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AARO 2020 Advocacy Survey Results Article 9: Citizenship-Based Taxation, Part 2

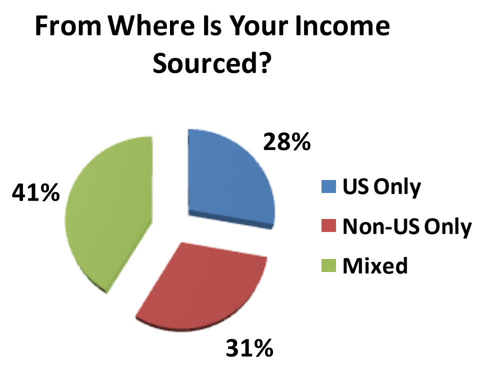
We continue our focus on citizenship-based taxation ("CBT"), i.e., the unique US practice of taxing its citizens and green card holders worldwide, regardless of where they live and regardless of where their income was sourced or earned. In this Part 2 of the CBT topic, we look in detail at your taxation views from the angle of where your income is sourced.

The 3 source-of-income groups

In the chart below we group our respondents based on their source of income: From a non-US country (31%, we call them the "Non-US Source Group"), from the US (28%, "US Source Group") or from both the US and a non-US country (41%, "Mixed Source Group").

You may recall from Article 8 that:

- 99% of the Non-US Source Group want to eliminate CBT
- 71% of the US Source Group want to eliminate CBT
- 92% of the Mixed Source Group want to eliminate CBT



CBT, RBT and source-based taxation

The US imposes tax under 3 predicates: (1) Based on residency in the US ("RBT"), (2) based on income sourced in the US ("source-based taxation," called "territorial taxation" by some) and (3) CBT.

Other countries also impose tax on one's (generally, worldwide) income based on residency in that country (we call this "local RBT").

Our 3 groups suffer due to conflicts created by this overlapping taxation:

- Non-US Source Group: CBT conflicting with local RBT
- US Source Group: CBT and US source-based taxation conflicting with local RBT
- Mixed Source Group: CBT and US source-based taxation (on the US part) conflicting with local RBT and local source-based taxation (in many cases)

In this article we explore how these conflicts drive your taxation views.

By whom does each group want to be taxed?

Our survey methodology

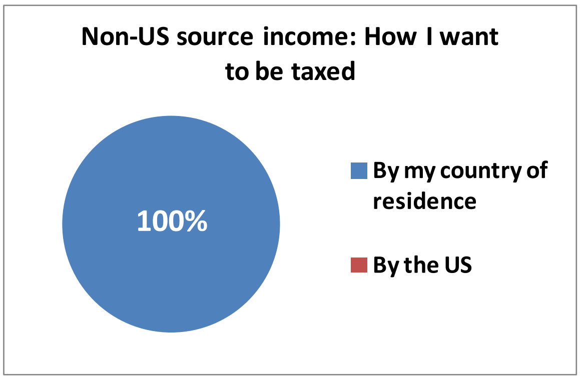
In order to drill deeper into your views on taxation, after the question "*do you want CBT eliminated?*" we posed a hypothetical question. We asked "*How would you prefer that your income be taxed if you had a choice?*"

- We gave 2 choices to the Non-US Source Group: "country of residence" or "US"
- We gave 2 choices to the US Source Group: "country of residence" or "US"
- We gave 3 choices to the Mixed Source Group: "country of residence," "US" or "US income by the US and non-US income by country of residence"

In each case one could also choose "no opinion' or "don't know," which we have excluded from the charts below. We did not use the terms "CBT" or "RBT" in the question as we believed that those terms could be misunderstood; our question related to the application by the country of residence of local RBT, not RBT by the US. We also did not specifically address tax treaties, as the US has 68 tax treaties world-wide, with differing provisions, which would have make any comparison impossible.

Non-US Source Group

The Non-US Source Group (31% of survey respondents) consists typically of a working overseas American who earns income outside the US, as well as "accidental Americans" (described in Article 7). This is the group caught in the crosshairs of CBT. Not surprisingly, 99% of this group said that they wanted to eliminate CBT (See Article No. 8).



Their responses to the hypothetical question were very consistent: 100% prefer to be taxed only by their country of residence and none want the US to tax their non-US income. You say; "*I should not have to report or pay US taxes if I have no income from the US*" and "*People should pay taxes where they live and receive their government services.*"

What do they want?

