Will the Reunification of U.S. Citizenship Still Be Worth Some Tax Savings - An Analysis of the Recent Reform on the Taxation of Expatriates

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WILL THE RENUNCIATION OF U.S. CITIZENSHIP STILL BE WORTH SOME TAX SAVINGS? AN ANALYSIS OF THE RECENT REFORM ON THE TAXATION OF EXPATRIATES.

"Over and over courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant."¹

I. INTRODUCTION

Michael D. Dingman, chairman of Abex, a New Hampshire-based maker of aerospace and industrial products, and a Ford Motor Corporation director, is now a citizen of the Bahamas.² He is representative of a trend: that of a few wealthy Americans who each year choose to expatriate³


². See Lenzner & Mao, supra note 1, at 131.

³. According to the Webster's Third New International Dictionary, expatriation is the act or action of expatriating, understood either as residing in a foreign country or renouncing allegiance to one's native country. Webster's Third New International Dictionary 799 (1986). According to the Black's Law Dictionary, however, expatriation is the voluntary act of abandoning or renouncing one's country, and becoming the citizen or subject of another. Black's Law Dictionary 576 (6th ed. 1990). Thus, there is some confusion, since the word "expatriate" has sometimes been used to refer to citizens who leave the United States to reside in a foreign country, but retain their American citizenship, and sometimes to refer to citizens who leave the United States and, in addition, renounce their U.S. citizenship. Compare Renée J. Sobel, United States Taxation of Its Citizens Abroad: Incentive or Equity, 38 Vand. L. Rev. 101, 103 n.6 (1985) (using the term "expatriate" to refer to citizens who leave the United States to reside but retain their American citizenship) [hereinafter Sobel] with Ditlev F. Vagts, The Proposed Expatriation Tax — A Human Right Violation?, 89 Am. J. Int'l L. 578, 578-79 (1995) (noting that the terminology is confusing, and that Americans living abroad refer to themselves as expatriates even though they retain their U.S. passport) [hereinafter Vagts]. The Internal Revenue Code refers to expatriates as individuals who relinquish their citizen-
themselves, with the goal, acknowledged or not, of avoiding tax liability. Being a U.S. citizen has its costs, and for some wealthy taxpayers, those costs are perceived as so high that they would rather renounce their citizenship than have to pay the costs. Although it has not always been so, there are now several ways one can expatriate. Any U.S. citizen may voluntarily renounce his or her U.S. citizenship by either: (1) becoming naturalized in another country; (2) formally declaring allegiance to another country; (3) serving in a foreign army; (4) serving in certain types of foreign government employment; (5) making a formal renunciation of nationality before a U.S. diplomatic or consular officer in a foreign country; (6) making a formal renunciation of nationality in the United States during a time of war; or (7) committing an act of treason.

ship. See I.R.C. § 877(a) (1996). Therefore, for clarity of expression, this comment also refers to expatriates as U.S. citizens who renounce U.S. citizenship.


5. Forbes Magazine identified some of the wealthy expatriates: Ted Arison, founder of Carnival Cruise Lines, who now lives in Israel; John Dorrance III, Campbell soup heir, who took Irish citizenship; Kenneth Dart, president of the foam cup company Dart container, now a citizen of Belize; J. Mark Mobius, a leading international money manager, who has German citizenship and lives in Hong Kong and Singapore; and Frederick Kriebel, a director and former treasurer of the Hartford-based Loctite Corporation, a maker of adhesives, who took residence in the Turks and Caicos Islands. Lenzner & Mao, supra note 1, at 131-32.

6. The costs that candidates to expatriation are most likely to consider are the income tax and the estate tax costs. The maximum marginal income tax rate is currently 39.6%, I.R.C. § 1(a) (1996), except for capital gains which are topped at 28%, I.R.C. § 1(h) (1996). The maximum marginal estate tax rate is 55%. I.R.C. § 2001(c)(1) (1996).

7. At common law, it was not possible to renounce one’s citizenship, the British rule, widely recognized in the United States was that of “perpetual allegiance.” Stanley Mailman, Expatriation and Senator Moyihan’s Tax Proposal, N.Y. L.J., Apr. 24, 1995 at 3. Then, in 1907 Congress enacted legislation specifying that the performance of certain acts would result in the loss of citizenship. Act of March 2, 1907, 34 Stat. 1228 (1907). For naturalized citizens, that included going back to their birth country for two years or to another country for five years. Id. An American woman who married a foreigner would take her husband’s citizenship. Id.

Many U.S. citizens decide to leave their nation, and there are approximately three million U.S. citizens living abroad.\textsuperscript{9} No statistics are available regarding the number of former U.S. citizens, but there is evidence that since 1980, an average of 781 U.S. citizens expatriated each year.\textsuperscript{10} Most do so for reasons that have nothing to do with taxes.\textsuperscript{11} However, a dozen or more U.S. citizens who are multimillionaires expatriated with the purpose of avoiding tax liability, hence the nicknames "tax expatriates,"\textsuperscript{12} taxpatriates\textsuperscript{13} or more derivatively, "ex-patriots."\textsuperscript{14}

Expatriates are subject to different tax treatment than U.S. citizens who simply live in another country.\textsuperscript{15} U.S. citizens are subject to the U.S. individual income tax on their worldwide income.\textsuperscript{16} On the other hand, expatriates become alien nonresidents for tax purposes and, as such, are taxed

\begin{table}[h]
\centering
\begin{tabular}{|l|c|}
\hline
Year & Abandonments/Renunciations \\
\hline
1994 & 858 \\
1993 & 697 \\
1992 & 557 \\
1991 & 619 \\
1990 & 571 \\
1989 & 724 \\
1988 & 489 \\
1987 & 612 \\
1986 & 751 \\
1985 & 766 \\
1984 & 788 \\
1983 & 771 \\
1982 & 952 \\
1981 & 1446 \\
1980 & 1119 \\
\hline
\end{tabular}
\caption{Abandonments/Renunciations}
\end{table}

\textsuperscript{9} Staff of Joint Comm. on Taxation, 104th Cong., Report on Issues Presented by Proposals to Modify the Tax Treatment of Expatriation 32 n.64 (Comm. Print 1995) [hereinafter Report].

\textsuperscript{10} The State Department established the following statistics:

\textsuperscript{11} For instance, those figures include naturalized U.S. citizens who return to their countries of birth, and who are forced to relinquish U.S. citizenship because their country of birth does not permit dual citizenship. Report, supra note 9, at 8.

\textsuperscript{12} de Witt, supra note 4, at A1.

\textsuperscript{13} Robert Lenzner, And Don't Come Back, Forbes, Nov. 18, 1996, at 44 (following-up on the November 1994 article).

\textsuperscript{14} Carl M. Cannon, Stop Those Billionaires at the Border, Baltimore Sun, Apr. 8, 1995, at 2A.

\textsuperscript{15} See discussion infra Part II.B.

\textsuperscript{16} See infra text accompanying notes 33-51.
only with regard to their U.S. source income. The tax savings are readily apparent. By simply shifting from the U.S. citizen to the alien nonresident category, the taxpayer can entirely avoid paying taxes on his non-U.S. income. Further, the alien nonresident 30% flat tax rate will generally be more advantageous than the rates applicable to U.S. citizens. There is, however, an important limitation to this scheme. The tax liability of a former U.S. citizen does not always stop when he or she renounces U.S. citizenship. Section 877 of the Internal Revenue Code (“I.R.C.”), in conjunction with other provisions, enables the U.S. government, under certain conditions, to impose special tax liability on individuals who expatriate with the intent of avoiding taxes for ten years after the date of expatriation.

Section 877 has recently been modified and this comment analyzes the expatriation tax regime created by the new § 877. It begins by presenting an overview of the present income tax treatment of U.S. citizens living abroad and nonresident aliens, here former U.S. citizens living abroad. This background section presents former § 877, the various legislative proposals that led to its revision, and the new § 877. Particular problems with the new and old body of law are identified and further discussed in the analysis section. Specifically, this comment addresses whether the new regime

17. “The source of income is the place where . . . the income at issue is produced.” BLACK’S LAW DICTIONARY 1395 (6th ed. 1990).
18. See infra text accompanying notes 95-97.
19. I.R.C. § 871(a)(1) (1996). This rate applies only to income not connected with a U.S. business. Id.
20. It will be more advantageous as soon as the taxpayer’s income—for married individuals filing joint returns—is over $89,150. See I.R.C. § 1(a) (1996).
21. See discussion infra Part II.C.
23. See discussion infra Part II.B.
25. See discussion infra Part II.A.1, 2.
27. See discussion infra Part II.B.1.a.
28. See discussion infra Part II.C.1-6.
29. See discussion infra Part II.C.7.
30. See discussion infra Parts III, IV.
conforms with due process and international law requirements, and the practical issues its application will raise.  

Finally, this comment proposes possible alternatives to the new legislation.

II. BACKGROUND

A. The U.S. Specificity: Worldwide Income Taxation of Nonresidents and its Consequences

Every U.S. citizen is subject to the U.S. individual income tax on his or her worldwide taxable income, whether he or she resides within the United States or not. Treasury Regulation § 1.1-1(b) reads: "[I]n general, all citizens of the United States, wherever resident, and all resident alien individuals are liable to the income taxes imposed by the Code whether the income is received from sources within or without the United States." This is a peculiarity of the United States. Other nations generally tax the worldwide income of their citizens and residents, but only the domestic source income of their nonresidents. For example, French nonresidents are subject to the income tax only on their French source income. So are German, Japanese and British nonresidents. There are two noted exceptions: the Philippines and Eritrea.

