probably are equitable for the majority of Americans subject to foreign income taxes. It may be argued that this relief, coupled with the benefit of section 911, goes further than necessary to treat Americans living overseas equitably vis-à-vis their compatriots living in the United States. Nevertheless, any such conclusion is incorrect, as will be shown.

**Faults in the Tax Credit System as it Applies to Americans Living Overseas.** The United States system of allowing a credit for for-

78. In the example, which ignores for purposes of illustration the reduced withholding rate on dividends provided by the Convention with the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income, May 24, 1951, art. VI, 2 U.S.T. 1751, T.I.A.S. No. 2316, the taxpayer paid $1200 in creditable foreign income taxes but was allowed a credit for only $860. The excess of $340 may be carried back two years and carried over five years, to a year, if any, in which the allowable credit exceeds the creditable taxes paid. Int. Rev. Code of 1954, § 904(d); see notes 80-87 infra and accompanying text.

79. E. Owens, supra note 70, at 296 (emphasis added).
eign income tax is based on the notion that the right of a foreign country to tax income earned within that country is superior to the right of the United States. Because the great majority of American citizens resident in the United States have little or no income subject to the taxing jurisdiction of foreign countries, the fairness of the system may not seem, to some, to be of much importance. For the average American citizen resident overseas, however, the foreign tax credit system does not function properly. In practice the system promotes gross inequities that should be corrected, if only because more than one million Americans are affected.

(a) FOREIGN TAX CREDIT CARRYOVER AND SECTION 911. The Internal Revenue Code provides for a carryover or carryback of the excess foreign tax credit that arises when the foreign income taxes paid in a given year exceed the maximum credit allowable by the limitation. In keeping with the American system of allowing the taxpayer to offset foreign taxes against United States income taxes attributable to foreign-source income, the Internal Revenue Code provides:

CARRYBACK AND CARRYOVER OF EXCESS TAX PAID.—Any amount by which such [income] tax paid or accrued to any foreign country . . . exceeds the applicable limitation under subsection (a) shall be deemed tax paid or accrued to such foreign country . . . in the second preceding taxable year, in the first preceding taxable year, and in the first, second, third, fourth, or fifth succeeding taxable years, in that order . . .

Accordingly, when the taxpayer has income arising from foreign sources in one of the eligible years (even though he may not be subject to any foreign income taxes in that year), he may be able to obtain a foreign tax credit in that year for excess taxes from another year. It will be noted that the provision is clear in its wording that all taxes ("any amount") in excess of the allowable credit are available as a "carryover."

It happens, however, that just as some federal judges have reinterpreted the purpose of section 911, apparently because they feel that it grants an unfair advantage to the taxpayer resident overseas, another court has recently fallen prey to this "unfair benefit" doctrine and has concluded that the foreign tax credit carryover rules allow a windfall gain to the overseas resident when there is concurrent application of section 911. In United States v. Woodmansee, the court was

80. INT. REV. CODE OF 1954, § 904(d).
bothered by the fact that it is possible for an individual to have a zero allowable foreign tax credit (because all of his foreign income is excluded pursuant to section 911), yet still obtain a carryover of the excess foreign income tax credit to another year. This situation falls squarely within the carryover rules of the Internal Revenue Code quoted above. The court, however, after reasonably commencing its discussion of the law with the observation, "A literal reading of the foreign tax credit provisions of the Code and the regulations promulgated thereunder would in the absence of any other consideration result in the applicability of the credit in the instant case," ended by overruling three Internal Revenue Service revenue rulings and eighteen years of unchallenged and uniform practice.

The major flaw in the case appears to be a failure on the part of the court to appreciate the theory behind the "overall" limitation, which failure is evinced clearly by the statement, "Congress did not intend to mitigate high foreign tax rates but rather intended only to shield taxpayers from foreign taxes to the extent that they duplicated the United States income tax burden." Clearly, the overall limitation under which the taxpayer, in computing the allowable credit, may include income from all foreign sources (some of which may have been subjected to no foreign income tax, and some of which may have been taxed at very high foreign tax rates), contemplates just this result of mitigating high foreign tax rates. Oddly enough, the court quoted in support of its position a House Report which clearly states this different Congressional intent and which avers that "[t]he limitations on the allowance of a credit for taxes paid to foreign countries were placed in the law to make it certain that the Federal Government would receive its full tax on the income from United States sources." The application of the overall limitation and the foreign tax credit

82. Id. at 41.
84. 388 F. Supp. at 42 (footnote omitted).
85. Id. at 42 n.15, quoting H.R. REP. No. 855, 76th Cong., 1st Sess. 5 (1939) (emphasis added). What the court overlooked here is that allowing the carryover or carryback in no way deprives the United States of "its full tax," since the credit carried over or carried back is still limited by the allowable fraction, Int. Rev. Code of 1954, §904(d) (on the allowable fraction, see text accompanying note 76 supra), and therefore can be used (1) only if there is foreign taxable income, and (2) only up to the amount that the Congress willingly allows. Allowing the carryover and the carryback merely permits the taxpayer to catch up, by giving him the benefit of the taxes he has paid to other countries in other years; the application of the allowable fraction serves to assure that the United States will "receive its full tax," which is the same function it serves in the base year.
carryover rules would ensure in all cases that this doctrine is upheld.

The court was certain, however, that the taxpayer was benefiting unfairly, and concluded that "the foreign tax credit prescribed in § 901 cannot arise out of foreign taxes paid or accrued on income which is exempt from the United States income tax. It is further held that the foreign tax credit carryback and carryover provisions found in § 904(d) are applicable only as to income which is reportable in different time periods in the United States and the foreign country in question."88

Although the court did not pause to consider the practical consequences of its conclusion, among other unfortunate results will be the fact that it will inevitably be the low-income taxpayer who bears the brunt of this decision. For purposes of illustrating this point, let us consider two Americans who transfer to Germany for the same employer. For simplicity, we will assume that the two have four personal exemptions each, that their itemized deductions are the same proportion of gross income, and that each pays income taxes in West Germany which equal thirty-five percent of his salary. The only difference in the two individuals' situations will be that the engineer receives $20,000 in salary while the foreign operations manager receives $50,000. The foreign tax credit carryover available to each of these employees, according to Woodmansee, will be as follows:

Example 6

<table>
<thead>
<tr>
<th>EFFECT OF WOODMANSEE</th>
<th>Engineer</th>
<th>Manager</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Salary (all from foreign sources)</td>
<td>$20,000</td>
<td>$50,000</td>
</tr>
<tr>
<td>Less: Section 911 Exclusion</td>
<td>(20,000)</td>
<td>(20,000)</td>
</tr>
<tr>
<td>Net Salary</td>
<td>$None</td>
<td>$30,000</td>
</tr>
<tr>
<td>Less: Itemized Deductions &amp; Exemptions (4 x $750)</td>
<td>(800)</td>
<td>(2,000)</td>
</tr>
<tr>
<td></td>
<td>(3,000)</td>
<td>(3,000)</td>
</tr>
<tr>
<td>Taxable Income</td>
<td>$None</td>
<td>$25,000</td>
</tr>
<tr>
<td>United States Income Tax Thereon</td>
<td>$None</td>
<td>$6,020</td>
</tr>
<tr>
<td>Less: Foreign Tax Credit:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(1) Amount Paid to West Germany:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Engineer—$7,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Manager—$17,500</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(2) Amount Allowable:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>($None/$None) x $None</td>
<td>(None)</td>
<td>(6,020)</td>
</tr>
<tr>
<td>($30,000/$30,000) x $6,020</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net United States Income Tax Liability</td>
<td>$None</td>
<td>$None</td>
</tr>
</tbody>
</table>

