

Taxes on Foreign Earned Income

By Eric Toder

While taxation of overseas profits of U.S. multinational corporations has made the headlines lately, U.S. citizens who work overseas also face special rules. Unlike most countries, the United States requires that its citizens pay tax on their worldwide income (with a credit for foreign taxes paid), even when they are residing elsewhere. But the United States also allows its citizens who reside abroad exclusion for the first \$97,600 of their foreign earned income¹ and a special housing allowance.

In 2006, 334,851 individual taxpayers claimed the foreign earned income exclusion (then equal to \$82,400), about 0.2 percent of all returns.² These

taxpayers had a much higher average income (\$170,292) than all individual taxpayers (\$58,092). About the same share of taxpayers with foreign earnings had adjusted gross income (AGI) less than \$50,000 as all taxpayers, reflecting the fact that the exclusion exempts most of their earnings from AGI. At the top end, 10 percent of taxpayers with foreign earnings had AGIs between \$200,000 and \$1 million, compared with 2.7 percent of all taxpayers, and 0.8 percent had AGIs more than \$1 million, compared with 0.3 percent of all taxpayers.

Within each income group, taxpayers with foreign earned income paid a lower average U.S. tax rate as percentage of income (AGI plus the exclusion and housing allowance) than all taxpayers. But adding back the foreign tax credit, their average tax rate is higher except among taxpayers with AGI less than \$50,000.

¹This is the foreign earned income exclusion for 2013; the amount is indexed annually for inflation.

²The IRS Statistics of Income Division publishes data on taxpayers who claim the foreign earned income exclusion once every five years. The latest published figures are for tax year 2006.

Income and Taxes Paid by U.S. Citizens Claiming Foreign Earned Income Exclusion (FEIE) in 2006^a
(Comparison Figures for All Individual Taxpayers in Parenthesis)

Adjusted Gross Income	Percent of Returns (percentage)		Income* Per Return (dollars)		Average U.S. Tax Rate (percentage)		Average Total Tax Rate (percentage)**	
	With FEIE	All Returns	With FEIE	All Returns	With FEIE	All Returns	With FEIE	All Returns
Less than \$50,000	67.9	66.7	\$59,040	\$19,505	0.9	4.8	1.2	4.8
\$50,000-\$200,000	21.3	30.4	\$172,883	\$88,537	6.4	10.6	10.8	10.6
\$200,000-\$1 million	10.0	2.7	\$539,317	\$348,918	9.3	21.0	22.9	21.1
\$1 million and over	0.8	0.3	\$4,885,540	\$3,420,761	12.7	22.5	26.8	22.7
All returns	100.0	100.0	\$170,292	\$58,092	7.5	12.7	16.1	12.8

^aNote two limitations of these data: (1) individuals with foreign earned income appear in AGI classes lower than their total income class, making their total tax rate appear comparatively high; and (2) foreign taxes paid may exceed the allowed foreign tax credit, making their total tax rate appear too low.

*Calculated by adding back the foreign earned income exclusion and housing allowance to adjusted gross income.

**Computed by adding back foreign tax credit to U.S. income taxes after credits.



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