In the United States, the Sixteenth Amendment to the Constitution gives Congress the "power to lay and collect taxes on income, from whatever source derived, without apportionment among the several States, and without regard to any census of enumeration." Ever since the amendment
was ratified, Congress has imposed a tax on the net income of every U.S. citizen.\(^4\)

The Supreme Court, in *Cook v. Tait*,\(^4\) upheld the constitutionality of taxing the foreign income of a U.S. citizen.\(^4\) Cook, a native citizen of the United States, moved to Mexico.\(^4\) There, he derived income from real and personal property located in Mexico.\(^4\) Cook refused to pay taxes on that income and argued that the imposition of the U.S. income tax on that income "would be subversive of the sovereignty of Mexico."\(^4\) The Supreme Court disagreed:

> [T]he government, by its very nature, benefits the citizen and his property wherever found and, therefore, has the power to make the benefit complete. Or to express it another way, the basis of the power to tax was not and cannot be made dependent upon the situs of property in all cases, it being in or out of the United States, and was not and cannot be made dependent upon the domicile of the citizen, that being in or out of the United States, but upon his relation as citizen to the United States and the relation of the latter to him as citizen.\(^4\)

Tax practitioners have long criticized this approach, emphasizing that "the United States are [sic] out of the international norm in choosing to tax on the basis of citizenship."\(^5\)

As a result of this U.S. specificity, all income earned by a U.S. citizen, whether from sources inside or outside the United States, is taxable, whether or not the individual lives within the United States.\(^5\) However, two rules alleviate this seemingly harsh treatment. First, a U.S. citizen who works and lives abroad may exclude up to $70,000 of annual compensation from his or her income, and he or she can also exclude or deduct certain housing expenses.\(^5\) Second, if the income that was earned abroad is subject to foreign income

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43. *See* Sobel, *supra* note 3, at 101-02 & n.3.
44. 265 U.S. 47 (1924).
45. *Id.* at 56.
46. *Id.* at 54.
47. *Id.*
48. *Id.* at 52.
49. *Id.* at 56.
50. Paul A. Sczudlo et al., *Comments and Proposed Revisions to Pending Legislation To Tax Expatriating Americans*, CAL. TAX L. (a paper sponsored by the California State Bar International Tax Committee).
51. *REPORT*, *supra* note 9, at 15.
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taxes, the U.S. taxpayer will be able to apply a foreign tax credit against his or her U.S. income tax liability.53 If the U.S. citizen successfully expatriates, on the other hand, he or she will be considered an alien nonresident, and as such, will only be taxed with regard to his or her U.S. source income; all the foreign source income is free from U.S. taxation.54

1. Income Taxation of U.S. Citizens Living Abroad

a. In General

In order to compute the taxable income of a U.S. citizen living abroad, the classic procedure of figuring exclusions, deductions, and exemptions applies.55 An exclusion is an item of income that is excluded from gross income by particular Internal Revenue Code provisions.56 For instance, gifts and inheritance are excluded.57 Scholarships, to the extent that they are qualified, are also excluded.58 A deduction is the part that is taken away from total income to arrive at adjusted gross income.59 An exemption is an amount allowed as a deduction from adjusted gross income60 to arrive at taxable income.61 Almost every individual taxpayer is allowed an exemption for himself or herself.62 If they do not itemize their deductions, most individuals will also get a basic standard deduction, which is currently $5,000 for a joint return or a surviving spouse, $4,400 in the case of a head of household,

54. See discussion infra Part II.B.2.
55. REPORT, supra note 9, at 15.
60. The adjusted gross income is "the difference between the taxpayer's gross income and allowable adjustments . . . [such as] contributions to an individual retirement account, alimony payments and reimbursed employee business expenses." BLACK’S LAW DICTIONARY 763-64 (6th ed. 1990).
61. There are two types of exemptions allowed: personal and dependency exemptions. I.R.C. § 151 (1996). The personal exemption is for the taxpayer, and dependency exemptions are allowed as follows: the taxpayer, the taxpayer's spouse, the taxpayer who is 65 or older or who is blind, and the taxpayer's dependent children for whom the taxpayer provides more than half of the dependent support. Id.
62. Some high income individuals may be denied the exemption. See I.R.C. § 151(d)(3) (1996).
$3,000 if the taxpayer is not married, and $2,500 in the case of a married individual filing a separate return.\textsuperscript{63}

The determination of the income tax liability is then made by applying the appropriate tax rate to the taxable income.\textsuperscript{64} These basic rules apply to all taxpayers, wherever they reside.

b. Specific Rules

U.S. citizens living abroad can avail themselves of two specific exclusions: the foreign earned income exclusion and the foreign housing cost exclusion.\textsuperscript{65} Further, to make amends for being subject to U.S. income taxes, and to minimize double taxation, the United States allows them to take advantage of foreign tax credit rules.\textsuperscript{66}

i. The Foreign Earned Income Exclusion

A U.S. citizen who works and lives abroad may exclude up to $70,000 of annual remuneration.\textsuperscript{67} Only foreign earned income is eligible for the exclusion.\textsuperscript{68} Earned income is income received for the performance of personal services.\textsuperscript{69} To be considered foreign, the earned income must be received as compensation for services performed in a foreign country.\textsuperscript{70} If the income is derived from the conduct of a trade or business in which both capital and services generated the income, only a maximum of 30% of the income derived therefrom can be deemed earned income.\textsuperscript{71} Earned income does not, however, include items such as amounts received from pensions, annuities, amounts paid by the U.S. Government to its employees or non-exempt employees' trusts.\textsuperscript{72}

\begin{itemize}
\item \textsuperscript{63} I.R.C. § 63(c) (1996).
\item \textsuperscript{64} \textit{Report}, \textit{supra} note 9, at 15.
\item \textsuperscript{65} See infra text accompanying notes 67-88.
\item \textsuperscript{66} See infra text accompanying notes 89-94.
\item \textsuperscript{67} I.R.C. § 911(b)(2)(A) (1996).
\item \textsuperscript{68} See I.R.C. § 911(a) (1996).
\item \textsuperscript{69} I.R.C. § 911(b)(1)(A) (1996).
\item \textsuperscript{70} It is the country where the services are performed, and not the country where the payment is made, that will determine the characterization of the income. Therefore, if compensation for services performed abroad is received in the United States, that income will still be deemed foreign earned income. If, however, compensation is paid in a foreign country for services performed in the United States, it will be deemed domestic income.
\item \textsuperscript{71} I.R.C. § 911(d)(2)(B) (1996).
\item \textsuperscript{72} I.R.C. § 911(b)(1)(B) (1996).
\end{itemize}
ii. The Foreign Housing Cost Exclusion

Americans living abroad can also exclude amounts paid as reimbursement of foreign “housing expenses.” Such amounts would generally be included in gross income, but this exclusion was created to take into account the fact that corporations employing foreigners usually provide lodging. In some foreign countries, the value of such lodging may well be substantial, even though the lodging itself may be modest to the taxpayer compared to American standards. Thus, in addition to the foreign earned income exclusion, a U.S. citizen working and living abroad may exclude part of the housing with which he or she is provided. There are also special rules allowing deduction where housing is not provided by the employer.

The earned income and foreign housing cost exclusions are both elective. The elections must be made separately, and once they are made, they remain in effect in future years unless revoked.

To be able to take advantage of the exclusions, the American taxpayer must be “qualified.” In order to be qualified, the taxpayer must maintain a “tax home” in a foreign country and satisfy either the “bona fide residence” test or the “physical presence” test. If the taxpayer moves to a foreign country with the intent to live and work there, and is considered a resident of that country for tax purposes, then he or she will satisfy the “bona fide residence” test. If the taxpayer resides in a foreign country for an uninterrupted period that includes an entire taxable year, or at least 330 days during any period of twelve consecutive months, then he or she will satisfy the “physical presence” test. If a taxpayer is

76. Id. at 12-27.
77. The exact formula is found in I.R.C. § 911(c)(1) (1996).
forced to flee the foreign country because of "war, civil unrest, or similar adverse conditions," the Treasury Secretary may
determine that the physical presence test is nevertheless met.86

The exclusions for foreign earned income and housing ex-
penses will not be available if the taxpayer lives and work in
a foreign country covered by the Trading with the Enemy
Act87 or the International Emergency Economic Powers Act.88

iii. The Foreign Tax Credit

If a U.S. citizen earns income from sources outside the
United States, and that income is subject to foreign taxes, the
taxpayer will be permitted a foreign tax credit against his or
her U.S. income tax liability paid on that income.89 The ap-
plicable rules are found in § 901, which is modified by §
904(a), limiting the amount of foreign tax qualifying for the
credit.90 The credit cannot exceed "the portion of the U.S. tax
which the taxpayer's total taxable foreign income bears to his
entire taxable income."91 Alternatively, the taxpayer can de-
duct from his or her gross income the foreign income taxes he
or she paid under § 164(a)(3).92 A direct credit against the
U.S. income tax liability will generally produce a greater ben-
efit than a deduction, however, if the taxpayer has an overall
net operating loss, taking the deduction may be more
advantageous.93

Given the regime outlined above, for some wealthy tax-
payers there may be a real incentive to renounce citizenship,
particularly if they own assets that have been appreciating in
value for many years. Indeed, once the taxpayer successfully
expatriates, he or she then becomes a nonresident alien and

countries currently include Iran, Iraq, Libya, Angola and Yugoslavia. 50 U.S.C.
§ 1701 annex.
89. See infra text accompanying notes 90-93.
91. LEIMBERG, supra note 75, at 12-23.
93. LEIMBERG, supra note 75, at 12-20 to 12-21 (explaining that "since there
is no tax liability, the credit provides no benefit, however, a deduction can in-
crease a net operating loss whose benefits [per I.R.C. § 172] can be utilized over
the following 15 years or the three preceding taxable years.").
does not have to worry about the U.S. specificity anymore. The taxpayer can then realize considerable tax savings with regard to income, and more importantly, estate taxes.94

2. Income Taxation of Nonresident Aliens

Once a U.S. citizen has successfully completed his or her expatriation, he or she then becomes, for tax purposes, a non-resident alien.95

Nonresident aliens are subject to U.S. tax only with regard to their U.S. source income and their income which is effectively connected with the conduct of a trade or business within the United States.96 Profits derived from the conduct of a trade or business within the United States are taxed at regular graduated rates.97

Income from the United States that is not effectively connected with the conduct of a United States trade is subject to a different treatment than income that is effectively connected.98 Such investment income99 is taxed at a flat rate of 30%,100 with the exception of capital gains and gains from the sale of patents and copyrights.101 Further, tax treaties may limit or altogether prevent U.S. taxation of nonresident aliens.102 Interest earned with respect to deposits with U.S. banks and savings and loans is not taxed.103 On the other

94. Under the current estate tax regime, if the estate is valued at more than $3 million the marginal rate of the estate tax is 55%. I.R.C. § 2001(c)(1) (1996).