88. 388 F. Supp. at 44 (footnotes omitted). Although the court characterized these as alternative holdings, id. at 44 n.23, the second one seems to be dictum.
Computation of Available Foreign Tax Credit Carryover:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign Taxes Paid</td>
<td>$7,000</td>
</tr>
<tr>
<td>Less: Credit Utilized This Year</td>
<td>($6,020)</td>
</tr>
<tr>
<td>Excess Available for Carryover</td>
<td>$11,480</td>
</tr>
</tbody>
</table>

Less: Woodmansee Adjustment:

\[
\text{Woodmansee Carryover Available} = \frac{\text{Excluded Foreign Income}}{\text{Total Foreign Income}} \times \text{Foreign Tax Liability}
\]

\[
\begin{align*}
\text{Excluded Foreign Income} & = \frac{20,000}{20,000} \times 7,000 \\
\text{Total Foreign Income} & = \frac{20,000}{50,000} \times 17,500 \\
\text{Woodmansee Carryover Available} & = \frac{7,000}{7,000} \times 4,480
\end{align*}
\]

This decision necessarily denies a foreign tax credit carryover to those individuals earning less than the exclusion available to them under section 911, but allows a carryover to those fortunate enough to earn more than the exclusion. This case also points clearly to the fact that United States tax policy as it applies to Americans residing overseas is being established in a piecemeal and irrational manner.87

(b) SOURCE-OF-INCOME RULES. The American citizen residing overseas is not paying income taxes to a foreign country merely because that country has jurisdiction over some part of his income; he is paying those taxes because he is a resident of a country that has jurisdiction over him personally, and thus over all of his income. The rules for determining sources of income are irrelevant when the foreign country is legitimately taxing income of the taxpayer on a worldwide basis. That the foreign country is exercising a legitimate claim to jurisdiction by taxing the world-wide income of its noncitizen residents cannot be challenged by the United States, which taxes resident aliens on the same basis as it taxes American citizens.88

87. It will be noted that this discussion of Woodmansee is concerned only with the limitation on carryover and carryback, and not with the fact that the section 911 exclusion is taken into account also in determining the amount of foreign tax credit allowable in the current year. Section 911 is considered in the determination of the allowable fraction for the current year because the credit is allowed only in the proportion of United States taxes that foreign taxable income bears to total taxable income. See Int. Rev. Code of 1954, § 904(d), quoted in the text at note 80 supra. This use of the term “taxable” requires that the amount excluded under section 911 be subtracted from the numerator (foreign taxable income) and the denominator (total taxable income) of the allowable fraction. Rev. Rul. 68-622, 1968-2 CUM. BULL. 298, 299. See Example 5 supra. Of course, the excess foreign taxes attributable to the excluded income could then be applied in the current year against United States taxes on foreign income not taxed by any foreign country. It is difficult to believe that Congress would specifically allow this treatment in the current year but not allow it in other years as a carryover or carryback. This is, however, the conclusion that the Woodmansee court reached.

88. Treas. Reg. § 1.1-1(b) (1956). Resident aliens who are citizens of certain countries can even qualify for the section 911 exclusion despite the language of section 911(a) referring to “citizen of the United States,” because of treaty provisions. Rev. Rul. 72-330, 1972-2 CUM. BULL. 444 (affecting citizens of Canada, Denmark, Germany,
found in many foreign countries and because of the United States source-of-income rules, a taxpayer may be forced to structure transactions artificially, solely in order to generate foreign-source income in order to use up the excess credits created when these foreign taxes exceed the limitation. For example, an individual may be forced to sell stock overseas to generate foreign-source gains, the commission going to the overseas broker. An individual living in Sweden might purchase Swedish stock (since all of his dividend income will be taxable in Sweden anyway) in order to avoid having United States-source dividends. An individual may forego working trips to the United States because of the legitimate fear of generating United States-source income; as a result, the United States will lose whatever expenditures he would have made while in the United States. The American system thus tends to drive capital and business out of the United States.

The net effect is that the country in which the individual resides taxes all of his income, regardless of source, and the United States taxes all United States-source income, so there is a double tax on United States-source income but not on foreign-source income.

(c) VALUE-ADDED TAXES. More important, from the perspective of equity, is the limitation that the United States imposes in allowing credit only for foreign income taxes. Entirely aside from the definitional problems in determining what is an income tax, the United States system takes no account of the fact that many governments rely on individual income taxes to a lesser extent than does the United States, and put proportionately great emphasis on other forms of gathering revenue. This is universally so in the countries of the European Economic Community, which place a great reliance on value-added taxes. It is certain that this reliance will be increased in the future as the rates are equalized between the various member countries and as more countries enter the E.E.C.

Value-added taxes are taxes which are ultimately expressed as a fixed percentage of the final cost of an article purchased by or service rendered to the consumer. This tax may be substantial on certain

---

the Netherlands, and the United Kingdom); Rev. Rul. 72-598, 1972-2 CUM. BUL. 451 (amplifying Rev. Rul. 72-330, supra) (affecting citizens of Austria, Belgium, Finland, France, Greece, Ireland, Luxembourg, Norway, Pakistan, Sweden, Switzerland, Trinidad and Tobago, and Union of South Africa).

89. A more detailed description is as follows:

As the name implies, a value-added tax is imposed on the value added to a commodity by a producer or the value of services rendered where products are not involved. In Europe, with the exemption provided for exports, the VAT becomes a tax on consumption in the domestic economy collected in stages as goods are sold or services rendered. In practice no attempt is made to deter-
items: residents of France who purchase an automobile, for example, must pay a tax equal to one-third of the price of the car without the tax.\textsuperscript{90} The difference in governmental tax policies is clear when it is noted that France in the years 1965 through 1971 derived 35.57 percent of its total tax revenues from taxes on consumption, while the United States gathered only 17.35 percent of its revenue from such taxes during this same period.\textsuperscript{91} France thus places twice as much emphasis on this source of revenue as does the United States. In fact, of the fifteen member countries of the Organization for Economic Cooperation and Development surveyed in Appendix 1, only Japan placed less emphasis on consumption taxes than did the United States, whether one considers taxes on consumption as a percentage of gross national product or as a percentage of total tax revenues.\textsuperscript{92} This figure becomes more significant when one considers that almost three-fifths of all Americans overseas reside in those fourteen foreign countries.\textsuperscript{93}

A close examination of Appendix 1 will disclose the varying tax policies of fifteen selected countries and will show that the great emphasis the United States places on gathering revenues from personal income taxes is not matched by any other country.\textsuperscript{94} It would appear from this analysis that the failure of the United States to give recogni-
tion for taxes paid in a form other than income taxes works a hardship on an individual who is totally subject to the taxing jurisdiction of the United States and one of these other countries.

