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AARO 2020 Advocacy Survey Results Article 6: Taxation and Banking

We are caught between 2 systems

By Doris L. Speer

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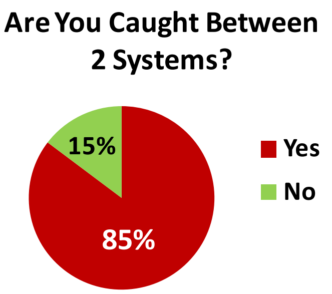
We have a lot to tell you about how taxation affects our survey respondents, so this is only the first article on tax. We address here how overseas Americans are hopelessly caught between two incompatible systems, limiting us to what we can do in our lives and subjecting us to the worst of each system.



How does this affect us?

As you can see by the chart above, 85% of you tell us that you are caught between 2 systems. Some expats who have moved around the world are caught by even more!

This is because the extraterritorial application of US taxation and banking laws and systems overlaps and interferes with the taxation, business, banking, investment and retirement planning policies of other countries. So, we interact with these systems in both our resident country and the US and, in trying to benefit from one while complying with the other, we discover that they are often incompatible.

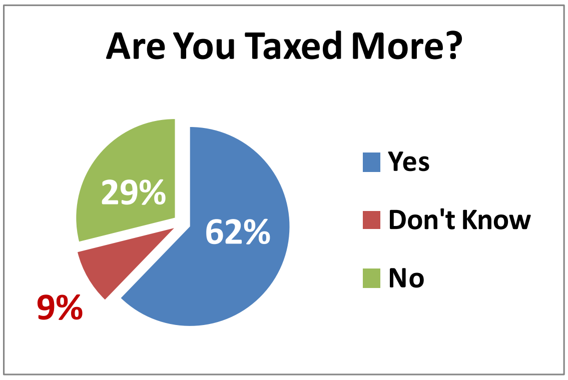
In this article we call the 85% the “Caughts” and the 15% the “Nots.” Our survey shows that the Caughts have one or more of the following problems:

1. Penalizing taxation
2. Denial of US banking services
3. Inadequate non-US investments and retirement plans
4. Restricted employment and business opportunities
5. Considerable expense to file US taxes
6. Suffering spouses

We address each of these points below.

Penalizing taxation

As you can see by this chart, 62% of the Caughts believe that they are double taxed or taxed more because of being an overseas American. "*I lose tax benefits in my country of residence,*" "*Yes, some income elements will not line up,*" "*yes, double taxed, especially with property,*" and "*My country does not have a Capital Gains Tax so the US can apply its CGT.*"



But, 29% of the Caughts do not believe that they are taxed more. This could be because "*I have little USA income so don't pay US taxes,*" and "*my income is very low, the tax credit eliminates taxes possibly due in the USA.*" A few highlighted a tax treaty as eliminating unfair taxation. One of you had a strikingly unusual situation: "*I believe that I actually benefit from the requirement of reporting and paying the US and getting credits in my country of residence.*"

As you know, the US has rules intended to limit double taxation, granting us the US foreign earned income exclusion (FEIE) (allowing us to exclude some foreign income from US taxation) and tax credits to reduce our US tax for certain foreign taxes paid.

But, FEIE does not help everyone. For example, foreign unemployment, maternity, and disability payments, which are not considered "earned," do not qualify for the exclusion. It also does not apply to interest, capital gains, insurance proceeds or many types of pension income. So, the FEIE does not exclude all the types of income that you are likely to have over the course of your overseas life; you must pay US tax on them, even if your resident country taxes them at low rates or not at all.

The exchange rate also affects our US taxes, as you note: "*Expats are penalized when the US dollar is low because foreign earned income limits are insufficient to deduct all income.*" For example, in 2020 a €100,000 salary would have converted to $114,000 for calculation of US tax, whereas, in 2008, when the US dollar was low versus the Euro, a €100,000 salary would have converted to $147,000, resulting in much higher US tax. Our US tax is based on a conversion rate we cannot control, so one must take this into account when moving overseas.