95. Before the Tax Reform Act of 1984, the alien taxpayer’s intent was the criteria used to determine whether he or she was a resident or nonresident. LEIMBERG, supra note 75, at 12-8. The 1984 Act enacted I.R.C. § 7701(b), whereby the alien will be deemed to be nonresident unless (1) he or she is a lawful permanent resident within the meaning of the immigration law; or (2) he or she meets a test of physical presence in the United States. Id.


97. Id.

98. Id.


101. LEIMBERG, supra note 75, at 12-8.

102. For instance, dividends and interest derived from United States corporations by a Canadian resident will only be taxed at the rate of 15%, per Article XI(1) of the tax treaty between the United States and Canada. LEIMBERG, supra note 75, at 12-8. Treaties may also include an article called “relief from double taxation” which specifies which country is authorized to impose its tax on a particular category of income, and which country is obligated to yield its tax jurisdiction. REPORT, supra note 9, at 112.

103. REPORT, supra note 9, at 17.
hand, nonresident aliens are taxed on any gain recognized upon the disposition of an interest in real property in the United States at the same rates that are applicable to U.S. citizens.\textsuperscript{104} Nonresident aliens are also taxed on distributions received from U.S. qualified pensions plans\textsuperscript{105} and similar arrangements, to the extent that the amount received does not merely represent a return of basis.\textsuperscript{106} Plan benefits attributable to services performed within the United States are taxed at a rate of 30%, if the amount is not effectively connected with the conduct of a trade or business in the United States, otherwise the graduated rates apply.\textsuperscript{107}

B. A Special Rule for U.S. Citizens Who Expatriate With a Principal Purpose of Avoiding Taxes: I.R.C. § 877

1. Overview of Former Version of I.R.C. § 877

There is a special rule for U.S. citizens who decide to expatriate\textsuperscript{108} with the goal of avoiding tax liability, embodied in § 877 of the I.R.C.\textsuperscript{109} Under the former version of this provision, if the Treasury determines that the expatriate's loss of U.S. citizenship would, but for the application of the provision, result in a substantial reduction in tax liability, then the taxpayer has the burden of proving that such loss did not have for one of its principal purposes the avoidance of U.S. taxes.\textsuperscript{110} If the taxpayer cannot sustain this burden, he or she will continue to be specially taxed on his or her U.S. source income for ten years after the date of expatriation.\textsuperscript{111} Further, former § 877 provides special, alternative tax treatment because the tax expatriate is subject to the rates applicable to U.S. citizens rather than the rates applicable to alien nonresidents.\textsuperscript{112}

\textsuperscript{104} Id.

\textsuperscript{105} A qualified pension plan is "[a] employer-sponsored plan that meets the requirement of I.R.C. § 401." Black's Law Dictionary 1135 (6th ed. 1990). "If these requirements are met, none of the employer's contributions to the plan are taxed to the employee until distributed to him or her." Id. "The employer will be allowed a deduction in the year the contributions are made." Id.

\textsuperscript{106} Report, supra note 9, at 17.

\textsuperscript{107} I.R.C. § 871(b) (1996).

\textsuperscript{108} See infra text accompanying note 3.


\textsuperscript{110} I.R.C. § 877(e) (1996).

\textsuperscript{111} I.R.C. § 877(a) (1996).

\textsuperscript{112} Id.
Finally, former § 877 modifies the sourcing rules generally used to determine the country having primary taxing jurisdiction over certain items of income. More items are deemed "U.S. source income" than are generally considered such under the I.R.C. This results in the increased possibility of double taxation.

2. The Requirement of Tax Avoidance Purpose

The requirement of a tax avoidance intent was at the heart of former § 877. If the Internal Revenue Service ("IRS") suspected that the taxpayer renounced his or her citizenship in order to avoid taxes, the IRS would tax his or her worldwide income for another ten years. The burden of proving that the expatriation was not made for tax reasons fell on the taxpayer, and it would appear to have been a difficult burden to overcome. However, practically, former § 877 has not been enforced. In fact, there are only two published cases dealing with the enforcement of former § 877: Kronenberg v. Commissioner and Furstenberg v. Commissioner.

a. Kronenberg v. Commissioner

In Kronenberg v. Commissioner, the Tax Court held that one of the principal purposes of petitioner's loss of citizenship was the avoidance of federal income taxes, therefore the court deemed § 877 applicable. Kronenberg was born in Switzerland in 1922. He immigrated to the United States in 1949 and became a naturalized American citizen in

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113. Id.
114. See supra note 17.
115. REPORT, supra note 9, at 58.
116. Id. at 7. For example, an expatriate subject to § 877 rules may have capital gains derived from stock in a U.S. corporation. Under § 877, such gains would be treated as U.S. source income, and, therefore, would be subject to U.S. tax. However, it is possible that the tax laws of the country where the taxpayer resides provide that all capital gains realized by a resident are subject to taxation in that country. In such a case the taxpayer would face the possibility of double taxation. Id.
118. See discussion infra Part IV.A.
121. Kronenberg, 64 T.C. 428.
122. Id. at 435.
123. Id. at 429.
1955, but he retained his Swiss citizenship.\textsuperscript{124} He became a successful businessman and formed a corporation in 1960, which he liquidated in 1967.\textsuperscript{125} That year, Mr. Kronenberg resolved to return to Switzerland.\textsuperscript{126} He instructed his attorneys to distribute to him the liquidated assets of the corporation at the latest possible time.\textsuperscript{127} He departed for Switzerland on February 21, 1967 and arrived the next day.\textsuperscript{128} The day following his arrival, he renounced his U.S. citizenship.\textsuperscript{129} The day after his renunciation, the transfer of funds from the liquidation was carried out by his attorneys.\textsuperscript{130}

The court noted that "the timing of Mr. Kronenberg's activities . . . is too perfect to be unplanned."\textsuperscript{131} Mr. Kronenberg had testified that he renounced his U.S. citizenship because he thought that remaining a U.S. citizen would interfere "with his participation in the privileges and duties of a Swiss citizen."\textsuperscript{132} Yet the evidence showed that, although he did not give any thought to renouncing his U.S. citizenship before he learned of the possible tax advantages of doing so, after doing so, "he speedily arranged his affairs to take advantage of it."\textsuperscript{133} The court, therefore, "was not convinced that he renounced his U.S. citizenship without any regard to the avoidance of U.S. taxes."\textsuperscript{134} The court concluded that "at least one of his principal reasons for expatriation was to secure the tax advantage," and held § 877 applicable.\textsuperscript{135}

b. Furstenberg v. Commissioner

In \textit{Furstenberg v. Commissioner},\textsuperscript{136} the petitioner was a wealthy American heiress of the Exxon empire, who spent most of her life divided between Europe and the United States.\textsuperscript{137} In 1970, she settled in Paris.\textsuperscript{138} In 1975, she mar-

\begin{itemize}
\item \textsuperscript{124} Id.
\item \textsuperscript{125} Id. at 429-30.
\item \textsuperscript{126} Id. at 430.
\item \textsuperscript{127} Kronenberg, 64 T.C. at 435.
\item \textsuperscript{128} Id.
\item \textsuperscript{129} Id.
\item \textsuperscript{130} Id.
\item \textsuperscript{131} Id.
\item \textsuperscript{132} Id.
\item \textsuperscript{133} Kronenberg, 64 T.C. at 435.
\item \textsuperscript{134} Id.
\item \textsuperscript{135} Id.
\item \textsuperscript{136} Furstenberg v. Comm'r, 83 T.C. 755 (1984).
\item \textsuperscript{137} Id. at 757-58.
\end{itemize}
ried Prince Tassilo Von Furstenberg, an Austrian citizen.\textsuperscript{139} The Prince explained to her the importance of his Austrian heritage\textsuperscript{140} and expressed to her his desire that she adopt the Austrian nationality.\textsuperscript{141} Mrs. Furstenberg agreed and subsequently obtained Austrian citizenship on December 23, 1975, thereby losing her U.S. citizenship on the same day.\textsuperscript{142}

The evidence showed that at the time she agreed to adopt the Austrian nationality, she did not know that she would lose her U.S. citizenship, nor did she know the tax consequences of her act.\textsuperscript{143} Further, until the date of her expatriation, Mrs. Furstenberg reported her income and paid U.S. income taxes according to the tax rates applicable to all U.S. citizens.\textsuperscript{144} Thereafter, she reported only her U.S. source income as a nonresident alien.\textsuperscript{145} The Tax Court, relying on precedent,\textsuperscript{146} held that "one of its principal purposes" can be interpreted as "one of its 'first-in-importance' purposes."\textsuperscript{147} In light of all the circumstances, the court concluded that Mrs. Furstenberg's expatriation "was the result of both her commitment to marry and the ultimate culmination of her lifelong ties in Europe."\textsuperscript{148}

\begin{quote}
At the time of her expatriation, petitioner was aware not of any possible tax advantage, but only of possible tax consequences which could follow from giving up her U.S. citizenship. Avoidance of taxes therefore could not have been a consideration either as of the date of her decision to expatriate or the date of expatriation itself.\textsuperscript{149}
\end{quote}

The court, in \textit{Furstenberg}, distinguished its reasoning from that of the \textit{Kronenberg} case.\textsuperscript{150} The court found that Furstenberg did not engage in a "flurry of activity" in connec-

\begin{itemize}
\item \textsuperscript{138} \textit{Id.} at 758.
\item \textsuperscript{139} \textit{Id.} at 764.
\item \textsuperscript{140} Tassilo Von Furstenberg is an aristocrat whose family lineage dates as far back as 1664. \textit{Id.} at 764.
\item \textsuperscript{141} \textit{Id.} at 761.
\item \textsuperscript{142} \textit{Furstenberg}, 83 T.C. at 762.
\item \textsuperscript{143} \textit{Id.} at 761-62.
\item \textsuperscript{144} \textit{Id.} at 772.
\item \textsuperscript{145} \textit{Id.}
\item \textsuperscript{146} Dittler Bros., Inc. v. Comm'r, 72 T.C. 896, 915 (1979), aff'd, 642 F.2d 1211 (5th Cir. 1981).
\item \textsuperscript{147} \textit{Furstenberg}, 83 T.C. at 775-76.
\item \textsuperscript{148} \textit{Id.} at 776.
\item \textsuperscript{149} \textit{Id.}
\item \textsuperscript{150} \textit{Id.} at 779.
\end{itemize}
tion with her expatriation. She had decided to expatriate long before she knew anything about the tax consequences of the expatriation. She had lived in Europe for more than seven years before renouncing her U.S. citizenship. Under the circumstances, the court found that "petitioner ha[d] ade-
quately met her burden of proving a lack of tax-avoidance motives."

