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# AARO 2020 Advocacy Survey Results

## Article 8: Citizenship-Based Taxation

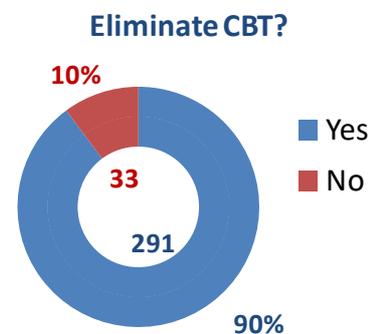
By Doris L. Speer

May 25, 2021

Taxation is a significant issue for overseas Americans. In this article, a follow-up to Article No. 6 (“Taxation and Banking: We are caught between 2 systems”), we focus on citizenship-based taxation (“CBT”), i.e., the US practice of taxing its citizens worldwide, regardless of where they live and regardless of where their income was sourced or earned. This is Part 1 of a two-part article on CBT.

### 90% of survey respondents want to eliminate CBT

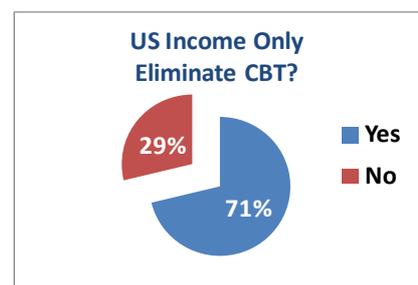
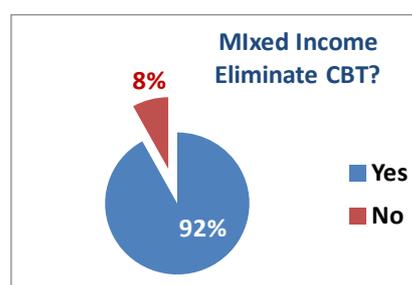
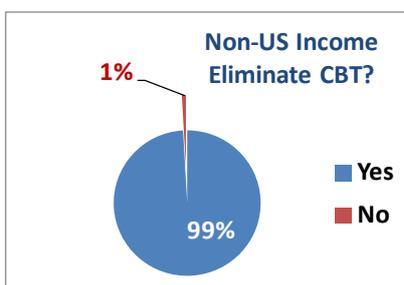
As you can see by this chart, 90% of our respondents believe that CBT should be eliminated (we call them the “Droppers”). *“I believe that the current system is immoral and unjustifiable based on the facts.” “Living with two tax codes is extremely difficult for a normal person.”* Yet, 10% do not want to eliminate CBT (who we call the “Keepers”). The charts in this article do not include “no opinion” responses.



In this article we will examine the views of the 90% Droppers and the 10% Keepers.

### But, difference of opinion based on source of income

Our respondents told us from where their income was sourced: From a non-US country (114 persons), from both the US and a non-US country (mixed income) (153) or from the US (103). Below you see how each group answered the CBT question.



Almost all (99%) of those whose income is sourced outside the US, and 92% of those whose income is mixed, reject CBT. Compare to those whose income is sourced from the US, 71% of whom want to eliminate CBT.

One of the CBT Droppers said “*Absolutely eliminate it – immoral non[e] of my income is from the USA.*” Conversely, one CBT Keeper said: “*I have no income in my country of residence and US taxes are cheaper.*” Source of income is only one of the many differences between the two groups, as we see below.

## Some background on CBT

As one of you has rightly said, “*Citizenship-based taxation dates from the Civil War.*”

Most countries impose tax based on 2 methods: residency and source (also called “territorial”). The US also imposes tax on persons living in the US (residency-based taxation) and on income sourced in the US (source-based, or territorial, taxation) but, unlike any other country in the world, it also taxes its citizens and green card holders extraterritorially (CBT).

Under CBT, the US taxes non-US-source income of overseas Americans. Therefore, the entire income of an overseas American citizen and green card holder, including income with zero economic connection to the US, is subject to taxation by the US as well as (in most cases) by one’s country of residence.

The original rationale of CBT was that overseas Americans had to pay taxes to show their civic duty during a time of war (the Civil War!). In 1924, the US Supreme Court upheld the constitutionality of the principle that the US may tax people and property located outside the US (Cook v. Tait) on the basis that the US “*government, by its very nature, benefits the citizen and his property wherever found.*” Most of our survey respondents fail to see what these benefits are. But there has been little appetite by Congress to eliminate CBT; it affects a minority of people without a strong political voice and who vote in low numbers (see Article No. 4) and green card holders who cannot vote.