A Simple Comparison. In order to determine the equitability of the United States system of taxing worldwide income of nonresident citizens with a credit allowed only for foreign income taxes, the proper test is to make a comparison between the tax burden a citizen bears in his country of residence and the burden he would bear in the United States on the same amount of income. To make any comparison valid, however, the following assumptions must be made explicit:

1. The effect of section 911 will be ignored.95

2. Foreign taxes will be considered creditable as follows:
   a. income taxes will be fully creditable;
   b. social security taxes will be creditable in those countries whose social security taxes the IRS has publicly ruled to be creditable.96

---

95. There are several reasons why the effect of section 911 should be ignored for this purpose:

1. Section 911 is largely inapplicable in this comparison since the United States resident will obtain no section 911 relief and the computations for the residents of other countries are based upon the foreign income tax burden. The foreign tax laws of course are not affected by American tax rules such as section 911.

2. There is strong sentiment in Congress to repeal section 911. This comparison attempts (among other points) to demonstrate on an accurate hypothetical basis the effect on the average American overseas were section 911 to be repealed without substantial compensating adjustments in the tax law having been provided. Accordingly, for the four countries where the absence of section 911 would make a difference in this example (Belgium, France, The Netherlands, and Spain), the allowable foreign tax credit has been computed assuming that the citizen would be fully taxed in the United States on his worldwide income, notwithstanding his foreign residence. The example then shows that Americans in these four countries would be in the highly anomalous situation of paying higher taxes than either United States residents at the same level of income or citizens of their country of residence at the same income level.

96. Strictly speaking, the only such countries are the United Kingdom (Rev. Rul. 72-579, 1972-2 Cum. Bull. 441) and Canada (Rev. Rul. 67-328, 1967-2 Cum. Bull. 257, dealing with the Old Age Security tax; Rev. Rul. 68-411, 1968-2 Cum. Bull. 306, dealing with the Canada Pension Plan). In addition, the Internal Revenue Service has issued a private ruling that French social security taxes are creditable. This ruling is not published, though the IRS will admit its position upon specific inquiry. A private ruling, of course, may not be relied upon by a taxpayer since it applies only to the specific case for which the ruling was requested. Treas. Reg. § 601.201(1)(1); see, e.g., Minchin v. Commissioner, 335 F.2d 30, 33 (2d Cir. 1964); Weller v. Commissioner, 270 F.2d 294, 298-99 (3d Cir. 1959), cert. denied, 364 U.S. 908 (1960).

In view of the fact that the IRS has chosen not to make its position public by the issuance of a Revenue Ruling, there are undoubtedly a large number (perhaps a majority) of concerned individuals who are not aware of this position and who are therefore not claiming the credit. For these reasons, the author has chosen to reflect French so-
3. Except for the individual residing in the United States, all income will be considered to be from foreign sources. Accordingly, full credit will be given for foreign income taxes, and social security taxes where creditable, up to the amount of United States income taxes against which the credit could be taken.

4. Although the standard deduction is not available when a credit is claimed for foreign income taxes, it will be assumed that actual itemized deductions equal the standard deduction of $2,000.

5. For purposes of comparing the taxes on consumption paid from country to country, we will use the average rate of taxes on consumption expressed as a percentage of gross national product for the years 1965-71 (see Appendix 1). In our example, the individual will be considered to be contributing $34,500 to the gross national product in each country. That amount multiplied by the average rate of taxes on consumption (expressed as a percentage of gross national product) will determine the amount of taxes on consumption paid by the individual in each country. 

---


98. Although in practice the amount of taxes on consumption paid by any given individual may vary substantially from that of another because of differences of life style, amount of salary invested in savings, etc., it is necessary for purposes of this hypothetical model to assume that individuals in similar income circumstances in each country will incur approximately the same amount of taxes on consumption. Since we know the total amount collected in consumption taxes in each country, expressed as a percentage of the gross national product of that country (see Appendix 1), it is only necessary to allocate the gross national product to each individual in order to determine his hypothetical taxes on consumption. The author believes that for these purposes it is reasonable to assume that the sum of all employment, plus a normal before-tax profit factor of fifteen percent, will approximate the total gross national product in each country. Accordingly, each individual’s “share” of the gross national product in the example will be 115 percent of his salary of $30,000, or $34,500. In this respect, it is important to note that if there is the possibility of an error in this model, it is most likely to be in failing to allocate sufficient gross national product to each individual and thus failing to attribute sufficient consumption taxes to the individual. Accordingly, since the United States has the lowest percentage of taxes on consumption (with the exception of Japan), the tax burdens of the residents overseas would be increased in a higher proportion than any increase in the tax burden of the United States resident. The correction of the error, if any, in the model thus would strengthen the conclusion that the American resident overseas bears a significantly higher tax burden than the American resident in the United States.

The revenue statistics summarized in Appendix 1 independently support the reasonableness of this treatment.
6. For purposes of computing the individual income and social security taxes paid in each foreign country, the individual will:

a. receive total income from salary, for services performed within the country, of $30,000,99 with no income from other sources;
b. have two dependent children;
c. be allowed maximum permissible deductions;
d. be allowed a deduction, where applicable, for $400 of whole life insurance premiums paid; and
e. be subject to the maximum withholdings for social security for his income level.

Based upon the foregoing assumptions (and other minor assumptions as necessary for local tax calculations), we have calculated the entire tax burden the individual would bear in each country and have graphically displayed the results in Appendix 2. The figures demonstrate clearly that the American citizen residing overseas is at a staggering tax disadvantage in many countries when one looks at the tax burden he would have borne on the same amount of income had he resided in the United States. In Sweden, for example, he would pay 260.74 percent of the tax burden in the United States; in Germany, 156.32 percent; and in Canada (where almost one-fourth of all Americans overseas reside),100 156.87 percent. The result obtains without the addition of a single dollar of the United States tax which would be due if any of the income were from United States sources.

In addition, it is important to note that the individual residing in France is already paying taxes equal to 124.38 percent of the tax burden he would bear if residing in the United States, but because most of the taxes paid were attributable to noncreditable consumption and social security taxes, he must pay an additional 14.80 percent (of the American tax burden) in income taxes to the United States, making his total tax burden equal to 139.18 percent of that of a citizen residing in the United States. Individuals residing in Belgium, the Netherlands, and Spain similarly pay an additional tax.101

The results of Appendix 2 are largely supported by Appendix

99. Though the taxpayer's salary is $30,000, his contribution to GNP is shown in Appendix 2 as $34,500, to allow for the employer's gain on the services rendered. See note 98 supra.
100. See Appendix 4.
101. See also note 50 supra and accompanying text.
and must be closely studied in conjunction therewith. Because graduated income tax rates tend to rise more quickly in Europe than in the United States and because we have chosen as “typical” an individual earning $30,000 yearly (slightly high by European standards), the actual proportion of creditable income and social security taxes to taxes on consumption is correspondingly higher throughout in Appendix 2 than in Appendix 1. A comparison of lower-income individuals would show a higher proportion of their tax burden to be noncreditable taxes on consumption, and would, in fact, strengthen the results shown in Appendix 2 (that is, increase the likelihood that an individual would be required to pay additional taxes to the United States even though his overseas tax burden was already in excess of the tax burden of a United States resident). It is essential to note in considering Appendix 2 that the application of the United States source-of-income rules in determination of the foreign tax credit can only aggravate the economic disadvantage already suffered by the American overseas. The conclusion then is inescapable that Congress, in establishing tax policy, must consider the effect and amount of the taxes on consumption which are paid in their countries of residence by Americans resident overseas.