Practically, former § 877 was not enforced. In November of 1994, an article published in Forbes Magazine placed the controversy surrounding tax-related expatriation in the public eye. Soon thereafter, Congress tackled the problem, numerous bills were introduced and one was eventually passed into law.

C. The Proposals to Modify Present Law

1. The Administration's Proposal

The Clinton Administration had addressed the issue of the ineffectiveness of former § 877 as early as February 1995, and proposed, what has thereafter been called, the "exit" or "departure" tax.

a. A "Deemed Sale" Approach

The Administration's proposal treats U.S. citizens who relinquish their U.S. citizenship as having sold all of their property at fair market value immediately prior to the expatriation or cessation of residence. Gain or loss from the "sale" is recognized at that time, without regard to other provisions of the I.R.C. Gains are to be taxed to the extent that they are in excess of $600,000 ($1.2 million in the case of

151. Id.
152. Id. at 779.
153. Furstenberg, 83 T.C. at 779.
154. Id. at 782.
155. Lenzner & Mao, supra note 1, at 131.
156. The Administration's proposal was introduced in the House as H.R. 981, 104th Cong. (1995), and in the Senate as S. 453, 104th Cong. (1995).
158. H.R. 981 § 201; REPORT, supra note 9, at 35.
159. A recognized gain or loss is "the portion of realized gain that is subject to income taxation." BLACK'S LAW DICTIONARY 1272 (6th ed. 1990).
160. H.R. 981 § 201; REPORT, supra note 9, at 35.
TAXATION OF EXPATRIATES

married individuals filing a joint return if both expatriate). The IRS allows a taxpayer to defer, for no more than five years, payment of the tax attributable to the deemed sale of a closely held business interest.

b. Scope of the Proposal

The proposal encompasses all property interests that would be included in the individual's gross estate under the federal estate tax if the taxpayer had died on the day he or she expatriated. There is an exception for interests in qualified retirement plans and, subject to a limit of $500,000, interests in certain foreign pension plans.

The "exit tax," under the Administration’s proposal, applies to long-term residents who terminate their residency in the United States. Long-term residents are defined as lawful permanent residents of the United States for at least ten of the fifteen taxable years preceding their departure (the "testing period").

c. Rationales Underlying the Administration’s Proposal

The Administration based its proposal first on the fact that each year, U.S. citizens are relinquishing their citizenship to avoid paying taxes on the appreciation in value of their assets while they “enjoyed the privileges and protection of the U.S. citizenship.” The rationale is that U.S. citizens should pay a price for having enjoyed the benefit of U.S. citizenship. Another justification proffered for the proposal is

161. H.R. 981 § 201; Report, supra note 9, at 35.
162. A closely held corporation is one “whose shares or at least voting shares are held by a single shareholder or closely-knit group of shareholders.” Black’s Law Dictionary 341 (6th ed. 1990).
163. Report, supra note 9, at 35.
164. H.R. 981 § 201; Report, supra note 9, at 35.
165. See supra note 105.
166. H.R. 981 § 201; Report, supra note 9, at 35.
167. H.R. 981 § 201; Report, supra note 9, at 35.
168. H.R. 981 § 201; Report, supra note 9, at 35.
170. Senator Edward M. Kennedy said that “[t]he renunciation of one’s citizenship is a right that we respect,” but that “[t]he renunciation of citizenship by individuals so that they do not have to pay their fair share of taxes is unacceptable.” Kennedy Amendment on Expatriate Tax Loophole Passes, Tax Notes Int’l, Apr. 24, 1995, available in LEXIS, Taxana Library, TNI File. Senator
that individuals who relinquish their citizenship are, in fact, continuing to maintain significant ties with the United States, including spending significant periods of time within the U.S. territory. Therefore, such individuals do not entirely sever their relationship with the U.S. and should continue to be taxed." 171

2. The Senate Finance Committee's Proposal 172

The Senate Finance Committee's proposal adopted the Administration's proposal, with some exceptions. 173 It is only made applicable to expatriating citizens, not to departing permanent residents. 174 The date of relinquishment of citizenship is the date of formal renunciation or the date when the expatriate provides written notice to the State Department of the performance of an expatriating act, rather than the date when the certificate of loss of nationality is issued, as under the Administration's proposal. 175

The Senate Finance Committee's proposal was dropped in a House-Senate conference. 176 It was ultimately replaced by a directive to the staff of the Joint Committee on Taxation to undertake a comprehensive study of the issues relating to the taxation of expatriation and to report its results to the Chairman of the Committee on Ways and Means and of the Committee on Finance. 177

Kennedy cited an estimation of the costs of the practice: "[T]his provision only affects twenty five Americans a year. But the cumulative loss to the Federal Treasury is $1.5 billion over a 5-year period and $3.6 billion over a 10-year period." Id. He concluded by stating that "[a]n individual has every right to renounce his or her citizenship and leave America, and we have some 800 every year who do so. We are not saying that they cannot leave. We are saying that if they decide to leave, they should pay their taxes prior to their leaving." Id.

171. The Treasury issued a press release on February 6, 1995, stating that the proposal was aimed at "stopping multimillionaires from escaping taxes." REPORT, supra note 9, at 11. The press release included an example of how a U.S. citizen could expatriate but continue to have a residence and driver's license in the United States and continue to travel on a U.S. passport. Id.


173. See H.R. 831 § 5.

174. Id.

175. Id.


177. The directive called for an evaluation of the following:
3. *S. 700, Senator Moynihan's Proposal*\(^{178}\)

Senator Moynihan introduced his proposal as a free standing bill shortly after the defeat of the Senate proposal.\(^{179}\) The Moynihan proposal is very similar to the Administration’s proposal, with the distinctive feature of the deemed sale.\(^{180}\) It does not apply to an individual who relinquishes U.S. citizenship before attaining the age of eighteen and a half years, if the individual lived in the U.S. for less than five taxable years before the date of relinquishment.\(^{181}\) It applies, on the other hand, to departing permanent residents who lived in the U.S. for eight of the fifteen years preceding their departure.\(^{182}\) Those latter individuals get a basis in the property subject to tax equal to the *fair market value* as of the earlier of the date they first came to the U.S., or the date the property was first subject to U.S. tax, because it was either used in a trade or business, or it was a real property interest, as opposed to an *historical cost basis*.\(^{183}\) Further, the fair market value basis applies for all purposes of computing gain or loss on actual disposition, and not merely for the purpose of computing the exit tax.\(^{184}\)

The most significant feature of Senator Moynihan’s proposal is that taxpayers are offered the possibility to elect to

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(1) the effectiveness and enforceability of current law with respect to the tax treatment of expatriation, (2) the current level of expatriation for tax avoidance purposes, (3) any restrictions imposed by any constitutional requirement that the Federal Income Tax apply only to realized gains, (4) the application of international human rights principles to taxation of expatriation, (5) the possible effects of any such proposals on the free flow of capital into the United States, (6) the impact on any such proposals on existing tax treaties and future treaty negotiations, (7) the operation of any such proposals in the case of interests in trusts, (8) the problems of potential double taxation in any such proposals, (9) the impact of any such proposals on the trade policy objectives of the United States, (10) the administrability of such proposals, and (11) possible problems associated with existing law, including estate and gift tax provisions.

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\(^{179}\) S. 700, 104th Cong. § 1 (1995).


\(^{180}\) S. 700, 104th Cong. § 1 (1995).

\(^{181}\) *Id.* § 1.

\(^{182}\) *Id.* § 2.

\(^{183}\) *Id.*

\(^{184}\) *Id.*
continue to be taxed as U.S. citizens instead of being subject to the expatriation tax on an asset by asset basis.\textsuperscript{186} In order to benefit from this provision, the taxpayer must waive any tax treaty benefit, provide security for payment, and generally comply with other requirements imposed by the Treasury.\textsuperscript{186}

4. \textit{H.R. 1812, Chairman Archer's\textsuperscript{187} Proposal}\textsuperscript{188}

The Chairman's own version of the expatriation tax was approved by the Ways and Means Committee on June 13, 1995 and reported to the House.\textsuperscript{189} It was included in the House's version of the Budget Bill and was adopted by the Conference Committee as the expatriation provision of the Budget Act.\textsuperscript{190} The Archer proposal differs from the others because it is designed to improve existing law, not change it.\textsuperscript{191}

a. \textit{The Presumption of Tax Avoidance Intent}

H.R. 1812 creates a \textit{presumption of tax avoidance intent} if the taxpayer's average annual federal income tax liability for the five preceding years exceeded $100,000 or if the taxpayer's net worth at the date of the expatriation is $500,000 or more.\textsuperscript{192} This may seem like a very broad provision, however, the presumption can be easily rebutted by certain taxpayers: individuals born with dual citizenship who retain only their non-U.S. citizenship; individuals who become citizens of the country where they, their spouse, or either of their parents were born; individuals not present in the U.S. for more than thirty days in any of the ten years prior to the loss of the citizenship; individuals relinquishing citizenship before reaching the age of eighteen and a half; and any other category of individual that would be exempted by regula-
Another way to defeat the tax avoidance presumption is provided: the taxpayer who does not fit within the categories enunciated above would submit a ruling request for the Treasury Secretary to make an individualized determination about the taxpayer's intent. The Archer proposal preempts inconsistent tax treaty provisions for ten years after enactment.

b. Scope of the Archer Proposal

The Archer proposal applies to any citizen who loses U.S. citizenship on or after February 6, 1995 and any long term permanent resident whose U.S. residency is terminated on or after June 13, 1995. For citizens, the date of loss of citizenship remains the same as under present law. Permanent residents must qualify as "long term," before they can be reached by the proposal. For this purpose, a long term resident is any individual who was a lawful permanent resident of the United States for at least eight of the fifteen taxable years ending with the year in which the termination of status occurs. In applying this eight year rule, an individual is not considered to be a permanent resident for any year in which the individual is taxed as a resident of another country under a treaty tie-breaker rule. Furthermore, a long term permanent resident may elect to value his or her assets at the fair market value basis on the date the individual became a resident, rather than the historical cost basis.