The Non-US Source Group completely rejects CBT and embraces of local RBT by the country of residence. "*Income should be taxed where it is earned.*"

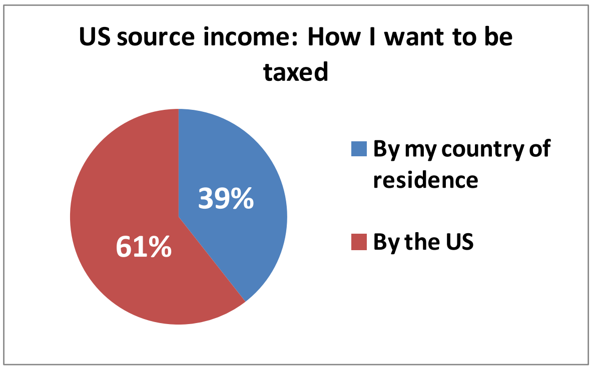
Currently, this group relies on US tax law to minimize the local RBT/CBT taxation conflict, although that is often insufficient to eliminate some double taxation for many of them (see Article 6). If CBT were eliminated, these persons would get their wish for local RBT without the risk of double taxation.

US Source Group

The US Source Group (28% of survey respondents) consists typically of an American who moved overseas in retirement with US social security, US pensions and/or earnings from US investments (88% of group 3 is retired, as we see below). This group suffers from a "local RBT /US source of income" taxation conflict.

A clear majority, 61%, responded that they would prefer that only the US, and not their country of residence, tax the US source income. "*Since it is 100% US based income.*"

A significant minority, 39%, want to be taxed only by their country of residence on this US source income.



What do they want?

This group is split into two completely opposite views:

- The 61% majority wants only US source-based taxation, rejecting local RBT: "*Where income is from the US it should be taxed only by the US.*"
- The 39% minority wants local RBT, rejecting US source-based taxation

The US Source Group differs also in what it thinks of CBT: A little more than half of the 61% don't mind (or prefer) CBT, while the remainder reject CBT. People in the 39% subgroup overwhelmingly (all but one) reject CBT.

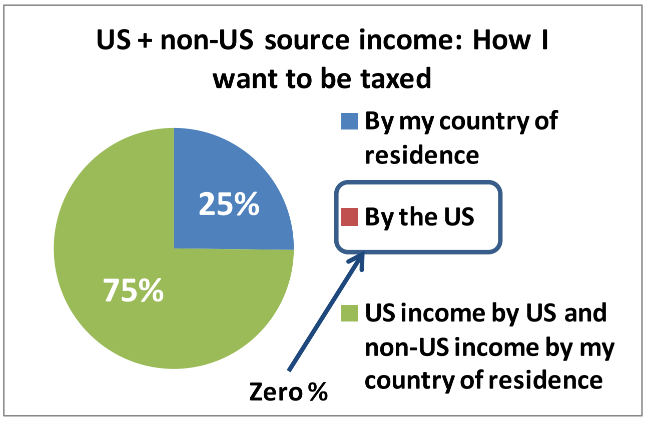
One in the US Source Group expressed solidarity for the Non-US Source Group: "*As a US citizen receiving income only from the US I don't mind paying taxes on it. For people who earn only in a non-US country and live abroad I think that they should not be taxed by the US.*"

This group needs tax treaties and US and local tax law to mitigate potential double taxation of their US source income under local RBT. But tax treaties would not help the 39% who wish to avoid US source-based taxation as the US will likely not concede this tax revenue to another country.

Mixed Source Group

The largest group of survey respondents (41%), with US source income as well as non-US source income, endures the most complexity because it is subject to several overlapping layers of taxation: CBT by the US on worldwide income; local RBT by the country of residence on (generally, worldwide) income; and taxation by each the US and (generally) the resident country on income sourced in that country.

To the question of how they would like to be taxed, 25% want all their income to be taxed only by the country of residence, and 75% chose the residency/source-based option: That non-US income be taxed by country of residence and that US income be taxed by the US. No one chose to be taxed solely by the US.



What do they want?

The Mixed Source Group is most likely to suffer from penalizing taxation (69% of them say that they are double taxed or taxed more). They also have opposing views:

- A quarter (25%) of them reject US source-based taxation, prefering local RBT
- The rest (75%) prefer a combination of local RBT and source-based taxation, provided that each country taxes only "its own income"

The vast majority of the 75% subgroup (94% of them) wants to eliminate CBT. One said: "*It's complicated – I'm unsure what is the best policy but what we have now is probably the worst policy.*" Another said: "*While I continue to benefit from my American citizenship it is normal that I pay taxes on the U.S. part of my income, but not that the US taxes me on what I earn in my country of residence.*"