C. Noneconomic Considerations in Taxing Nonresident Americans

Besides the actual dollar cost to thousands of American citizens, discussed above, there are other areas where the United States system may be working inequities or infringing on the sovereignty of other countries by requiring citizens resident overseas to pay taxes to the United States each year.

For example, many individuals find the rules relating to source of income, section 911, disallowance of moving expenses as related to tax-exempt income, and house sales gains (which generally must be reported since most individuals do not purchase a residence during

102. A close comparison of the first two appendices will reveal, however, an inconsistently, in that the individual in Appendix 2 in Italy should be paying a much smaller proportion of income taxes in order to be consistent with the Italian revenue statistics shown in Appendix 1. That is, Appendix 1, which is based on taxes actually collected, shows that Italy collects in income taxes on individuals only 3.40 percent of its gross national product (line 2B), but Appendix 2, which is based on the taxes legally imposed, shows that about one-third of GNP—$10,300 plus $2,010 out of $34,500—should have been collected. The author believes that this discrepancy is evidence of a lack of general compliance with the Italian income tax law. Taxes on consumption are not so easily avoided.

103. See text accompanying notes 89-93 supra.
the first year overseas)\textsuperscript{104} to be of overwhelming complexity. Owens acknowledges that

the administrative requirements for claiming a foreign tax credit are somewhat complicated. However, they call for no unnecessary information and present no excessive difficulty, except perhaps in the case of individuals preparing tax returns without professional advice. . . . Perhaps the most important problem is that several items of information called for may be either unknown to the taxpayer or not easily accessible, or may presume a knowledge of the law beyond the average taxpayer.\textsuperscript{105}

The present author has personally assisted or been involved in the preparation of United States income tax returns for over 500 American citizens resident overseas and can testify that the foregoing quotation is a substantial understatement. Moreover, it may be simply stated that professional tax help is expensive, increasing the taxpayer's out-of-pocket costs relating to his taxes. This is, of course, in addition to the mental discomfort an individual suffers when he realizes he is no longer competent to prepare his own return.

In spite of the fact that the American overseas must pay taxes to the United States, it seems he is receiving little if any benefit from this expenditure. Owens considered the possibility that this might be the case, and concluded that

104. Any United States citizen who disposes of his home (principal residence) may defer recognition of any capital gains realized on this disposition by simply investing the proceeds of the sale in a new principal residence within one year of the date of sale. \textit{Int. Rev. Code of 1954, § 1034(a)}. This procedure may be repeated any number of times, and may result in the deferral of a substantial amount of gain, as the gain from each residence is added to the deferred gains from all previous residences. The American resident overseas, however, rarely reinvests in a new residence within the required one-year period because of exceedingly high foreign real estate prices, and probably also because of a lack of familiarity with the foreign real estate market. Accordingly, the deferral process is terminated and the total accumulated gain must be reported in the year that the taxpayer disposes of his residence in order to relocate overseas. Few Americans resident in the United States are ever in the position of paying income taxes upon the disposition of their home, but virtually all Americans overseas who owned their own residence in the United States are in this complicated and costly position.

105. E. Owens, \textit{supra} note 70, at 515.
With respect to individual taxpayers, it is clear that this cannot be demonstrated. Even though an alien or citizen resident in the United States derives all his income from a foreign country, he is, nevertheless, obviously enjoying the protection of the United States Government and the benefits of most of its expenditures.\textsuperscript{106}

However, the foregoing statement clearly does not consider the existence of one million American residents overseas deriving their personal protection, civil services, transportation, communications, medical benefits, and other prerequisites to a convenient life not from the United States government, but from the government of the country in which they reside.\textsuperscript{107} Furthermore, as has been shown, they are paying a higher price for these benefits than their compatriots in the United States.\textsuperscript{108}

Another problem is that the requirement that United States citizens pay either to a foreign country or to the United States an amount of income tax equivalent to the tax that would be due at the United States income tax rate may subvert a unilateral attempt by an underdeveloped or other country to encourage immigration by setting low individual income tax rates. This is not a wise policy, for “if a country seeking capital [or technicians] tries to attract [such] by having a low rate of tax on income, it is desirable that it should be free to do so. It is wrong that the country which supplies the capital [or technicians] should thwart the attempt of the underdeveloped country by annulling the inducement of a local low tax by imposing a supplementary tax at home.”\textsuperscript{109}

Finally, in view of the fact that the United States government must place agents throughout the world in order to police its taxpaying nonresident citizens, there could be an enforcement problem in any country that might feel its sovereignty infringed by foreign agents entering the country to collect tax revenue from residents (and sometimes citizens, in the common case of dual nationality). Since many countries do not recognize income tax evasion as a criminal and thus extraditable offense, if Americans overseas were to refuse to pay, the IRS would simply not be able to enforce the law. Americans are not likely to adopt noncompliance as a method of avoiding an inequitable tax policy, but the option is available to them and the danger exists.

\textsuperscript{106} Id. at 565-66 (footnote omitted).
\textsuperscript{107} See notes 26-30 supra and accompanying text.
\textsuperscript{108} See notes 95-103 supra and accompanying text.
III. SOLUTION

A. A Proposal

If, as seems to be the case, the present system fails to recognize adequately the special circumstances of Americans living abroad, then perhaps it is time to consider changes that may equalize the treatment of all Americans, or, in the event equalization is not possible, changes that will at least eliminate the inequities caused unilaterally by the United States system.

Clearly the problem presented in accurately measuring the impact of taxes on consumption imposed in almost all foreign countries will effectively preclude any system which makes the United States the first frame of reference for the reporting of worldwide income: credit, if any, granted for non-income taxes can only be by approximation and necessarily will be inequitable.\textsuperscript{1}

The tax credit method can only credit income taxes against similar taxes. If the country where the income is earned obtains its revenue by other means than income or profits taxes, such as taxes on capital or on sales or services or even on an arbitrary figure which takes into account the size of the capital, of the payroll, or of the turnover, no relief against double taxation is possible beyond charging the tax against the income instead of against the tax.\textsuperscript{111}

The simplest and fairest answer to this problem then is to exempt the American citizen resident overseas from United States income tax jurisdiction altogether, and allow the country of residence to collect the worldwide tax (giving credit, ideally, for any taxes imposed on income at its source). Any citizen who qualified as a fiscal resident of another country would pay no taxes to the United States,

\textsuperscript{110} The United States tax system is based upon the accurate reporting of worldwide income and the calculation of an exact tax liability based upon published and generally well-understood rules. With the sole exception of the comparatively insignificant deductions for state sales and gasoline taxes (which are determined by reference to a table of guidelines published by the Commissioner of Internal Revenue), deductions and credits are allowed only for exact and provable amounts of funds expended or expenses incurred. To introduce into this precise system either a credit or a deduction, such as one for foreign consumption taxes, which could be enough to eliminate all or most of the taxpayer's liability to the United States, and then to base this credit or deduction on a rough estimate would be to do violence to the American system of measured taxation.