Moreover, overseas Americans pay the higher of the taxes imposed by their 2 systems, and, what's more, this amount is often inflated. A simplistic hypothetical shows this:

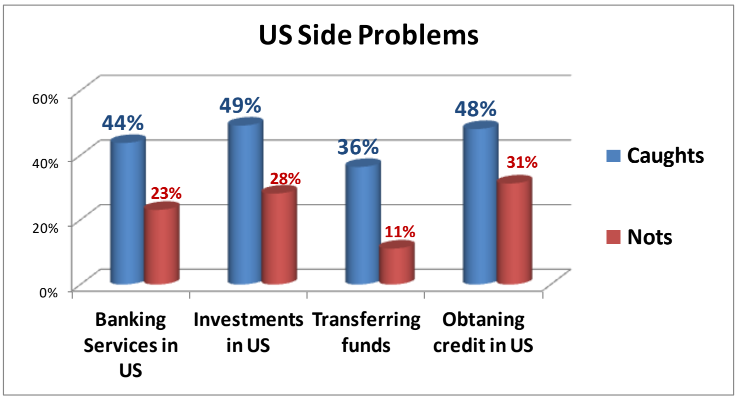
- My taxes are $500 in my country of residence and $1500 in the US: I pay $500 to my country of residence and pay to the US the $1000 difference.
- My taxes are $2000 in my country of residence and $1500 in the US: I pay $2000 to my country of residence claim a tax credit in the US. Depending on

many factors, including the type of income the foreign tax relates to, I may or may not pay US tax. But, even if I don't pay US tax, I am still penalized because some countries (such as France) include US income "*to get the rate of taxation, which is always higher than it should be.*" Another of you says: "*I pay a high percentage because both countries use total income in both countries to determine the tax rate.*"

The US has income tax treaties with 68 countries, intended to address unfair taxation. But if a treaty does not cover a particular income, or if there is no treaty between your resident country and the US, you must pay US tax on this income.

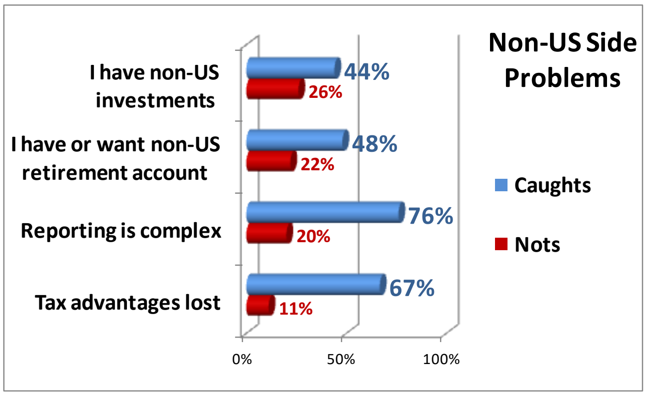
Denial of US banking services

The Caughts have faced many more issues on the US side in the banking area. Many have been denied service by US banks and investment firms (see Article 4 of this Survey Series). The Caughts also have had much more difficulty transferring funds and obtaining credit in the US.



Inadequate non-US investments and retirement plans

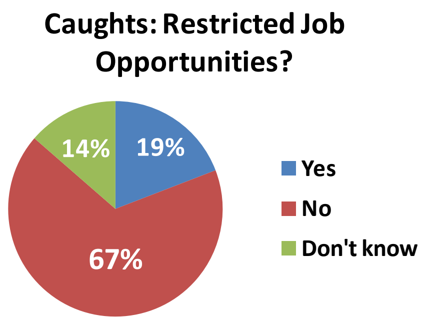
The Caughts are twice as likely to have investments and retirement accounts in their country of residence, as you can see by this chart. But 76% of them have found complex reporting *("I cannot invest in mutual funds in France because too hard to report")* and two thirds (67%) have lost tax advantages or suffered penalizing taxation on these foreign investments and retirement accounts. This is because many foreign retirement plans are not recognized under US tax law, so they are fully taxed in the US. It is practically impossible to find investments and retirement savings plans that are compatible with 2 tax systems. "*We have lost a lot of potential for retirement savings because of this.*"

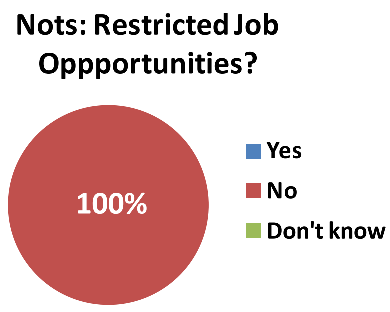


Restricted employment and business opportunities

Many of the Caughts or their spouses (19%) have been refused employment, faced restricted job options or were denied business opportunities because they are subject to US financial reporting requirements. *"Try having a "foreign corporation". Huge tax implications."*

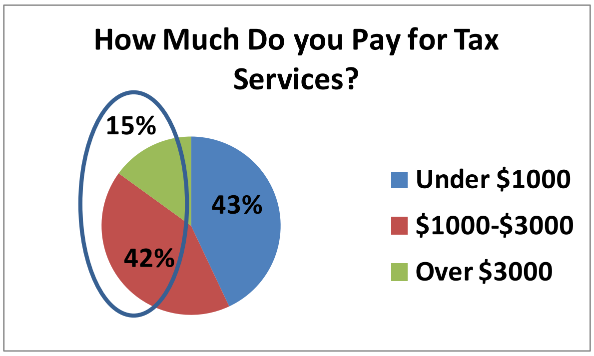
Compare to the Nots in our survey, none of whom have had this problem.