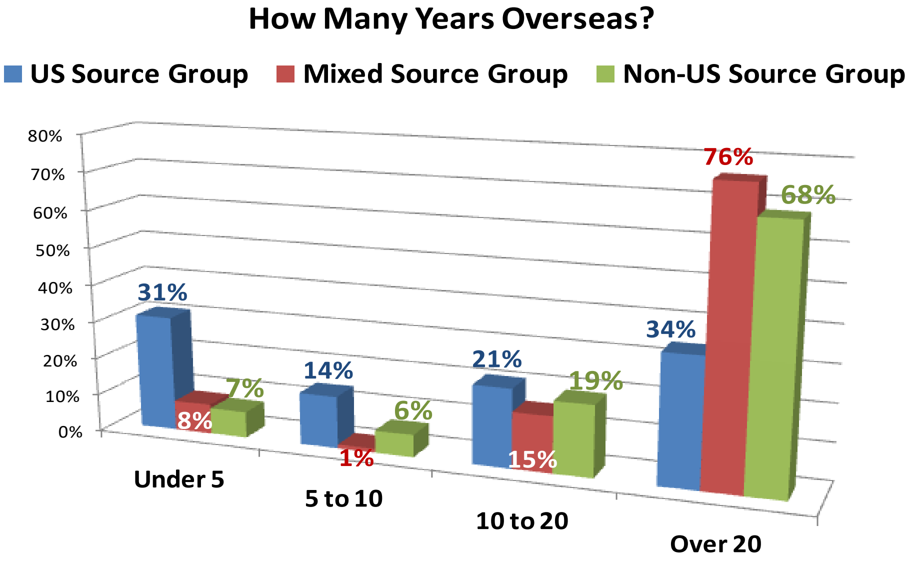
The 25% subgroup also generally wants to eliminate CBT (91% of them), saying "*I think one should pay taxes where they are living and receiving services (roads, medical services, etc.)*" and "*My taxes should go to my country of residence.*"

One person in the Mixed Source Group didn't choose an option, instead stating that "*All income should be taxed in only one country, either country of residence, or country of origin of the income. I could live with either of those.*"

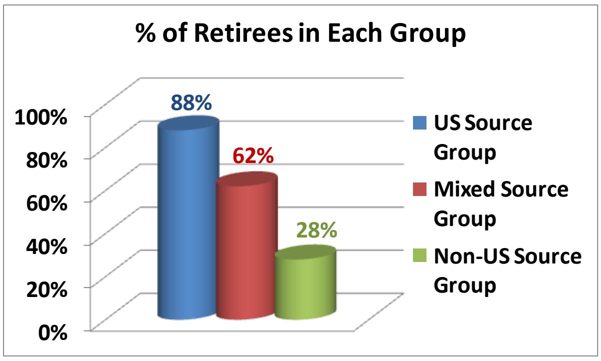
As with the US Source Group, this group needs tax treaties and US and local tax law to allocate their taxation fairly. This works well for one: *"Have to declare in both the US and France, and conform with treaty obligations. No problem."* But another worries about the fairness involved: "*Although I benefit from the fact that I can exempt my US income from French tax, I actually think that it is not fair to France. It seems that American citizens can live in France and pay no tax to the country*."

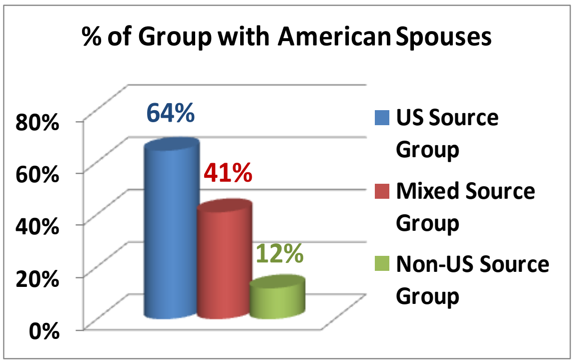
Some demographics

As you can see by the chart below, setting out the length of time each group has been overseas, the US Source Group is dispersed fairly evenly, with the % living overseas over 20 years (34%) similar to the % living overseas under 5 years (31%). This is significantly different from the time overseas of the other two groups, who are long termers: 76% of the Mixed Source Group and 68% of the Non-US Source Group are overseas over 20 years, with very few in the "under 5" or "5 to 10" categories.

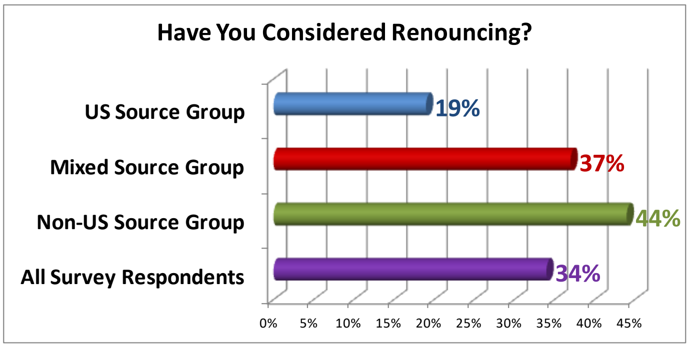


Another difference is that 88% of the US Source Group is retired. Compare this to the other two groups: 62% of the Mixed Source Group and only 28% of the Non-US Source Group is retired. The overall survey retirement rate is 58%. Further, 64% of married US Source Group members are married to Americans, far more than those in the Mixed Source Group (41%) and the Non-US Source Group (only 12%). See the charts below.