It should be apparent that, as is the case with the analogous state sales taxes, it will prove impossible (or at least uneconomical) to measure with any degree of accuracy the amount of consumption taxes paid by any given individual. Because of this, and because of the amount and importance of these consumption taxes, the author believes that any attempt to provide either a credit or a deduction for them will by definition be inequitable and therefore unacceptable.

\textsuperscript{111} Id. at 17.
except on United States-source income (such as dividends) on which the tax was withheld at the source.

Although there may be countries besides the United States whose laws do not adequately provide citizens and residents with relief from double taxation, any American may simply remove himself from the jurisdiction of such a country by not living there. While that alternative may not be particularly attractive, it is certainly simpler and more equitable than the alternative which now exists, that of rejecting United States citizenship in order to avoid inequitable double taxation. In any event, most taxes will be paid to one single country of residence. Presumably that country will have considered the double impact of consumption and income taxes on all residents (including its own resident citizens) and will have constructed its tax policy accordingly.

In adopting this plan, the United States would of course retain the primary right to tax United States-source income as the country of source. One would hope, however, that the usual exceptions for nonresidents would be given, such as (1) special withholding tax rates as provided by treaty for dividends, interest, and fixed income, and (2) the “commercial traveler’s” exception which treats income earned on a business trip to the United States as nontaxable if the income derived from it does not exceed $3,000 and the trip lasts less than ninety days.112 In other words, the nonresident United States citizen would be taxed in exactly the same manner as any nonresident alien. That he would be getting no unfair gain from this treatment has been clearly demonstrated.113

---

113. In fact, it is possible for an individual to be exempted from United States income taxation on worldwide income while he is an overseas resident and yet pay more income taxes to the United States than he does currently. This would be the case for an individual who presently has all of his salary excluded pursuant to section 911, leaving him with (say) $2,000 of taxable dividend income from United States corporations. Against this dividend income would be applied the individual’s personal exemptions ($3,000 for a family of four), leaving him with zero taxable income and no tax liability in the United States under current United States tax law. If, on the other hand, he were to be taxed as a nonresident, he would be required to pay $300 to the United States (assuming a fifteen percent withholding tax on dividend income received by nonresidents) on this $2,000 of dividend income. (If this income has been reported in his country of residence, the taxpayer would presumably then receive a credit in that country for this tax paid to the United States.)

This result of higher United States taxes on the American overseas under the exemption theory would stand in the face of the “unfair benefit” contention, and is in accordance with the internationally accepted territoriality basis of taxation, which gives the country of source the primary right to tax income. The United States government would have a stronger claim for exercising jurisdiction in this case than it would have
The benefit of this system would be that the United States would still have jurisdiction over and derive revenues from United States-source income, but without requiring the United States citizen overseas to file a complicated tax return every year and without requiring him to pay inequitable taxes. In addition, the citizen would be allowed to plan his financial life around considerations other than United States income tax, but would nevertheless be carrying his fair tax burden in his country of residence.

Accordingly, life would be greatly simplified for Americans overseas, who at the same time would be placed on an equal footing with their compatriots and with the citizens of their country of residence. No more could be asked.

B. Problems and Answers

*United States Income Tax Evasion.* The most obvious potential problem area if this proposal is adopted is that an individual could temporarily absent himself from the United States and, while so exempt from United States tax laws, trigger large amounts of income which might or might not be subject to taxation in his country of residence. For instance, an individual could take with him greatly appreciated securities, and sell them while residing outside the United States; many countries do not tax capital gains on the disposition of securities, so the gain would go untaxed. Tax avoidance, however, plainly cannot be regarded from the point of view of any single tax. For example, a Scandinavian may consider it to be avoidance of taxation for a Swede to reside in the United States in order to avoid the high income and consumption taxes of Sweden. Every country that imposes excessive or unusual taxes on its citizens risks driving those citizens out. In any case, the same tax-avoidance result can be accomplished under present law by structuring foreign sales of the stock in order to use up excess foreign tax credits, thus generating a tax-free "bail out" of accumulated capital gain.

Further, a knowledgeable individual with good tax advice should conclude that, with the increased cost of living plus the increased taxes on income and consumption imposed on the overseas resident, he is unlikely to benefit in the final analysis unless he has very substantial income that he can bail out without tax, an unlikely circumstance for the great majority of individuals.
Finally, the frequent occurrence of abuse would require a mobility of population which probably does not exist. It takes a special type of individual to live (as opposed to travelling) overseas, and with few exceptions these individuals will be motivated by considerations other than the saving of tax dollars.

Nevertheless, the risk of abuse may exist and it might be advisable to strengthen the foreign residence requirements before implementing a change so complete as eliminating taxation of a group of citizens. In this regard it is important to stress that the emphasis is on residence in a foreign country and not on nonresidence in the United States. Cases exist where individuals drift for years among countries without becoming a resident for tax purposes in any of them. Such cases are outside the scope of this discussion, which takes as a basic premise that everyone must have some fiscal domicile, if not in a foreign country then in the United States. Moreover, if an individual claims a foreign residence, he should be required to prove it, preferably by the offering of authenticated copies of his tax returns submitted to his country of residence.

As for the period of residence necessary to qualify, any period will be arbitrary, but certainly two full years of bona fide residence should be sufficient when coupled with the filing of local tax returns as a resident. Any individual not prepared to establish a tax domicile would be classified as a United States resident; in other words, the physical presence rules of section 911(a)(2) as they apply to American citizens should be reconsidered.

If it is believed that an extended residency requirement is insufficient to reach those who move overseas for the purpose of avoiding United States income taxes, the option of imposing a special tax or deposit on departing citizens, as Canada does, is still available. A departing resident of Canada must declare his accumulated capital gains and pay an income tax as if they were realized immediately before departure. In the alternative, he may defer recognizing the accrued gain by electing to deposit sufficient collateral to cover the tax that would have been due had the gains been realized: in such a case, the property is classed as "taxable Canadian property" and the gain must be reported to Canada when the property is sold. The objective of such provisions is clear.

115. Id. § 48(1)(c).
116. Furthermore, entering residents and returning citizens could declare tax-free their accumulated gains in order to avoid being unfairly taxed on gains accumulated dur-
Splitting Income—Foreign Income Tax Evasion. Much of the discussion up to this point has been based upon the assumption that the American citizen overseas has established a true fiscal domicile in his country of residence; that is, that he is paying taxes in that country as would a resident citizen of the country. It would be naive, however, to assume that all Americans are declaring their worldwide income to their country of residence. Although certain countries have provisions allowing the exclusion of specific types of income (i.e., the United Kingdom and France), most do not, and the omission of income is therefore tax evasion practiced in the country of residence.