Finally, H.R. 1812 enlarges the scope of the taxable income, including income or gain realized by a foreign corporation, owned more than 50% by a former resident or permanent resident, and includes provisions designed to eliminate the ability, under the old regime, to engage in certain trans-

193. Id. at (b).
194. Id.
195. Treasury Assistant Secretary Leslie B. Samuels raised a specific objection to this clause, stating that "[a]lthough our Constitution allows legislative overrides of tax treaties, these overrides violate U.S. obligations under international law." Leslie B. Samuels, Treasury Objects to Archer Expatriation Bill, TAX NOTES, Sept. 25, 1995.
197. Id. § 3.
198. Id. § 2(f).
199. Id. at (1).
200. Id.
201. Id.
actions that enable tax expatriates to circumvent the ten-year reach of § 877.202

c. The Information Requirement

Expatriating citizens and departing permanent residents are required to provide extensive information to the State Department and the IRS.203 Failure to do so exposes them to a penalty of an amount equal to the greater of 5% of the tax to be paid, or $1,000.204

5. H.R. 2491, The Expatriation Amendment in the Budget Act205

Yet another proposal was presented in H.R. 2491, which adopted word for word Chairman's Archer's version of the expatriation reform.206 This bill passed both houses but was ultimately vetoed by President Clinton.207

6. The Expatriation Amendment in the Small Business Tax Package208

H.R. 3448, features an expatriation amendment and a return of the deemed sale approach, with a $600,000 exclusion, as in the Administration's initial proposal.209 The taxpayer can elect to continue to be taxed as a U.S. citizen if he or she provides adequate security and consents to the waiver of any rights he or she may have under any treaty.210

Once made, the election applies to all of the taxpayer's property and is irrevocable.211 The expatriation amendment

203. The information to be provided includes:
(1) the taxpayer's TIN, (2) the mailing address of such individual's principal foreign residence, (3) the foreign country in which such individual is residing, (4) the foreign country of which such individual is a citizen, (5) in the case of an individual having a net worth of [more than $500,000], information detailing the assets and liabilities of such individual, and (6) any other information that the Secretary may prescribe.
Id. § 3.
204. Id.
206. Id.
209. Id.
210. Id.
211. Id.
was eventually removed from the Small Business Tax Package and reconsidered as part of the Health Insurance Reform.\textsuperscript{212} However, H.R. 3448 will have an impact on tax related expatriation since it amended § 6048(a) to require that any U.S. person who transfers property to a foreign trust after August 20, 1996 file an information return, and also adds a penalty for the failure to file such return in § 1494(c).\textsuperscript{213} Section 1491 also imposes an excise tax on the transfer of property by a U.S. person to a foreign corporation, to a foreign estate or trust, or to a foreign partnership.\textsuperscript{214} Those transfers are routinely used by tax expatriates. This is an overall tightening of the expatriation tax related rules. On the other hand, H.R. 4338 removed the tax on employees’ trusts lump sum distributions\textsuperscript{215} from the scope of the § 877 regime.\textsuperscript{216}

8. The Expatriation Amendment in the Health Insurance Bill\textsuperscript{217}

It is this final version, in the long list of expatriation tax proposals, that was finally passed into law on August 21, 1996.\textsuperscript{218}

\textsuperscript{212} CONG. Q., Aug. 24, 1996, at 2408.
\textsuperscript{214} I.R.C. § 1491 (1996).
\textsuperscript{216} Small Business Job Protection Act of 1996, § 1901(b)(11). The new regime thus created will be effective in tax years beginning after Dec. 31, 1999.
\textsuperscript{218} Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191, §§ 511-13, 110 Stat. 2093 (1996) (codified \textit{inter alia} as I.R.C. § 877). § 877(a), (b) and (c) now read as follows (modifications indicated in italics):

\begin{quote}
§ 877. Expatriation to avoid tax.
(a) TREATMENT OF EXPATRIATES
(1) In General

\textit{Every nonresident alien individual who, within the 10-year period immediately preceding the close of the taxable year, lost United States citizenship, unless such loss did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle B, shall be taxable for such taxable year in the manner provided in subsection (b) if the tax imposed pursuant to such subsection exceeds the tax which, without regard to this section, is imposed pursuant to section 871.}

(2) Certain Individuals Treated as Having Tax Avoidance Purpose.

\textit{For purposes of paragraph (1), an individual shall be treated as having a principal purpose to avoid such taxes if —}
\end{quote}
(A) the average annual net income tax (as defined in section 38(c)(1)) of such individual for the period of 5 taxable years ending before the date of the loss of United States citizenship is greater than $100,000, or

(B) the net worth of the individual as of such date is $500,000 or more.

In the case of the loss of United States citizenship in any calendar year after 1996, such $100,000 and $500,000 amounts shall be increased by an amount equal to such dollar amount multiplied by the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting 1994 for 1992 in subparagraph (B) thereof. Any increase under the preceding sentence shall be rounded to the nearest multiple of $1,000.

(b) ALTERNATIVE TAX.

A nonresident alien individual described in subsection (a) shall be taxable for the taxable year as provided in section 1, 55 except that:

(1) the gross income shall include only the gross income described in section 872(a) (as modified by subsection (d) of this section), and

(2) the deductions shall be allowed if and to the extent that they are connected with the gross income included under this section, except that the capital loss carryover provided by section 1212(b) shall not be allowed; and the proper allocation and apportionment of the deductions for this purpose shall be determined as prescribed by the Secretary.

For purposes of paragraph (2), the deductions allowed by section 873(b) shall be allowed; and the deductions (for losses not connected with the trade or business if incurred in transactions entered into for profit) allowed by section 165(c)(2) shall be allowed, but only if the profit, if such transaction had resulted in a profit, would be included in gross income under this section.

(c) TAX AVOIDANCE INTEND NOT PRESUMED IN CERTAIN CASES.

(1) In General

Subsection (a)(2) shall not apply to an individual if —

(A) such individual is described in a subparagraph of paragraph (2) of this subsection, and

(B) within the 1-year period beginning on the date of the loss of United States citizenship, such individual submits a ruling request for the Secretary’s determination as to whether such loss has for one of its principal purposes the avoidance of taxes under this subtitle to subtitle B.

(2) Individuals described

(A) Dual Citizenship, etc. An individual is described in this subparagraph if —

(i) the individual became at birth a citizen of the United States and a citizen of another country and continues to be a citizen of such other country, or

(ii) the individual becomes (not later than the close of a reasonable period after loss of United States citizenship) a citizen of the country in which

(I) such individual was born,

(II) if such individual was married, such individual’s spouse was born, or

(III) either of such individual’s parents were born. . . .
TAXATION OF EXPATRIATES

a. Overview

The conference agreement generally adopted the House's (Chairman Archer's) approach. It rejected the Administration/Senate version of taxing the net unrealized gains of the property of expatriating persons as if such property was sold for fair market value on the expatriation date. The basic tenet of the new regime is, as under the House's approach, the presumption of tax avoidance intent once the taxpayer reaches a certain wealth. The new expatriation tax is not to be imposed unless (1) the individual's average annual U.S. federal income tax liability for the five taxable years ending before the expatriation (or termination of residency) is greater than $100,000, or (2) the taxpayer's net worth as of the date of such expatriation (or termination) is $500,000 or more. However, once either threshold is passed, the requisite tax avoidance intent is presumed to exist and the new expatriation tax is imposed. Unless the presumption is rebutted, the taxpayer will be taxed for ten years after expatriation at tax rates applicable to U.S. citizens.

b. Who is Covered by the New Provision?

The same exceptions provided for in H.R. 1812 de facto exempt certain expatriates from the new regime. The exceptions include: bi-nationals who opt for the other country and individuals becoming citizens of a country where they were born, or their spouse was born, or either of their parents was born. Further, all taxpayers also have the possibility of submitting a ruling request praying that the Treasury Secretary determine that they did not have a tax avoidance purpose.

I.R.C. § 877 (West Nov. 1996) (Pamphlet No. 4, supplementing 1996 Pocket Parts and Pamphlets Nos. 1, 2, 3) (Citations omitted). Former subsection (c) (Special rules of source, etc.) is kept as is but redesignated as new subsection (d).

219. See infra text accompanying notes 187-204.
220. See infra text accompanying notes 156-63.
222. Id. (codified as I.R.C. §§ 877(a)(2), (f)).
223. Id. at (a) (codified as I.R.C. § 877(a)(1)).
224. See infra text accompanying notes 193-94.
226. Id. (codified as I.R.C. § 877(c)(1)(B)).
In addition to taxing expatriating citizens, the new provision is made applicable to "long-term foreign residents" of the United States whose U.S. residency ends.\textsuperscript{227}

\textsuperscript{227} Id. (codified as I.R.C. § 877(e)). New § 877(e) now reads as follows:

(e) COMPARABLE TREATMENT OF LAWFUL PERMANENT RESIDENTS WHO CEASE TO BE TAXED AS RESIDENTS.

(1) In general. Any long-term resident of the United States who —

(A) ceases to be a lawful permanent resident of the United States (within the meaning of § 7701(b)(6)), or

(B) commences to be treated as a resident of a foreign country under the provisions of a tax treaty between the United States and the foreign country and who does not waive the benefits of such treaty applicable to residents of the foreign country,

shall be treated for purposes of this section and §§ 2101, 2501, and 6039F in the same manner as if such resident were a citizen of the United States who lost United States citizenship on the date of such cessation or commencement.

(2) Long-term resident. For purposes of this subsection, the term "long-term resident" means any individual who is a lawful permanent resident of the United States in at least 8 taxable years during the period of 15 taxable years ending with the taxable year during which the event described in subparagraph (A) or (B) of paragraph (1) occurs. For purposes of the preceding sentence, an individual shall not be treated as a lawful permanent resident for any taxable year, if such individual is treated as a resident of a foreign country for the taxable year under the provisions of a tax treaty between the United States and the foreign country and does not waive the benefits of such treaty applicable to residents of the foreign country.