So, the US Source Group, although not necessarily overseas for a long time, tends to be retired with an American spouse. The respondents from the Non-US Source Group are more likely to be working (only 28% are retired) and married to non-Americans (only 12% have American spouses). The persons in the Mixed Source Group fall in between.



We see also a big difference in whether they have considered renouncing their American citizenship, with the US Source Group (at 19%) far below the 34% rate of overall survey respondents who have considered renouncing. The other two groups are more in line with the 34% overall rate, although the suffering Non-US Source Group is at 44%. See the chart above right.

We see a great similarity between the US Source Group members and the CBT Keepers from Article 8 (those who do not want to eliminate CBT): similar retirement rates (88% vs. 75%); American spouses (64% vs. 68%); lack of desire to renounce US citizenship (19% vs. 18%). On the contrary, the other two groups resemble more the Article 8 CBT Droppers (those who do want to eliminate CBT).

Putting it all together

The tax situation for overseas Americans is very convoluted, a mosaic involving the application of:

- Three methods of US taxation overlapping with taxation by the resident country;
- Complicated tax laws in two countries (or more); and
- Intricate international tax treaties,

all of which we must navigate to comply with our tax obligations and avoid penalties. The differing views of our 3 groups reflect this complexity. Their (understandable) preference for a manner of taxation which is the most advantageous for them can generally be traced to their source of income.

CBT

The analysis in this article is consistent with that of Article 8: 90% of survey respondents want to eliminate CBT. All of the Non-US Source Group (100%) reject CBT, while only some in the US Source Group and a few in the Mixed Source Group prefer to keep it (for a combined 10% of respondents).

Local RBT

Everyone in the Non-US Source and Mixed Source Groups, as well as a 39% minority of the US Source Group, favor or are not opposed to local RBT (for a combined 86% of respondents), with the rest of the US Source Group (14% of respondents) rejecting local RBT.

How to help the 86% of respondents who prefer that their country of residence tax them? Elimination of CBT would fully grant this wish of the Non-US Source Group, and, to a certain extent, the Mixed Source Group; tax treaties and US and local tax law would be necessary to address the balance. For the remaining 14% (all of whom have only US source income) who reject local RBT and prefer the US to tax their US source income, keeping CBT will not accomplish their objective; they already have US sourced-based taxation for that, and tax treaties to manage the local RBT.

Source-based

Large minorities in the US and Mixed Source Groups, representing a total of 19% of respondents (who are also in the "pro-local RBT" group above), do not want the US to tax their US source-based income. Eliminating CBT will not help them because it is inconceivable that the US would give up its taxation of income sourced in the US.

A 75% majority of the Mixed Source Group unsurprisingly wants a source-based approach: The US to tax US source income and the residence country to tax non-US source income. Elimination of CBT would simplify their taxing lives, although tax treaties and US and local tax law would still be necessary to mitigate double taxation.

Your summation

We close with a few quotes from respondents who support ending CBT:

- From the Non-US Source Group: "*It's unethical for US governments to take from and impoverish citizens/residents who live abroad particularly since they have no representation in Congress. It's extremely unfair and fairness is a core American value.*" The same person said "*I love the US but this law impacts citizens overseas and the government can ill afford to antagonize or let this important constituency slip away since they function as unpaid ambassadors.*"
- From the US Source Group: "*Non-US source income should not be taxed by the US in the case of someone truly resident outside the US. It's the general rule everywhere else.*"

AARO’s advocacy

AARO believes that American citizens abroad are unfairly burdened by CBT. Our survey bears this out.

AARO advocates ending CBT and aligning the US with the universal practice of residency-based taxation, i.e., that there be changes to US law so that that the US no longer taxes persons based solely on citizenship or green cards. Although there would still remain other taxation issues which would require tax treaties, elimination of CBT would go a long way to mitigate the significant costs of tax preparation and reporting, double taxation, employment discrimination and competitive business disadvantages suffered by the vast majority of Americans overseas.

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The Association of Americans Resident Overseas (AARO) researches issues that significantly affect the lives of overseas Americans and keeps its members informed on these issues. Founded in 1973 and headquartered in Paris, AARO is an international, non-partisan association with members in 46 countries. For more information please email us at **contact@aaro.org**.