Although many American executives have strong moral convictions with regard to the payment of United States income taxes (and this undoubtedly accounts for the high percentage of compliance with United States reporting requirements), these same individuals quickly catch the spirit of tax “avoidance” found in parts of Europe. To some degree the failure to report worldwide income is rationalized by these executives on grounds that they are reporting the income to the American tax authorities anyway: that is, they are not reducing their taxes but are merely paying them to a different jurisdiction. In addition, the American executive, as part of a multifarious international corporation, is in a good position to receive his salary through various subsidiaries in different countries, thus effectively hiding his true income. Most multinational corporations avoid this practice at all costs, but certain of them are not so scrupulous, sometimes even going so far as to advise employees not to declare all income to the local government.

The problem presented here is troublesome, but it will not be aggravated to any extent by a system under which the American citizen resident overseas pays no taxes to the United States. To the contrary, removal of the psychological justification mentioned above should ease the problem somewhat. Also, because most European countries

ing an earlier period when they had no contacts with the United States. The United States would then be taxing only those capital gains accumulated during a period in which the individual was subject to the taxing jurisdiction of the United States. Canada has enacted a parallel provision. See id. § 48(a).

117. See text accompanying notes 22 & 68 supra.

118. In fairness, it must be remarked that the attitude of some local taxing authorities probably encourages this practice somewhat.

119. This is because under most tax equalization programs (see text accompanying note 69 supra) the employer must pay any foreign income taxes attributable to the employee's company income. For companies with local profit centers, this additional tax will reduce the local company's profit and thus detract from the apparent performance of the manager responsible for the profit center.
derive much of their revenue from nonavoidable taxes on consumption, the seriousness of this problem is probably overestimated to some degree.

*Effect on United States Tax Revenues.* There may be those who believe that this proposed solution may cause the United States government to receive less tax revenue from American citizens resident overseas than currently is the case, and that it is therefore unacceptable. The author does not have access to the information necessary to determine whether or not that might be true. However, inasmuch as certain Americans would still remain subject to United States taxing jurisdiction under the more acceptable (from an equitable viewpoint) territorial basis of taxation, not all Americans would be paying less taxes to the United States government. As pointed out above,\(^\text{120}\) it is entirely possible that some taxpayers will be incurring a higher tax obligation to the United States government under this proposed basis of taxation. Others will be paying more or less the same amount, as in the case of a businessman who has a trip to the United States during which either he is in the country more than ninety days, or he earns more than $3,000 in the country.\(^\text{121}\) Thus, it is not evident that the United States government will be receiving less revenue from United States citizens resident overseas. What is clear is that the burden of these revenues will be more equitably distributed than is currently the case.

What is more important, the author believes, is that it is inappropriate to consider the effect on tax revenues when weighing the equitability of establishing (or continuing) taxing jurisdiction over a class of citizens. The determining question is, rather, whether these tax revenues are being equitably borne by all persons subject to the taxing jurisdiction of the country imposing the tax. The author believes that the equitability consideration would outweigh any considerations of reduced tax revenues even if it were certain the United States tax revenues would be lessened by this proposed solution.

*Other Problems.* There may be other practical problems such as the effect on the collection of, or the rendering of benefits attributable to, taxes other than income taxes, such as social security taxes and medicare benefits. These considerations are not lightly dismissed, but are nevertheless considered to be extraneous to this discussion.

\(^{120}\) See note 113 *supra*.

\(^{121}\) See note 112 *supra* and accompanying text.
C. Conclusion

For nearly half a century, American citizens resident overseas have been the passive victims of a policy that could at best have been characterized as benign neglect and at times as outright confusion. Very possibly, a requirement that a nonresident citizen report his income to the United States was not overly burdensome in earlier years. It is apparent that this is not the case today.

It should be clear that the United States system of requiring all citizens wherever resident to report worldwide income to this country is inequitable: the United States system with its heavy reliance on income taxation is at great odds with the "value-added" taxing systems to which most American citizens resident overseas find themselves subject, and it fails to compensate adequately for high foreign income tax rates. The United States system of simply providing credit for foreign income taxes (regardless of the formula for determining the amount of that credit) is now an anachronism in a world that has moved on to more balanced taxing systems.

It appears that criticism of section 911 may be justified and that Congress should consider its outright repeal as an indispensable step in the complete restructuring of United States individual income tax policy as it applies to American citizens resident overseas.

Perhaps the price we are charging for American citizenship is too high.
## Appendix 1—Comparison of Revenue Statistics of 15 Selected Member Countries of the O.E.C.D.*

<table>
<thead>
<tr>
<th>DESCRIPTION</th>
<th>United States</th>
<th>Australia</th>
<th>Belgium</th>
<th>Canada</th>
<th>France</th>
<th>Germany</th>
<th>Greece</th>
<th>Italy</th>
<th>Japan</th>
<th>Netherlands</th>
<th>Norway</th>
<th>Spain</th>
<th>Sweden</th>
<th>Switzerland</th>
<th>United Kingdom</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>National product per person**</td>
<td>$4,291</td>
<td>$2,304</td>
<td>$2,287</td>
<td>$3,330</td>
<td>$2,545</td>
<td>$2,509</td>
<td>$931</td>
<td>$1,471</td>
<td>$1,465</td>
<td>$2,054</td>
<td>$2,456</td>
<td>$839</td>
<td>$3,519</td>
<td>$2,926</td>
<td>$2,048</td>
</tr>
<tr>
<td>Revenue as percentage of gross national product</td>
<td>27.43%</td>
<td>25.43%</td>
<td>33.32%</td>
<td>30.06%</td>
<td>35.79%</td>
<td>33.72%</td>
<td>23.19%</td>
<td>19.38%</td>
<td>38.70%</td>
<td>37.74%</td>
<td>18.59%</td>
<td>39.61%</td>
<td>23.00%</td>
<td>34.57%</td>
<td></td>
</tr>
<tr>
<td>Revenue in dollars per person</td>
<td>$1,177</td>
<td>$586</td>
<td>$762</td>
<td>$1,001</td>
<td>$911</td>
<td>$846</td>
<td>$216</td>
<td>$442</td>
<td>$234</td>
<td>$792</td>
<td>$927</td>
<td>$1,156</td>
<td>$1,394</td>
<td>$673</td>
<td>$708</td>
</tr>
</tbody>
</table>

### INDIVIDUALS: Tax revenues as a percentage of gross national product:

- Consumption: 4.76% (Australia), 7.22% (United States), 11.76% (Belgium), 7.25% (Canada), 12.73% (France), 9.72% (Germany), 9.02% (Greece), 11.03% (Italy), 4.44% (Japan), 8.83% (Netherlands), 14.61% (Norway), 6.74% (Spain), 11.64% (Sweden), 5.97% (Switzerland), 9.52% (United Kingdom).