(3) Special rules.

(A) Exception not to apply. Subsection (c) shall not apply to an individual who is treated as provided in paragraph (1).

(B) Step-up in basis. Solely for purposes of determining any tax imposed by reason of this subsection, property which was held by the long-term resident on the date the individual first became a resident of the United States shall be treated as having a basis on such date of not less than the fair market value of such property on such date. The preceding sentence shall not apply if the individual elects not to have such sentence apply. Such an election, once made, is irrevocable.

(4) Authority to exempt individuals. This subsection shall not apply to an individual who is described in a category of individuals prescribed by regulation by the secretary. . . .
b. What Income is Targeted by the New Provision?

In the same manner as former § 877, the new provision applies to U.S. source income and gains for a period of ten years after expatriation or loss of residency. H.R. 3103 does not modify former § 877(b).

The new provision also keeps the special sourcing rules.\(^{228}\) Thus, gains on the sale or exchange of property located in the United States and gains on the sale or exchange of stock issued by a domestic corporation are included.\(^ {229}\)

c. Information

A U.S. citizen who terminates his or her citizenship is now required to provide detailed information to the State Department, including his or her social security number, forwarding foreign address, new country of residence and citizenship and, in the case of taxpayers with a net worth of at least $500,000, a balance sheet.\(^ {230}\) Further, the Secretary may require other information. Failure to provide the information will result in financial penalties.\(^ {231}\) Any federal agency collecting such information is required to provide it to the Secretary.\(^ {232}\)

The IRS has issued an interim guidance for the new regime.\(^ {233}\) It provides that the IRS will issue a detailed guidance before the end of 1996 and that "the forthcoming guidance will not require the submission of a ruling request under § 877, an information statement under § 6039F, or an information return under § 6048(a) before a date that is at

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229. Id. (codified as I.R.C. § 877(d)(1)(A), (B)).
230. Id. § 512 (codified as I.R.C. § 6039F(a), (b)).
231. The statutory penalty is five percent of the exit tax due or $1,000, whichever is greater, for each year where the failure to provide the information continues, unless the taxpayer proves that his or her failure was due to reasonable cause and not to willful neglect. Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191, § 512, 110 Stat. 2093 (1996) (codified as I.R.C. § 6039G(d)). Because existing § 6039F has not been repealed, there are currently two sections designated as I.R.C. § 6039F. The IRS will seek a technical correction to redesignate the new § 6039F as § 6039G. See Interim Guidance No. 96-29969, 1996-49 I.R.B. 1, at 7 n.1.
least sixty days after the issuance of that guidance."  

Further, the interim guidance states that "no penalty will be imposed under § 1494(c) if a return required with respect to a § 1491 transfer is filed no later than sixty days after the issuance of the [detailed] guidance."  

III. IDENTIFICATION OF THE PROBLEM

Former § 877 did not fulfill its assigned role because it was ineffective and unenforceable. It created a de facto loophole in the tax system which enabled taxpayers willing to surrender their U.S. passports to avoid paying taxes on the income they accumulated while benefiting from the laws and protection of the United States. To address the problem, two schools of thought proposed two different solutions. The first proposal, led by the President and the Senate, suggested a deemed sale approach whereby the tax expatriates would be taxed when they leave the country, i.e., the exit tax approach. The second proposal, led by Chairman Archer and the House, merely sought to amend existing § 877. The second approach won. However, the issue remains: is the new provision more effective, more enforceable?

IV. ANALYSIS

A. Former § 877 was Ineffective and Unenforceable

The overall effectiveness of former § 877 was doubtful. Tax practitioners indicated that this provision did not act as a deterrent to individuals seeking to expatriate for tax reasons. The Treasury Department itself viewed the provision as ineffective and unenforceable.  

It was not effective because there were legal methods, through proper tax planning, to avoid taxation under §

234. Id. at 8. At the time this comment went to press, the detailed guidance had not been issued.
235. Id. The interim guidance also indicates that Michael Kirsch, of the Office of the Associate Chief Counsel (International), can be contacted for further information regarding § 877 at (202) 622-3860.
236. See discussion infra Part IV.A.
237. A loophole is a special provision of the I.R.C. that does not benefit everybody. JAMES J. FREELAND ET AL., FUNDAMENTALS OF FEDERAL INCOME TAXATION 991 (Foundation Press, Inc. ed., 8th ed. 1994).
238. REPORT, supra note 9, at 61.
239. Id.
240. Id.
877. A taxpayer could easily avoid taxation by owning only foreign assets, or by converting most of his or her income into foreign source income, through carefully timed transactions.

It was not enforceable because there was little voluntary compliance with former § 877, and it is almost impossible for the IRS to catch the tax expatriates, given the practical difficulties of monitoring and pursuing them when they have physically left the United States. Further, former § 877 was not enforceable with respect to individuals who expatriated to nations with which the United States has a tax treaty, because these treaties may forbid the United States to tax its former citizens who are now citizens of these nations.

The IRS did not devote much of its time or resources to attempt to enforce former § 877. For instance, no regulations were issued under former § 877 after its enactment in 1966. Section 367 of the I.R.C. enables taxpayers to transfer property to a foreign corporation, and § 1491 imposes a special excise tax on the transfer of property to a foreign corporation. The IRS could have enforced the concurrent use of those two provisions against the tax expatriates, but it did not. The IRS's rationale was that it was not worthwhile to devote significant resources to the enforcement of former § 877 because of the difficulty in proving a tax avoidance purpose.

Procedurally, once the IRS established that the individual's loss of citizenship would substantially reduce his or her taxes, the burden of proof shifted to the taxpayer to prove that the avoidance of taxes was not one of the principal purposes of the expatriation. In order to prevail, the IRS must have then rebutted the taxpayer's assertion of non-tax motives. Facts suggest that the IRS rarely attempted to refute the taxpayer's contentions. In fact, there were only two

241. Id.
242. Id.
243. Id.
244. REPORT, supra note 9, at 62.
245. Id.
246. Id.
247. Id.
248. Id.
249. See supra text accompanying notes 117-54.
250. REPORT, supra note 9, at 62.
cases dealing with the enforcement of § 877, and the Treasury won only one.  

B. A Preliminary Comparison of the Administration/Senate Approach with the House Approach

In fact, the Administration/Senate and the House proposals embodied two different approaches to the problem. The Administration proposed a radical approach under which the taxpayer is deemed to have sold all of his assets at the time he or she leaves the country and is asked to pay an "exit tax." The House version is much more moderate, it presumed the tax avoidance intent, which was the major obstacle to the enforcement of former § 877, and then imposed regular income taxes for ten years after the date of expatriation.

The symbolic aspect of the Administration's version may appear very attractive because the tax expatriates are required to pay the price when they leave, like a toll or a fine. However, it raises important issues.

1. The Realization Hiatus in the Administration's Proposal

The strongest objection to the Administration's proposal is that it is a covert attempt to tax unrealized gains. Indeed, the property has not been disposed of, the taxpayer has not realized any gain, therefore, one can argue that the tax is imposed on property rather than income. The only way one can justify such a proposition is to say that if there has been no realization, still there has been a tax event (the expatriation) that can justify the tax liability. It has been argued that

251. See discussion infra Part II.C.2.
252. See discussion supra Part II.C.1.
253. See discussion supra Part II.B.2.
254. See supra text accompanying note 223.
255. The Sixteenth Amendment contains an implicit requirement that gains be "realized" before taxes may be imposed. U.S. Const. Amend. XVI ("The Congress shall have power to lay and collect taxes on incomes . . .") (emphasis added). It has therefore been argued that the realization requirement is a constitutional prerequisite to the imposition of tax. Following Eisner v. Macomber, 252 U.S. 189 (1920), there can be no realization of gain, hence no income if the taxpayer has not received some profit "for his separate use, benefit and disposal." Id. at 193. However, although Eisner v. Macomber has never been overruled, the weight of the doctrine is that the realization concept is not a constitutional requirement.
“the realization requirement is satisfied when property effectively is transferred to a new legal situs\textsuperscript{256} that alters the taxpayer’s and the government’s legal relationship to the property.”\textsuperscript{257}

The rationale underlying this argument is that the change of status of an individual from citizen to alien nonresident similarly affects the attributes of the property he or she holds for tax purposes.\textsuperscript{258} Viewed from the Administration’s perspective, the realization event would not be a transfer or a sale, but simply the change of relation between the property and the owner. Further, the exit tax would apply regardless of other provisions of the Internal Revenue Code, hence, gain that would otherwise be eligible for special non-recognition or deferral provisions would nevertheless be subject to the exit tax.

If there is no income, it may appear unfair and contrary to well-established principles of our tax regime to tax the expatriate. However, things are not as clear cut as they may look. There are indeed other situations where taxpayers may be taxed on income they did not receive.\textsuperscript{259} Nevertheless, the fact remains that taxing unrealized gains is likely to cause liquidity problems.\textsuperscript{260} The expatriates would have to pay the assets at the time they leave the country, even though they still hold the assets and may thus not have the cash needed to pay the tax.

The House version, on the other hand, merely continues the current regime of taxing the income of the expatriates after the expatriation, hence it does not suffer from this realization issue.

\begin{itemize}
\item \textsuperscript{256} The situs is “the place where a thing is considered, for example, with reference to jurisdiction over it, or the right or power to tax it.” \textit{Black's Law Dictionary} 1387 (6th ed. 1990).
\item \textsuperscript{257} \textit{Report}, supra note 9, at 73.
\item \textsuperscript{258} \textit{Id}.
\item \textsuperscript{259} \textit{See} Eder v. Comm'r, 138 F.2d 27, 28 (2d Cir. 1943) (noting that “in a variety of circumstances it has been held that the fact that distribution of income is prevented by the operation of law or by agreement among private parties is not bar to its taxability”).
\item \textsuperscript{260} Liquidity is “the status or condition of a person or business in terms of his or its ability to convert assets into cash.” \textit{Black's Law Dictionary} 931 (6th ed. 1990).
\end{itemize}
2. The Retroactivity Problem in the Administration’s Proposal

Under the Administration’s proposal, a U.S. citizen would be treated as having relinquished his or her citizenship on the date he or she is issued a certificate of loss of nationality, and not the date he or she may have effectively ceased to be a U.S. citizen, which can be at a substantially earlier date. The individual would therefore remain subject to the U.S. taxing jurisdiction as a citizen until he or she eventually gets his or her certificate of loss of nationality. It has been argued that the Administration was trying to implement its new regime with selected individuals who expatriated in 1994, in mind. Those individuals did not already have their certificates of loss of nationality at the time the legislation would have become effective precisely because the Administration delayed the issuance of the certificates. If the Administration’s proposal had been implemented, those individuals would have been able to bring discrimination and violation of due process claims.