One of the CBT Droppers asks “*Is the rest of the world wrong?*” Another says “*Almost no other countries in the world do this, it is a ridiculous anomaly.*” In fact, several other countries have in the past tried CBT, but abandoned it, and Eritrea’s “diaspora tax” was condemned by UN Security Council.

A prevalent theme among CBT Droppers is unfairness: “*USA is the most democratic country in the world but the US taxation system is the most unfair system in the world,*” “*It is unfair to have to file two tax returns every year,*” “*Burdensome and unfair,*” “*it is unfair, difficult to comply and creates other problems ...*” and “*It’s completely unfair!*”

Conversely, one of the CBT Keepers said: “*I still vote; paying tax on my small US income is fair.*”

## The consequences of CBT

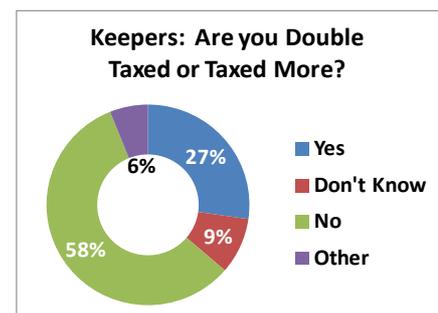
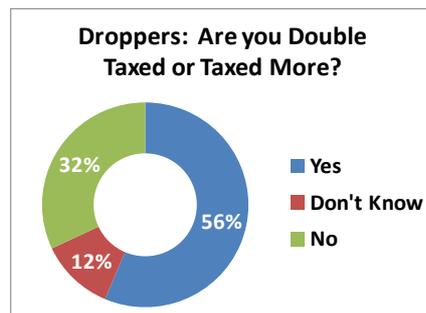
How has CBT has affected (or not) the lives of our survey respondents? Several themes arose from your comments: Double/punitive taxation, FATCA reporting complications, investment and retirement account issues, and taxation without representation or benefit (“*No benefits! Heavy compliance burden. Some double taxation...*” and “*It adds enormous complexity to my life. It severely reduces my investment options in my country, etc, etc, etc.*”

One of you summed it up nicely: “*Invasion of privacy, financial and emotional hardship reporting on what, for me, is my local life ... in my country of residence.*” We address these issues below.

### Double/punitive taxation

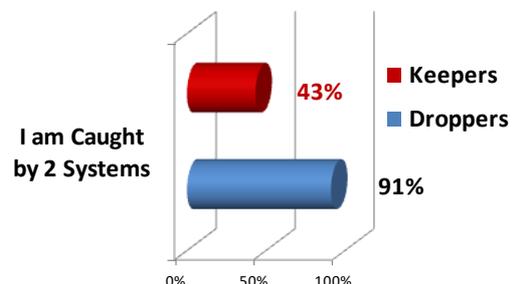
We discussed in Article 6 how overseas Americans are hopelessly caught between two incompatible systems, one aspect of which is punitive taxation. This is because of CBT. Several of the CBT Droppers specifically highlighted this: CBT causes “*Double taxation, cost of two returns, difficulty in tax planning.*”

These charts highlight an important reason why Droppers and Keepers believe as they do. A significant 56% of the CBT Droppers



believe that they are double taxed or taxed more, while only 27% of the CBT Keepers believe so. For the Droppers, CBT “*amounts to double taxation.*” Although US taxation treaties are intended to eliminate double taxation, one Dropper says “*Treaties systematically fail to resolve mismatches between fiscal concepts and systems in different countries.*”

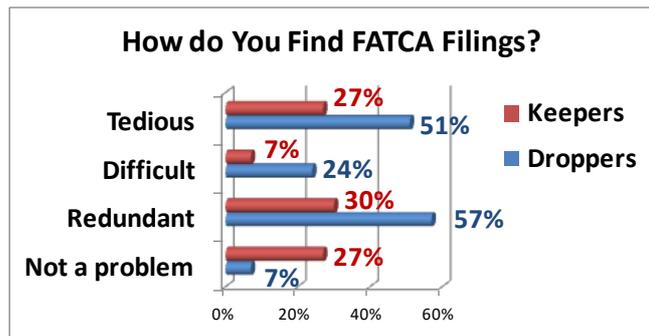
There is also a huge difference in opinion as to whether they are caught between 2 systems. A whopping 91% of Droppers believe so, as compared to only 43% of the CBT Keepers.