- Income, profits, and capital gains paid by households: 9.00% (Australia), 8.97% (United States), 7.79% (Belgium), 8.39% (Canada), 3.70% (France), 8.66% (Germany), 1.93% (Greece), 3.40% (Italy), 4.24% (Japan), 10.57% (Netherlands), 11.19% (Norway), 2.21% (Spain), 17.24% (Sweden), 7.47% (Switzerland), 10.79% (United Kingdom).

- Social security contributions paid by employees: 2.23% (Australia), 0.00% (United States), 5.14% (Belgium), 0.00% (Canada), 3.24% (France), 4.15% (Germany), 0.00% (Greece), 0.00% (Italy), 1.81% (Japan), 7.00% (Netherlands), 4.29% (Norway), 1.33% (Spain), 2.38% (Sweden), 3.38% (Switzerland), 2.41% (United Kingdom).

- Income, profits, and capital gains plus social security contributions: 11.23% (Australia), 8.97% (United States), 10.95% (Belgium), 8.39% (Canada), 6.94% (France), 12.81% (Germany), 1.93% (Greece), 3.40% (Italy), 6.05% (Japan), 17.57% (Netherlands), 15.48% (Norway), 3.54% (Spain), 19.82% (Sweden), 10.86% (Switzerland), 13.20% (United Kingdom).

<table>
<thead>
<tr>
<th>REVENUE: Taxes borne by individuals expressed as a percentage of total tax revenues:</th>
<th>United States</th>
<th>Australia</th>
<th>Belgium</th>
<th>Canada</th>
<th>France</th>
<th>Germany</th>
<th>Greece</th>
<th>Italy</th>
<th>Japan</th>
<th>Netherlands</th>
<th>Norway</th>
<th>Spain</th>
<th>Sweden</th>
<th>Switzerland</th>
<th>United Kingdom</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consumption, income, profits, and capital gains plus social security contributions</td>
<td>17.35%</td>
<td>28.51%</td>
<td>35.29%</td>
<td>30.87%</td>
<td>35.57%</td>
<td>29.03%</td>
<td>39.20%</td>
<td>36.71%</td>
<td>23.43%</td>
<td>25.40%</td>
<td>38.71%</td>
<td>36.26%</td>
<td>29.39%</td>
<td>25.96%</td>
<td>27.54%</td>
</tr>
<tr>
<td>Directly borne by individuals</td>
<td>58.30%</td>
<td>65.83%</td>
<td>68.10%</td>
<td>58.74%</td>
<td>54.99%</td>
<td>66.97%</td>
<td>47.53%</td>
<td>46.02%</td>
<td>54.76%</td>
<td>70.81%</td>
<td>79.70%</td>
<td>55.49%</td>
<td>79.39%</td>
<td>73.21%</td>
<td>65.68%</td>
</tr>
</tbody>
</table>

### DUTIES PAID BY INDIVIDUALS:

- Consumption, income, profits, and capital gains plus social security contributions: $204 (Australia), $167 (United States), $269 (Belgium), $309 (Canada), $324 (France), $246 (Germany), $85 (Greece), $162 (Italy), $67 (Japan), $202 (Netherlands), $57 (Norway), $410 (Spain), $175 (Sweden), $195 (Switzerland).

- Directly borne by individuals: $666 (Australia), $374 (United States), $519 (Belgium), $588 (Canada), $501 (France), $567 (Germany), $103 (Greece), $212 (Italy), $156 (Japan), $563 (Netherlands), $739 (Norway), $87 (Spain), $1107 (Sweden), $492 (Switzerland), $465 (United Kingdom).

### OF COMPOSITION OF TAXES PAID BY INDIVIDUALS:

- Consumption: 29.74% (Australia), 44.70% (United States), 51.83% (Belgium), 52.53% (Canada), 64.68% (France), 43.35% (Germany), 82.49% (Greece), 76.04% (Italy), 42.79% (Japan), 35.87% (Netherlands), 48.57% (Norway), 65.35% (Spain), 37.00% (Sweden), 35.47% (Switzerland), 41.90% (United Kingdom).

- Income, profits, and capital gains: 70.26% (Australia), 55.30% (United States), 48.17% (Belgium), 47.45% (Canada), 35.32% (France), 56.65% (Germany), 17.51% (Greece), 23.56% (Italy), 57.21% (Japan), 64.13% (Netherlands), 51.43% (Norway), 34.65% (Spain), 63.00% (Sweden), 64.53% (Switzerland), 38.10% (United Kingdom).

- Social security contributions: 100% (Australia), 100% (United States), 100% (Belgium), 100% (Canada), 100% (France), 100% (Germany), 100% (Greece), 100% (Italy), 100% (Japan), 100% (Netherlands), 100% (Norway), 100% (Spain), 100% (Sweden), 100% (Switzerland), 100% (United Kingdom).
### Appendix 2—Comparison of the Direct Tax Burden of Hypothetical United States Citizens Resident Overseas with Compaqtot Resident in United States

**Description**

<table>
<thead>
<tr>
<th>Description:</th>
<th>United States</th>
<th>Australia</th>
<th>Belgium</th>
<th>Canada</th>
<th>France</th>
<th>Germany</th>
<th>Greece</th>
<th>Italy</th>
<th>Japan</th>
<th>Netherlands</th>
<th>Norway</th>
<th>Spain</th>
<th>Sweden</th>
<th>Switzerland</th>
<th>United Kingdom</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross National Product</td>
<td>4.76 %</td>
<td>7.25 %</td>
<td>11.76 %</td>
<td>9.29 %</td>
<td>12.73 %</td>
<td>9.79 %</td>
<td>9.09 %</td>
<td>11.03 %</td>
<td>4.54 %</td>
<td>9.83 %</td>
<td>14.61 %</td>
<td>6.74 %</td>
<td>11.64 %</td>
<td>5.97 %</td>
<td>9.52 %</td>
</tr>
<tr>
<td>Individual's Share of Gross National Product</td>
<td>$34,500</td>
<td>$34,500</td>
<td>$34,500</td>
<td>$34,500</td>
<td>$34,500</td>
<td>$34,500</td>
<td>$34,500</td>
<td>$34,500</td>
<td>$34,500</td>
<td>$34,500</td>
<td>$34,500</td>
<td>$34,500</td>
<td>$34,500</td>
<td>$34,500</td>
<td>$34,500</td>
</tr>
<tr>
<td>Consumption Paid</td>
<td>1,642</td>
<td>2,501</td>
<td>4,057</td>
<td>3,205</td>
<td>4,392</td>
<td>3,378</td>
<td>3,136</td>
<td>3,805</td>
<td>1,566</td>
<td>3,391</td>
<td>2,040</td>
<td>2,325</td>
<td>4,016</td>
<td>2,060</td>
<td>3,284</td>
</tr>
<tr>
<td>Pay Taxes Paid</td>
<td>632</td>
<td>625</td>
<td>815</td>
<td>173</td>
<td>1,152</td>
<td>1,022</td>
<td>584 *</td>
<td>2,010</td>
<td>391</td>
<td>1,603</td>
<td>1,055</td>
<td>239</td>
<td>335</td>
<td>1,350</td>
<td>101</td>
</tr>
<tr>
<td>Total Paid</td>
<td>8,294</td>
<td>14,221</td>
<td>10,605</td>
<td>13,011</td>
<td>10,316</td>
<td>12,965</td>
<td>10,776</td>
<td>16,115</td>
<td>8,287</td>
<td>10,794</td>
<td>20,317</td>
<td>8,318</td>
<td>21,626</td>
<td>10,408</td>
<td>15,405</td>
</tr>
</tbody>
</table>