Further the Administration’s proposal, in that regard, is not without certain contradictions, since it suggests that, for instance, where a naturalized U.S. citizen has his or her naturalization revoked, the individual would be treated as relinquishing citizenship on the date the court cancels his or her naturalization, even though for all other purposes the individual would be treated as having never been a U.S. citizen.

The House version, albeit not on the same scale, also suggests retroactivity issues, which will be addressed below.

261. REPORT, supra note 9, at 37.
262. Id.
264. Id. The New York Times reported the case of Joseph Bogdanovitch, the 83 year-old vice-chairman of the H.J. Heinz Company, who expatriated in 1994 and would not have received his certificate of loss of nationality by the time the Administration’s regime would have been enforceable. Id. The article suggests that Mr. Bogdanovitch is a large Republican contributor and that H.R. 1812 was specifically designed to get him out of the net. Id.
265. REPORT, supra note 9, at 37.
3. Different Policies?

One cannot help but notice that the proponents of the Administration's proposal are mostly Democrats and that the supporters of the House version are mostly Republicans. From this, one is easily tempted to conclude that the Democrats are fighting for the destitute and the middle class while the Republicans are arguing for the rich. Vice-President Gore himself said that the House version was "the poster child of Republican tax policy" and that "while Democrats are fighting for $1.3 billion in funding for kids and education, Republicans are fighting to allow 24 billionaires to escape $1.4 billion in taxes by renouncing their citizenship." The Republicans' answer is that the Administration's proposal "smack[s] of unfair, perhaps unconstitutional penalizing of successful people by big government." There certainly are ideological differences behind the two approaches, however one should be wary of oversimplifying the issues.

C. Is the New Version of § 877 Any Better?

1. Constitutional and International Law Issues

   a. The New Regime, if Enforced Retroactively, May Constitute a Violation of Due Process

The Fifth Amendment generally forbids the government from depriving persons of property without due process of law. In *Brushaber v. Union Pacific R.R.*, the Supreme Court held that although the Due Process Clause of the Fifth Amendment does not restrict Congress' taxing power, there is still room for judicial intervention if

   [t]he act complained of [is] so arbitrary as to [force] the conclusion that it [is] not the exertion of taxation but a confiscation of property, that is, a taking of the same in violation of the Fifth Amendment, or, what is equivalent thereto, [is] so wanting in basis for qualification as to produce such a gross and patent inequity as to inevitably lead to the same conclusion.

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266. Cannon, supra note 14, at 2A.
268. U.S. Const. amend. V.
270. Id. at 24-25.
If in theory there is room for invalidation, in practice courts have given Congress a lot of leeway with regard to tax legislation. So far, with the exception of some early cases involving retroactive estate and gift taxation, no federal tax legislation has ever been found so arbitrary as to justify a finding of unconstitutionality. To the contrary, in United States v. Carlton, the Supreme Court made it clear that as long as a tax statute's retroactive application is supported by a legitimate legislative purpose furthered by rational means, it is constitutional.

There may be, however, some limitations on how far-reaching retroactive legislation can be. In Carlton, the Supreme Court upheld the retroactive statute because "Congress acted promptly and established only a modest period of retroactivity." The Court relied on precedent establishing that Congress, "almost without exception," had given general revenue statutes effective dates prior to the actual dates of enactment, and that this "customary congressional practice" was required by the practicalities of producing national legislation.

Here, the new regime is made applicable to former U.S. citizens who renounced citizenship after February 5, 1995, and former long term permanent residents who ceased to be taxed as lawful permanent residents after that date. The new regime was passed into law on August 21, 1996, therefore, the retroactivity period is 19 months.

Any taxpayer who expatriated between February 5, 1995 and August 21, 1996, who is willing to combat the application of the new regime himself or herself, may consider raising due process arguments.

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271. REPORT, supra note 9, at 82.
272. Id.
274. Id. at 35.
275. REPORT, supra note 9, at 87.
277. Id. at 32.
279. Carlton, 512 U.S. at 33.
280. Interim Guidance, supra note 233.
281. REPORT, supra note 9, at 82.
b. Whether the New Regime Constitutes a Human Rights Violation

On November 10, 1948, the Universal Declaration of Human Rights (the "Declaration") was adopted as a United Nations General Assembly resolution. The Declaration recognizes the right to physically leave, so-called "emigration," and a right to relinquish citizenship, so-called "expatriation." The Declaration was followed by the International Covenant on Civil and Political Rights (the "Covenant"). Article Twelve, Subsection Two of the Covenant provides: "Everyone shall be free to leave any country, including his own." Subsection Three reads: "[t]he above mentioned right . . . shall not be subject to any restrictions except those which are provided by law, are necessary to protect national security, public order, public health or morals or the rights and freedoms of others, and are consistent with the other rights recognized in the present Covenant." The fact that the expatriating citizen must pay federal income taxes for ten years following his or her expatriation, constitutes a burden on his or her right to emigrate. It has been argued that if the proposed tax constitutes a special requirement, imposed only to expatriating citizens, the government has the burden, under the Covenant, of proving that the law is "necessary to protect national security, public order, public health or morals or the rights and freedoms of others." Further grounds for that argument can be found

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282. At the time of adoption, the U.S. delegate expressly stated that the resolution "is not and does not purport to be a statement of law or of legal obligation, however, there seems to be now an international consensus that the Declaration is legally binding by virtue of reflecting customary international law." Robert F. Turner, Testimony of Naval War College's Turner at Finance Hearing on Expatriate Taxation, Tax Notes Int'l, March 21, 1995.

283. Article 13(2) of the Declaration reads: "Everybody has a right to leave any country, including his own, and to return to his country." REPORT, supra note 9, at 90.

284. Article 15(2) of the Declaration reads: "No one shall be arbitrarily deprived of his nationality nor denied the right to change his nationality." Id.

285. Id.

286. The Covenant was unanimously approved in 1966 by the United Nations General Assembly, and finally approved by the Senate on April 2, 1992. Turner, supra note 282.

287. Id.

288. Id.

289. Id. Professor Turner pointed to the fact that during the drafting of Article Twelve, suggestions were made to include in the list of possible justifications
in the 1974 Jackson-Vanik Amendment, also known as the "Freedom of Emigration" Amendment.\textsuperscript{290}

Some congressional Republicans have compared the exit tax to the kind of exorbitant exit fees that the former Soviet Union imposed on departing Jews.\textsuperscript{291} It should be easy to understand that "there is a substantial difference in the motivation behind the proposed exit tax and the impediments placed in the path of Soviet Jews (and others) in the early 1970s."\textsuperscript{292} Still, one can argue, as did Professor Turner when he testified at a finance hearing on expatriate taxation, that:

[from the standpoint of International Law, . . . it may be more difficult to make the distinction between the old Soviet practice of charging a special "diploma tax" to compel citizens who wish to emigrate to compensate the state for its investment in their education, and the proposed U.S. "exit tax" designed to compel U.S. citizens who wish to emigrate to compensate the state for income taxes they would likely eventually owe if they remained citizens.\textsuperscript{293}

Detlev F. Vagts, of the American Journal of International Law, did not share Professor Turner's analysis.\textsuperscript{294} He distinguished the right to expatriate oneself from the right to emigrate.\textsuperscript{295} He acknowledged that "the right of expatriation is a natural and inherent right of all people, indispensable to the

\textsuperscript{290} The Amendment prohibits the President from granting "non-discriminatory tariff treatment" to any "non-market economy country" which "imposes more than a nominal tax, levy, fine, fee or other charge on any citizen as a consequence of the desire of such citizen to emigrate to the country of his choice." \textit{Id.}

\textsuperscript{291} de Witt, \textit{supra} note 4, at A1.

\textsuperscript{292} Turner, \textit{supra} note 282.

\textsuperscript{293} \textit{Id.}

\textsuperscript{294} Mr. Vagts furnished an opinion to the Treasury Department, at its request, to the effect that the proposal did not represent a human rights violation. Vagts, \textit{supra} note 3, at 578.

\textsuperscript{295} \textit{Id.}
enjoyment of the rights of life, liberty and the pursuit of happiness." Yet, he pointed out that after expatriation, one is still subject to the obligations of military service if they exist, to the obligation to return to the United States to testify if required, and to the duty not to commit treason. On the other hand, the right to emigrate, he wrote, "has considerable human status as an international human right because "[t]he inability to make a physical move from one point to another is a much more drastic infringement of one's personal liberty than is the inability to sever one's legal ties." Mr. Vagts concluded: "[t]he thought that there is a human rights violation here seems wide of the mark."

Mr. Vagts's conclusion relied on two facts. First, "the restriction is not on the right of emigration, which is recognized in international law, but on expatriation, which is not so recognized." Second, "a tax that is designed to equalize long-term tax burdens as between those who keep their citizenship and those who surrender it does not impose such an unjust burden either on expatriation or on emigration as to render it a violation of U.S. human rights commitments."

Although it is possible to view the right to expatriate (understood as the right to relinquish one's citizenship) as less protected than the right to emigrate (understood as the right to physically leave one's country), the United States recognizes both rights. Every U.S. citizen can leave the United States without restrictions, and return whenever they wish. Yet, if the exit tax constitutes such a heavy burden that people will refrain from expatriating, then, arguably, the rights of emigration and expatriation are infringed.

296. Id.
300. Vagts, supra note 3, at 579.
301. Id.
302. Id. at 580.
303. Id.
304. Id.
305. REPORT, supra note 9, at 90-91.
306. Id. at 91.
The Universal Declaration of Human Rights, together with the International Covenant on Civil and Political Rights, argue in favor of a finding of violation of international norms. However, there are no "clearly defined, objective standards for judging whether the expatriation tax... constitutes an arbitrary infringement on the rights to emigrate or expatriate recognized under international law." Therefore, it is difficult to make any kind of definite argument, either in favor of a violation, or of a finding of conformity with international norms.