Considerable expense to file US taxes

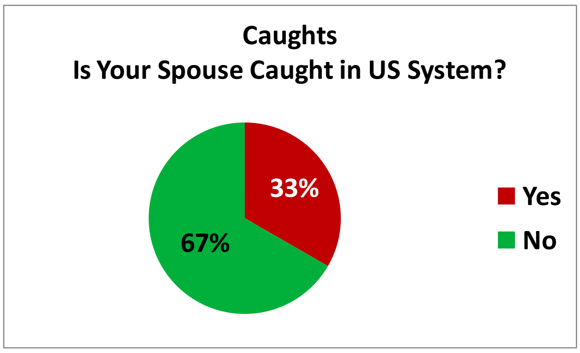
All American citizens with income above a certain amount ($12,500 for singles in 2020) must file a US federal tax return. The tax return for an overseas American is much longer and more complex than that of a US resident, and the Caughts spend siginificant amounts for tax preparation services (a combined 57% pay more than $1000 each year, see circle at right) when, in most cases, they do not even owe any US tax! The Nots spend less on tax services (61% pay less than $1000 and 7% pay more than $3000), but "*the tax prep fee is a tax in itself*."

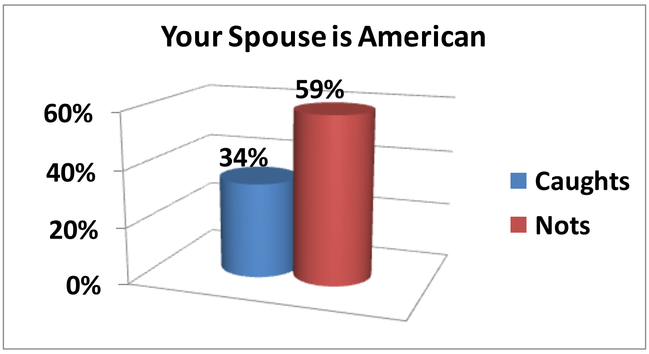


Suffering spouses

One third of the Caughts' spouses find themselves also caught up in the US system, such intrusion being for no reason other than marriage to an American. See the chart below at left. One poor single soul said "*I would not ever marry anyone here in [removed]. I would not want to subject them to the trauma of US taxation issues.*" For another who did actually marry, "*every year he threatens to divorce me*!!!"

Two-thirds of the married Caughts have foreign spouses. Only 34% of them are married to Americans, unlike the Nots, 59% of whom are married to Americans.



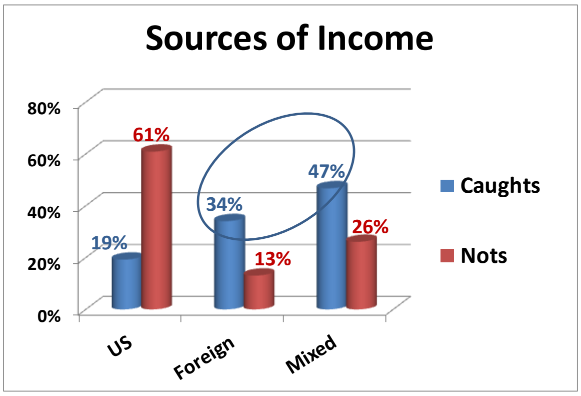


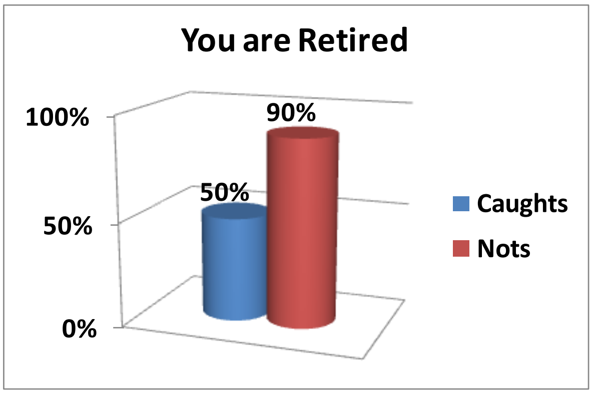
A few more demographics

Where and how does each group earn its money?