**Presentation of Above Information**

<table>
<thead>
<tr>
<th>Amount in U.S. Dollars</th>
<th>16,588</th>
<th>12,441</th>
<th>8,294</th>
<th>6,020</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of U.S. Tax Burden</td>
<td>200</td>
<td>150</td>
<td>100</td>
<td>50</td>
</tr>
</tbody>
</table>

10% Stamp Tax.
Assuming Special 30% Deduction for Temporary Residents.
Assuming Special 35% Deduction for Foreign Nationals Assigned to the Netherlands.
Explanation of Appendix 2

The purpose of Appendix 2 is to present, in an understandable manner, a comparison of (1) the tax burden of a hypothetical American citizen resident overseas with (2) the tax burden of the same hypothetical American citizen resident in the United States. The basic assumptions necessary to effect the calculations in Appendix 2 have been detailed in the text accompanying notes 72-73.

In order to derive maximum understanding from the chart in Appendix 2, the reader should note that:

1. In countries where the creditable income taxes are less than the United States income tax burden (i.e., Belgium, France, the Netherlands, and Spain), an amount has been added which represents the amount of additional income taxes an American would be required to pay in to the United States under the present foreign tax credit rules, assuming that:
   
   (a) all of his income were from foreign sources,

   (b) the United States taxes worldwide income of nonresident citizens, and

   (c) the hypothetical American citizen resident overseas obtains no relief under section 911.

   This additional amount has been added to the top of the column for each of the four countries in question.

2. All percentage figures are based upon the total United States tax burden of $8,294, which equals 100 percent. For example, in Germany the individual's income tax burden of $8,565 equals 103.27 percent of the individual's total United States tax burden.

3. The dotted line traversing the graph is a reference point representing the United States income tax burden of $6,020 or 72.58 percent of the total United States tax burden.

4. For purposes of easily identifying the components of each column, the amount of each type of tax has been indicated as follows:

   Income taxes [plain]

   Social security taxes [diagonal lines]

   Consumption taxes [dots]

   Additional U.S. income taxes [vertical lines]
### Appendix 3

**United States Department of State**

**Indexes of Living Costs Abroad and Living Quarters Allowances**

**October 1973**

<table>
<thead>
<tr>
<th>Country and City</th>
<th>Local Index*</th>
<th>Living quarters allowances**</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia, Canberra</td>
<td>124%†</td>
<td>$5,100‡</td>
</tr>
<tr>
<td>Belgium, Brussels</td>
<td>141%</td>
<td>6,200</td>
</tr>
<tr>
<td>Canada, Montreal</td>
<td>101%</td>
<td>3,800</td>
</tr>
<tr>
<td>France, Paris</td>
<td>154%</td>
<td>7,500</td>
</tr>
<tr>
<td>Germany, Frankfurt</td>
<td>155%</td>
<td>3,900</td>
</tr>
<tr>
<td>Greece, Athens</td>
<td>105%</td>
<td>3,600</td>
</tr>
<tr>
<td>Italy, Rome</td>
<td>129%</td>
<td>4,900</td>
</tr>
<tr>
<td>Japan, Tokyo</td>
<td>162%</td>
<td>2,900</td>
</tr>
<tr>
<td>Netherlands, The Hague</td>
<td>133%</td>
<td>5,200</td>
</tr>
<tr>
<td>Norway, Oslo</td>
<td>139%</td>
<td>4,700</td>
</tr>
<tr>
<td>Spain, Barcelona</td>
<td>105%</td>
<td>4,500</td>
</tr>
<tr>
<td>Sweden, Stockholm</td>
<td>169%</td>
<td>6,100</td>
</tr>
<tr>
<td>Switzerland, Geneva</td>
<td>146%</td>
<td>6,600</td>
</tr>
<tr>
<td>United Kingdom, London</td>
<td>109%</td>
<td>4,600</td>
</tr>
</tbody>
</table>

* The local index is "a comparison of the prices of goods and services at local retail sources in the foreign city with the prices of corresponding items in Washington, D.C., weighted by the expenditure pattern of an American government employee living in Washington D.C. . . . adjusted to reflect modifications in consumption that are necessary to transplant, to the extent permitted by local conditions, an American pattern of living to the foreign city." U.S. Dept. of Labor, Bureau of Labor Statistics, U.S. Dept. of State, "Indexes of Living Costs Abroad and Quarters Allowances, October 1973" at 2.

** The living quarters allowance "reimburses the employee for the [total] cost of rent, electricity, gas, fuel, and water and any taxes required by local law or custom to be paid by the tenant." *Id.* at 7. This cost may be compared to the average cost of housing in the United States.

† The value of 100 percent is assigned to Washington, D.C.

‡ Amount allowed for a family of two with a U.S. government salary range of $13,000 to $23,000.
### Appendix 4

**American Residents in 14 Selected Countries—1973**

<table>
<thead>
<tr>
<th>Country</th>
<th>Number of American residents</th>
<th>Percentage of all Americans overseas</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>36,766</td>
<td>3.08%†</td>
</tr>
<tr>
<td>Belgium</td>
<td>21,850</td>
<td>1.83%</td>
</tr>
<tr>
<td>Canada</td>
<td>277,615</td>
<td>23.27%</td>
</tr>
<tr>
<td>France</td>
<td>25,120</td>
<td>2.11%</td>
</tr>
<tr>
<td>Germany</td>
<td>63,565</td>
<td>5.33%</td>
</tr>
<tr>
<td>Greece</td>
<td>34,900</td>
<td>2.93%</td>
</tr>
<tr>
<td>Italy</td>
<td>67,468</td>
<td>5.66%</td>
</tr>
<tr>
<td>Japan</td>
<td>20,881</td>
<td>1.75%</td>
</tr>
<tr>
<td>Netherlands</td>
<td>9,390</td>
<td>.79%</td>
</tr>
<tr>
<td>Norway</td>
<td>10,100</td>
<td>.85%</td>
</tr>
<tr>
<td>Spain</td>
<td>35,850</td>
<td>3.01%</td>
</tr>
<tr>
<td>Sweden</td>
<td>3,030</td>
<td>.25%</td>
</tr>
<tr>
<td>Switzerland</td>
<td>22,400</td>
<td>1.88%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>72,114</td>
<td>6.05%</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>701,049</strong></td>
<td><strong>58.79%</strong></td>
</tr>
</tbody>
</table>

* All figures on this appendix were derived or computed from U.S. Dept. of State, Deputy Director—Personnel & Management, Analysis & Requirements Div., "U.S. Citizens Residing in Foreign Countries—FY 1973."

† Percentages are computed on total Americans residing abroad in FY 1973 of 1,192,799.