In connection with these issues, a noteworthy development is that under the Illegal Immigration Reform and Immigrant Responsibility Act of 1996, signed into law on September 30, 1996, tax expatriates who come back will be excludable upon a determination by the Attorney General of their tax avoidance purpose. In sum, Congress is saying: "We can't force you to stay, but if you do leave, you can't come back!" As harsh as it sounds, such a proposition still comports with due process and human rights concerns, as there is no such thing as the right to come to the United States.

2. Practical Issues

a. New § 877 Does Not Really Close the Loophole

While the House version creates a presumption of tax avoidance intent for the taxpayers who have some money to save by expatriating, there are simply too many exceptions in the new regime, and as a result, it may not be more enforceable than former § 877. Opponents of the House version, mostly Democrats, have voiced their disagreement to the new regime especially on that ground. Even GOP congressmen

307. See supra text accompanying notes 282-85.
308. See supra text accompanying notes 286-88.
309. REPORT, supra note 9, at 99.
311. See supra text accompanying notes 224-26.
312. Congressman Richard Gephardt (Democrat-Missouri) said that "The Republican bill tries to cover a loophole with a fig leaf. The bottom line is that it will merely take a bit more legal maneuvering and more creative accounting for these wealthy tax evaders to escape their obligations." Democratic Policy Committee, Democrat's Comments on Ways and Means Committee Action on Expatriate Tax Bill, June, 15, 1995, available in LEXIS, Taxana library, Tnt file.
have indicated that they find the new regime insufficient to close the loophole.\textsuperscript{313}

The new regime presumes the tax avoidance intent, once a certain threshold of wealth is passed, yet it immediately excludes from its scope of application dual citizens, individuals married to foreign citizens and individuals who have at least one parent who was born in a foreign country.\textsuperscript{314} As the United States is an immigration country, these exceptions, especially the last category, are very likely to swallow the presumption. Further, it is questionable "whether the difference in status justifies providing a benefit to citizens with connections to another country that is not available to most Americans."\textsuperscript{315}

b. \textit{New § 877 Still Permits Tax Avoidance by Patient Expatriates}

The major difference between the House version of the expatriate tax and the Senate or Administration's version, is straightforward. Under the House version the expatriate will only be taxed, assuming he cannot avail himself or herself of the numerous exceptions to the provision, for ten years after the loss of citizenship or termination of residency. Under the Senate version, the expatriate is taxed when he or she exits the country, on the basis of the deemed sale of his or her assets. Under the new § 877, as under its former version, a taxpayer willing to wait for ten years before disposing of the assets will not be taxed.\textsuperscript{316} As Assistant Treasury Secretary put it, "the structural problem of current Section 877 which permits a patient expatriate to avoid tax by waiting ten years is not corrected."\textsuperscript{317} Moreover, the taxpayers may have the

\textsuperscript{313} See Godfrey, \textit{supra} note 176 (reporting that at a July 1, 1995 Senate Finance hearing GOP Senators indicated that they found Chairman Archer's approach insufficient).

\textsuperscript{314} See \textit{infra} note 218.

\textsuperscript{315} Letter from Leslie B. Samuels, Assistant Secretary (Tax Policy), to The Honorable Sam Gibbons, House of Representatives (June 12, 1995), available in LEXIS, Taxana Library, Tnt file. In that letter, Samuels was discussing H.R. 1812, however as H.R. 1812 takes the same approach as H.R. 3103, his remarks remain relevant.

\textsuperscript{316} See Godfrey, \textit{supra} note 176 (reporting a statement by Alfonse d'Amato — Republican-N.Y. — to the effect that "the rich are far more likely to expatriate patiently, holding on to their assets until they can be cashed in tax free" because "they are not dumb.").

\textsuperscript{317} Letter from Leslie B. Samuels, \textit{supra} note 315.
beneficial use of their assets during this ten year span by, for example, borrowing against the assets.\textsuperscript{318}

c. \textit{New § 877 Does Not Address the Problem of Foreign Earned Assets}

Under former § 877, gains from foreign assets that accrued before expatriation are not subject to U.S. tax after expatriation. Tax lawyers have long taken advantage of this structural loophole by converting domestic source income into foreign source income. This problematic issue is not addressed in the new regime.

d. \textit{The New Provision May Still Be Ineffective and Unenforceable}

Even if the tax expatriate cannot avail himself or herself of one of the numerous exceptions to the new regime, and even if he or she disposes of the assets before the ten year window, there are other holes in the net that permit avoidance of the new regime. The new provision still allows the expatriates to leave U.S. jurisdiction without paying the expatriation tax or posting security.\textsuperscript{319}

There is much improvement made in the direction of the information required from the expatriates. This should improve the monitoring of the expatriate population and the enforcement of the new regime. Still, if an expatriate decides to leave, not to come back and if he or she does not own any domestic assets, his tax liability may be lost. The penalties for failure to provide the information requested are extremely low. Their deterrent effect seem negligible, especially when one has in mind the fact that the expatriation tax will not be imposed in the first place unless the expatriates had either an average tax liability of $100,000 for the five preceding years or a $500,000 net worth when he left.

3. \textit{Is It Fair to Tax Long-Term Permanent Residents?}

Where former § 877 targeted only U.S. citizens, the new version also encompasses long-term permanent residents.\textsuperscript{320}

This may appear particularly unfair. Contrary to U.S. citi-
zens, permanent residents never enjoyed the benefits of U.S. citizenship. Indeed, green card holders cannot vote, cannot serve on juries, are not represented in Congress, and they do not share the benefits of traveling on a U.S. passport. Further, if there is something inherently treacherous for a U.S. born citizen to take Bahamian citizenship, the situation is completely different for a permanent resident who wishes to return to his or her birth country, as "resident alien[s] who leave . . . the United States are generally motivated by considerations other than tax avoidance."321

V. PROPOSAL

The former body of law had to be modified because it was not fulfilling its assigned role.322 The new regime, however, continues the peculiarity of the United States with regard to its taxation of citizens and former citizens alike. The United States is already one of a very few nations to tax on the basis of citizenship.323 The new regime will carry on the isolation of the United States regarding tax policy, as very few countries currently impose taxes on expatriates.324

Taxation should not be based on the citizenship of the taxpayer, but on the situs325 of the income subject to taxation. The United States is one of the few countries using such a method of taxation.326 The world is now a global market, and Americans investing offshore find themselves at a competitive disadvantage in competing with others in the international marketplace when they are taxed on the proceeds of

321. Id.
322. See discussion supra Part IV.A.
323. See supra text accompanying notes 36-41.
324. REPORT, supra note 9, at 114. In addition, in the case of countries that tax former citizens, the regimes are substantially less expansive than the new regime. For example, Australia imposes an expatriation tax when an Australian citizen leaves the country. Id. at 143 app. B-7. However, it is limited; the Australian taxpayer is treated as having sold only all of his non-Australian assets at fair market value on the day of expatriation. Id. A Canadian taxpayer is considered as having sold all capital gain property at fair market value at the date of expatriation. Id. Since 1987, Denmark taxes certain unrealized gains and certain pension plans. Id. at 143 app. B-8. However, payment of the tax may be deferred, with security until the actual disposition occurs. Id.
325. See supra note 256.
326. See supra text accompanying notes 36-41.
foreign investments. If the U.S. tax regime was not based upon such unfair premises, the tax burden would not be perceived as so costly and there would not be any tax expatriates in the first place. In that case, taxpayers would be taxed only with regard to their U.S. source income, and there would not be any tax incentive for them to expatriate.

Further, there are other ways to render former § 877 effective. The requirement of tax avoidance intent is an important requirement, unfortunately totally eliminated under the new regime. It should be maintained because it is the only way to differentiate between the real tax expatriates (the individuals who expatriated in order to avoid or minimize tax liability) and the other expatriates who may have non-tax reasons to expatriate, or no reason at all, as one can lose the U.S. citizenship "involuntarily," for example by becoming naturalized in another country. Without the requirement of tax avoidance purpose, the application of new § 877 would be unfair, as it would impose a blind penalty on every expatriating taxpayer, contrary to the basic principles of tax equity. Until now, the requirement of proving tax avoidance intent may have seemed like the principal barrier to the enforcement of § 877, however, especially with the improvements made in connection with reporting, enforcement should be facilitated and proving tax avoidance intent may not remain the hurdle it used to be.

Another way of making the provision more equitable would be to apply it only with regard to expatriates who continue to maintain "significant ties" with the United States. If citizens want to expatriate, that is their fundamental right and they should be able to do so without any restriction. Expatriates who totally sever their relation with their government should be free to go. On the other hand, if they want to maintain a relationship with their former government and still benefit from its laws and protections, they should have to pay a price for that.

The ten year window feature of the new regime is not a clever proposition. First, it appears arbitrary. Why ten years, why not five or twenty-five? Further, as noted above,

327. Michael D. Dingman told the New York Times that he was investing in China and in the Czech Republic, and that he did not want to pay U.S. income taxes on the proceeds of such investments. de Witt, supra note 4, at A1.
328. See supra text accompanying note 8.
patient expatriates who can still hold onto their assets for ten years will be able to bypass the new § 877. Using the deemed sale approach, and taxing expatriates when they leave has its inconveniences, for example, the fact that unrealized gains are taxed, and that the taxpayer may not have the cash needed to pay the tax. An alternative would be to lock up the assets in some kind of trust where they could be reached for taxation when they are disposed of or when the expatriate dies. Such a system already exists with regard to estate tax. Devises to a foreign surviving spouse will not qualify for the marital deduction unless the assets devised are locked in a Qualified Domestic Trust. 329

Finally, the new regime should not be made applicable to permanent residents. Permanent residents do not enjoy the benefits of U.S. citizenship and they should not be penalized if they decide to return to their country of birth.

VI. Conclusion

The revision of the tax treatment of expatriation can be perceived as part of a bigger scheme to achieve deficit reduction by attempting to close a loophole. 330 However, as it has been demonstrated, the loophole has not been closed and the renunciation of the U.S. citizenship may still be worth substantial savings.

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