### FATCA reporting complications

If there were no CBT, the US would not need FATCA (the Foreign Account Tax Compliance Act, discussed at length in Articles 2 and 7). The US uses FATCA to detect non-US financial accounts, and then uses CBT as the basis for requiring overseas Americans to file tax returns, thus bringing them into the US system and

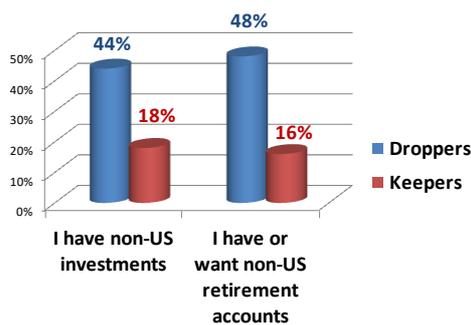
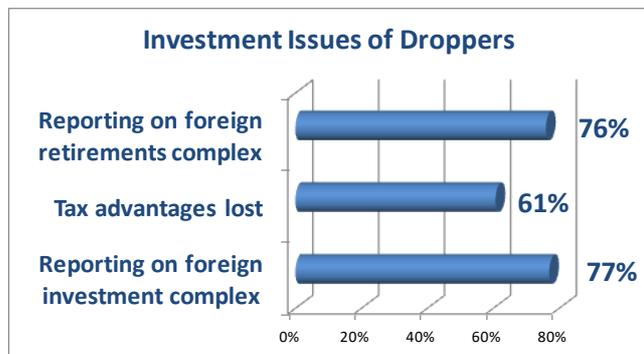
imposing tax on their worldwide income, including from these accounts. The Droppers find FATCA compliance much more of a burden than the CBT Keepers, generally by a margin of around 25%. *“Reporting obligations to the US are unfair and extremely tedious.”* See the chart at right.



In addition, 20% of the CBT Droppers told us that they or someone they know have been subject to penalties or fines for errors, oversights or mistakes with respect to FATCA reporting, compared to 0% of the CBT Keepers.

## Investment and retirement account issues

Droppers tell us that CBT has severely limited their investment and retirement opportunities. *“Also, my investment options are limited because of CBT.”* CBT *“creates other problems like limiting available banking and investment opportunities.”* See the chart at right, where 61% of Droppers say they have lost tax advantages and 76-77% find reporting on foreign accounts to be complex. *“Difficulty of cross-border estate planning and retirement investment and use.”*



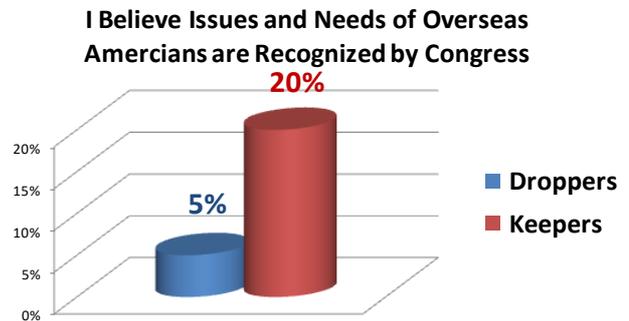
Very few Keepers have any of these problems. But that is because Keepers are far less likely (16-18%) to even have such accounts than Droppers (44%-48%), as you can see by the chart at left. In fact, overseas Americans generally cannot open investment or retirement accounts in their country of residence due to CBT complications (see Article 7).

## Taxation without representation or benefit

*“The US has provided no representation for my taxation.”* Not surprisingly, few Droppers believe that their needs and issues are recognized by Congress (5%, which is in line with our survey respondents overall at 7%). *“At the very least, I believe that taxation without representation is unfair.”*

*“Also receive nothing in return nor am I represented politically.”* Many find limited services despite their tax payments. *“I don’t receive the same services the citizens residing in the US do, nor do I have government representation”* and *“Minimal services for US citizens abroad.”* This flies in the face of the Supreme Court’s rationale in 1924.