The Caughts overwhelmingly earn their income entirely or partially overseas (a combined 81%, see circle in the chart below at left) while, conversely, a high majority of the Nots' income is sourced from the US (61%).

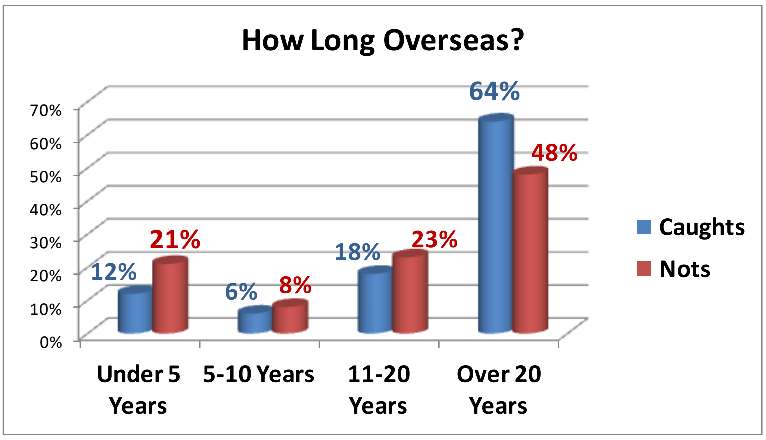
We assume that the reason the Nots generally have US-source income is because almost all of them (90%) are retired, as noted in the chart below right, and typical US retirement income is Social Security and US pensions, and possibly US investments.





Where do they live, how long overseas, are they dual citizens?

The Caughts in our survey generally live in the same countries in the same proportions as survey respondents overall. The Nots are slightly more concentrated in France (6% more) than the Caughts, an interesting correlation considering that the US/France tax treaty is favorable to pensioners. Of our survey respondents, no Nots lived outside Europe except for a very few in Thailand, Canada and the US.



One Caught said "*I have kept my American residency in order not to be taxed higher in France.*"

We see from this chart above that 64% of the Caughts have been overseas over 20 years. To see a higher % of Nots in the early years is not surprising as they possibly have not yet had time to integrate into a system other than the US system.

More dual citizens (91%) believe that they are Caught than non-dual citizens (80%).

♪ *Can it be that it was all so simple then?* ♪ …

Clearly, Caughts have a more difficult overseas experience than Nots. That is because they have a different set of overseas personal and professional circumstances.

According to this survey, you tend to be a Not if you:

a. have a low foreign salary (below the FEIE limit), a US pension not taxed in your country of residence (i.e., per a favorable tax treaty with the US) or no income at all;

b. succeed in maintaining US banking relationships and investments;

c. don't need credit from the US;

d. don't have local investments or a local retirement account;

e. aren't looking for a new overseas job or trying to operate an overseas business;

f. are able to do your own taxes; and/or

g. are not married at all or are married to a US citizen.

But, remember that circumstances can change during your overseas life. Many of life's normal activities could cause today's Not to be ensnared in the future by the incompatibility of the 2 systems. For example, if you increase your monetary assets, amass other wealth, open US and local bank and investment accounts, save for retirement, buy and sell real estate, transfer money, change jobs, obtain credit, open a business, marry a foreigner, gain a second nationality, inherit assets, etc., you or the one you love could move closer to being Caught by your 2 systems.

You may then sing as did Barbara Streisand in "The Way We Were": "*Can it be that it was all so simple then?*"

Being a Not is an illusion, you are simply "Less Caught"

Nots are not really "not caught."

Our survey question was binary ("yes" or "no"), but the situation cannot be binary because overseas life is complex. Yes, 15% of you think you are "not caught," but we all have to file US tax returns and may well need to pay more taxes, and in multiple countries. And some of the Nots did tell us that they have banking, investment and retirement plan issues. Whether we think we are Caught or Not, all overseas Americans have to deal with the high level of complexity of, and cannot avoid dealing with, two (or more) systems; we all have be very vigilant and plan carefully to avoid nasty surprises or penalties in the event of an innocent mistake.

Bottom line: We are all Caught between two systems to some extent.

AARO’s advocacy

The topics addressed in this article are wide-ranging, reflecting how US legislation and practices in tax and banking make it increasingly difficult for Americans to live and work overseas.   American citizens abroad are unfairly burdened by a complex citizenship-based taxation system with high tax preparation costs, the risk of double taxation, employment discrimination and competitive business disadvantage while receiving little of the benefits provided to citizens residing in the US.

AARO’s mission is to urge Congress and the Administration to pass new tax legislation and to simplify financial reporting requirements to help overseas Americans in their role as ambassadors abroad.

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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.