The Keepers are more satisfied (20%) with their Congressional representation, far more than survey respondents overall (7%).



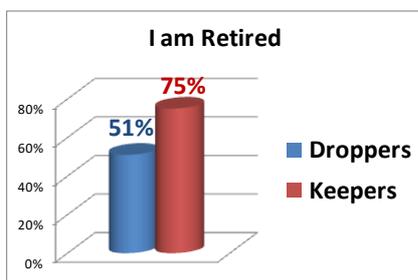
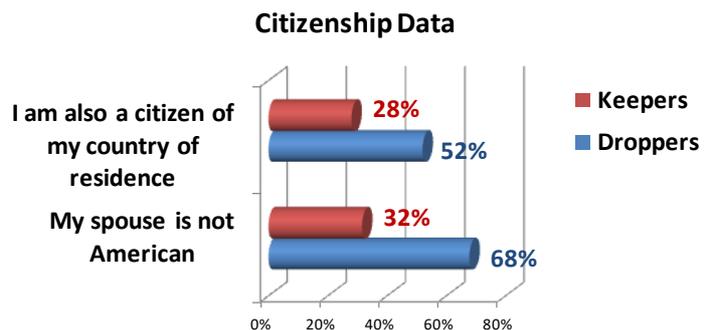
## More about the Keepers and the Droppers

### Some demographics

Interestingly, there is a significant difference in the local citizenship status of these two groups. About a fourth of Keepers (28%) are dual citizens as opposed to half of CBT Droppers (52%). In the same vein, only 32% of Keepers are married to non-Americans, while 68% of the married Droppers have foreign spouses.

One could say that the CBT Droppers have more of an “anchor” overseas. This may also explain why so many more

Droppers (40%) have considered renouncing US citizenship, as opposed to the only 18% of CBT Keepers who have considered renouncing. For comparison, the overall rate of survey respondents who have considered renouncing is 34% (see Article 3).



Another interesting demographic is that 75% of Keepers are retired, as opposed to half of the Droppers (51%), as noted by the chart at left. Taxation of retiree income could be a reason why a few of the Keepers prefer to maintain CBT, as discussed below.

### Why do some Keepers not mind CBT?

Keepers prefer to keep the status quo for various reasons. Some believe CBT does not affect them negatively, and a couple of them even believe CBT is beneficial to them, each of which is possible as individual tax situations can vary.

But, one conflicted keeper prefers CBT *“Because the situation is currently favorable to me; otherwise I believe it should be eliminated from a logical perspective.”*

## **A specific Keeper concern**

Some Keepers are concerned that the elimination of CBT would result in their being taxed more by their resident country, with France, a higher tax jurisdiction, being often cited (a vast majority of Keepers live in France). *“I would pay much higher taxes on my income in France.” “I have only us income, I do not want to be taxed in france for this.”* But, CBT does not protect against this, the US-France tax treaty (discussed below) does.

As a basic principle, if one is a tax resident in France, one pays tax in France on one’s worldwide income (under its residency-based taxation), whether CBT exists or not. Eliminating CBT, a US issue, would not create French tax jurisdiction, a French issue.

An exception to French residency-based taxation is found in the US-France tax treaty, under which only the US can tax US-sourced social security and pensions paid to French residents. This exception is reciprocal; French-sourced pensions of US residents are only taxable by France. The treaty also addresses taxation of US source dividends, interest and capital gains, other sources of income for retirees. The treaty is appreciated for its fairness to US retirees in France (unlike other treaties).

As we have seen above, almost all Keepers live in France and ¾ of them are retired. A few US retiree/French resident Keepers fear that elimination of CBT could trigger modification of this favorable treatment in the treaty. But Droppers question the relevancy of CBT to tax treaties. For context, many Droppers are also retired and live in France, and yet want to eliminate CBT.

## **AARO’s advocacy**

AARO believes that American citizens abroad are unfairly burdened by CBT. This complex system, unique in the world, imposes significant costs on tax preparation and reporting, often where no tax is due and many times leads to double taxation, employment discrimination and competitive business disadvantage. Despite CBT, Americans receive little of the benefits provided to citizens residing in the homeland.

To address these issues, AARO advocates ending CBT and aligning the US with the universal practice of residency-based taxation. From this would follow the replacement of the FATCA reporting regime with the Common Reporting Standard, now widely used internationally.

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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

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